"Life Insurance and Private Equity: Questions & Answers"

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What are your criteria for eligibility of a Private Equity asset in your policies: maximum percentage, types of eligible funds or assets, or liquidity?

Reply from Bâloise Vie Luxembourg:

A distinction will be made between Private Equity funds and Private Equity assets in the broadest sense (e.g. shares in companies).

One must first be sure that the asset is eligible under the regulations of the Luxembourg Commissariat aux Assurances. Then, concerning the types of fund, most fund types are eligible in our policies: we accept Luxembourg RAIFs (Reserved Alternative Investment Funds) and SIFs (Specialised Investment Funds) as well as most of the French Private Equity funds. The only downside to these funds is if they have fiscal transparency, which means that you have to take action in other countries.

At regards the maximum percentage – and taking the case of France, for reasons associated with French taxation - we would limit it in the policy to a holding of no more than 60% for life insurance policies, compared with 40% for assets which are more easily sold. If the client dies having taken out the policy before the age of 70, we would have to pay tax (at the rate prescribed in Article 990 I of the French General Tax Code) which could be as high as 31.25%. In addition to tax, we have to ensure payment of the costs of the policy. This is why, for France, we limit holdings of Private Equity to 40% of assets. For other countries, we can go up to percentages which are a little higher but this is always on a case-by-case basis. Do we have a regulation, like in France, which obliges us to pay a lump sum, and therefore to keep part of the policy available in liquid assets? Are there any other problems? The answer is not necessarily the same in all countries.

Are restrictions on transferability a problem when investing in Private Equity?

Reply from Bâloise Vie Luxembourg:

Transferability is an aspect which must be analysed prior to subscription and it is managed by entering into an agreement with the Private Equity funds. The purpose of this agreement is to enable the transfer of these assets, in the form of securities, to the policyholder in the event of surrender, or to the beneficiaries in the event of death, thus enabling the insurance company to ensure that it can pay out their benefits.

Discussions, and the setting-up of an agreement with the various private equity funds, make it possible for insurance companies to manage liquidity risk.

How do you work with the custodian banks listed in the register? How do you deal with capital calls?

Reply from Bâloise Vie Luxembourg:

The company can negotiate two types of cooperation with the custodian banks of the dedicated funds or specialised insurance funds :

- Subscription in "pure registration" form, which places the company directly on the fund's register.

  With this option, the company is the fund's point of contact for future capital calls and for documents realting to valuation. The company uses an internal control system which enables it to monitor as closely as practicable the cash flows linked to the life cycle of Private Equity funds.

  These flows result from instructions given directly by the company to the custodian bank, which will be responsible for making the payment on the basis of these instructions, accompanied by the document evidencing them (i.e. the capital call notice). Once the payment is made, the bank re-

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flects in its records the increase in shares associated with this capital call. The company also sends quarterly account statements to the bank, which enables valuations to be updated and the necessary monitoring of the investment to be made.

- Subscription in "administered registration" form, in which case the bank can subscribe on behalf of the company. The bank will then receive directly from the private equity fund the various notifications, such as the capital call notices. With this option, the bank will be entirely responsible for monitoring the flows and for valuation of the securities.

Which, in your view, is the European market with the greatest demand for Private Equity investments in their insurance policies?

Reply from Bâloise Vie Luxembourg:

Our main requests are for clients who are resident in France. This demand is due, in particular, to the fact that French regulations and the specialised vehicles increasingly encourage residents in France to hold this type of asset, particularly through a life insurance policy, with the objective of participating in the financing of the real economy.

Indeed, why are insurance companies so very restrictive in their acceptance of Private Equity and why do three-quarters of them not accept it at all?

Reply from Bâloise Vie Luxembourg:

The acceptance of Private Equity funds requires:

- the necessary in-house skills;
- an analysis prior to acceptance of the asset in question;
- for insurance companies, the management of their liquidity risk.

These various factors - relating particularly to the illiquid and risky nature of Private Equity assets compared with other more traditional asset classes - may explain why such companies appear to be very restrictive. Depending on each company's internal skills and risk appetite, funds' acceptance of Private Equity may be more or less possible for different companies in the market.

Is it possible, in a life insurance policy, to include shares or securities acquired in the Private Equity secondary market?

Reply from Bâloise Vie Luxembourg:

We can compare two markets, the French and the Luxembourg life insurance markets (for residents in France or in Luxembourg). In France, it is not possible to make contributions of securities, so a resident in France cannot do this. However, a resident in Luxembourg could consider such a transfer of assets. Of course, one must make a prior analysis and attach all the necessary disclaimers to it, because we must bear in mind the different exceptions applicable in all countries.

Is it possible to include shares of European real estate companies and/or commercial companies in a life insurance policy? Is this regarded as Private Equity?

Reply from Bâloise Vie Luxembourg:

From a Luxembourg regulatory perspective, shares in commercial companies or real estate companies are eligible for inclusion in a life insurance policy. These assets need to be thoroughly analysed. As a life insurance company, we consider this to be Private Equity, because we consider as Private Equity anything which is not sold within the period for our delivery of the benefits. This is not the true classification of the asset, but this is how we consider it.

Assuming that it is eligible, then further analysis in needed in order to ascertain how to value these assets within the policies? What are the tax implications for the company holding them? Who are the people who manage these types of company? What are these companies' businesses? Because the insurance company acts as an investor, and there may be business sectors in which you do not want to invest.

In principle therefore, this is possible … but thorough analysis is required before accepting the assets.

Wildgen's response:

Yes, it is possible. Real estate-type investments are indeed considered as Private Equity. However, it is not easy to include them and they require a whole due diligence process because the structural illiquidity of this type of asset (minimum five years or even more than 10 years) will pose a number of operational and legal difficulties for the insurance company, in particular questions of liquidity, redemption, etc. So, it is possible but it is complicated because it requires a lot of analysis, a lot of going back-and-forth on legal questions, including questions concerning the surrender or transfer of the policy or the death of the policyholder. This requires a great deal of care by the company with regard to its clients. And this type of investment should be considered as being restricted to a particular type of investor - more commonly known as 'professional' or 'sophisticated' investors - who are aware of, and knowledgeable about, the risks taken when investing in this type of underlying.

Do you – or don't you - still see Special Purpose or Note Issuance Vehicles for pooling small investors within one single 'commitment'?

Reply from Bâloise Vie Luxembourg:

We see very few of them. There was a time, a few years ago, when we saw a lot of demand. Today, it has become an investment tool which is no longer suitable for insurance.

Wildgen's response:

In general, from a legal point of view, there has been a very sharp fall in interest for this type of vehicle. First of all, tax regulations are becoming increasingly unfavourable to them; and most counterparties (insurance companies, banks) no longer agree to open bank accounts for them. It has become very complicated to work for investors who have this type of vehicle.

Why, despite this resilience, does the conventional financial world consider Private Equity to be a dangerous and uncontrollable asset class?

Wildgen's response:

First of all, this is more a matter of perception than reality. A perception that goes back rather to the crisis of 2008. Thereafter - and in addition to the problems concerning the banking system - funds, asset managers and Private Equity were accused of having been mainly responsible for the crisis. Generally speaking, legislators and particularly those in Europe, did not at that time identify Private Equity directly, but rather the whole world of asset management as presenting a systemic risk for the global economy, and more particularly the European economy. They therefore decided that there were no, or too few, regulations and that the activities concerned with asset management - and therefore Private Equity - should be much more strictly regulated. This is how we ended up with the Alternative Investment Fund Managers ('AIFM') Directive and the AIFM Law which has been transposed in the Grand Duchy of Luxembourg. There is a fairly well-established perception that these assets are dangerous and uncontrollable. On the uncontrollable point, they are increasingly so, since if they were not controllable before, they are even less controllable today, when unregulated assets or activities have been reduced to almost nothing. This risk is increasingly manageable and controllable.

On the question of whether these assets are dangerous: yes, they are, because they are more dangerous than completely traditional assets; and this is why they are intended, first and foremost, for informed professional investors who generally have the awareness and the means required for investment in this type of assets, and who can run the risk of losing them. Especially since the very nature of these assets is complicated and dangerous. Real estate in particular, but there are plenty of other assets. And this is the great beauty of the Grand Duchy of Luxembourg: the number of Private Equity assets cannot be counted, the range is huge. We used to talk about real estate in the

traditional sense, but there are also shares in companies, and other much more exotic assets: investments in horses, watches, wine, and luxury goods, or in start-ups (an increasingly important activity in the Grand Duchy of Luxembourg). The very nature of most of these assets is more complicated, or at any rate more dangerous than most traditional assets: therefore, controllable and sometimes dangerous.

Further comment by Bâloise Vie Luxembourg:

People often think that a life insurance policy will provide liquidity for a Private Equity asset, or for any asset in general. Insurance policies do not add any liquidity and sometimes, in some cases, it is better to invest directly in certain Private Equity funds for which minimum investment amounts are lower than they would be when investing through a life insurance policy. Illiquidity is a fact, you have to deal with it, but you have to consider investment over the long term: i.e. 7 years, 8 years or even 10 years, which is realistic considering that, generally, in an insurance policy you are committed for 20 years, 30 years, or more.

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