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Research Update:

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

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Overview

- We note that Dhaman has not received a portion of expected capital payments, relating to the 2013 increase, as agreed by shareholders.
- In addition, we have concerns over Dhaman's ability to deliver on its growth targets.
- While these factors may indicate a weakening of Dhaman's policy importance, we still consider that Dhaman has a very strong business risk profile and strong financial risk profile, as defined by our criteria for multilateral and supranational institutions.
- We are revising our outlook on Dhaman to negative from stable and affirming our 'AA' ratings.
- The negative outlook reflects our view that Dhaman's policy importance may decline if agreed capital payments remain outstanding by the end of 2015 or if Dhaman's 2015 growth targets are materially lower than the agency's budget.

Rating Action

On April 13, 2015, Standard & Poor's Ratings Services revised its outlook on Arab Investment and Export Credit Guarantee Corporation (Dhaman) to negative from stable. At the same time, we affirmed our 'AA' long-term foreign and local currency counterparty credit and financial strength ratings on Dhaman.

Rationale

Our ratings on Dhaman are based on our assessments of the agency's 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, on RatingsDirect). Dhaman's stand-alone credit profile (SACP) is 'aa'. We incorporate no uplift from extraordinary shareholder support into our 'AA' credit 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 Arab states and trade flow to and from 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 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. The agency has an operational track record of more than 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.

Despite the high operating risks in a number of member countries, specially since 2011, we note that Dhaman's membership has remained stable and supportive. For example, members injected new capital during 2013 and 2014, including a voluntary $50 million (approximately 20% of capital at the end of 2013) increase from the five largest shareholders, which has been paid in. Overall, paid-in capital increased 10% in 2014 to Kuwati dinar (KWD) 75.3 million (about $24.8 million). However, this is below the 19% increase that was subscribed and subsequently ratified during Dhaman's April 2013 shareholders' council. Three of the four pan-Arab institutional shareholders are still to pay in their pledged 2013 and 2014 annual capital increases, which accounts for the bulk of the delayed capital. We also note that the amount of gross written premiums at the end of 2014 remains 25% below 2010 levels, despite a 10% increase over 2014. While 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 economic impact. Given the agency's past underperformance versus budget, we are concerned that Dhaman will materially undershoot the budgeted 35% increase in gross premiums over 2015. We view the delayed capital and potential for continued underperformance versus budget as indications of under-delivery on Dhaman’s mandate that could ultimately cause us to change our opinion of the agency’s overall policy importance and very strong business profile.

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 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 criteria for multilaterial lending institutions criteria. This reflects very strong capitalization, exceptional liquidity, an intermediate risk position, and adequate financial flexibility.

Dhaman's risk-based capital adequacy is very strong. We estimate its gross annual commitments were 2.73x shareholders' equity at year-end 2014, (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 2014 were $440 million, compared with shareholders' funds of $398 million or 111% (105% at year-end 2013), which we regard as very conservative. The reduced level of capital utilization in 2014 reflects the additional capital paid in by several key member states that year.

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. In 2014, paid-in capital rose by 10% (9% below expectation, related to the delayed pan-Arab institutions). We note that the Gulf Cooperation Council members have raised their ownership to 35% with new capital injections as of December 2014 (22% at year-end 2012). We anticipate that 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% over our forecast horizon, before adjusting for any new capital injections. Dhaman's return on equity in 2014 was 1.7% of shareholder funds.

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.

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 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, held largely in U.S. dollars, and an internationally diverse mix of equity-type funds. Still, the spread of that 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 negative outlook reflects our view that Dhaman's policy importance may decline if agreed capital payments remain outstanding by the end of 2015 or if Dhaman’s 2015 growth targets are materially lower than the budget.

We could lower the ratings if delays to subscribed capital increases continue, because we may see this as a sign of declining policy importance to member states. We could also lower the ratings if Dhaman's operating performance materially undershoots targets, which could also indicate a weakening of Dhaman's policy importance. Other influencing factors are if management and members--contrary to our expectations--adopt more aggressive capital utilization policies than the convention prescribes, if insurance activities generate material operating losses, or if members cease to support Dhaman, either as member states or as preferred creditors.

We could change the outlook to stable if delayed capital payments are forthcoming over 2015 and if Dhaman's growth performance indicates a strengthening of its mandate.

Related Criteria And Research

Related Criteria

- 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

Ratings List

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

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