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Ratings

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Liberty Group Ltd.

Primary Credit Analyst:
Trevor Barsdorf, Johannesburg + 27 11 214 4852; trevor.barsdorf@spglobal.com

Secondary Contact:
Ali Karakuyu, London (44) 20-7176-7301; ali.karakuyu@spglobal.com

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Liberty Group Ltd.

Credit Highlights

Operating Company Covered By This Report
Financial Strength Rating
None

Overview

Strengths	Risks
Major position in South African life insurance, particularly in the middle-affluent market.	Heightened economic risk in South Africa weighs negatively on Liberty's revenues and earnings, in line with local peers such as Sanlam and Old Mutual (South Africa).
Enjoys 'AA' risk-based capital adequacy (measured using our model), reflecting significant levels of capital buffer relative to balance sheet risks.	Economic conditions in South Africa have led to weakened asset quality in Liberty's balance sheet, in common with above-mentioned peers.
Unlikely to default on its liabilities under a foreign currency sovereign stress scenario, courtesy of its significant level of available capital and robust liquidity levels.	Challenges associated with operational execution risks in benign economic climate.

Liberty carries a strong competitive position in South African life insurance, particularly in the retail-affluent market. We expect Liberty to maintain its strong business position within the South African life assurance market. That said, country- and industry-related risks weigh negatively on Liberty's business risk profile, given the weak economic conditions, and potential knock-on implications for revenue and earnings.

We anticipate Liberty to maintain risk-based capital adequacy (measured using our model) in excess of 'AA' requirements. We recognize the significant capital buffer relative to balance sheet risks contained within the group. That said, economic conditions have weakened asset quality in South Africa. This in turn has impacted the credit quality of Liberty's investments in line with peers that hold most of their assets in South Africa. We anticipate the current investment market volatility will impact earnings, should market related losses be sustained. That said, this will not impact overall capital sufficiency levels in excess of AA requirement, in our opinion.

The challenging economic environment in South Africa will continue to pose challenges for Liberty and its peers. We cap the ratings on Liberty and its peers (Sanlam and Old Mutual) at the local currency sovereign rating on South Africa because we believe that Liberty's asset and liability concentration in the domestic economy makes it vulnerable to the financial and macroeconomic stresses associated with a local currency sovereign default.

Our national scale ratings have no outlooks. That said, any rating action on the global scale sovereign rating on South Africa could have a multiple-notch effect on our national scale ratings. We could also lower the rating if we see signs that Liberty's capital and earnings are not in line with our expectations.

Key Assumptions

Macroeconomic Assumptions

South Africa Economic Forecast Summary					
	2017	**2018**	**2019**	**2020F**	**2021F**
Real GDP growth (%)	1.4	0.8	0.2	(4.5)	3.5
Real GDP per capita growth	(0.2)	(1.3)	(1.6)	(6.0)	1.9
Inflation (annual average, %)	5.3	4.7	4.1	3.9	4.4
Unemployment rate (%)	27.5	27.1	28.7	30.0	29.9

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

Key Metrics

Key Metrics						
	--Fiscal year ended Dec. 31--					
(Mil. ZAR)	**2021F**	**2020F**	**2019**	**2018**	**2017**	**2016**
Gross premium written	46,506	44,291	42,182	40,611	39,970	41,288
Net income (attributable to all shareholders)	>2,500	>2,500	3635	3,042	3,704	2,626
Return on shareholders' equity (%)	~10.0	~10.0	11.4	9.9	12.5	9.6
Financial leverage* (%)	<20	<20	19.8	20.9	N/A	N/A
Fixed charge coverage (x)	>8	>8	10.3	8.1	N/A	N/A

ZAR--South Africa Rand. F--S&P Global Ratings forecast. *Relative to EBITDA.

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

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

Liberty benefits from the oligopolistic nature of South Africa's life sector as one of the five players that control a significant market share. Other players find it challenging to gain market share, in our opinion. Liberty and the other major players--Sanlam Group, Old Mutual Life Assurance Co. (South Africa), MMH Group, and Discovery Group--benefit from economies of scale and generally post strong results despite the challenging operating conditions. Liberty's competitive position particularly benefits from its well-established position in the middle-affluent market, where it is a top 3 player. However, Liberty lags behind its major peers in the institutional sector, which has resulted in it 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.

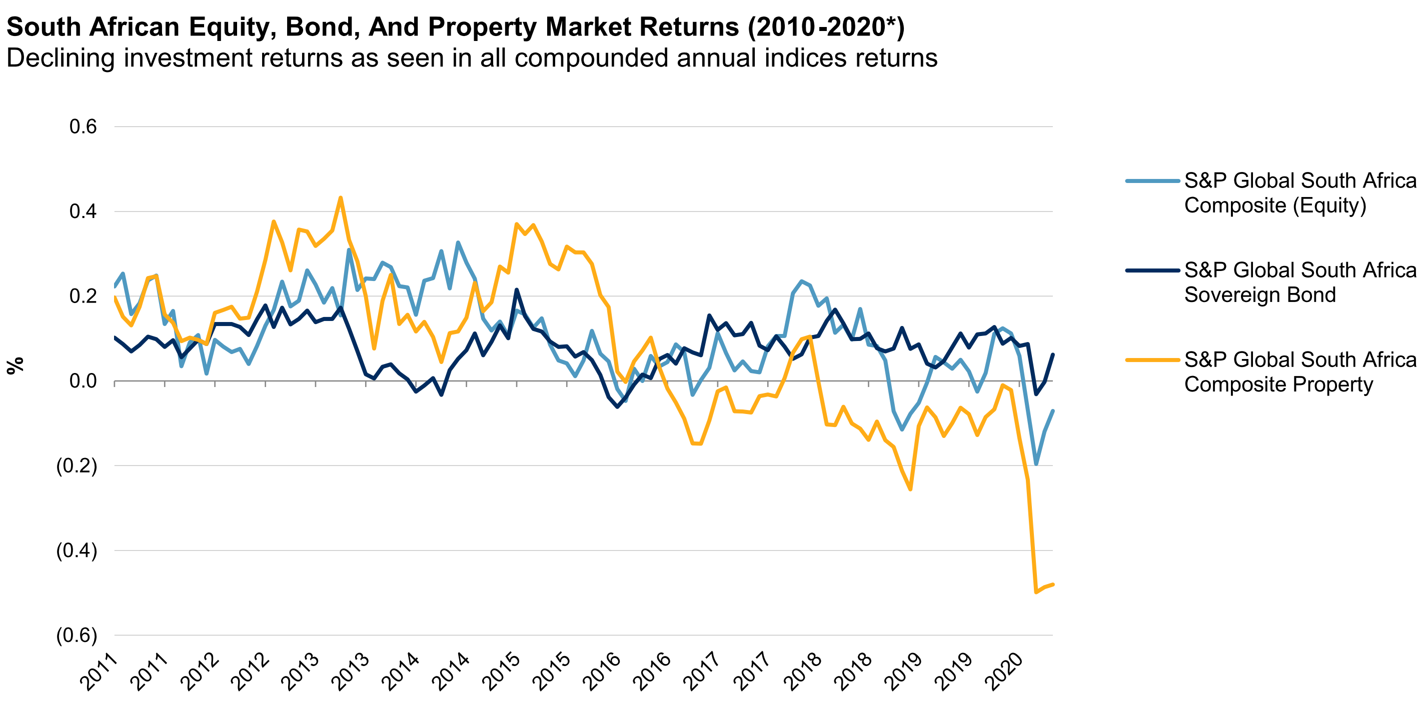
In terms of operating performance, Liberty's return on equity (ROE) has recovered over the past two years amid the execution of its turnaround strategy. The corrective actions have focused on:

- Maximizing its bancassurance relationship with Standard Bank (through a more suitable product offering);
- Increasing sales volumes for retail business in South Africa (by enhancing its sales strategy); and
- Improving STANLIB's (Asset Manager) performance (through more risk reviews or product simplification--for example, by reducing the number of unit trust products).

There remains a concentration of earnings generation to the South African life insurance market similar to its South African peer group; given the benign economic climate we anticipate further challenging operating conditions. Liberty carries a relatively less diverse business profile by product and higher expense base relative to its peer group, accordingly Liberty's income performance is likely to remain below its peers, in our opinion.

During the first quarter of 2020, group total assets under management reduced to ZAR668 billion (ZAR738 billion as of financial year-end 2019), with the decrease largely attributed to negative investment market returns during the quarter and transfers amid discontinuation of small African exposures. We forecast that Liberty's premium income is likely to grow in line with inflation. Although Liberty's bottom line results (see Key Metrics) for 2019 were similar to 2018, we expect 2020's results to be reduced relative to 2019. This is due to the market related stress, reduced related fee income, and risk of higher than anticipated claims. Based on the operational update for first-quarter 2020, new indexed business sales notably rose 4.2% to ZAR1.6 billion, relative to 2019. Single premium new business sales increased by 6.5%, mainly driven by conventional annuity sales. Net customer cash outflows, however, increased to R701 million in first-quarter 2020, compared with R252 million in first-quarter 2019. This is mainly attributable to a rise in annuity payments, higher death and disability claims, and increased outflows in respect of investment policies. Liberty's corporate business remained relatively resilient in first-quarter 2020, along with STANLIB, all things considered.

Chart 1



Source: S&P Global Ratings, S&P Dow Jones Indices. *As at May 31, 2020.

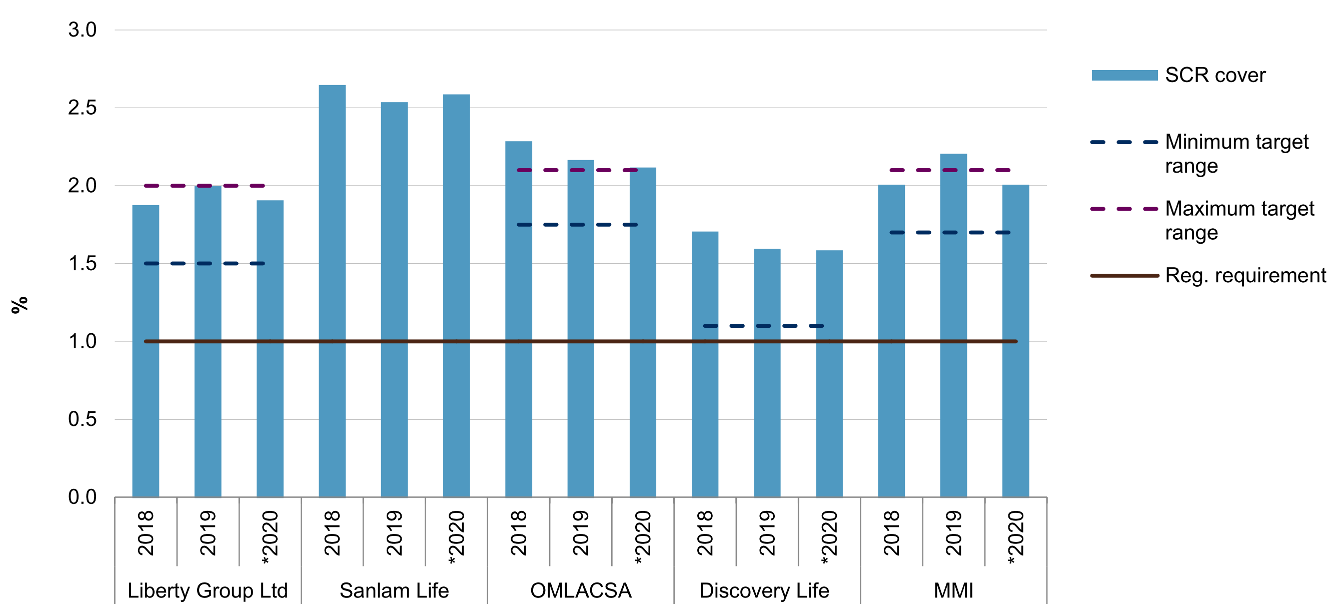
Financial Risk Profile: Sound Capital Buffers, With Low Asset Quality Reflecting Concentrations To South Africa

Our assessment is derived from Liberty's 'AA' level risk-based capital adequacy, based on our model. We recognize the significant capital buffers relative to balance sheet risks. Another factor informing our assessment is the low asset quality reflecting the quality of available assets in South Africa. 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 to retain at least a strong level of risk-based capital (measured using our model) over 2020-2022.

The Solvency Capital Requirement cover of LGL, the group's main long-term insurance company at 31 March 2020, remains strong at approximately 1.9x, toward the upper end of Liberty's target range and only marginally below the 31 Dec. 2019 level of 1.99x. The financial market volatility had minimal impact on the group's capital ratio. The reduction reflects the final dividend declared by the group in February 2020. We expect Liberty to maintain its regulatory solvency level comfortably above its required level and toward its internal upper limit of its target range (as seen in chart 2). This is due to the significant capital and liquidity buffers.

Chart 2

Top-Tier South African Life Insurance Solvency Capital Requirement Coverage Ratios
Liberty towards upper limit of target capital range



Source: S&P Global Ratings, Audited Financial Statements. Data as of Dec. 31, 2019. *1Q 2020 #Sanlam Life Insurance Ltd (Stated target range only available for Sanlam Life covered business excluding strategic participations, discretionary capital and other capital not allocated to covered business); Old Mutual Life Assurance Company (South Africa) Ltd; Momentum Metropolitan Holdings Limited

We note Liberty's exposure to high-risk assets, as well as concentrations in the investment portfolio, which is geared toward financial services. This creates potential volatility in its capital and earnings. That said, the group's risk profile is favorable thanks to fee-related business and products with profit/loss-sharing features (with policy holders) that balance the high level of high-risk assets. Liberty 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 to 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 the 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 Key Credit Considerations

Governance and Strategy

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

Liquidity

We assess Liberty's liquidity as sufficient 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.

Enterprise risk management

Liberty's risk management culture is strong, with a sound governance structure and good awareness of the importance of risk management. Most of the risk as a proportion of the economic capital requirement is concentrated towards underwriting (policy persistency) risks and market-related risks. Risk tolerance limits are generally based on the approved strategic initiatives per business unit. Although the group provides guarantees, it has an effective hedging program.

Ratings above the sovereign

Like local peers Old Mutual Life Assurance Co. (South Africa) Ltd. and Sanlam Group Ltd, we limit the ratings on Liberty Group Limited to the local currency ratings on South Africa. This is because these entities' asset and liability concentration in the domestic economy makes them susceptible to the financial and macroeconomic stresses associated with a local currency sovereign default, in our view.

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.

Ratings Score Snapshot

Rating List--Liberty Group Ltd.	
Issuer Credit Rating	
South Africa National Scale	zaAAA/--/zaA-1+
Subordinated Non-deferrable	zaAA
Subordinated Deferrable	zaA+

Related Criteria

- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Methodology For National And Regional Scale Credit Ratings, June 25, 2018
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Ratings Above The Sovereign--Corporate And Government Ratings: Methodology And Assumptions, Nov. 19, 2013
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Various South Africa-Based Insurers Downgraded Following Sovereign Downgrade; National Scale Ratings Affirmed, May 4 2020
- South Africa Ratings Lowered To 'BB-' From 'BB' As COVID-19 Further Impairs Fiscal And Growth Prospects; Outlook Stable, April 29, 2020
- South Africa National Scale Mapping Revised Following Sovereign Downgrade, April 29, 2020

- COVID-19's Economic Effects Cloud The Outlook For EMEA Insurers, May 18, 2020

Regulatory Disclosures

- Regulatory disclosures applicable to the most recent credit rating action can be found at: Various South Africa-Based Insurers Downgraded Following Sovereign Downgrade; National Scale Ratings Affirmed, May 4 2020

Glossary

- Anchor: The starting point for rating an insurer, based on S&P Global Ratings' assessments of the business and financial risk profiles.
- Business risk profile (BRP: Assesses the risk inherent in the insurer's operations and therefore the potential sustainable return to be derived from those operations.
- Capital and earnings: Measure of an insurer's ability to absorb losses.
- Combined ratio: The ratio of the sum of loss expense, loss adjustment expense, and operating expenses divided by premiums earned. All elements are net of ceded reinsurance. We may use net premiums written (NPW) in the denominator where net premiums earned is not available or where expenses are not deferred in the accounting system the insurer uses (e.g., U.S. statutory accounting).
- Competitive position: An assessment based on an insurer's market or niche position, scale or efficiency of operations, brand name recognition or reputation, and strength of distribution.
- Date initial rating assigned: The date S&P Global Rating's assigned the long-term foreign currency issuer credit rating on the entity.
- Date of previous review: The date S&P Global Rating's last reviewed the credit rating on the entity.
- Earnings before interest (other than interest on nonrecourse or operational leverage) and taxes. We may apply analytical adjustments for items such as nonrecurring events; realized investment gains/losses; or impairments to goodwill.
- Earnings before interest (other than interest on nonrecourse or operational leverage), taxes, depreciation, and amortization. We may apply analytical adjustments for items such as nonrecurring events, realized investment gains/losses, impairments to goodwill, or other non-cash items. Where we believe depreciation and amortization is immaterial, we may use EBIT in the relevant ratios.
- Financial leverage. Financial obligations/(reported equity + financial obligations). We deduct from reported equity any off-balance-sheet pension deficit, net of tax, and any financial obligations included in reported equity, such as preferred stock. We typically include noncontrolling interests as part of reported equity. We may use net assets rather than reported equity, for example in the case of mutual insurers.
- Financial obligations/EBITDA. Determines the number of years of normalized earnings required to pay back debt and is another measure of the sustainability of the level of debt taken on by an insurer.
- Financial risk profile (FRP): The consequence of decisions that management makes in the context of its business risk profile and its risk tolerances.

- Financial strength rating (FSR): A forward-looking opinion about the financial security characteristics of an insurer with respect to its ability to pay under its insurance policies and contracts, in accordance with their terms.
- Fixed-charge coverage. EBITDA/fixed charges. Fixed-charge coverage represents an insurer's ability to service interest on financial obligations out of EBITDA. Fixed charges include total interest expense including interest expense reported as investment expense, lease expense, and preferred stock dividends (tax-adjusted), minus any interest expense on debt that we consider to be nonrecourse or operational leverage.
- High-risk assets: Volatile or illiquid assets.
- Insurance Industry And Country Risk Assessment (IICRA): Addresses the risks typically faced by insurers operating in specific industries and countries, and is generally determined at a country or regional level.
- Intangibles: The sum of goodwill, intangible assets, deferred acquisition costs (DAC), value of in-force, value of business acquired, and deferred tax assets.
- Issuer credit rating (ICR): A forward-looking opinion about an obligor's overall creditworthiness, focusing on its capacity and willingness to meet its financial obligations in full and as they come due.
- Prebonus pretax earnings are the sum of EBITDA and policyholder dividends.
- Return on assets (ROA): Indicates to us how efficiently management uses its assets to generate earnings by comparing EBIT to the two-year average of total assets adjusted. Total assets adjusted is total assets minus reinsurance assets.
- Return on revenue (ROR): EBIT divided by total revenue. Total revenue is the sum of net premiums earned (or net written premium if net earned premium is not available), net investment income, and other income. We remove the effects of realized and unrealized gains or losses from investments and derivatives to provide a more complete picture of an insurer's revenue-generating abilities.
- Risk exposure: Assesses material risks that the capital and earnings analysis does not incorporate and specific risks that it captures but that could make an insurer's capital and earnings significantly more or less volatile.
- Return on equity (ROE): Reported net income divided by the average of opening and closing reported equity for the year. Reported net income is before remuneration of preferred stock and non-controlling interests. Reported equity includes non-controlling interests and preferred stock.
- Stand-alone credit profile (SACP): S&P Global Ratings' opinion of an insurer's creditworthiness, in the absence of extraordinary intervention from its parent, affiliate, or related government.
- Total adjusted capital (TAC): S&P Global Ratings' measure of the capital an insurer has available to meet capital requirements.
- Total assets are the average of opening and closing total assets (less reinsurance assets) for the year.

Appendix

Liberty Group Ltd.--Credit Metrics History

Ratio/Metrics	2019	2018
(Mil. ZAR)		
Total invested assets	435,458	412,600

Liberty Group Ltd.--Credit Metrics History (cont.)

Ratio/Metrics	2019	2018
Total shareholder equity	32,389	31,393
Gross premiums written	42,182	40,611
Net premiums written	39,801	38,521
Net premiums earned	39,801	38,521
Reinsurance utilization (%)	5.6	5.1
EBIT	6,540	4,407
Net income (attributable to all shareholders)	3,635.0	3,042.0
Return on shareholders' equity (reported) (%)	11.4	9.8
Life: Net expense ratio (%)	36.1	38.2
EBIT fixed-charge coverage including realized and unrealized gains/losses (x)	10.3	8.1
Financial leverage including pension deficit as debt (%)	19.8	20.9
Net investment yield (%)	1.2	1.2
Net investment yield including investment gains/(losses) (%)	8.0	1.3

ZAR--South African Rand.

Ratings Detail (As Of June 15, 2020)*

Operating Company Covered By This Report	
Liberty Group Ltd.	
Issuer Credit Rating	
South Africa National Scale	zaAAA/--/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.

Additional Contact:
Insurance Ratings Europe; insurance_interactive_europe@spglobal.com