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Research Update:

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

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Overview

- We have affirmed our 'AA' long-term foreign and local currency counterparty credit and financial strength ratings on Dhaman.
- In our opinion, Dhaman has a very strong business risk profile and strong financial risk profile, as defined by our criteria for multilateral and supranational institutions.
- The stable outlook reflects our view that Dhaman will maintain these credit strengths.

Rating Action

On April 14, 2014, Standard & Poor's Ratings Services affirmed its 'AA' long-term foreign and local currency counterparty credit and financial strength ratings on Arab Investment and Export Credit Guarantee Corporation (Dhaman). The outlook is stable.

Rationale

The ratings on Dhaman are based on its "very strong" business profile and "strong" financial profile, as our criteria define these terms (see " Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Nov. 26, 2012). Dhaman's stand-alone credit profile (SACP) is 'aa'. We incorporate no uplift from extraordinary shareholder support into our 'AA' issuer credit rating, since the capital base is currently fully subscribed and paid-up.

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

We base our assessment of Dhaman's "very strong" business profile on its public policy importance and governance and management expertise. It has an operational track record of almost 40 years and a clear public policy mandate to facilitate the development of Arab states' economies through providing insurance. The sources of its underwritten investment and trade risk flows derive from the Arab region, particularly the less economically developed states.

Dhaman was established by a convention signed by all members. It has a demonstrably stable and supportive relationship with its member states, as indicated by regular capital increases. It also has a history of preferred creditor treatment by member states on its non-commercial risks. However, we note that recoveries can happen over an extended period and waivers have previously been applied. Dhaman is exempt from corporation or income taxes and is not currently permitted to pay dividends. We view Dhaman as transparent, prudent, and with good governance and management.

We assess Dhaman's financial profile as "strong," under our MLI criteria. This reflects very strong capitalization, exceptional liquidity, an intermediate risk position, and adequate financial flexibility.

Its risk-based capital adequacy is very strong. We estimate its gross annual commitments in 2013 were 4.0x shareholders' equity at Dec. 31, 2013 (5.4x at Dec. 31, 2012). This was comfortably within Dhaman's internal underwriting benchmark of maximum gross annual commitments of 7.5x capital and reserves; we would still view capitalization as very strong at this level of potential exposure. Outstanding commitments at Dec. 31, 2013 were US$397 million, compared to shareholders' funds of $379 million or 105% (Dec. 31, 2012: 107%), which we regard as very conservative. Reduced capital utilization in 2013 reflects the additional capital paid-in by several key member states that year. We note that members have agreed to raise the subscribed capital through annual instalments until 2018. At that time, we expect paid-in capital will have reached Kuwaiti dinar (KWD) 93 million, up 37% from KWD68 million at end-2013.

We expect Dhaman will maintain extremely strong capitalization as insured commitments increase as it meets its primary goal of helping service economic growth across the Arab region. While political turbulence in target areas has impeded business growth in the past three years, member commitment is very strong. We saw this in new capital injected in 2013, and planned through to 2018, to support economic expansion. We anticipate Dhaman will at least break even at the net profit level and we do not expect the value of shareholder funds to decline beyond 10% in any year, before adjusting for any new capital injections. Dhaman's return on equity in 2013 was 1.6% of shareholder funds before new capital.

While 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 instances and needs have been relatively few over the past decade. We note that all member countries agreed in April 2013 to increase paid-in capital with annual injections up to 2018. In 2013, paid-in capital rose by 23% with specific injections from Kuwait, Libya, Qatar and Saudi, among other states. We note that the Gulf Cooperation Council members raised their ownership to 32% at March 2014 (22% at end-2012) by new capital injections.

Liquidity will continue to be exceptional, but is likely to diminish in absolute terms if transaction volume rises as targeted. We estimate Dhaman's liquid assets to cover 99% of outstanding commitments at Dec. 31, 2013 (2012: 97%). Liquidity is supported by Dhaman's investment policy, which focuses on securely rated deposit-holding banks and fixed-income instruments, held largely in U.S. dollars, and an internationally diverse mix of equity-type funds. The spread of that portfolio and the amount in unrated instruments does cause 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 sources of funding used by Dhaman limits our assessment of its financial flexibility to adequate.

Outlook

The stable outlook reflects our view that Dhaman's business profile, capital levels, funding, and liquidity are sufficiently robust and its access to capital support are sufficiently strong that there is less than a one-in-three chance of us lowering or raising the rating on Dhaman within the next two years.

Pressure on the rating would arise if management--contrary to our expectations--adopts more-aggressive capital utilization policies, or if insurance activities generate material operating losses, or if members cease to support Dhaman, either as member states or as preferred creditors.

We do not expect to raise the ratings on Dhaman at this stage.

Related Criteria And Research

- Insurers: Rating Methodology, May 7, 2013
- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Principles Of Credit Ratings, Feb. 16, 2011
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

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/--

Complete ratings information is available to subscribers of RatingsDirect at www.globalcreditportal.com and at spcapitaliq.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following Standard & Poor's 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.