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Research Update:

Arab Investment and Export Credit Guarantee Corp. (Dhaman) 'AA' Ratings Affirmed; Outlook Stable

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Overview

- Dhaman's net profitability and business volume increased materially in 2017, which we view as supportive of the institution's role.
- Dhaman's capital levels remain high, which obviates concerns over minor delays to capital payments.
- We are therefore affirming our 'AA' ratings on Dhaman.
- The stable outlook reflects our expectation that Dhaman will meet its growth targets while maintaining a strong financial position.

Rating Action

On March 28, 2018, S&P Global Ratings affirmed its 'AA' long-term issuer and financial strength credit ratings on Arab Investment and Export Credit Guarantee Corp. (Dhaman). The outlook remains stable.

Rationale

Dhaman's financial statements indicate that gross written premiums increased by 34% in 2017, compared with 15% in 2016, and almost consecutive annual declines since 2011. Ultimately, we view Dhaman's mandate as relatively narrow--to facilitate the development of Arab states' economies by providing insurance--and one that prevents a countercyclical role. Therefore, lower business volumes following regional political upheavals and the low-commodity-price environment since 2011 were not necessarily indicative of a weakening policy importance. Oil-related insurance activity accounts directly for about 10%-15% of Dhaman's business; we expect the indirect figure to be much larger. We expect the recent positive momentum in regional business volumes to continue over the medium term. In our opinion, the evolution of Dhaman's role over this period could be a key indicator of its importance.

In our view, Dhaman's operational performance supports its role and reflects its management's growth strategy but, with relatively low levels of annual business insured compared with other global and regional trade credit insurers, its operations remain limited. Dhaman's risk-based capital adequacy is very strong, in our view, thanks to the company's low utilization of its capital. Its annual business insured was 2.9x shareholders' equity at year-end

2017, versus 4.0x at year-end 2013. Business insured during 2017 was about $1.4 billion, compared with total equity of $479.3 million. This was comfortably within Dhaman's internal underwriting benchmark of maximum annual business insured of 7.5x capital and reserves.

Our ratings on Dhaman continue to be based on our view of the agency's very strong business profile and strong financial profile. Our assessment of Dhaman's stand-alone credit profile (SACP) is 'aa'. We incorporate no uplift from extraordinary shareholder support into our 'AA' ratings on Dhaman, since the capital base is effectively fully subscribed and paid up.

We base our assessment of Dhaman's very strong business profile on its public policy importance and governance and management expertise. The agency has operated for more than 40 years and has a clear public policy mandate. The sources of its underwritten investment and trade risk flows derive from the Arab region, particularly the less economically developed states. We view Dhaman as transparent and prudent, and we believe it has good governance and management.

Dhaman was established, by convention, in 1974, to support investments into and trade with Arab states by providing political risk (noncommercial) insurance, including export credit guarantee (commercial) insurance. The agency currently has a stable membership of 25 shareholders, of which 21 are Arab states and four are pan-Arab regional funds owned by Arab states.

There were some delays to capital payments in 2017, with approximately Kuwaiti dinar (KWD) 4 million ($13.2 million) received relative to KWD6 million ($19.8 million) due. Almost half of the delays were from economically weaker member states that are currently involved in conflict. However the amount of delays was not material in the context of the organization's ample capital position, meaning we do not view this as a sign of weakening support. In 2013, the larger member states voluntarily increased their contributions. If weaker member states' capital shortfalls were to significantly increase, we would expect wealthier member states to voluntarily increase their contributions, as they did in 2013.

Despite the continued high operating risks in a number of the member countries, we note that Dhaman's membership has remained stable and supportive. The members agreed to a phased 50% increase in capital, 2014-2018, including a voluntary $50 million increase in 2013-2014, paid by the five largest shareholders. Overall, paid-in capital increased some 5% in 2017 to KWD90.5 million (about $299 million). 2017 marked the end of the capital-raising period, which we consider leaves the institution ample room for growth. Dhaman is unlikely to announce further capital raising in the near future, in our view.

Dhaman has a history of preferred creditor treatment by member states on its noncommercial risks, and we expect this to continue. However, we note that recoveries can occur over an extended period and Dhaman has previously applied relatively small waivers. It is exempt from corporate or income taxes and is not currently permitted to pay dividends.

Management's efforts to increase business volumes in spite of a difficult geopolitical environment have included Dhaman underwriting risks when commercial insurers have pulled out, underlining its policy importance. Overall business flows in 2017 also benefitted recently from a slightly more favorable commodity price environment. We view Dhaman's medium-term growth targets of around 9% per year as attainable, given the considerable scope to increase insurance penetration in the region from low levels.

Dhaman is implementing a growth strategy that includes working with other multilateral lending institutions and regional agencies, as well as continuing to strengthen its relationship with a wider network of brokers. Furthermore, Dhaman is working on a guarantee scheme with a trade finance arm of the Arab Monetary Fund, which would help its business.

In this light, the 34% increase in business volume over 2017 supports both management's strategy and Dhaman's role. Furthermore, the development of Dhaman's market share in its target countries of operation, particularly those that are more economically and politically volatile, is supportive of Dhaman's policy importance in our view.

We expect Dhaman will maintain extremely strong capitalization while insured commitments increase as it meets its primary goal of helping service economic growth across the Arab region. By the end of 2017, paid-in capital reached KWD90.5 million ($299 million), up 33% from the KWD68 million at year-end 2013. Members of the Gulf Cooperation Council (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates) directly own 34% of Dhaman. We anticipate that Dhaman will at least break even at the net profit level, and we do not expect the value of shareholder funds will decline beyond 10% over our forecast horizon, before adjusting for any new capital injections. Dhaman's extremely strong capital position dilutes the company's return on equity, which stood at 3.4% in 2017, compared with 1.6% in 2016.

Although Dhaman's underwriting exposes it to ongoing political uncertainties in some member states, we do not believe these present a material risk of increased underwriting losses that would cause unmanageable capital erosion. Dhaman has a proven track record of recovering noncommercial losses from its member governments, but such losses have been relatively few over the past decade.

Liquidity will continue to be exceptional, in our view, but is likely to reduce in absolute terms if transaction volumes rise as targeted. Liquidity is supported by Dhaman's investment policy, which focuses on securely rated deposit-holding banks and fixed-income instruments, mostly held in U.S. dollars, and an internationally diverse mix of equity-type funds. Nevertheless, the spread of the portfolio and the amount invested in unrated instruments causes us to view the risk position as intermediate, which acts as a modest constraint on our financial risk assessment. We recognize the ongoing strength and committed support of the membership, but the relatively narrow range of funding sources Dhaman uses caps our assessment of its financial flexibility at adequate.

Outlook

The stable outlook reflects our expectation that Dhaman will meet its growth targets while maintaining a strong financial position.

We could lower the rating if Dhaman materially underperforms against its growth targets, particularly in the regions and sectors where the company is concentrating its growth efforts, since we could view this as indicating a weakening in policy importance.

We do not expect to raise the ratings over the next two years, but a further strengthening of Dhaman's role, illustrated for example, by managed high growth rates in areas where commercial insurers are not active, or reduce their presence, could provide upward rating pressure.

Related Criteria

- Criteria - Insurance - Specialty: Trade Credit Insurance Capital Requirements Under Standard & Poor's Capital Adequacy Model, Dec. 6, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 2013
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- 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

Ratings List

Ratings Affirmed

The Arab Investment and Export Credit Guarantee Corp.	
Issuer Credit Rating	
Foreign Currency	AA/Stable/--
Financial Strength Rating	
Local Currency	AA/Stable/--

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on the S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.