Preqin Special Report: Banks as Investors in Private Equity

Content Includes

Impact of Regulation
We discover what impact forthcoming regulatory changes are likely to have on banks' allocations to private equity.

Future Investment Plans
We ask banks where they are looking to allocate their capital and when they plan to make their next investments. What are the key private equity strategies and geographies being targeted by banks?

Importance of Banks as PE Investors
Banks have historically been important backers of PE funds; we examine how they fit within the limited partner universe and their typical allocations to the asset class.

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Methodology

Preqin, the alternative assets industry's leading source of data and intelligence, welcomes you to this **Preqin Special Report: Banks as Investors in Private Equity Funds**, a unique look at banks investing in the asset class, their current opinions of the market and their outlook for investments going forward.

This report is based on information taken from Preqin's **Investor Intelligence** database, the most comprehensive and accurate source of information on investors in private equity funds available today, which profiles over 4,000 investors actively committing to private equity funds, including 240 banks, as well as an additional 160 banks that previously invested in private equity funds but are not currently active in the asset class. More details on the information available in the Investor Intelligence database can be found on page 9 of this report.

This report draws on the results of detailed interviews conducted with 50 banks from around the world during April 2012. The sample of banks was selected from Preqin's Investor Intelligence database, and the interviews were carried out by our skilled teams of multi-lingual analysts.

We hope that you find the information included within this report useful and interesting and, as always, we welcome any feedback and suggestions you may have for future editions.

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Editor:
Helen Kenyon

Production Editor:
Tim Short

Sub-Editor:
Sam Meakin

Managing Editors:
Emma Dineen

Preqin:
New York: +1 212 350 0100
London: +44 (0)20 7645 8888
Singapore: +65 6408 0122

Email: info@preqin.com
Web: www.preqin.com

Banks as Part of the Limited Partner Universe

Preqin's Investor Intelligence database currently tracks 240 banks worldwide that actively invest in private equity funds. Banks make up 6% of all active investors in private equity, making them the eighth largest investor type by number of LPs. However, it is interesting to note that banks account for 8% of aggregate capital currently invested in private equity, making them the fifth most significant investor type in terms of invested capital, behind public and private sector pension funds, foundations and insurance companies.

Within the private equity limited partner universe, banks continue to be a significant source of capital to the asset class. However, with increasing concerns over liquidity, and in light of the uncertainty surrounding certain financial regulations, such as Basel III and the Volcker Rule (part of the Dodd-Frank Act), banks are becoming increasingly restricted when allocating capital to the asset class. The impact on the level of commitments secured from banks can already be seen. Banks accounted for 11% of the total capital invested in private equity funds in 2008 ($115bn), whereas this figure fell to 8% ($110bn) in 2011.

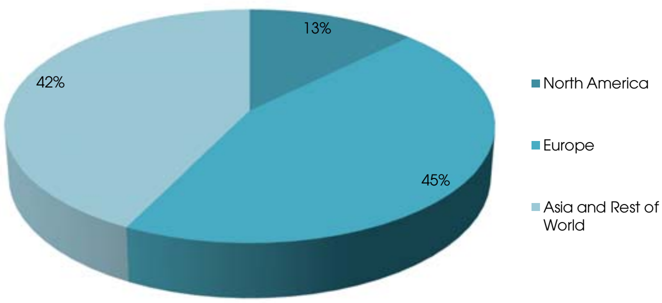
As shown in Fig. 1, 45% of the banks that invest in private equity are based in Europe, with 43% based in Asia and Rest of World and the remaining 13% headquartered in North America. The geographical make-up of banks that invest in private equity is significantly different from the make-up of all institutional investors in private equity; 29% of all LPs are Europe-based, 53% are based in North America and 18% are Asia and Rest of World-based investors.

"Fifty-two percent of banks have over $250mn allocated to private equity."

Banks are some of the largest institutions in the limited partner universe by total assets under management, with aggregate total assets of $37.5tn and many have significant private equity programs. Banks have an estimated aggregate current allocation to private equity of $96.6bn.

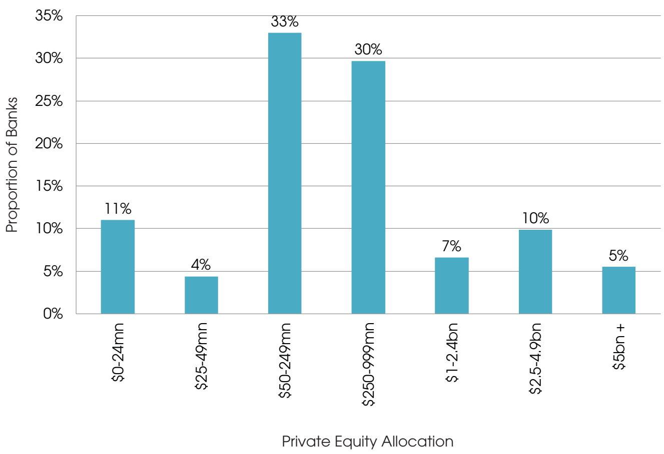
As Fig. 2 illustrates, 52% of banks have in excess of $250mn currently allocated to private equity, including a noteworthy 15% which have over $2.5bn currently allocated to the asset class. An additional 33% of banks have private equity allocations in the range of $50mn to $249mn.

Fig. 1: Breakdown of Banks that Invest in Private Equity by Region (Number of LPs)



Source: Preqin Investor Intelligence Online Service

Fig. 2: Breakdown of Banks that Invest in Private Equity by PE Allocation



Source: Preqin Investor Intelligence Online Service

Banks' Appetite for Private Equity

Preqin interviewed a sample of 50 banks that invest in private equity to gain an insight into their views and preferences regarding the asset class, and their plans for investments going forward. We also looked to assess whether forthcoming regulations are having an impact on banks' private equity investments. The banks interviewed are a representative sample diversified by geography, assets under management and allocation to private equity.

Nearly a fifth (19%) of respondents told us they are currently below their target allocations to private equity, with only 9% over-allocated to the asset class, and the remaining 72% at their target allocations, as illustrated in Fig. 3. This indicates that the majority of banks interviewed will need to continue to commit to private equity in order to maintain their level of exposure or build towards their long-term target allocations.

It is interesting to note that while the majority of banks are at their target allocations, just one-third of banks interviewed have made new private equity fund commitments in the past 12 months.

More than a quarter (28%) of banks are planning to commit capital to private equity funds during 2012, with a further 10% looking to make commitments in 2013, as shown in Fig. 4. One Japanese bank told us it is looking to make its next commitment to the asset class before Q3 2012, and is looking to commit to between five and eight new private equity funds, totalling $200mn, over the next 12 months. However, the proportion of banks seeking to invest in 2012 is significantly lower than the 72% of all private equity investors interviewed in December 2011 that planned to make new commitments in 2012.

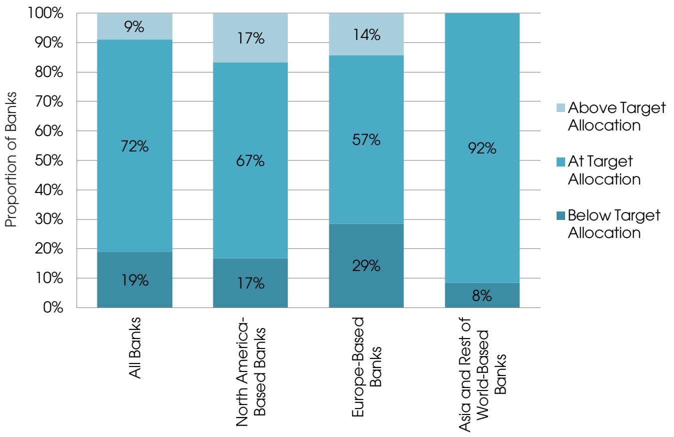
The lack of appetite from banks investing in private equity is down to a variety of reasons including key issues such as regulatory changes, liquidity concerns, and limited appetite for private equity from some banks' clients. A number of the banks holding off from committing to new funds are North America-based institutions concerned about the future implications of the Volcker Rule, part of the Dodd-Frank Act.

"One-third of banks have made new private equity commitments in the past 12 months."

New regulations and liquidity requirements have led many banks to consider secondary sales. Twenty-three percent of the banks we spoke to have previously sold private equity fund interests on the secondary market, and 40% of banks would consider selling on the secondary market in the future. A recent example of this trend is UniCredit Bank Austria, which sold two separate fund interests – Doughty Hanson & Co Technology and Candover 2001 – on the secondary market in Q2 2012.

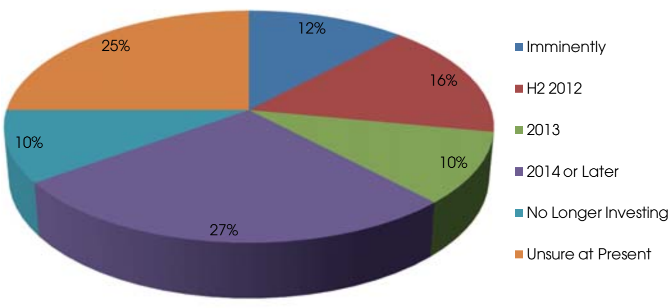
One-quarter of banks are unsure as to the timing of their next commitment to private equity, and therefore may invest should they be presented with an appealing opportunity.

Fig. 3: Proportion of Banks Currently At, Above or Below Their Target Allocations to Private Equity



Source: Preqin

Fig. 4: Timeframe for Next Planned Commitment to a Private Equity Fund



Source: Preqin

Biggest Challenges Facing Banks' Private Equity Programs

With new regulations such as Basel III and the Volcker Rule coming into play, we asked banks what they see as the biggest challenges facing their private equity programs at present, and what impact new regulations have had on their private equity plans.

As shown in Fig. 5, just under a third (30%) of respondents told us that they see regulatory changes, such as Basel III and the Volcker Rule, as being the biggest challenge facing banks seeking to operate an effective private equity investment program in the current market. Twenty-one percent of banks said that liquidity is a major concern when investing in private equity, in particular with regards to having capital available to meet capital calls.

Many banks invest capital on behalf of clients, as opposed to investing from their own balance sheets; 18% of banks said that client appetite for private equity is an issue they are facing when considering investing in the asset class. One investment bank in Bahrain commented that its clients have lost interest in private equity as they currently prefer short-term investments.

Fifteen percent of banks feel that market volatility is affecting their investments in private equity, while 12% feel that the market currently lacks attractive investment opportunities. Other challenges some banks feel are currently affecting their private equity programs include the high fee levels associated with investing in funds, the lack of deal flow and poor exit opportunities.

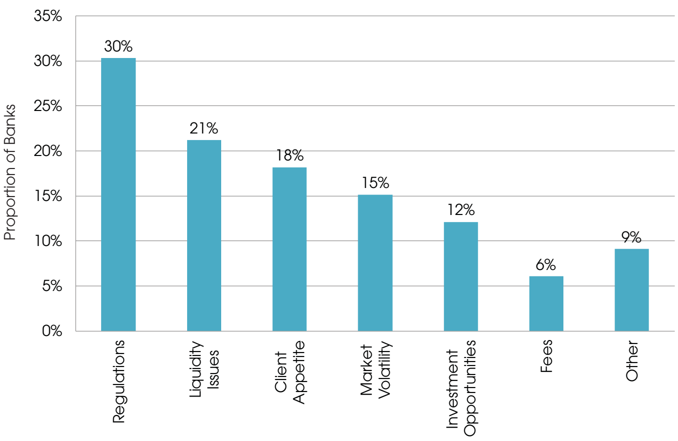
"Seventy-four percent of banks stated they had not been affected by legislative changes."

Impact of Regulation

We asked the banks what effect recent regulatory changes have had on their private equity investments to date, and in turn, if they expect regulation to impact their investments going forward. As shown in Fig. 6, 10% of banks told us that they have stopped investing in the asset class altogether as a result of recent regulatory changes. Overall, just over a quarter (26%) of banks have either stopped investing in private equity or reduced their level of investment activity in the asset class.

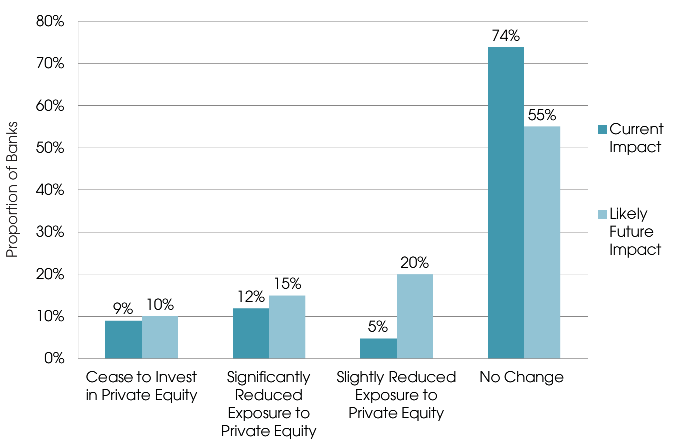
Importantly, 74% of banks stated that they had not been affected by legislative changes, and over half (55%) feel it is unlikely that regulatory changes will impact their level of private equity investment in the future. Of the 26% of banks that have stopped or reduced investment activities in the asset class, 90% are based in either North America or Europe, the regions in which investors are directly impacted by regulatory changes. One Ohio-based bank stated that "the Volcker Rule has killed banks' ability to invest in private equity."

Fig. 5: Biggest Challenges Currently Facing Banks Seeking to Operate Effective Private Equity Programs



Source: Preqin

Fig. 6: Impact of Regulatory Changes on Banks' Exposure to Private Equity



Source: Preqin

None of the banks we spoke to have increased, or plan to increase, their allocations to private equity as a result of regulatory changes. However, most of the banks that have stopped investing due to regulatory issues mentioned that they would be keen to resume investing in the asset class should changes to legislation be made.

Key Geographies over the Next 12 Months

We asked banks which regions they currently feel are presenting the best opportunities for private equity investments, and if there are any regions that they are likely to be avoiding where they would previously have considered investing due to the current financial climate.

As shown in Fig. 7, Europe is considered to be an attractive region to invest in by the largest proportion of banks interviewed (37%), despite the European sovereign debt crisis. Northern and Western Europe were specifically named by many investors as offering appealing investment opportunities. It is worth noting that some banks are avoiding specific areas within Europe; one German bank told us: "Western Europe is presenting the best opportunities, but we are avoiding Southern Europe." Twenty-six percent of banks named North America and the same proportion named Asia as offering attractive investment opportunities in the current market.

Importantly, more than three-quarters (78%) of banks told us that there are no regions that they are avoiding due to the current financial climate. Six percent of banks we spoke to are avoiding North America; one such Canadian investor stated that "the Volcker Rule is currently not affecting international investments, so we will now be looking at investments internationally, as opposed to seeking opportunities in North America." None of the banks we spoke to are avoiding opportunities in Asia.

Six percent of banks said they would avoid investing in funds targeting regions outside of North America, Europe and Asia. One UK-based institution noted that it would avoid Africa, and another bank based in Kuwait stated that it would avoid investing in Islamic regions. Eleven percent of banks told us they are avoiding opportunities in European regions where they would have previously considered investing. Specific regions within Europe that some banks told us that they are avoiding include Russia and Southern Europe.

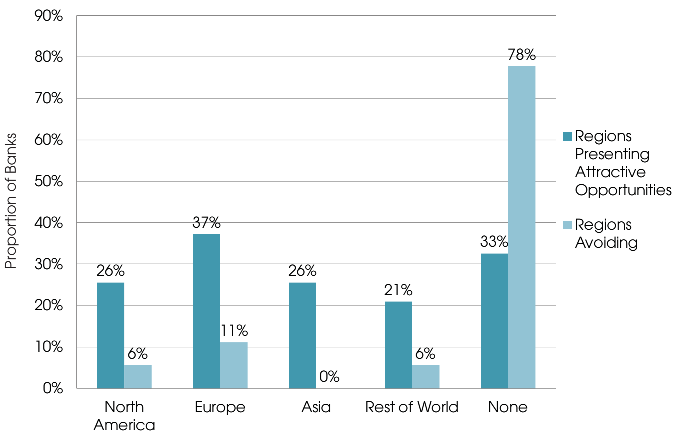
"Sixty-seven percent of banks consider investments in emerging markets."

Appetite for Emerging Markets

Sixty-seven percent of banks consider investments in emerging markets; over half (56%) already invest and 11% are considering such opportunities. Thirty-three percent of banks do not invest in emerging markets private equity.

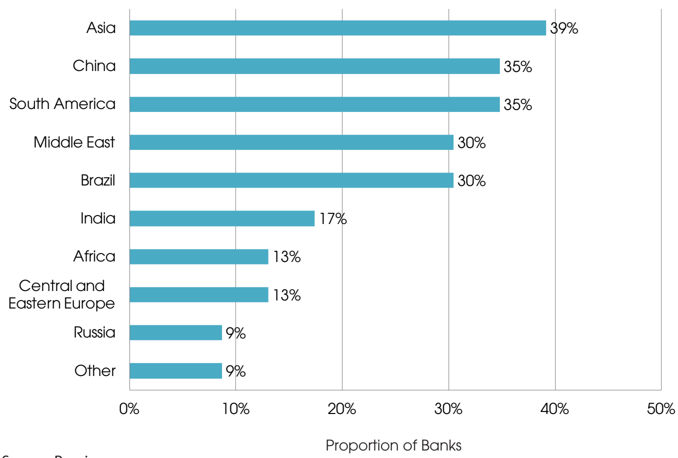
We asked banks with an appetite for emerging markets which regions within emerging markets are currently presenting attractive opportunities. As Fig. 8 shows, the highest proportion of banks (39%) view Asia as presenting appealing opportunities within emerging markets. Thirty-five percent of banks named China specifically. South America is also appealing to many banks, named by 35%, while 30% feel that Brazil in particular is offering attractive opportunities within emerging markets.

Fig. 7: Regions that Banks View as Presenting Attractive Opportunities in the Current Financial Climate and Regions They Are Avoiding Where They Would Previously Have Considered Investing



Source: Preqin

Fig. 8: Countries and Regions within Emerging Markets that Banks View as Presenting Attractive Opportunities



Source: Preqin

However, some investors are being put off South America due to its recent popularity among LPs, as one Canadian investor commented: "Now Latin America is so popular and more investors are looking there, prices have inflated and the region is less attractive."

Key Strategies over the Next 12 Months

As banks plan for the next 12 months, many are considering which fund types to target to best take advantage of opportunities in the market. We asked those banks looking to make new commitments where they expect to invest their capital over the next 12 months, and whether they are interested in co-investment opportunities.

Banks that plan to invest in funds over the next 12 months were asked which fund types they view as presenting attractive opportunities in the current market and also where they will actually be looking to invest over this period. Respondents were invited to name any fund type they felt fit these categories and were not asked about each fund type individually, so the results displayed in Fig. 9 demonstrate the fund types at the forefront of banks' minds.

Over half (57%) said that small to mid-market buyout funds are currently presenting the best opportunities, while 53% are looking to make commitments to such vehicles. Thirty-six percent feel large to mega buyout funds are presenting attractive opportunities, and 32% named growth funds as an appealing fund type to invest in at present.

Appetite for Co-Investments

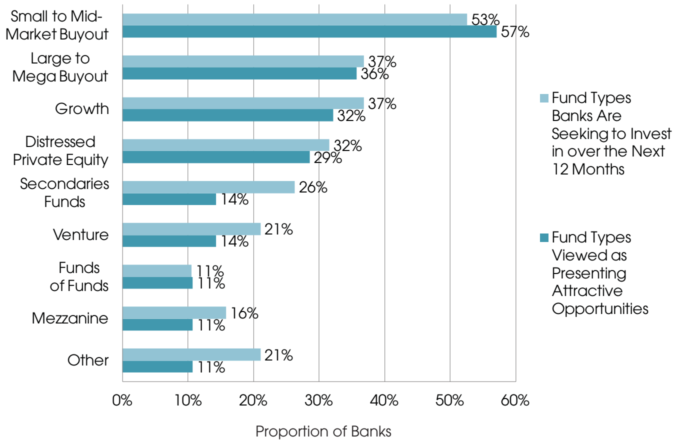
As investors look for new ways to access the private equity market, many are increasingly seeking co-investment rights, viewing such opportunities as a way to build stronger relationships with their managers, get closer to deals and take advantage of the potential higher returns and reduced fees co-investment opportunities can offer. With changes to regulations creating obstacles for banks investing in private equity funds, we asked banks whether they seek co-investment opportunities alongside GPs in their investment portfolios.

"Forty-five percent of banks are currently seeking co-investment opportunities."

As shown in Fig. 10, 45% of banks are currently seeking co-investment opportunities. Nineteen percent actively look for co-investment deals, while 26% co-invest on an opportunistic basis. Interestingly, of the banks that currently co-invest, 93% expect to either maintain or increase their allocations to co-investments in future.

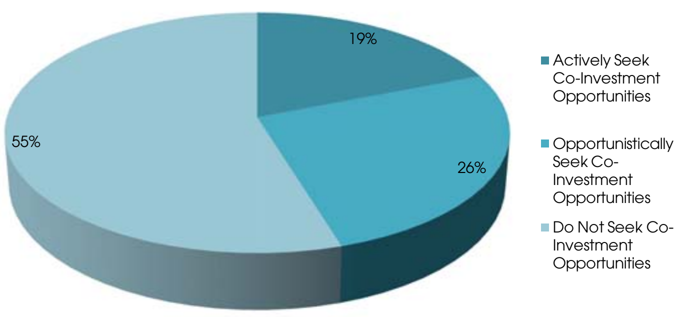
A number of investors cited changes to regulation as a reason to co-invest. One bank based in Texas said that it would co-invest going forward as co-investing provides the potential to gain further exposure to private equity, while another bank based in Ohio also noted that it has turned to co-investing as a means of accessing the asset class in light of new regulations.

Fig. 9: Banks' Attitudes towards Different Fund Types in the Current Financial Climate



Source: Preqin

Fig. 10: Banks' Attitudes towards Co-Investments



Source: Preqin

GP Relationships and Outlook for Banks Investing in Private Equity

With a number of banks expecting to allocate further capital to private equity in 2012, we asked if they will be looking to work with managers with which they have a prior relationship or if they will be forming new GP relationships. We also asked banks if they would be looking to increase or decrease their private equity allocations following regulatory changes and the instability of the current financial climate.

Reassuringly for GPs raising capital, 87% of banks will consider forming some new GP relationships in the next 12 months. As shown in Fig. 11, only 13% will solely commit to their existing GP base, while 35% will predominantly re-up but will consider some new relationships. Forty-eight percent expect to commit capital to a mix of re-ups and new relationships over the next 12 months. Four percent mostly plan to form new relationships when committing to new funds, but none of the banks we spoke to will solely commit to funds raised by GPs they have not worked with in the past.

In the current market many LPs are cautious about allocating capital to first-time managers, preferring a more established team with a demonstrated track record of good returns. Of the banks looking to make new commitments over the next 12 months, 48% will consider investing in funds being raised by a first-time fund manager, which is slightly higher than the 45% of all institutional investors in private equity that will consider investing in a first-time fund. Twelve percent of banks would invest in a first-time fund, and a further 20% would consider doing so if presented with a particularly appealing opportunity. A further 16% of banks are open to investing in vehicles managed by spin-out teams. Fifty-two percent of banks are not interested in investing in first-time funds.

"Sixteen percent of banks expect to increase their exposure to the asset class over the longer term, while 59% will continue committing to funds at the same pace."

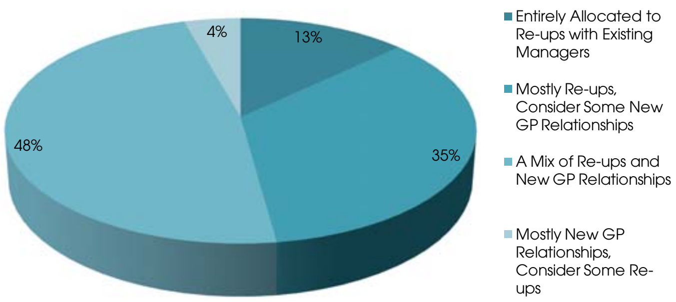
Allocations and Intentions for 2012 and Beyond

As Fig. 12 demonstrates, two-thirds of banks expect to maintain their allocations to private equity over the next 12 months, and a further 13% expect to increase their exposure to the asset class over the same period. However, a fifth of banks expect their private equity allocations to fall in the short term.

For many banks investing in private equity, particularly those based in the US, new regulations are going to have a big impact on their investments in the asset class. Like many US investors, a Californian bank told us: "We will be decreasing our exposure to private equity in light of the regulatory changes."

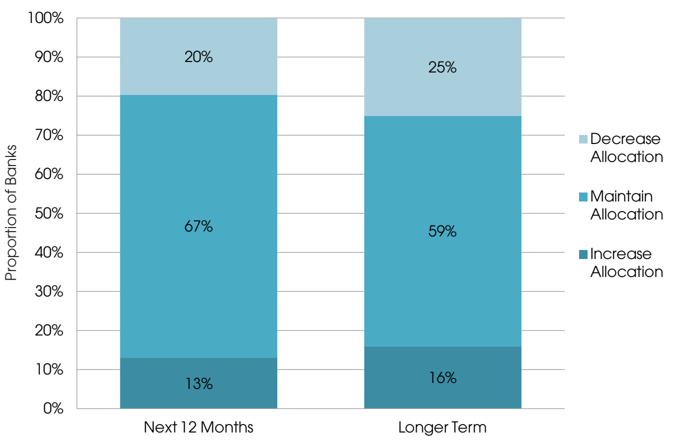
Many banks not affected by the Volcker Rule or Basel III are set to continue allocating to private equity. Sixteen percent of banks expect to increase their exposure to the asset class over the longer term, while 59% will continue committing to funds at the same pace.

Fig. 11: Banks' Intentions for Forming New GP Relationships over the Next 12 Months



Source: Preqin

Fig. 12: Banks' Intentions for Their Private Equity Allocations



Source: Preqin

Although 16% of banks expect to increase their exposure to private equity over the longer term, a higher proportion, 25% expect to reduce their exposure to the asset class, which suggests that while banks look set to remain an important source of capital for private equity firms, we are likely to see the amount of capital they invest in the asset class gradually decline.

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Investor Intelligence

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- Included as part of the Preqin online private equity services, or available as a separate module.

Preqin 2012 Limited Partner Universe

The Limited Partner Universe is a 600-page publication featuring a directory of over 2,800 of the most important investors in private equity worldwide, as well as detailed, vital analysis on all the latest trends affecting the private equity universe.

- Features all the most important investors in private equity, and their contact details. Investors are arranged by country and region (including US split by census region).
- Use latest trends and analysis on the market to construct a targeted strategy and identify the most likely sources of funding for your new vehicle.
- An excellent complement to the online service, as well as providing a useful fundraising tool in its own right.

Contact Us:

New York: +1 212 350 0100
London: +44 (0)20 7645 8888
Singapore: +65 6407 1011

Email: info@preqin.com
Website: www.preqin.com

About Preqin

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- Buyout Deals
- Fund Performance
- Fundraising
- Investor Profiles
- Fund Terms
- Fund Manager Profiles
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If you have any comments on this report, please contact:
info@preqin.com

If you want any further information, or would like to apply for a demo of our products, please contact us:

New York:

One Grand Central Place
60 E 42nd Street
Suite 2544
New York
NY 10165

Tel: +1 212 350 0100
Fax: +1 440 445 9595

London:

Equitable House
47 King William Street
London
EC4R 9AF

Tel: +44 (0)20 7645 8888
Fax: +44 (0)87 0330 5892

Singapore:

Asia Square Tower 1
#07-04
8 Marina View
Singapore 018960

Tel: +65 6407 1011
Fax: +65 6407 1001

Email: info@preqin.com
Web: www.preqin.com