NAIC National Association of Insurance Commissioners & The Center for Insurance Policy and Research
Capital Markets Special Report

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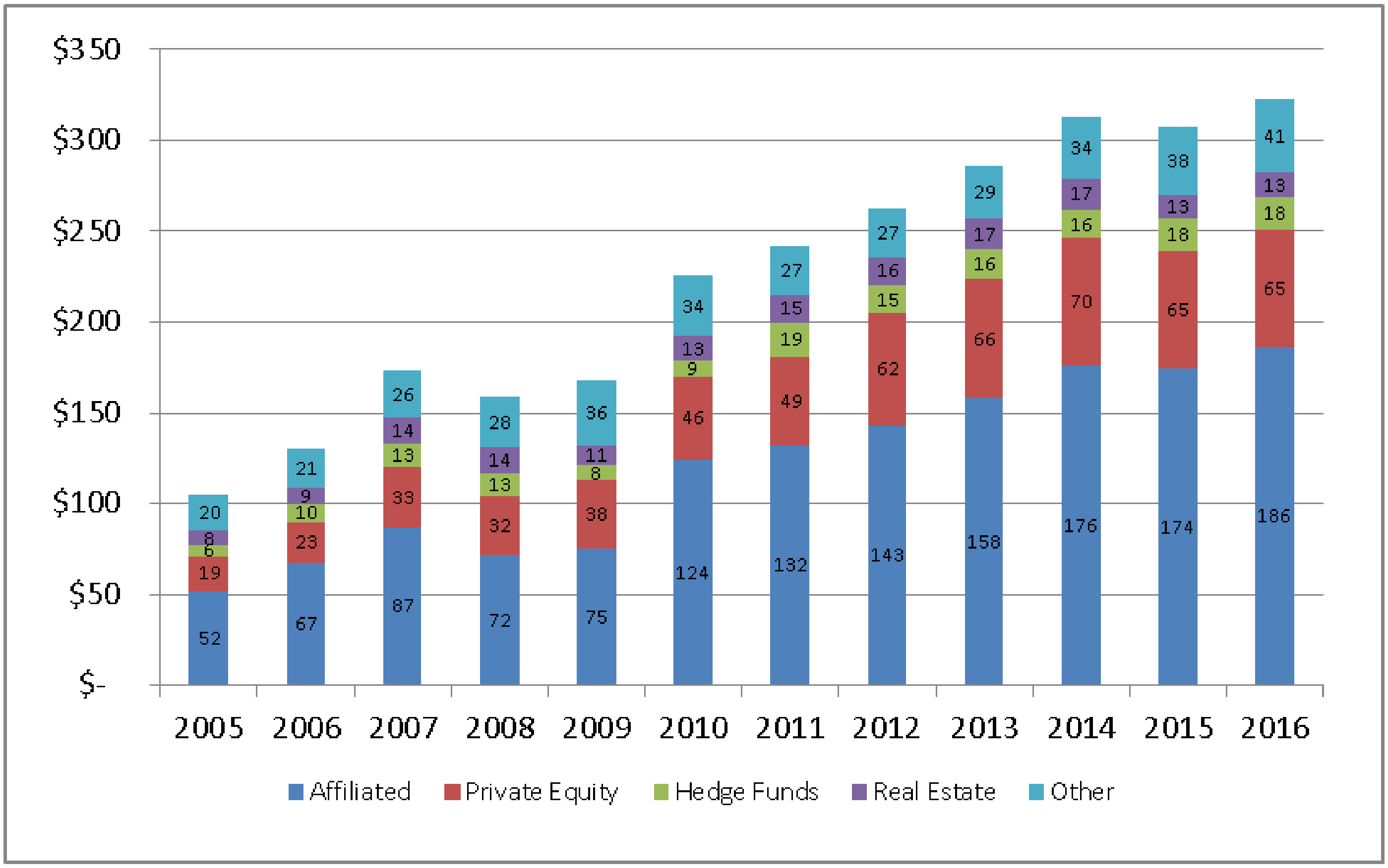
U.S. Insurer Exposure to Schedule BA (Other Long-Term Invested Assets): Focus on Private Equity, Hedge Funds and Real Estate

This special report is an update to the NAIC Capital Markets Bureau special report titled, "U.S. Insurer Exposure to Schedule BA (Other Long-Term Invested Assets): Focus on Private Equity, Hedge Funds and Real Estate," published March 4, 2016. This special report analyzes U.S. insurer exposure to "other long-term invested assets," as reported on Schedule BA, focusing on joint ventures, partnerships and limited liability companies (LLCs) that have the underlying characteristics of common stock (primarily private equity funds, or PE), real estate (primarily real estate funds, or RE, not including mortgages) or "other" (primarily hedge funds, or HF), as they are the significant component of insurer investments in other long-term invested assets. While investments reported as having the characteristics of common stock and as other may not be all private equity funds and hedge funds, respectively, the NAIC Capital Markets Bureau has historically found a high correlation with those investment types. Insurers' other long-term invested assets are comprised of affiliated and unaffiliated investments; affiliated investments were 58% of the industry's other long-term invested assets in 2016, up from 56% in 2015, and they have ranged between 45% and 58% since 2005. The focus of the analysis in this special report (as in the previously published special report) is on the industry's exposure to unaffiliated PE, HF and RE.

As of year-end 2016, U.S. insurer exposure to other long-term invested assets was $323.4 billion in book/adjusted carrying value (BACV), which is 5.3% of total cash and invested assets. Affiliated investments accounted for $186.0 billion; therefore, $137.0 billion were unaffiliated investments. Insurer exposure to unaffiliatedinvestments that comprised PE, HF and RE were $64.8 billion, $18.0 billion and $13.0 billion, respectively, at year-end 2016 (totaling $96.0 billion, or 1.6% of total cash and invested assets, unchanged from 2015, but down from 1.8% in 2014), as shown in Chart 1.

Chart 1: U.S. Insurer Other Long-term Invested Assets – Major Components, 2005–2016 ($Bil.)



SEC Regulation and the HF and PE Universe

Title IV (Regulation of Advisers to Hedge Funds and Others) of the federal Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank) mandates funds with between $25 million and $150 million in assets under management (AUM) register with the state in which they operate, while those with more than $150 million in AUM must register with the U.S. Securities and Exchange Commission (SEC). Registered funds must report to the SEC using Form PF (a report deemed highly confidential from which the SEC does provide some summary data).

As of third quarter 2016, Form PF reporting showed there were 9,719 PE, 8,947 HF and 2,108 RE funds with net asset value (NAV) of $1.9 trillion, $3.5 trillion and $323.0 billion, respectively. NAV is defined by the SEC as total assets minus total liabilities. Notwithstanding recent news that HF closings outpaced launches, Form PF reporting shows the number of HFs grew 2% from the fourth quarter of 2015 to the third quarter of 2016, PE grew less than 1%, while the number of RE grew about 3% over the same period. NAV growth for HF, PE and RE was also low from the fourth quarter of 2015 to the third quarter of 2016, with HF up 1.1%; PE and RE were each up 1.3% for the same time period. These figures do not include SEC-registered advisers with AUM of $150.0 million or less (as they are exempt from filing Form PF).

The 20 largest advisers managed 28% of total Form PF reported assets as of third quarter 2016, down from 30% in October 2014. According to Preqin, Bridgewater Associates remains the largest hedge fund manager based on AUM at year-end 2016.

Some large investors, including several large insurance companies, have announced reviews and/or redemptions from HFs, while others are increasing allocations. Opportunistic purchasers made possible the launch of 118 HFs in third quarter 2016, according to Hedge Fund Online (a hedge fund industry data provider).

Background on HF, PE and RE

For a more detailed discussion on the background of HE, PE and RE, see the NAIC Capital Markets Bureau aforementioned special report on other long-term invested assets published in March 2016.

Structure of HF and PE, Capital Commitment, Lock-up and Fees

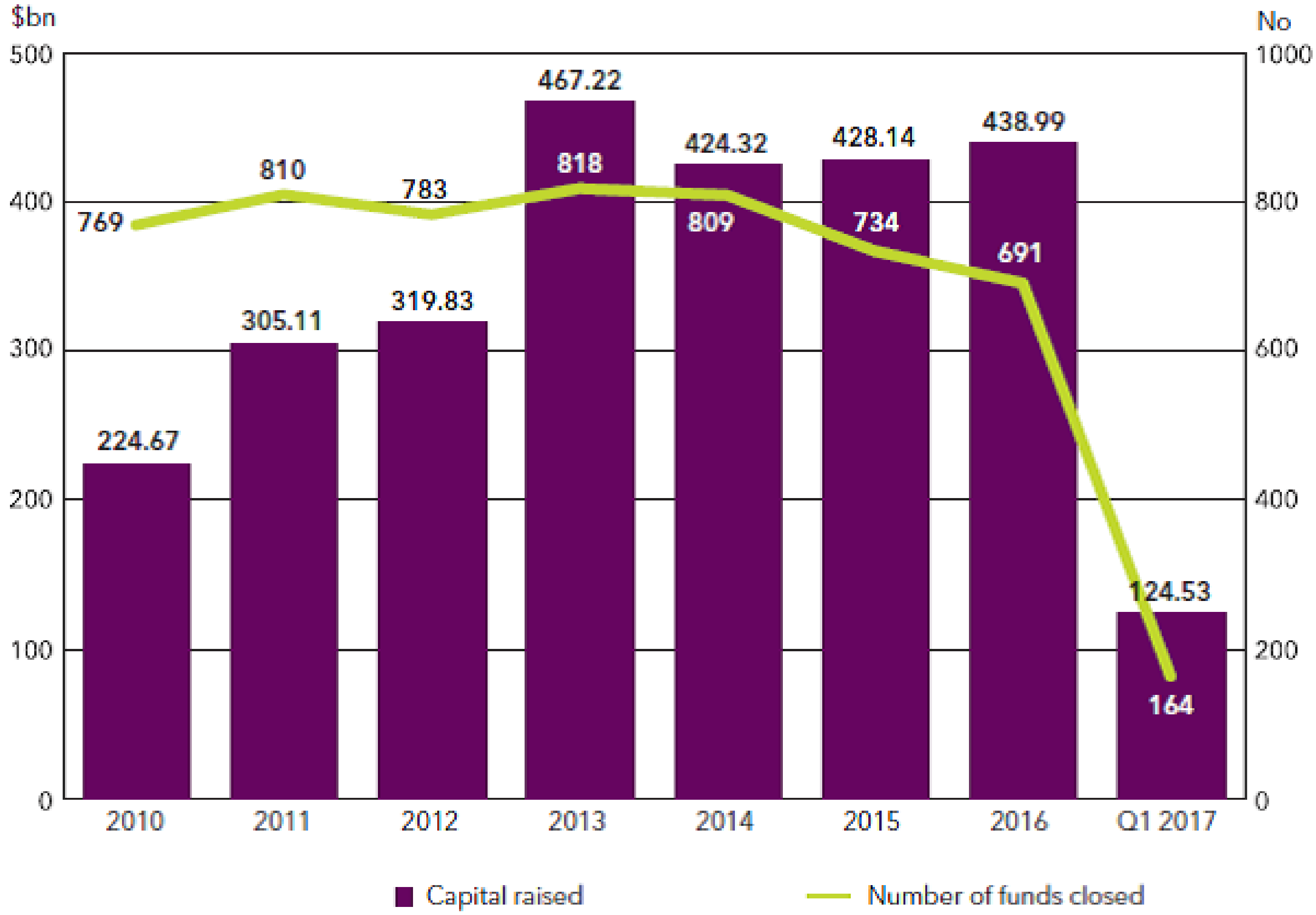
HF, PE and RE have significant limitations on liquidity for their investors. PE and RE have a commitment period, usually around five years, during which investments are made, and no payouts or redemptions occur. This is often referred to as a “lock-up” period. After that, the PE will make distributions to limited partners (LPs) as the fund’s investments mature and are sold. RE make distributions to LPs from any income received from rent or profit from the sale of a property. HF also have lock-up periods, which can be as short as three months to as long as seven years. After the lock-up period, HF allow periodic withdrawals, typically either quarterly or annually. Each withdrawal of capital by an LP generally requires advance notice to the general partner (GP). HF limit the amount of capital that can be withdrawn with each request; these features increase the illiquidity of an HF. HF also have the option to raise “gates” that prohibit withdrawals at the discretion of the GP, in addition to restrictions on the resale of their holdings.

Total 2016 Fundraising

According to Preqin, there were 1,006 HF launched and 981 HF liquidated in 2016. Although there were net 25 new HF launched in 2016, 47% of HF managers surveyed by Preqin reported challenges in fundraising (30% reported a less challenging environment). As of November 2016, HF reached about $3.2 trillion of global AUM.

Fundraising in the first-half of 2016 for PE was the second-highest since 2010, at $216.5 billion in 333 new funds. As of year-end 2016, 691 PE funds completed an offering, raising $439.0 billion (see Chart 2). Ardian Secondary Fund VII was the largest PE to complete an offering in 2016, taking in $14.0 billion, which was $5.0 billion more than its target amount. The average PE raised $635.0 million in 2016, compared to $583.0 million in 2015.

Chart 2: Private Equity Fundraising, 2010 – First Quarter 2017



Source:*Private Equity International.*

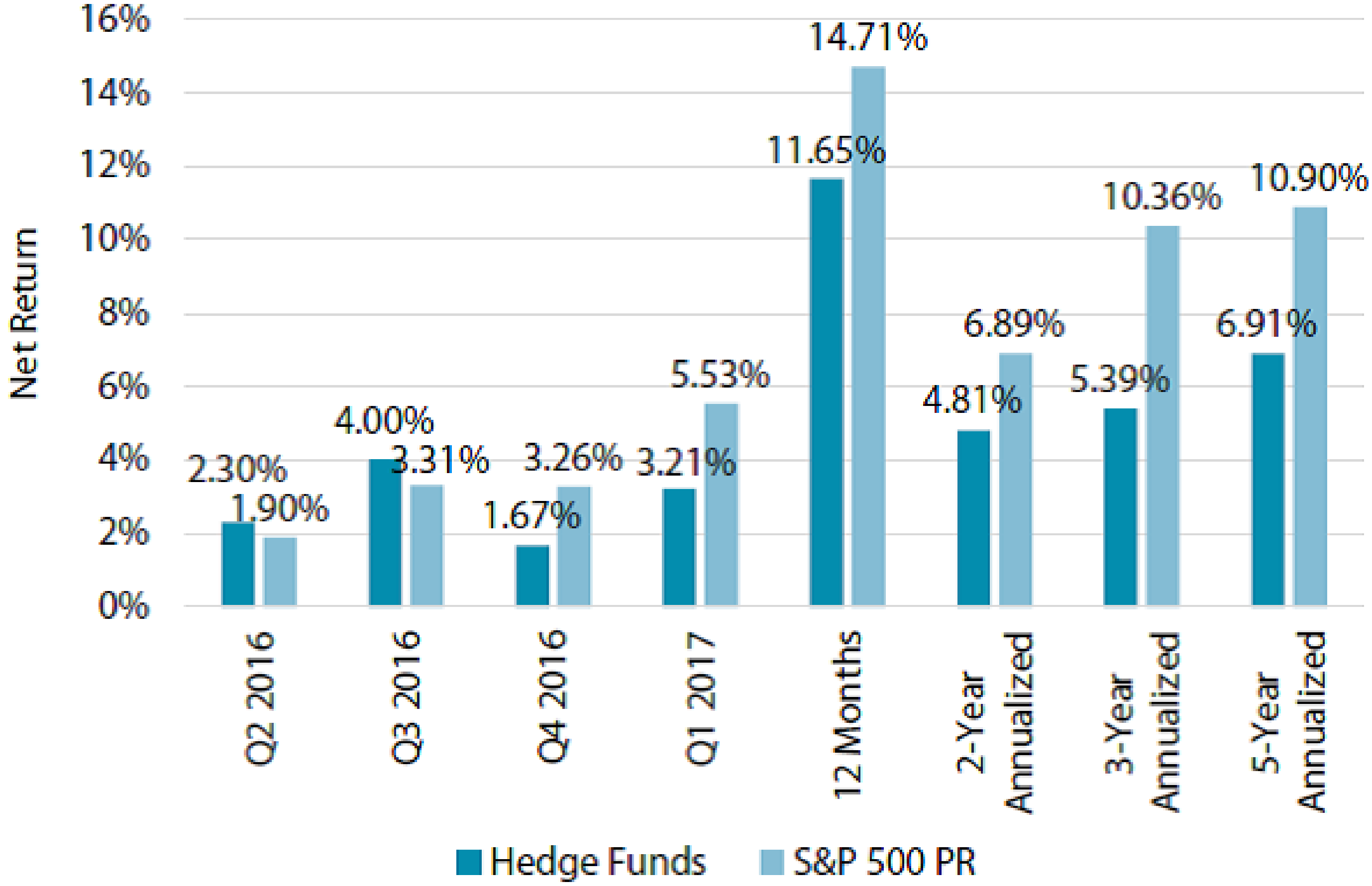
Seven of the largest 10 PE that completed an offering in 2016 were buyout funds. As of April 1, 2017, according to Private Equity International, there were 2,241 PE funds with a total target amount of $605.0 billion. Of the $124.0 billion raised by the 163 funds completing an offering in first quarter 2017, 46% (or $5.0 billion) were with buyout funds. Mezzanine funds were the next largest, at 20% (or $25.3 billion).

Capital raised by RE rose consistently from $62.9 billion in 2010 to $142.5 billion in 2015, followed by a decrease to $100.5 billion in 2016. While the amount of capital raised peaked in 2015, the number of RE completing an offering was highest in 2012, at 316. By year-end 2016, only 183 funds completed an offering according to PERENEWS.com. Brookfield Strategic Real Estate Partners II was the largest fund to close in 2016, at $9.0 billion.

Performance of HF, PE and RE Universe

HF performance, as measured by the Preqin All-Strategies Hedge Fund benchmark, underperformed the Standard & Poor's 500 Index (S&P 500) over the 12-month period ended March 2017 (see Chart 3). The underperformance, in fact, stretches into a five-year period ending March 2017, where the Preqin All-Strategies Hedge Fund benchmark returned 6.9% versus 10.9% for the S&P 500. Performance was uneven across strategies in first quarter 2017. Equity strategies were the best performer, returning 4.11%, followed by event-driven strategies at 3.74%. Funds focused on commodity trading performed worst, at -0.3% for the period. For the 12-month period ending March 2017, event-driven strategies outperformed the S&P 500, returning 17.7% versus 14.7%.

Chart 3: Performance of Hedge Funds vs. S&P 500 Price Return Index (as of March 2017)



Source:*Preqin Hedge Fund Online, All-Strategies Hedge Fund Benchmark.*

With regard to PE performance, the Bloomberg Private Equity Index (tracking the performance of globally listed private equity stocks) has a year-to-date price return of 15.8% compared to 8.68% for the S&P 500, as of June 21, 2017. For the one-year period ending March 2017, the Bloomberg Private Equity Index outperformed the S&P 500 with a 16.3% return versus 14.7%. In addition, as of year-end 2016, the Bloomberg Private Equity Index underperformed the S&P 500 in the one-year period, but outperformed in the five- year period (i.e., Bloomberg Private Equity returned 79.6% and the S&P 500 returned 78%) and 10-year period (i.e., Bloomberg Private Equity returned 244.4% and the S&P 500 returned 57.9%).

According to Preqin Real Estate Online, RE returned 14.9% for the three-year period ending June 2016 (the most recent period for which data is available). During the same three-year period, buyout strategy returned 17.5%, outperforming all other RE strategies.

U.S. Insurer Exposure to HF, PE and RE

As of year-end 2016, U.S. insurers reported exposure to unaffiliated HF, PE and RE with an aggregate BACV of $96.0 billion, consistent with year-end 2015, but down 7% from 2014. The decrease in BACV from 2014 to 2015 (and 2016) was the first decrease in unaffiliated HF, PE and RE exposure reported by U.S. insurers since 2009 (see Table 1). High fees and relative underperformance to public equity led to investor redemptions.

Table 1: U.S. Insurer Historical Total Exposure to Unaffiliated HF, PE and RE (BACV, $Bil.)

Asset	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Private Equity (PE)	19	23	33	32	38	46	49	62	66	70	65	65
Hedge Fund (HF)	6	10	13	13	8	9	19	15	16	16	18	18
Real Estate	8	9	14	14	11	13	15	16	17	17	13	13
Total	**33**	**42**	**60**	**59**	**57**	**68**	**83**	**93**	**99**	**103**	**96**	**96**

As shown in Table 2, in 2016, of the total exposure to unaffiliated HF, PE and RE, about 67.5% of BACV was concentrated in PE investments, while 18.8% was in HF and 13.7% was in RE. Unaffiliated HF, PE and RE investments continue to be relatively attractive to U.S. insurers because of their higher yields compared to traditional investments, given the continued low interest rate environment. As of year-end 2016, unaffiliated HF, PE, and RE accounted for 30% of total Schedule BA investments.

Across the five industry types, life and P/C companies together accounted for the largest investment in unaffiliated HF, PE and RE for an aggregate of $90.8 billion at year-end 2016, or 94% of total unaffiliated other long-term investments. This is relatively unchanged from year-end 2015. Life companies alone accounted for about 61% of the unaffiliated HF, PE and RE investments (see Table 2 and Table 3). U.S. insurers reported commitments for $38.0 billion additional unaffiliated PE, HF and RE investments as of year-end 2016, with the largest share committed to PE ($28.0 billion), followed by HF ($6.0 billion) and RE ($3.9 billion).

Table 2: 2016 U.S. Insurer Exposure to Unaffiliated HF, PE and RE by Industry Type (BACV, $Mil.)

Asset	Fraternal	Life	P/C	Title	Health	Total	Pct of Total
Private Equity (PE)	500	47,940	15,507	-	885	64,831	67.5%
Hedge Fund (HF)	503	4,746	10,543	13	2,267	18,072	18.8%
Real Estate	225	6,246	5,838	4	826	13,140	13.7%
Total	**1,228**	**58,933**	**31,888**	**17**	**3,977**	**96,043**	**100%**
Pct of Total	1%	61%	33%	0%	4%	100%	

Note: Pct. of Total may not sum to 100 due to rounding.

Table 3: 2015 U.S. Insurer Exposure to Unaffiliated HF, PE and RE by Industry Type (BACV, $Mil.)

Asset	Fraternal	Life	P/C	Title	Health	Total	Pct of Total
Private Equity (PE)	592	48,810	15,290	-	777	65,469	68.0%
Hedge Fund (HF)	338	4,444	11,314	7	1,867	17,969	18.7%
Real Estate	160	6,753	5,178	57	641	12,789	13.3%
Total	**1,090**	**60,007**	**31,781**	**64**	**3,285**	**96,227**	**100%**
Pct of Total	1%	62%	33%	0%	3%	100%	

Notable HF Exposure Among Small Insurers

The characteristics of insurers vary with respect to their ability to absorb complex investments with volatile and unpredictable cash flows that are also illiquid. A more complete breakdown of exposures to PE, HF and RE by insurer type and asset size is particularly warranted given these concerns. Unaffiliated HF exposure grew 46% to $1.9 billion at year-end 2016 (from $1.3 billion at year-end 2015) among U.S. insurers with total cash and invested AUM between $5.0 billion and $10.0 billion (see Table 4 and Table 5). The year-over-year (YOY) increase in BACV was mainly from net acquisitions ($548.0 million) and net unrealized increases in valuation ($58.0 million). Small insurers (those with less than $250.0 million in total cash and invested assets) reported an increase of 45% in BACV among HF to $282.5 million from $194.4 million for the same YOY period. Small insurers represented the largest number of new insurers reporting unaffiliated HF exposure at year-end 2016, at 19. New insurers include those with reported HF exposure in 2016 but no reported HF exposure in 2015. The 19 new insurers reported a total of $121.6 million in 2016. The pattern of smaller insurers increasing their exposure to HF, while larger, predominately life companies, exit the asset type, continues from year-end 2015. U.S. insurers with total cash and invested assets between $2.5 billion and $5.0 billion reported a 29% decrease in HF BACV to $1.1 billion at year-end 2016 from $1.5 billion in 2015.

Table 4: 2016 U.S. Insurer Exposure to Unaffiliated HF, PE and RE by Total Cash and Invested Assets (BACV, $Mil.)

Asset	Less than $250mm	Between $250mm and $500mm	Between $500mm and $1B	Between $1B and $2.5B	Between $2.5B and $5B	Between $5B and $10B	Greater than $10B
Private Equity (PE)	186	363	525	1,579	1,753	3,753	56,673
Hedge Fund (HF)	282	472	640	3,202	1,062	1,913	10,500
Real Estate	126	86	194	1,178	738	1,569	9,250
Total	**594**	**921**	**1,359**	**5,959**	**3,553**	**7,234**	**76,423**
Pct of Total	1%	1%	1%	6%	4%	8%	80%

Table 5: 2015 U.S. Insurer Exposure to Unaffiliated HF, PE and RE by Total Cash and Invested Assets (BACV, $Mil.)

Asset	Less than $250mm	Between $250mm and $500mm	Between $500mm and $1B	Between $1B and $2.5B	Between $2.5B and $5B	Between $5B and $10B	Greater than $10B
Private Equity (PE)	177	361	513	1,537	1,509	2,962	58,310
Hedge Fund (HF)	194	423	516	3,035	1,516	1,307	10,978
Real Estate	129	90	89	1,026	1,007	1,291	9,153
Total	**501**	**874**	**1,118**	**5,597**	**4,033**	**5,560**	**78,441**
Pct of Total	1%	1%	1%	6%	4%	6%	82%

U.S. insurer unaffiliated HF, PE and RE exposure as of year-end 2016 was about 1.6% of total cash and invested assets. While this is a relatively small exposure as a percentage of the industry's total cash and invested assets, at year-end 2016, HF exposure increased for small insurers. Given asset-liability matching and liquidity considerations, particularly for smaller insurers, BACV as a percentage of capital and surplus is a more conservative and more appropriate way to consider the exposure risk. As a percentage of capital and surplus, seven small insurers (8% of small insurers reporting HF exposure at year-end 2016) reported HF exposure in excess of 10%, with the highest at 36% as of year-end 2016.

Valuation of HF, PE and RE by U.S. Insurers

For accounting treatment, investments in a joint venture, partnership or limited liability company are subject to the *Statement of Statutory Accounting Principles (SSAP) No. 48—Joint Ventures, Partnerships and Limited Liability Companies*, which requires an equity method for all such investments regardless of whether the insurer has a minor ownership interest, or if the insurer holds more than a minor interest. Under the equity method, investments are initially valued at cost, with periodic adjustments for subsequent capital contributions, amortization of the basis difference, and earnings and losses of the investee adjusted for any distributions received. For 2016, U.S. insurers reported other-than-temporary impairments (OTTI) of $1.6 billion from unaffiliated HF, PE and RE investments. The equity in the SSAP No. 48 entities is generally required to be based on audited U.S. generally accepted accounting principles (GAAP) financial statements. If audited U.S. GAAP financial statements are not available and the insurer only holds a minor ownership interest, SSAP No. 48 specifies other options that may be utilized (e.g., audited International Financial Reporting Standards (IFRS) basis or audited U.S. tax basis). If the investment in an LLC reflects wholly owned real estate, which meets specific conditions in *SSAP No. 40R—Real Estate Investments*, then the investment is captured in scope of SSAP No. 40R (and not SSAP No. 48).

Summary

As of year-end 2016, U.S. insurer exposure to other long-term invested assets, as reported in Schedule BA, reached about $323.4 billion (including affiliated and unaffiliated exposure). Within the unaffiliated exposure (which was about 42% of the industry's other long-term invested assets), unaffiliated HF, PE and RE were the largest components at approximately $96.0 billion, with PE being the largest at $65.0 billion. As of year-end 2016, 691 PE funds closed, compared to 734 funds in 2015, raising an average of $635.0 billion per fund. Within the U.S. insurance industry's unaffiliated PE investments, the largest strategy type reported by insurers in 2016 remains leveraged buyouts (unchanged since at least 2005), and, for HF investments, it was long/short equity (which has varied from year to year with multi-strategy since at least 2005). Note, however, that the reported strategies (i.e., leveraged buyout, long/short equity) are subjective and based on insurer reporting. Commitment for additional HF, PE and RE investments totaled $38.0 billion in 2016. Liquidity, limited by restrictions on withdrawal, may be an issue for some U.S. insurers in asset-liability matching. The issue is greatest for small insurers (19 of which reported new HF exposure in 2016), where these assets may be a significant percentage of capital and surplus. As PE, HF and RE are characterized as illiquid and non-transparent, they also continue to not be core investments for U.S. insurers, demonstrated by their overall 1.6% of total cash and invested assets exposure at year-end 2016. Rather, PE, HF and RE represent alternative options to traditional investments in a continued low interest rate environment.

The Capital Markets Bureau will continue to monitor trends within the insurance industry and report on any developments as deemed appropriate.

July 21, 2017 Major Insurer Share Prices			Change %			Prior		
		Close	Week	QTD	YTD	Week	Quarter	Year
Life	Aflac	$77.57	(0.4)	(0.1)	11.5	$77.87	$77.68	$69.60
	Ameriprise	136.34	1.2	7.1	22.9	134.74	127.29	110.94
	Genworth	3.50	(2.0)	(7.2)	(8.1)	3.57	3.77	3.81
	Lincoln	70.73	(0.9)	4.7	6.7	71.34	67.58	66.27
	MetLife	54.65	(1.2)	(0.5)	1.4	55.34	54.94	53.89
	Principal	66.42	0.5	3.7	14.8	66.10	64.07	57.86
	Prudential	111.74	0.3	3.3	7.4	111.41	108.14	104.06
	UNUM	47.80	0.3	2.5	8.8	47.66	46.63	43.93
PC	Axis Capital	65.00	1.7	0.5	(0.4)	63.90	64.66	65.27
	Allstate	89.16	0.1	0.8	20.3	89.05	88.44	74.12
	Arch Capital	98.50	2.4	5.6	14.1	96.16	93.29	86.29
	Cincinnati	74.42	2.4	2.7	(1.8)	72.69	72.45	75.75
	Chubb	147.00	1.3	1.1	11.3	145.18	145.38	132.12
	Everest Re	270.12	2.4	6.1	24.8	263.75	254.59	216.40
	Progressive	46.36	1.7	5.1	30.6	45.58	44.09	35.50
	Travelers	125.15	(0.5)	(1.1)	2.2	125.72	126.53	122.42
	WR Berkley	70.58	1.0	2.0	6.1	69.89	69.17	66.51
	XL	46.41	2.7	6.0	24.6	45.17	43.80	37.26
Other	AON	$139.14	2.1	4.7	24.8	$136.22	$132.95	$111.53
	AIG	64.20	0.1	2.7	(1.7)	64.11	62.52	65.31
	Assurant	105.41	0.7	1.7	13.5	104.63	103.69	92.86
	Fidelity National	47.57	4.5	6.1	40.1	45.54	44.83	33.96
	Hartford	53.79	0.8	2.3	12.9	53.36	52.57	47.65
	Marsh	80.01	1.5	2.6	18.4	78.86	77.96	67.59
Health	Aetna	$156.31	0.7	3.0	26.0	$155.27	$151.83	$124.01
	Cigna	174.23	0.2	4.1	30.6	173.80	167.39	133.39
	Humana	235.92	(1.3)	(2.0)	15.6	239.09	240.62	204.03
	United	191.78	2.6	3.4	19.8	186.90	185.42	160.04
Monoline	Assured	$45.09	1.5	8.0	19.4	$44.41	$41.74	$37.77
	MBIA	10.43	1.0	10.6	(2.5)	10.33	9.43	10.70
	MGIC	11.91	2.3	6.3	16.9	11.64	11.20	10.19
	Radian	17.54	0.8	7.3	(2.4)	17.40	16.35	17.98
	XL Capital	46.41	2.7	6.0	24.6	45.17	43.80	37.26

July 21, 2017 Major Market Variables	Close	Change % Week	Change % QTD	Change % YTD	Prior Week	Prior Quarter	Prior Year
Dow Jones Ind	21,580.07	(0.3)	1.1	9.2	21,637.74	21,349.63	19,762.60
S&P 500	2,472.54	0.5	2.0	10.4	2,459.27	2,423.41	2,238.83
S&P Financial	411.73	(0.3)	0.5	6.5	412.90	409.59	386.53
S&P Insurance	389.44	0.6	2.1	10.2	387.11	381.48	353.26
US Dollar $		Change %			Prior		
/ Euro	$1.17	1.7	2.1	10.9	$1.15	$1.14	$1.05
/ Crude Oil bbl	45.69	(2.0)	(1.1)	(15.1)	46.62	46.22	53.81
/ Gold oz	1,254.50	2.1	1.0	9.0	1,228.40	1,241.80	1,150.90
Treasury Ylds %	%	Change bp			%	%	%
1 Year	1.21	0.02	(0.02)	0.40	1.20	1.23	0.82
10 Year	2.24	(0.09)	(0.06)	(0.21)	2.33	2.30	2.45
30 Year	2.81	(0.11)	(0.02)	(0.26)	2.92	2.83	3.07
Corp Credit Spreads -bp		Change %			Prior		
CDX.IG	56.90	(2.2)	(6.0)	(15.8)	58.17	60.52	67.59

July 21, 2017 Major Insurer Bond Yields	Company		Coupon	Maturity	Weekly Change Price Current	Price Change	Yield	Spread over UST B.P.	Spread over UST Change	YTD Spread Change
Life	Ameriprise	AMP	3.700%	10/15/2024	$105.35	$0.77	2.87%	77	(4)	(27)
	Lincoln National	LNC	3.350%	3/9/2025	$101.10	$0.22	3.19%	103	0	(8)
	MassMutual	MASSMU	3.600%	4/9/2024	$105.14	$0.59	2.75%	71	(2)	(22)
	MetLife	MET	4.050%	3/1/2045	$102.68	$2.06	3.89%	112	(2)	(15)
	New York Life	NYL	2.350%	7/14/2026	$96.51	$0.71	2.79%	60	(1)	(14)
	Pacific Life	PACLIF	5.125%	1/30/2043	$113.51	$1.78	4.25%	155	(1)	(35)
	Principal	PFG	6.050%	10/15/2036	$127.82	$1.65	3.97%	141	(1)	(29)
	Prudential	PRU	4.600%	5/15/2044	$111.42	$2.14	3.91%	118	(1)	(15)
	Allstate	ALL	4.500%	6/15/2043	$111.21	$2.32	3.81%	110	(1)	(10)
	Berkshire Hathaway	BRK	4.300%	5/15/2043	$108.87	$2.19	3.76%	104	(2)	(6)
	Travelers	TRV	4.600%	8/1/2043	$113.04	$1.61	3.81%	108	0	3
	XL Group	XL	6.250%	5/15/2027	$120.12	$0.61	3.77%	149	1	(20)
Other	AON	AON	4.250%	12/12/2042	$99.07	$1.29	4.31%	157	2	(17)
	AIG	AIG	6.820%	11/15/2037	$132.04	$1.68	4.41%	184	(2)	(27)
	Hartford	HIG	4.300%	4/15/2043	$103.19	$1.78	4.10%	139	(1)	(46)
	Nationwide	NATMUT	5.300%	11/18/2044	$115.68	$1.56	4.32%	156	3	(43)
Health	Aetna	AET	6.750%	12/15/2037	$141.19	$2.21	3.82%	126	(3)	(38)
	CIGNA	CI	6.150%	11/15/2036	$128.42	$1.90	4.02%	148	(3)	(60)
	United Healthcare	UNH	4.750%	7/15/2045	$117.27	$2.70	3.75%	98	(3)	(15)

Questions and comments are always welcome. Please contact the Capital Markets Bureau at **CapitalMarkets@naic.org**.