Research Update:

Arab Investment and Export Credit Guarantee Corp. (Dhaman) Downgraded To 'A+' On Weaker Policy Role; Outlook Stable

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Overview

- Although the Arab Investment and Export Credit Guarantee Corp.'s (Dhaman's) gross insured business rebounded by almost 50% in 2021, the bulk of this growth came from a few contracts in the export credit insurance (ECI) business line.
- Total business across other lines remained below pre-pandemic levels in a still-difficult operating environment, intensifying competition from private insurers, and reduced geographic coverage due to geopolitical uncertainties in some member states.
- Despite Dhaman's recent introduction of a new five-year strategic plan over 2022-2026, we believe structural challenges will continue to undermine its ability to achieve sustainable growth in core business lines that underpin its policy mandate.
- Consequently, we have lowered our rating on Dhaman to 'A+' from 'AA-'.
- The stable outlook reflects our expectation that Dhaman will work toward implementing its new strategic plan, including expansion, while maintaining robust capital and liquidity.

Rating Action

On March 30, 2022, S&P Global Ratings lowered its long-term issuer credit and financial strength ratings on the Arab Investment and Export Credit Guarantee Corp. (Dhaman) to 'A+' from 'AA-'. The outlook is stable.

Rationale

In our view, Dhaman's policy importance and development role have continued to weaken on long-standing difficulties to expand in its core business lines. Total insured business and gross premiums written recovered from a low base by about 47% and 22%, respectively, in 2021, although most of this growth stemmed from higher ECI volumes from a few oil-related policyholders. Separately, stiffer competition from private credit insurers and other export credit agencies contributed to stagnant business in the investment guarantee line, while poor performance of ceding companies led to a 30% contraction in the reinsurance line. The latter was partly offset by some recovery in trade finance relative to 2020, owing to Dhaman's penetration into new South Asia markets such as Bangladesh and Sri Lanka, but remained at half the pre-COVID-19 levels.

Several structural challenges could further undermine Dhaman's ability to implement its public-policy mandate in the longer term. The investment guarantee line, where Dhaman's development impact could be highest, has stagnated, with the portfolio totaling about $120 million in 2019-2021 from a peak of $540 million in 2009. A lack of investor interest and geopolitical uncertainty in the region could continue to complicate Dhaman's expansion plans in this line of business.

In addition, removing Lebanon from its portfolio in late 2019 narrowed Dhaman's geographic coverage and the scope of its business operations, since it was a key country for the letters of credit business. Five to six member countries out of 21, including Libya, Syria, Somalia, Sudan, and Yemen (alongside Iraq on a selective basis) are regularly placed off cover for geopolitical and economic reasons. Although this reflects the continued difficult operating conditions, we believe it to be an output of Dhaman's prudent risk settings that, ultimately, could limit the agency's development impact.

At the same time, Dhaman faces steep competition from private insurers and other development agencies in the remaining countries under cover, with some players entering the market with new products and coverage of a wider range of risks. Lack of awareness of Dhaman in non-member countries, eligibility criteria for its business, and its limited range of risk coverage could undermine the company's competitive position relative to peers'.

Dhaman's concentration in oil- and other petrochemical-related insurance activity (around 30% of total insured business) also prevents it from performing a countercyclical role, in our view. In our base-case scenario, we assume the ongoing oil price rally will have a favorable impact on Dhaman's ECI and trade finance volumes. However, we expect structural volatility of hydrocarbon prices will constrain long-term business expansion. In 2020, the oil price slump and reduced global demand for energy depressed investment and trade activity in Dhaman's core regions, limiting its ability to act as a countercyclical lender.

In 2021, Dhaman's leadership team introduced a new five-year strategic plan over 2022-2026 to enhance the corporation's development role and efforts in the region. The new strategy is intended to repurpose Dhaman's vision and mission, redefine its risk appetite, outline plans for growth including new markets and products, and specify new requirements for systems and risk management. We understand that to revive its business operations, Dhaman plans to increase marketing efforts and expand its geographic reach to new non-Arab markets, including Asia and Sub-Saharan Africa, as allowed under its mandate. The new strategy and a broader regional recovery of investment and trade activity, fueled by higher oil prices, could translate into increased business volumes in 2022. Nevertheless, we expect structural hurdles will continue to restrict Dhaman's ability to register sustainable growth across its main business lines.

Despite high operating risks in several member countries, Dhaman's shareholder base has remained stable and supportive. It currently has 25 shareholders: 21 are Arab states and four are pan-Arab regional funds owned by similar shareholders. The funds do not have voting rights. No shareholder has left, and we do not expect any departures over the medium term.

We do not incorporate preferred creditor treatment in 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, although recoveries can occur over an extended period and Dhaman has granted small waivers in the past. We 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, based on its very strong financial risk profile under our insurance criteria. Dhaman's financial risk profile is underpinned by the company's 'AAA' capital adequacy, as measured by our risk-based capital model, and its low tolerance to investment risk. Moreover, Dhaman's capital adequacy continues to show a significant buffer above the 'AAA' level. Based on the scale of operations and business growth projections, we expect Dhaman will maintain robust capital adequacy over the next two years, supported by profitable earnings.

We view Dhaman's investment portfolio as conservative. The company's relatively low tolerance for investment risk is demonstrated by the portfolio being denominated primarily in cash, which also contributes to its exceptional liquidity. The investment portfolio mainly includes bank deposits (about 38%) and fixed-income instruments (about 46%), with only small exposure to high-risk assets like equities and real estate (about 16%).

We incorporate one notch of uplift in our 'A+' long-term issuer credit rating on Dhaman to reflect our view that the company's liquidity will remain excellent, and a significant rating strength relative to peers.

Outlook

The stable outlook reflects our expectation that Dhaman will work toward implementing its new strategic plan and expand in areas where commercial insurers have a reduced presence, while maintaining its robust capital and liquidity positions.

Downside scenario

We could lower the rating in the next two years if Dhaman's capital or liquidity positions materially weakened, although we currently view this as unlikely. Signs of weakening shareholder support would also put pressure on the rating.

Upside scenario

We do not expect to raise the ratings over the next two years, but very strong shareholder support, demonstrated, for example, by a significant capital increase from member states, could lead to a positive rating action.

Ratings Score Snapshot

Issuer credit rating: A+/Stable/--

SACP: a

Holistic approach: +1

Enterprise risk profile: Adequate

- Policy importance: Adequate
- Governance and management expertise: Adequate

Financial risk profile: Strong

- Capital adequacy: N/A
- Funding and liquidity: N/A

Related Criteria

- Criteria | Governments | General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Jan. 31, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Insurance | General: Insurers Rating Methodology, July 1, 2019
- Criteria | Insurance | Specialty: Trade Credit Insurance Capital Requirements Under S&P Global Ratings' Capital Adequacy Model, Dec. 6, 2013
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Insurance | General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Related Research

- Supranationals Special Edition 2021, Oct. 27, 2021
- Introduction To Supranationals Special Edition, Oct. 27, 2021
- S&P Global Ratings Definitions, Jan. 5, 2021

Ratings List

Downgraded; CreditWatch/Outlook Action

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

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,