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Liberty Group Ltd.

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Major Rating Factors

Strengths

- Dominant position in South African life insurance, particularly in the middle-affluent market.
- Enjoys strong risk-based capital adequacy (measured using our model), reflecting a significant level of capital buffer relative to balance sheet risks.
- Unlikely to default on its liabilities under our hypothetical foreign currency sovereign stress scenario thanks to its significant level of available capital and robust liquidity levels.

Weaknesses

- Heightened economic risk in South Africa weighs negatively on Liberty's revenues and earnings, in common with local peers such as Sanlam and Old Mutual (South Africa).
- Liberty-specific operational issues make it difficult to execute strategy.
- Economic conditions in South Africa have led to weakened asset quality in Liberty's balance sheet, in common with the abovementioned peers.

Rationale

We base our ratings on LGL on the group credit profile of its parent, Liberty Holdings Ltd. (Liberty, or the group). We consider LGL core to the group, since LGL makes up the majority of the group's revenue, earnings, and capital.

The ratings on Liberty reflect the group's strong competitive position. That said, country- and industry-related risks weigh negatively on Liberty's business risk profile. Economic conditions have weakened asset quality in South Africa. Therefore, the credit quality of Liberty's investments is marginal, in common with peers that hold most of their assets in South Africa. Nonetheless, Liberty benefits from robust risk-based capital (measured using our capital model) thanks to a significant capital buffer relative to balance sheet risks.

Furthermore, the group's liability profile is largely loss-absorbing. This would allow Liberty to withstand the stress associated with a foreign currency sovereign default. We limit the ratings on Liberty to the local currency ratings on South Africa. This is because Liberty's asset and liability concentration in the domestic economy makes it susceptible to the financial and macroeconomic stresses associated with a local currency sovereign default, in our view.

Over the next 12 months, the most likely trigger for further rating actions, positive or negative, would be a similar action on the sovereign. Furthermore, we could also lower the rating if we see signs that the group is unsuccessful in tackling its operational and market challenges, which could have a continuing adverse impact on earnings.

**Operating Company Covered
By This Report**

Financial Strength Rating

None

Base-Case Scenario

Macroeconomic Assumptions

South Africa Economic Forecast Summary

(% of change, volume, 2010 prices)	2016	2017	2018F	2019F
Real GDP	0.6	1.3	2.0	2.1
Real GDP per capita	(1.0)	(0.3)	0.4	0.5
Inflation (annual average, %)	6.3	5.3	5.0	5.2
Unemployment rate (%)	26.7	27.5	27.4	27.3

F--S&P Global Ratings forecast. Sources: S&P Global Ratings, SARB, Statistics South Africa.

Company-Specific Assumptions

- Liberty will continue to pass our foreign currency sovereign stress test.
- Group capital adequacy will be at least strong over 2018-2019.
- Return on equity (ROE) over 2018-2019 is likely to be slightly below peers in South Africa.

Key Metrics

	2019F	2018F	2017	2016
GPW (mil. ZAR)	46,498	44,284	39,970	41,288
Operating income (mil. ZAR)	3,861	3,349	3,704	2,626
Fixed-charge coverage	>8	>8	>8	>8
Financial leverage (%)	~8	~8	9.6	8.3
Return on shareholders' equity (%)	10-12	10-12	12.5	9.5

F--Forecast. GPW--Gross premiums written.
ZAR--South African rand.

Business Risk Profile: Dominant Position In South Africa Partly Mitigates Challenging Operating Conditions.

Our insurance industry and country risk assessment (moderate) captures the challenging market conditions that weigh on Liberty's business position. This is bearing in mind almost all of Liberty's revenue emanates from South Africa.

As one of the largest players in South African life insurance, Liberty's competitive position benefits from its well-established position in the middle-affluent market, where it is ranked No. 1. However, Liberty lags behind its major peers in the institutional sector, which has resulted in Liberty placing greater focus on this segment in recent years. Liberty does not actively focus on the entry-level market, which it perceives to be highly competitive.

We believe Liberty's premium growth will be modest (similar to the 2016-2017 level), compared with the double-digit

growth it achieved prior to 2014. This is mostly reflecting the continuing challenging economic conditions and some Liberty-specific operational issues.

Financial Risk Profile: Marginal, Reflecting Low Asset Quality

The average credit quality of Liberty's asset portfolio is within the 'BB' range because the significant majority of its assets are held as bank deposits (in local banks) and local currency sovereign bonds. This risk is partly mitigated by the significant level of excess capital (including shareholder equity and loss-absorbing policyholder funds) relative to Liberty's balance sheet risks.

We expect the group will retain at least a strong level of risk-based capital (measured using our model) over 2018-2019. That said, we do recognize that the group relies on material levels of weaker forms of capital relative to total capital, notably value in force.

We expect Liberty will maintain its regulatory solvency level comfortably above the required level under both the current regime and the upcoming regime (solvency assessment and management), which is likely to implement from 2018 onward.

The group's risk profile is favorable thanks to fee-related business and products with profit- and loss-sharing features (with policyholders) that balance the high level of high-risk assets. The group actively hedges its exposure to guarantees offered, and its exposure to high-risk assets is primarily through assets backing shareholders' equity.

Liberty's financial flexibility is good, in our view, based on its access to the local debt market for short-term debt issuance. Liberty's fixed-charge coverage is robust at well above 8x, and we expect it will remain so.

As part of its securities lending and bond repo agreements, Liberty receives collateral, which it primarily uses to meet the collateral requirements of its derivative transactions. We understand that under International Financial Reporting Standards, the interest earned on this collateral cannot be deducted from interest paid. This means the finance cost is gross of interest received from these collaterals. We consider these transactions to be operational leverage because collateral received is kept in the same asset class with the same duration--in other words, if cash collateral has three months' duration then it is kept as cash with three months' duration.

Overall finance cost is reduced significantly after reducing the interest paid on the collateral by interest earned.

Other Assessments

The group's key strategy is to maintain its dominant position in the middle-affluent market while expanding in the institutional segment. We think Liberty's management has clear vision, although the group is faced with challenging market conditions and various operational issues that weighed on its 2016 and 2017 results. The group has short-term (three-year) and long-term (six-year) strategic plans that feature financial and operational goals geared toward maximizing shareholder value.

The group's risk management culture is strong, with a sound governance structure and good awareness of the

importance of risk management. Although the group provides guarantees, it has an effective hedging program. Policy persistency risk is the most significant risk as a proportion of the economic capital requirement. Risk tolerance limits are generally based on the approved strategic initiatives per business unit.

We assess Liberty's liquidity as exceptional, owing to the strength of available liquidity sources relative to requirements. The group holds substantial cash and liquid resources relative to its technical reserves. We believe the group will be able to withstand liquidity stresses and we view any refinancing needs as manageable.

Group status

We consider Liberty to be strategically important to its parent, The Standard Bank of South Africa Ltd. (SBSA), primarily reflecting its contribution to the broad wealth management offer of the bank and its meaningful contribution to SBSA's earnings. At the same time, we insulate the ratings on Liberty from those on its parent. This reflects our view of Liberty's financial independence from its majority owner. Additionally, we expect that supervision from the South African regulator will safeguard Liberty's balance sheet independence, should SBSA experience financial distress. We also base our view on Liberty's independent board of directors and its sizable minority shareholders. Our view of Liberty as insulated from its parent could change if we reconsider the extent of SBSA's influence on Liberty's management of capital buffers, strategy, or risk-taking.

Related Criteria

- General Criteria: S&P Global Ratings' National And Regional Scale Mapping Tables, Aug. 14, 2017
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General: Methodology For The Classification And Treatment Of Insurance Companies' Operational Leverage, Oct. 31, 2014
- General Criteria: National And Regional Scale Credit Ratings, Sept. 22, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- General: Enterprise Risk Management, May 7, 2013
- General: Insurers: Rating Methodology, May 7, 2013
- General Criteria: Methodology: Management And Governance Credit Factors For Corporate Entities And Insurers, Nov. 13, 2012
- General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General: Methodology: Hybrid Capital Issue Features: Update On Dividend Stoppers, Look-Backs, And Pushers, Feb. 10, 2010
- Banks: Assumptions: Clarification Of The Equity Content Categories Used For Bank And Insurance Hybrid Instruments With Restricted Ability To Defer Payments, Feb. 9, 2010

- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- General: Hybrid Capital Handbook: September 2008 Edition, Sept. 15, 2008

Related Research

- S&P Global Ratings Raises Its GDP Growth Forecast For South Africa, March 27, 2018
- South African Life Insurer Liberty Group Ltd. 'zaAA+' South Africa National Scale Rating Affirmed, Feb. 19, 2018

Ratings Detail (As Of May 10, 2018)

Operating Company Covered By This Report

Liberty Group Ltd.

Counterparty Credit Rating

South Africa National Scale

zaAA+/-/zaA-1+

Subordinated

South Africa National Scale

zaA

South Africa National Scale

zaAA-

Domicile

South Africa

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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