

The [NAIC's Capital Markets Bureau](#) monitors developments in the capital markets globally and analyzes their potential impact on the investment portfolios of US insurance companies. A list of archived Capital Markets Bureau Special Reports is available via the [index](#)

Schedule BA – Private Equity and Hedge Funds

The [Capital Markets Bureau's](#) Special Report dated as of Sept. 23, 2011, looked at the U.S. insurance industry's Schedule BA investments, or "Other Long-Term Invested Assets." This Special Report takes a closer look at insurers' private equity and hedge fund investments as reported in Schedule BA as of year-end 2010.

Summary

The insurance industry's general account cash and invested assets at year-end 2010 totaled \$5 trillion in book/adjusted carrying value (BACV), of which Schedule BA accounted for \$232.6 billion (or 4.3%). Among those Schedule BA investments, \$61.6 billion (or 1.24%) were designated as private equity and hedge funds. At this percentage, reported private equity and hedge fund exposures were not material to regulated U.S. insurance companies. The investments of domestic insurers in hedge funds and private equity funds also do not appear to be material as a percentage of the total private equity and hedge fund market.

Only 372 of the 4,455 U.S. insurance companies reported private equity or hedge fund investments. Such investments were significant in relation to capital for only a few dozen companies. Of the total, \$48.3 billion (or 0.97% in cash and invested assets) was designated as private equity funds and \$13.4 billion (or 0.27%) as hedge funds. In addition, there are investments listed on Schedule BA not designated as a hedge fund or private equity fund, but with the same managers as those designated as either hedge funds or private equity funds. These totaled approximately \$23.3 billion as of year-end 2010.

Insurers' Private Equity and Hedge Fund Investments by Strategy

This report focuses on those private equity and hedge fund investments reported with one of 13 private equity or hedge fund "Type and Strategy" designations in Schedule BA, Part 1, column 9, pursuant to the 2010 *Annual Statement Instructions*. The designations are as follows:

Private equity

- Venture capital
- Mezzanine financing
- Leveraged buyout (LBO)

Hedge fund

- Global macro
- Long/short equity
- Merger arbitrage
- Fixed-income arbitrage
- Convertible arbitrage
- Futures/options/foreign exchange arbitrage
- Sector investing

- Distressed securities
- Emerging markets
- Multi-strategy

Private equity funds and hedge funds are generally illiquid with significant restrictions on transferability. In addition, private equity funds can only distribute cash when underlying investments, which are themselves illiquid, can be sold. Hedge funds are structured more as trading portfolios and offer investors some ability to request withdrawals at current market values. While many hedge funds offer quarterly or annual liquidity, “gates” and “side-pockets” limit redemptions, and some funds have multi-year lock-ups.

Insurers reported that \$61.6 billion of private equity and hedge fund BACV was distributed among the 13 different designated investment types and strategies (as shown in Table 1 below). Life companies accounted for 67% and property/casualty companies accounted for 29% of the industry’s private equity and hedge fund investments.

Table 1: Insurers’ Private Equity and Hedge Fund Investments (Smillions)

BACV by Strategy	Life		P&C		Fraternal		Health		Title		Total	
Venture Capital	\$6,827	16%	\$5,064	28%	\$38	2%	\$499	79%	\$1.3	74%	\$12,428	20%
Mezzanine	7,668	19%	1,559	9%	295	17%	0	0%	0.00	0%	9,522	15%
Leveraged Buyout	20,192	49%	4,751	27%	1,374	79%	13	2%	0.00	0%	26,329	43%
<i>Private Equity</i>	<i>\$34,687</i>	<i>84%</i>	<i>\$11,374</i>	<i>64%</i>	<i>\$1,706</i>	<i>98%</i>	<i>\$512</i>	<i>82%</i>	<i>\$1</i>	<i>74%</i>	<i>\$48,280</i>	<i>78%</i>
Global Macro	\$299	1%	\$533	3%	-	-	-	-	-	-	\$ 832	1%
Long/Short Equity	1,510	4%	1,739	10%	-	-	104	16%	-	-	3,352	5%
Merger Arbitrage	27	0%	92	1%	-	-	-	-	-	-	119	0%
Fixed Income Arbitrage	577	1%	53	0%	-	-	-	-	-	-	630	1%
Convertible Arbitrage	48	0%	86	0%	-	-	-	-	-	-	134	0%
Futures, Options	5	0%	100	1%	-	-	-	-	-	-	105	0%
Sector	115	0%	206	1%	-	-	-	-	-	-	322	1%
Distressed	1,227	3%	830	5%	-	-	-	-	-	-	2,057	3%
Emerging Mkts	181	0%	147	1%	-	-	-	-	-	-	328	1%
Multi-Strategy	2,712	7%	2,722	15%	27	1.6%	13	2%	0.45	26%	5,474	9%
<i>Hedge Funds</i>	<i>\$6,702</i>	<i>16%</i>	<i>\$6,507</i>	<i>36%</i>	<i>\$27</i>	<i>2%</i>	<i>\$116</i>	<i>18%</i>	<i>\$0</i>	<i>26%</i>	<i>\$13,352</i>	<i>22%</i>
Total	\$41,389	100%	\$17,880	100%	\$1,733	100%	\$628	100%	\$1.7	100%	\$61,632	100%
% of Total Industry	67%		29%		3%		1%		0%		100%	

Of the 4,455 U.S. insurance companies in the NAIC’s 2010 database, only 1,163 had Schedule BA investments and (as mentioned previously) only 372 reported private equity or hedge fund investments. The combined cash and invested assets of these 372 insurers was \$3.21 trillion, for an overall average allocation to private equity and hedge funds of 1.9%.

Among these 372 companies, the 20 largest insurance groups or holding companies held \$48 billion (or 80%) of the industry’s private equity and hedge funds in 2010. Thirty-four companies reported private equity and hedge fund BACV exceeding 20% of their capital and surplus.

Twelve companies accounted for \$31.8 billion (or 51.6%) of all such funds; they had a combined \$1.1 trillion in cash and invested assets.

Overall, private equity and hedge funds reported as “affiliated” accounted for only \$10 billion (or 16.2%) of all such investments, of which 70% was in the three private equity strategies and 24% were in multi-strategy hedge funds.

“Type and Strategy” Investments Over Time

The following table shows how the insurance industry’s private equity and hedge fund investments, by dollars and designated type and strategy, have evolved over the past six years.

Table 2: Insurers' Private Equity and Hedge Fund Investments Over Time (\$millions)

BACV by Strategy	2005	2006	2007	2008	2009	2010
Venture Capital	\$5,919	\$8,139	\$11,325	\$10,733	\$10,330	\$12,428
Mezzanine	3,391	5,050	5,967	8,726	9,425	9,522
Leveraged Buyout	9,489	13,594	19,315	18,598	21,233	26,329
<i>Private Equity</i>	<i>\$18,799</i>	<i>\$26,783</i>	<i>\$36,606</i>	<i>\$38,057</i>	<i>\$40,988</i>	<i>\$48,280</i>
Global Macro	\$283	\$397	\$414	\$562	\$790	\$832
Long/Short Equity	2,154	3,067	6,232	3,931	2,861	3,352
Merger Arbitrage	116	143	189	71	102	119
Fixed Income Arbitrage	1,287	1,089	890	422	601	630
Convertible Arbitrage	184	434	405	109	142	134
Futures, Options	50	70	64	44	87	105
Sector	525	496	564	217	294	322
Distressed	711	1,613	2,342	1,284	1,577	2,057
Emerging Mkts	142	259	557	379	346	328
Multi-Strategy	4,236	5,329	7,514	5,361	4,378	5,474
<i>Hedge Funds</i>	<i>\$9,689</i>	<i>\$12,897</i>	<i>\$19,171</i>	<i>\$12,379</i>	<i>\$11,177</i>	<i>\$13,352</i>
Total	\$28,488	\$39,679	\$55,777	\$50,436	\$52,165	\$61,632

While the insurance industry's private equity and hedge fund investments have both substantially increased since 2005, private equity has grown faster and now comprises 78% of the total, up from 66% in 2005. (Note: Fair value and actual cost in 2010 were \$62.3 and \$61.3 billion, respectively; not materially different from BACV.)

Unfunded Commitments

One aspect almost unique to private equity investing is unfunded commitment, or "overhang" liability. When investors subscribe to a private equity fund, their commitment is typically not fully or immediately paid-in; instead, capital is "called" or "drawn-down" over time as investment opportunities arise. Upon becoming a limited partner (or equivalent), such funding commitments are enforceable contractual obligations of the insurer. Subject to the terms of the agreement, such draw-downs generally are not within the insurer's discretion.

In 2010, insurers' private equity and hedge funds had unfunded commitments totaling \$21.5 billion: \$12.3 billion was with respect to leveraged buyout funds, with the rest split between venture capital (\$4.3 billion) and mezzanine (\$4.4 billion) funds, with hedge funds accounting for a relatively small \$471 million. If fully drawn, the \$21.0 billion overhang in private equity funding would increase the industry's exposure in that group by 43%, from \$48.2 to \$69.2 billion.

Risk and Return

Table 3 shows the year-to-year change in fair value, inclusive of contributions, distributions, other than temporary impairments (OTTI) and other adjustments. (It was not feasible to separate these components consistently, given revisions to Schedule BA in 2008). It comes as no surprise that 2008 was not a good year. Year-to-year changes in BACV (not shown) are nearly the same as for fair value, although merger arbitrage and emerging markets strategies performed worse on a fair value basis, whereas multi-strategy fared better.

Table 3: Year-to-Year Changes in Reported Fair Value (\$millions)

Changes in Fair Value	2005-06	2006-07	2007-08	2008-09	2009-10	2005-2010
Venture Capital	\$1,998	\$3,217	(\$628)	(\$380)	\$2,055	\$6,262
Mezzanine	1,698	924	2,791	643	190	6,247
Leveraged Buyout	4,257	5,539	(408)	2,095	5,356	16,839
<i>Private Equity</i>	<i>\$7,954</i>	<i>\$9,679</i>	<i>\$1,755</i>	<i>\$2,357</i>	<i>\$7,601</i>	<i>\$29,347</i>
Global Macro	\$114	\$17	\$148	\$232	\$38	\$549
Long/Short Equity	955	3,159	(2,272)	(1,067)	483	1,260
Merger Arbitrage	27	47	(119)	32	17	3
Fixed Income Arbitrage	(208)	(194)	(464)	181	227	(457)
Convertible Arbitrage	250	(31)	(295)	33	(7)	(50)
Futures, Options	21	(6)	(20)	43	18	55
Sector	(11)	57	(352)	97	6	(204)
Distressed	868	743	(1,041)	310	467	1,347
Emerging Mkts	117	298	(179)	(33)	(94)	110
Multi-Strategy	1,095	2,188	(2,155)	(987)	1,241	1,383
<i>Hedge Funds</i>	<i>\$3,227</i>	<i>\$6,277</i>	<i>(\$6,748)</i>	<i>(\$1,159)</i>	<i>\$2,396</i>	<i>\$3,995</i>
Total	\$11,182	\$15,957	(\$4,992)	\$1,199	\$9,997	\$33,341

As shown in Table 4 below, investment income of \$2.9 billion in 2010 had not yet recovered to the 2007 level of \$4.5 billion level. Investment income among the previously mentioned funds not designated as a hedge or private equity totaled \$933 million in 2010.

Table 4: Reported investment income by year (\$millions)

Investment Income	2005	2006	2007	2008	2009	2010	2005-2010
Venture Capital	\$314	\$307	\$759	\$423	\$192	\$463	\$2,457
Mezzanine	381	451	549	317	180	636	2,514
Leveraged Buyout	1,497	2,129	2,863	866	452	1,562	9,370
<i>Private Equity</i>	<i>\$2,192</i>	<i>\$2,886</i>	<i>\$4,172</i>	<i>\$1,606</i>	<i>\$825</i>	<i>\$2,661</i>	<i>\$14,342</i>
Global Macro	\$0	\$1	\$1	\$0	\$11	\$16	30
Long/Short Equity	15	18	42	121	118	14	329
Merger Arbitrage	0	0	0	0	0	0	0
Fixed Income Arbitrage	1	4	5	16	(7)	6	25
Convertible Arbitrage	(1)	0	0	8	0	1	9
Futures, Options	10	7	0	0	0	0	17
Sector	4	9	3	1	33	0	50
Distressed	74	109	147	4	75	29	437
Emerging Mkts	4	1	0	5	75	28	113
Multi-Strategy	129	129	156	78	105	126	722
<i>Hedge Funds</i>	<i>\$234</i>	<i>\$278</i>	<i>\$353</i>	<i>\$234</i>	<i>\$410</i>	<i>\$220</i>	<i>\$1,730</i>
Totals	\$2,427	\$3,164	\$4,525	\$1,840	\$1,235	\$2,881	\$16,072

Insurers as Providers of Investment Capital

In addition to private equity and hedge funds not being material to insurers' overall assets, neither is the U.S. insurance sector a material "capital provider" to such funds. The insurers' \$61.6 billion investment is compared with estimates of total private equity and hedge funds' capital of approximately \$4 trillion.

Why Do Insurers Invest in Private Equity and Hedge Funds?

Insurers invest in private equity and hedge funds for the same reasons as other institutional investors: to obtain higher returns, to increase diversification (thereby reducing risk), and to access additional or emerging asset classes. These investments fit within an overall framework of asset-liability management that balances risk and return, while providing for the overall

liquidity needs of the insurer. The long-term nature of insurers' liabilities, especially compared to those of banks and broker-dealers, lends itself ideally to longer-dated or illiquid investments such as private equity and hedge funds. Detailed reporting and valuation guidelines provide state insurance regulators the necessary tools to examine these investments for appropriateness at a given insurer. At the same time, recognizing the risks inherent in these investments, hedge funds and private equity funds also carry the highest risk-based capital factor for investments.

April 16, 2012								
Major Insurer Share Prices		Close	Change %			Prior		
			Week	QTD	YTD	Week	Quarter	Year
Life	Aflac	\$42.81	(2.0)	(1.0)	(1.0)	\$43.68	\$43.26	\$43.26
	Ameriprise	53.61	(1.8)	8.0	8.0	54.58	49.64	49.64
	Genworth	7.62	(0.8)	16.3	16.3	7.68	6.55	6.55
	Lincoln	24.17	(1.4)	24.5	24.5	24.51	19.42	19.42
	MetLife	35.49	(0.9)	13.8	13.8	35.80	31.18	31.18
	Principal	27.83	(1.6)	13.1	13.1	28.29	24.60	24.60
	Protective	28.35	(0.3)	25.7	25.7	28.43	22.56	22.56
	Prudential	60.05	(1.9)	19.8	19.8	61.23	50.12	50.12
	UNUM	23.55	0.2	11.8	11.8	23.51	21.07	21.07
PC	ACE	\$72.48	0.2	3.4	3.4	\$72.34	\$70.12	\$70.12
	Axis Capital	33.51	0.0	4.8	4.8	33.51	31.96	31.96
	Allstate	32.47	0.1	18.5	18.5	32.43	27.41	27.41
	Arch Capital	37.90	1.3	1.8	1.8	37.43	37.23	37.23
	Cincinnati	34.26	1.7	12.5	12.5	33.68	30.46	30.46
	Chubb	71.05	2.2	2.6	2.6	69.55	69.22	69.22
	Everest Re	93.13	0.2	10.8	10.8	92.99	84.09	84.09
	Progressive	22.61	(1.2)	15.9	15.9	22.89	19.51	19.51
	Travelers	59.16	1.6	(0.0)	(0.0)	58.23	59.17	59.17
	WR Berkley	36.91	1.8	7.3	7.3	36.24	34.39	34.39
	XL	21.21	(0.6)	7.3	7.3	21.33	19.77	19.77
Other	AON	\$48.53	0.9	3.7	3.7	\$48.08	\$46.80	\$46.80
	AIG	32.80	2.5	41.4	41.4	31.99	23.20	23.20
	Assurant	38.94	0.4	(5.2)	(5.2)	38.79	41.06	41.06
	Fidelity National	18.53	2.8	16.3	16.3	18.02	15.93	15.93
	Hartford	20.09	(1.7)	23.6	23.6	20.44	16.25	16.25
	Marsh	32.21	0.9	1.9	1.9	31.91	31.62	31.62
Health	Aetna	\$47.22	(3.2)	11.9	11.9	\$48.80	\$42.19	\$42.19
	Cigna	47.69	(0.6)	13.5	13.5	47.99	42.00	42.00
	Humana	87.48	(2.1)	(0.1)	(0.1)	89.39	87.61	87.61
	United	57.36	(1.5)	13.2	13.2	58.23	50.68	50.68
	WellPoint	68.74	(2.7)	3.8	3.8	70.64	66.25	66.25
Monoline	Assured	\$14.77	(2.6)	12.4	12.4	\$15.17	\$13.14	\$13.14
	MBIA	10.09	7.3	(12.9)	(12.9)	9.40	11.59	11.59
	MGIC	4.16	(7.3)	11.5	11.5	4.49	3.73	3.73
	Radian	3.45	(5.7)	47.4	47.4	3.66	2.34	2.34
	XL Capital	21.21	(0.6)	7.3	7.3	21.33	19.77	19.77

April 16, 2012								
Major Market Variables		Close	Change %			Prior		
			Week	QTD	YTD	Week	Quarter	Year
Dow Jones Ind		12,921.41	(0.1)	5.8	5.8	12,929.59	12,217.56	12,217.56
S&P 500		1,369.57	(0.9)	8.9	8.9	1,382.20	1,257.60	1,257.60
S&P Financial		205.23	(0.3)	17.1	17.1	205.81	175.23	175.23
S&P Insurance		184.16	0.0	8.2	8.2	184.10	170.17	170.17
US Dollar \$			Change %			Prior		
/ Euro	\$1.31		0.2	1.4	1.4	\$1.31	\$1.30	\$1.30
/ Crude Oil bbl	103.06		0.7	4.3	4.3	102.36	98.83	98.83
/ Gold oz	1,648.70		0.4	5.2	5.2	1,642.50	1,566.80	1,566.80
Treasury Ylds %	%		Change			%	%	%
1 Year	0.17		(0.02)	0.06	0.06	0.19	0.11	0.11
10 Year	1.98		(0.06)	0.11	0.11	2.04	1.88	1.88
30 Year	3.13		(0.06)	0.24	0.24	3.19	2.90	2.90
Corp Credit Spreads -bp			Change %			Prior		
CDX.IG	83.14		2.3	(27.0)	(27.0)	81.29	113.83	113.83

April 16, 2012				Major Insurer Bond Yields				
				Weekly Change				
				Price			Spread	
Company	Coupon	Maturity	Current	Change	Yield	B.P.	Change	
Life	Aflac	8.500%	5/15/2019	\$131.93	(\$0.03)	3.38%	190	2
	Ameriprise	5.300%	3/15/2020	\$111.70	\$0.38	3.59%	197	3
	Genworth	6.515%	5/15/2018	\$103.47	(\$0.20)	5.83%	466	9
	Lincoln National	8.750%	7/15/2019	\$127.99	\$0.39	4.20%	272	0
	MassMutual	8.875%	6/15/2039	\$144.22	\$0.15	5.66%	259	3
	MetLife	4.750%	2/15/2021	\$109.55	(\$0.65)	3.48%	164	13
	Mutual of Omaha	6.800%	6/15/2036	\$109.50	(\$0.11)	6.05%	317	5
	New York Life	6.750%	11/15/2039	\$129.83	\$1.11	4.79%	175	1
	Northwestern Mutual	6.063%	3/15/2040	\$120.92	\$0.42	4.71%	162	3
	Pacific Life	9.250%	6/15/2039	\$129.05	(\$0.52)	6.87%	383	9
	Principal	6.050%	10/15/2036	\$110.44	\$1.92	5.28%	238	(5)
	Prudential	4.500%	11/15/2020	\$106.73	(\$0.44)	3.58%	179	10
	TIAA	6.850%	12/15/2039	\$126.75	\$0.33	5.04%	196	2
P&C	ACE INA	5.900%	6/15/2019	\$121.24	\$0.01	2.62%	113	3
	Allstate	7.450%	5/15/2019	\$127.00	\$0.26	3.16%	173	0
	American Financial	9.875%	6/15/2019	\$126.36	\$0.36	5.38%	388	(1)
	Berkshire Hathaway	5.400%	5/15/2018	\$118.71	\$0.19	2.10%	89	2
	Travelers	3.900%	11/15/2020	\$109.13	\$0.05	2.69%	93	4
	XL Group	6.250%	5/15/2027	\$104.92	(\$0.00)	5.76%	336	3
Other	AON	5.000%	9/15/2020	\$111.20	\$0.01	3.46%	170	4
	AIG	5.850%	1/15/2018	\$109.24	(\$0.11)	4.03%	291	3
	Fidelity National	7.875%	7/15/2020	\$111.38	\$0.44	6.10%	450	(14)
	Hartford	5.500%	3/15/2020	\$105.35	(\$0.34)	4.69%	301	11
	Marsh	9.250%	4/15/2019	\$133.65	\$0.03	3.73%	227	5
	Nationwide	9.375%	8/15/2039	\$127.96	\$0.57	7.05%	399	0
Health	Aetna	3.950%	9/15/2020	\$106.96	\$0.18	3.00%	129	5
	CIGNA	5.125%	6/15/2020	\$111.32	(\$0.11)	3.52%	186	9
	United Healthcare	3.875%	10/15/2020	\$107.63	\$0.55	2.86%	115	(1)
	Wellpoint	4.350%	8/15/2020	\$110.39	\$0.27	2.93%	122	(0)

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

The views expressed in this publication do not necessarily represent the views of NAIC, its officers or members. NO WARRANTY IS MADE, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY OPINION OR INFORMATION GIVEN OR MADE IN THIS PUBLICATION.

© 1990 – 2018 National Association of Insurance Commissioners. All rights reserved.