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Research Update:

The Arab Investment and Export Credit Guarantee Corp. (Dhaman) Downgraded To 'AA-' On Updated Criteria; Outlook Stable

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Overview

- We have reviewed the Arab Investment and Export Credit Guarantee Corp. (Dhaman) under our revised criteria for multilateral lending institutions (MLIs).
- We now assess Dhaman's governance and risk management framework as adequate, similar to our assessment on its peers.
- Consequently, we are lowering our rating on Dhaman to 'AA-' from 'AA'. The rating is no longer under criteria observation.
- The stable outlook reflects our expectation that Dhaman will continue to expand its business, especially in areas where commercial insurers are not active or have a reduced presence, while maintaining its robust capital and liquidity positions.

Rating Action

On March 28, 2019, S&P Global Ratings lowered to 'AA-' from 'AA' its long-term issuer and financial strength credit ratings on The Arab Investment and Export Credit Guarantee Corp. (Dhaman). The outlook is stable.

The ratings are no longer under criteria observation, as they have been since Dec. 14, 2018, when we published our updated criteria for MLIs.

Rationale

The downgrade follows our classification of Dhaman's governance and risk management framework as adequate under our criteria, in line with peers. Under our updated criteria, we have only three categories for governance and risk management, rather than four.

Although we consider Dhaman's risk management framework to be conservative and appropriate for its needs, it lacks some of the features demonstrated by some of the organization's more-advanced peers. For example, its holistic oversight of risks is less well developed and all of Dhaman's voting shareholders are eligible for coverage, which exposes the institution to agency risk. In addition, governance indicators in most member countries are weak. That said, Dhaman has recently implemented improvements, such as creating a stand-alone risk management department and fully retaining its profits in recent years, which has helped it strengthen its capital position.

The rating on Dhaman is based on its strong enterprise risk profile and strong financial risk profile. We incorporate no uplift from extraordinary shareholder support for Dhaman because the capital base is effectively fully subscribed and paid up. The stand-alone credit profile is 'a+'. The long-term issuer credit rating incorporates a notch of uplift from our holistic assessment, reflecting capital and liquidity strengths beyond those captured by the financial risk profile. We outline these factors in our revised criteria, "Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Dec. 14, 2018, on RatingsDirect on the Global Credit Portal.

Established by convention in 1974, Dhaman was set up to support investments into and trade with Arab states by providing investment guarantee (noncommercial) insurance and export credit guarantee (commercial) insurance. Only investments made in member states are eligible for investment guarantee insurance, which covers risks of expropriation, transfer restrictions, war and civil disturbance, and breach of contract. Export credit guarantee insurance is available as long as one party is a member state and covers both commercial and political risks.

We view Dhaman's mandate as relatively narrow and one that prevents a countercyclical role. Oil-related insurance activity accounts directly for about 10%-15% of Dhaman's business and we expect the indirect figure to be much larger. Gross premium written increased by 12% in 2018 to about Kuwaiti dinar (KWD) 2.4 million ($7.9 million), compared with 32% growth in 2017. These growth figures represent an improvement over the low and sometimes negative growth reported in 2013-2015. We expect Dhaman's export credit line of business to continue to expand, particularly in the less economically developed member states and outside of the region, as allowed by the organization's mandate. The investment guarantee line accounts for about 12% of total insured business and growth has been stagnant since 2012. In our view, growth in this line of business would support our assessment of Dhaman's role.

Although operating risks in several member countries remain high, Dhaman's membership has remained stable and supportive. It currently has 25 shareholders, of which 21 are Arab states and four are pan-Arab regional funds owned by Arab states--the funds do not have voting rights. No shareholder has left and we do not expect any departures over the medium term. Member countries exempt Dhaman from all taxes and duties.

Despite the current boycott of shareholder Qatar by several other shareholders--including Saudi Arabia, the United Arab Emirates (UAE), and Egypt--relationships between shareholders and Dhaman are not strained. If the boycott were to cause operational problems for Dhaman, outside of the natural reduction in regional trade, it would weigh on our assessment.

Throughout Dhaman's existence, its shareholders have supported it by providing timely capital increases. Shareholders agreed to the most recent capital increase in 2013, which included a phased 50% increase in capital over 2014-2018 and an additional voluntary $50 million increase in 2013-2014, paid by the five largest shareholders. At year-end 2018, paid-in capital stood at about $300 million (KWD91.1 million), up from $197 million at year-end 2012. There were still outstanding capital payments due from members as of year-end 2018. Accumulated capital contributions due from member countries amounted to about $2.9 million (KWD879,000).

Most of this amount is due from countries in a state of open conflict: Somalia, Syria, and Yemen. Management does not expect to receive this money until after conflicts are resolved. Additionally, three member Arab financial authorities have outstanding capital contributions amounting to approximately $21 million (KWD6.4 million). Dhaman's member countries overlap with those of these three institutions and we expect that this overlap and the strength of Dhaman's relationship with its member countries will help resolve these overdue amounts in Dhaman's favor.

We exclude preferred creditor treatment (PCT) from our assessment of Dhaman's enterprise risk profile, because less than 25% of its insured business is noncommercial (the investment guarantee line). Within this line of business, Dhaman has a strong history of recoveries from member states, though recoveries can occur over an extended period of time and Dhaman has granted small waivers in the past. We would expect preferential treatment from member countries for Dhaman's commercial exposure, for instance, by exempting them from currency convertibility or transfer restrictions.

We view Dhaman's financial risk profile as strong, an assessment which maps from very strong under our insurance criteria. We expect Dhaman will maintain capitalization at the 'AAA' level (in our model), even as insured commitments increase, while maintaining a relatively conservative investment portfolio. This level of capitalization represents a rating strength beyond that captured in the initial financial risk profile. We do not expect the value of shareholder funds to decline beyond 10% over our forecast horizon, before adjusting for any new capital injections. Dhaman suffered a net loss in 2018 of $3.1 million (KWD942,000). Although its underwriting results remained profitable, the net loss was based on losses in its investment portfolio. Dhaman's extremely strong capital position dilutes the company's return on equity, which stood at -0.7% in 2018, compared with 3.9% in 2017.

Liquidity is exceptional and 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. Liquidity will continue to be exceptional, in our view, and represents a significant rating strength relative to peers, though we anticipate a slight reduction in absolute terms if transaction volumes rise as targeted.

Outlook

The stable outlook reflects our expectation that Dhaman will continue to expand its business, especially in areas where commercial insurers are not active or have a reduced presence, while maintaining its robust capital and liquidity positions.

We could lower the rating in the next two years if growth in Dhaman's insured business comes predominately from markets where private insurers are most active and the development impact is lowest, indicating a weakening role. We could also lower the rating if pressure on Dhaman's capital and liquidity positions materialized.

We do not expect to raise the ratings over the next two years, but very strong shareholder support, demonstrated, for example, by a large capital increase from shareholder states, could provide upward rating pressure.

Ratings Score Snapshot

Issuer Credit Rating	AA-/Stable
SACP	a+
Enterprise risk profile	Strong
Policy importance	Strong
Governance and management	Adequate
Financial risk profile	Strong
Capital adequacy	N/A
Funding and liquidity	N/A
Extraordinary support	0
Callable capital	0
Group support	0
Holistic approach	1

N/A--Not applicable.

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Criteria | Insurance | Specialty: Trade Credit Insurance Capital Requirements Under S&P Global Ratings' Capital Adequacy Model, Dec. 6, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology, May 7, 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

- Guidance | Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Dec. 14, 2018
- Supranationals Special Edition, Oct. 11, 2018

Ratings List

Downgraded

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

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