

Operational review: Investment Management & Life Insurance

The strong growth enjoyed in the South African investment markets during the latter half of 2004 continued throughout 2005. Liberty Life and Stanlib were beneficiaries of this growth.

Overview

For the life insurance industry, 2005 could well be regarded as a significant turning point. The unfavourable rulings against life insurance companies, including Liberty Life, by the Pension Fund Adjudicator (PFA) and the associated negative sentiment led to an industry-wide rethink of business models. Encouragingly, in spite of the negative perceptions, Liberty Life managed to deliver a strong financial performance for the year.

In April 2005, Liberty Life concluded the acquisition of Capital Alliance Holdings Limited (CAHL), and for the rest of the year a major focus was to ensure the swift and smooth merging of the businesses. CAHL employees were moved from their head office into Liberty Centre with the process being managed carefully to limit disruption and employee concerns. The integration provided the opportunity to restructure Liberty Life's business model to position the company to serve both intermediaries and policyholders more effectively and efficiently into the future.

We took the decision to consider the disposal of our offshore asset manager, Liberty Ermitage, and the Australian life insurance business, Prefsure, which was included in the acquisition of CAHL. Liberty Life also disposed of Hightree, a small UK distribution business, during the year.

Liberty Active was launched during the year, and subsequently integrated with CAHL to offer a simple, streamlined range of value-for-money risk products at the lower end of the market.

Another milestone for Liberty was that it became the first South African life insurer to issue a listed corporate bond. Applications for the bond outstripped initial expectations and R2,0 billion was raised at a very competitive long-term rate of 8,93%. This will be used primarily to fund working capital requirements.

Liberty Life won both categories of the South African Financial Services Intermediaries Association (SAFSIA) awards for life insurers (individual and corporate). This is the first time that SAFSIA, the largest intermediary body, has given both awards to one company in the same year.

Stanlib had its best year since it was formed in 2002. Its performance in equity markets continued to improve both in absolute terms and relative to its peers. The Alexander Forbes Global Manager Watch survey placed Stanlib third for 2005, with

its preferred asset portfolio returning 34,6% for the year. Costs were well controlled.

New chief executive of Liberty Life

During February 2006 it was announced that Myles Ruck, chief executive of Liberty Life, wished to retire as chief executive, for personal reasons, after his service retention agreement expires on 31 May 2006. Bruce Hemphill, currently chief executive of Stanlib, will succeed Myles with effect from 1 June 2006. Myles has been invited to remain on the board of the Standard Bank Group as a non-executive director.

Securing sustainability by committing to change

Whilst there were aspects of the PFA rulings that we disagreed with, many of the issues dealt with and rulings made were valid. However, for Liberty Life whether or not the rulings were legally defensible was of secondary importance. We were more concerned about the fairness of past practices in the industry, particularly in light of the way circumstances have changed since the products were first developed.

To bring about meaningful change, industry-wide consensus was needed. Under the auspices of the Life Offices Association (LOA), extensive discussions on reforming savings products took place internally and externally with parties such as the National Treasury and the Financial Services Board. The complex challenge was to find solutions that took into account future business, existing in-force books as well as business on the books that had already been terminated prior to the maturity of the contracts. The multi-lateral process culminated in a December meeting and signing of a Statement of Intent between the five largest members of the LOA and the Minister of Finance.

It is important to note that the issues raised in the settlement relate to a small and specific part of a life insurer's business. In general, it has been shown that customers who take out and maintain a retirement or endowment product to maturity will have invested wisely and at reasonable cost to themselves – although the choice of investment asset may impact that return. It has been primarily in situations where policies have been prematurely or partially terminated where the perceived high costs have been contentious. It is hoped that this has now been dealt with and we look forward to continuing to give our policyholders peace of mind in planning for the future.

Strategy

Becoming the life insurer and investment manager of choice

Our strategy is simple – we intend to become the South African life insurer and investment manager of choice for those who wish to buy and to sell life insurance and investment products. To do this we need to offer products that are relevant, easy to understand and provide real value for money.

We are reassessing the relevance of all products provided by Liberty Life and Stanlib, and will discontinue any we find to be no longer suitable for the markets we operate in. Similarly, where we find that inappropriate advice is being given or product sold – be it through our tied agency force or independent brokers – we will remove the party's contract to sell our products.

In addition, to be the life insurer and investment manager of choice means that we provide service excellence and put the customer at the forefront of everything we do.

The life insurance operations have made good progress but understand that they still have a long way to go. The decision to move the back office onto one delivery platform over the next few years will go some way towards helping us deliver on our service promise.

In the life insurance operations, we will also continue to focus on extending our distribution reach. Specifically, in the coming year we will ensure the efficient distribution of our Liberty Active products. In keeping with our philosophy of providing the right products for the right markets, we have discontinued selling savings products into the lower end of the market, as we believe they do not offer sufficient value for money when compared to alternatives such as unit trusts or bank savings accounts.

To be competitive, profitable and provide value for money means that we cannot be complacent when it comes to costs. We are constantly evaluating our processes to streamline them and extract value from cost efficiencies wherever possible.

Financial performance

Investment Management & Life Insurance comprises 7% of the group's headline earnings, and grew normalised headline earnings in 2005 by 51%. The division achieved a ROE of 24,1%, grew funds under management by 27% and grew normalised embedded value by 16%.

Liberty Life had a very good year and increased normalised headline earnings by 47%, notwithstanding a once-off R321 million after tax provision for the Statement of Intent relating to the PFA rulings. Significant gains on investments held in the shareholders' portfolio more than offset this provision. These gains were previously accounted for directly in equity.

The strong growth enjoyed in the South African investment markets during the latter half of 2004 continued throughout 2005. Liberty Life and Stanlib were beneficiaries of this growth in a number of areas. Indexed new business grew by 12% over 2004, from R4,3 billion to R4,9 billion, albeit at a slightly lower margin compared with 2004. Investment management fees earned grew by 14%.

Net cash inflows from insurance operations were up from R3,2 billion in 2004 to R5,7 billion, and net inflows into Stanlib amounted to a further R13 billion.

In the insurance operations, policy expense increases of a recurring nature were in line with actuarial assumptions (4,25% per annum) for the third year in a row although non-recurring items were considerably higher than 2004, due mainly to the restructuring and integration costs incurred with respect to the restructuring into three main divisions and the integration of CAHL. The capital adequacy requirement ratio remained strong at 2,0 times cover.

Stanlib's profit before tax was R348 million and third-party assets under management grew by 27% to R186 billion as at 31 December 2005.

Focus areas for 2006

Investment Management & Life Insurance earnings may be lower in 2006 due to the potential impact of a lower assumed equity and bond market performance although real growth in embedded value should be achieved.

Specific focus areas in 2006 will include:

- Continuing to refine our new business model and implement our strategy to become the life insurer of choice.

- Driving the distribution of Liberty Active products.

- Bringing out the best in our people.

- Improving and expanding Stanlib's equity business.