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Research Update:

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

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Table Of Contents

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Overview

- Although Dhaman's net profitability declined in 2016, its business volume increased materially, which we view as supportive of the institution's role.
- Dhaman's capital levels remain high, which obviates concerns over minor delays to capital payments.
- We are therefore affirming our 'AA' ratings on Dhaman.
- The stable outlook reflects our expectation that Dhaman will meet its growth targets while maintaining strong financials.

Rating Action

On March 29, 2017, S&P Global Ratings affirmed its 'AA' rating on Arab Investment and Credit Guarantee Corporation (Dhaman). The outlook remains stable.

Rationale

Dhaman's financial statements indicate that business volumes increased during 2016 and reached levels last seen before the Arab Spring in 2011. Gross premium written grew by 16%, compared with 2% in 2015 and almost consecutive annual declines since 2011. In our view, Dhaman's operations support its role and reflect its management's growth strategy but, with relatively low levels of annual business insured compared to other global and regional trade credit insurers, its operations remain limited. Dhaman's capital levels are high, and related utilization low--gross annual commitments represent about 3x shareholders' equity. The annual capital payments by economically weaker member states that are currently at war continue to be paid with minor delays, but given the orgainzation's ample capital position, we do not view this as a sign of weakening support. In 2013, the larger member states voluntarily increased their contributions.

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 continued high 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) paid by the five largest shareholders. Overall, paid-in capital increased some 5% in 2016 to Kuwaiti dinar (KWD) 86.5 million (about $283 million). 2017 marks the end of the current capital-raising period, which we consider leaves the institution ample room for growth. Dhaman is unlikely to announce further capital raising in the near future, in our view.

We anticipate that there will be some outstanding capital payments at the end of 2017, relating to members currently at war. The payments due over 2017 are roughly double those due in 2015 and 2016, at approximately KWD6 million ($20 million). Although about KWD1 million has been received in 2017 to date, we could view further delays, beyond those already expected, as a sign of weakening support.

Dhaman has a history of preferred creditor treatment by member states on its noncommercial risks and we expect this to continue. However, we note that recoveries can occur over an extended period and Dhaman has previously applied relatively small waivers. It 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 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. Alongside reduced regional business volumes, typically low levels of insurance penetration pose challenges for Dhaman's growth targets. Dhaman is implementing a growth strategy that includes working with other multilateral lending institutions (MLIs) and regional agencies, as well as continuing to strengthen its relationship with a wider network of brokers. Furthermore, we expect that Dhaman will initiate a consultation process with the Basel Committee over its status as an MLI (currently, most central banks assign it a risk weighting of 20%). It is also working on a guarantee scheme with a trade finance arm of the Arab Monetary Fund. These initiatives could lead to substantial business opportunities.

Oil directly accounts for about 10%-15% of Dhaman's business; we expect the indirect figure to be much larger. Ultimately, we view Dhaman's mandate as relatively narrow and one that prevents a countercyclical role. Therefore, lower business volumes in the current low-commodity-price environment would not necessarily indicate a weakening of policy importance. We expect business volumes in the region to increase over the medium term. In our opinion, the evolution of Dhaman's role over this period could be a key indicator of its importance.

In this light, the 16% increase in business volume over 2016 supports both management's strategy and Dhaman's role. Furthermore, the development of Dhaman's market share in its target countries of operation, particularly those that are more economically and politically volatile and the net oil importers, which benefit from lower oil prices, could also indicate changing policy importance.

Dhaman's risk-based capital adequacy is very strong, in our view. Its annual business insured was 3.1x shareholders' equity at year-end 2016, versus 4.0x at year-end 2013. Business insured during 2016 was $1.325 billion, compared with shareholders' funds of $437 million. This was comfortably within Dhaman's internal underwriting benchmark of maximum annual business insured of 7.5x capital and reserves. We would still view capitalization as very strong at this level of potential exposure.

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 the end of 2017, we expect paid-in capital to have reached KWD93 million ($304 million), up 37% from the KWD68 million at year-end 2013. Members of the Gulf Cooperation Council (GCC; Bahrain, Kuwait, Oman, Qatar, Saudi Arabia, and United Arab Emirates) own 34% of Dhaman. 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 extremely strong capital position dilutes the company's return on equity, which stood at 1.7% in 2016, compared with 3.1% in 2015.

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 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. 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. Nevertheless, the spread of the portfolio and the amount invested 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 meet its growth targets while maintaining strong financials.

We could lower the rating if Dhaman materially underperforms against its growth targets, particularly in the regions and sectors where the company is concentrating its growth efforts, since we could view this as indicating a weakening in policy importance. We could also lower the rating if delays in capital payments increase materially over 2017, the end of the current capital-raising period.

We do not expect to raise the ratings 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
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Ratings List

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

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. 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 S&P Global Ratings' public Web site at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings 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.