Research

Research Update:

Arab Investment and Export Credit Guarantee Corporation (Dhaman) Outlook Revised To Stable From Negative; 'AA' Affirmed

Primary Credit Analyst:
Benjamin Young, Dubai (971) 4-372-7191; benjamin.young@standardandpoors.com

Secondary Credit Analyst:
Kevin R Willis, Dubai (971) 4-372-7103; kevin.willis@standardandpoors.com

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Overview

- Arab Investment and Export Credit Guarantee Corporation (Dhaman) has received most overdue capital payments from shareholders related to the 2013 increase, and, although the payments are not in line with the initial timetable, we do not think this reflects weakening support for Dhaman.
- Additionally, to address undershooting business targets, Dhaman has stepped up efforts to diversify into new markets and geographies and revised down growth expectations, given the heightened operating risks in the region.
- We are therefore revising our outlook on Dhaman to stable from negative and affirming our 'AA' ratings.
- The stable outlook reflects our expectation that Dhaman will maintain its very strong business profile and strong financial profile, with very strong capital and earnings.

Rating Action

On March 16, 2016, Standard & Poor's Ratings Services revised its outlook on Arab Investment and Export Credit Guarantee Corporation (Dhaman) to stable from negative. At the same time, we affirmed our 'AA' long-term foreign and local currency counterparty credit and financial strength ratings on Dhaman.

Rationale

The outlook revision reflects our view that support for Dhaman has not weakened, taking into account that, since our last review in April 2015, capital payments related to the 2013 increase have continued--albeit in a manner at odds with the initial timetable that stated the $97.6 million increase would be paid in five equal instalments. In our view, while some delays relate to shareholders that are currently at war or without a government, delays from institutional shareholders (that also benefitted from capital increases decided at the same time and by the same membership) do not indicate waning support for Dhaman's mandate, but rather administrative bottlenecks and the already extremely high levels of capital. We expect that the full amount will be paid in by the end of 2017, which is the end of the capital increase period.

We have also observed management's efforts to increase business volumes during a period when overall business flows have significantly reduced, reflecting lower commodity prices and ongoing regional conflict. Reduced regional business volumes pose a challenge for Dhaman's growth targets (total insured business), which management has reduced to about 8% per year from 10% previously. Still, we do not expect this level of growth will be attained. In terms of efforts to increase business, Dhaman has entered into agreements with export credit agencies, many in North Africa, and strengthened ties with large European insurers to improve visibility. Dhaman has initiated projects with Arab Petroleum Investments Corporation and Multilateral Investment Guarantee Agency and may increase business in Jordan and Iraq in the future. Directly, oil accounts for about 10% to 15% of Dhaman's business, although indirectly we expect this figure will be much larger. Ultimately, we view Dhaman's mandate as relatively narrow and one that prevents a counter-cyclical role. Therefore, lower business volumes in the current low-commodity-price environment do not necessarily indicate a weakening of policy importance. In our opinion, the evolution of Dhaman's role over the medium term, however, when we expect business volumes within the overall region to increase, could be a key indicator of importance. Furthermore, the development of Dhaman's market share in its target countries of operation, particularly those that are more economically and politically volatile and those that benefit from lower oil prices, the net oil importers, could also indicate changing policy importance.

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 currently fully subscribed and in the process of being paid-up.

Dhaman was established, by convention, in 1974 to support investments into and trade with Arab states by providing political risk (noncommercial), 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.

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 to facilitate the development of Arab states' economies by providing insurance. The sources of its underwritten investment and trade risk flows derive from the Arab region, particularly the less economically developed states.

Despite the high--and increasing--operating risks in a number of member countries, we note that Dhaman's membership has remained stable and supportive. For example, members injected new capital in 2013 and 2014, including a voluntary $50 million increase (approximately 20% of capital at the end of 2013) from the five-largest shareholders, which they have paid. Overall, paid-in capital increased 9% in 2015 to Kuwaiti dinar (KWD) 82.2 million (about $274 million).

We expect that Dhaman's history of preferred creditor treatment by member states on its noncommercial risks will continue. However, we note that recoveries can occur 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 and prudent, and we believe it has good governance and management.

We assess Dhaman's financial profile as strong. Our assessment reflects the agency's very strong capitalization, exceptional liquidity, intermediate risk position, and adequate financial flexibility.

Dhaman's risk-based capital adequacy is very strong, in our view. We estimate its gross annual commitments were 2.73x shareholders' equity at year-end 2014 versus 4.0x at year-end 2013. 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 year-end 2015 were $437 million, compared with shareholders' funds of $416 million or 105% (111% at year-end 2014), which we regard as very conservative.

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 2018, we expect paid-in capital will have reached KWD93 million, up 37% from KWD68 million at year-end 2013. We note that the Gulf Cooperation Council (GCC; Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates) members ownership of Dhaman totals 34%. 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 return on equity in 2014 was 1.7% of shareholder funds.

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 instances and needs 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 volume rises as targeted. We estimate Dhaman's liquid assets to cover 110% of outstanding insured commitments at Dec. 31, 2014 (99% in 2012). 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. Still, the spread of the portfolio and the amount 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 used by Dhaman limits our assessment of its financial flexibility to adequate.

Outlook

The stable outlook reflects our expectation that Dhaman will maintain its very strong business profile and strong financial profile, with very strong capital and earnings.

We could lower the ratings or revise the outlook to negative if delays in capital payments increase materially, particularly in the run-up to the end of the capital payment period in 2017. We could also take those rating actions if Dhaman's growth performance remains low, particularly as regional business volume starts to pick up or in geographical or sectoral areas where the company is concentrating its growth efforts, since we could view this as a weakening in policy importance.

We do not expect to raise the ratings or revise the outlook to positive over the next two years.

Related Criteria And Research

Related Criteria

- Criteria - Insurance - Specialty: Trade Credit Insurance Capital Requirements Under Standard & Poor's Capital Adequacy Model - December 06, 2013
- Criteria - Insurance - General: Insurers: Rating Methodology - May 07, 2013
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology - November 26, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model - June 07, 2010

Related Research

- Supranationals Special Edition 2015: Five-Year Comparative Data For Multilateral Lending Institutions - October 08, 2015

Ratings List

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

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.

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783-4009.

Additional Contacts:
Insurance Ratings Europe; InsuranceInteractive_Europe@standardandpoors.com
SovereignEurope; SovereignEurope@standardandpoors.com