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The Arab Investment and Export Credit Guarantee Corp. (Dhaman)

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Table Of Contents

Table Of Contents (cont.)

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Major Rating Factors

Operating Company Covered By This Report
Financial Strength Rating
Local Currency
AA/Stable/--

Strengths:

- Very strong business profile, reflecting the benefits of multinational status and its overtly political/economic development role for the Arab region.
- Very strong capital position.
- Very strong liquidity.

Weaknesses:

- Relative lack of diversity in underwritten commitments.
- Industry and economic risks from the targeted regional markets.

Rationale

The ratings on Dhaman reflect its very strong business profile, based on our criteria for rating multilateral lending institutions (MLIs; see "Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology," published Nov. 26, 2012), and very strong financial profile based on our criteria for rating insurers. Dhaman's stand-alone credit profile (SACP) is 'aa'. We incorporate no uplift from extraordinary shareholder support into our 'AA' issuer credit rating, since all the subscribed capital has been fully paid-in.

Dhaman was established in 1974 to support trade and investments to and from Arab states by providing political risk and export credit guarantee 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.

Our assessment of a very strong business profile is based on our view of Dhaman's public policy mandate, the strength of its relationships with shareholders, and its quality of governance. Our assessment of its public policy mandate reflects its operational track record of almost 40 years, and its mandate to facilitate the development of Arab states' economies through providing insurance. Dhaman was established by a convention signed by all members and has no history of shareholder withdrawals, thus it has a demonstrably stable and supportive relationship with its shareholders. In addition, the agency is exempt from the requirement to pay any 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 very strong. This reflects very strong capitalization and liquidity, and strong investments and financial flexibility. The strength of capitalization reflects its extremely strong capital adequacy. We estimate its gross annual commitments in 2012 were 5.3x shareholders' equity at Dec. 31, 2012, comfortably within Dhaman's internal underwriting benchmark of gross annual commitments of 7.5x capital and reserves (maximum); we would still view capitalization as extremely strong at this level of potential exposure. At the same date, shareholders' equity was 107% of outstanding commitments, which we regard as very conservative.

We expect Dhaman will maintain extremely strong capitalization in a controlled environment as insured commitment volumes increase as it meets its primary goal of helping service economic growth across the Arab region. We anticipate Dhaman will break even at the trading level, and do not expect the value of shareholder funds to decline beyond 10% in any year, before adjusting for any new capital injections. While Dhaman's underwriting is exposed to ongoing political uncertainties in some member states, in our opinion these do not present material risks of increased underwriting losses that would create uncertain recovery prospects and cause unmanageable capital erosion. Dhaman has a demonstrable track record of recovering non-commercial losses from its member governments. We note that all member countries agreed in April 2013 to raise paid-in capital in 2013 by 36%, with further annual injections up to 2017.

Liquidity will continue to be very strong, but will diminish in absolute terms as transaction volume rises. We estimate Dhaman's liquid assets cover 97% of outstanding commitments at Dec. 31, 2012 (2011: 78%). The strength of 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. We view Dhaman's financial flexibility as strong, reflecting the membership and committed support of GCC states, which combined hold 22% of total capital at the end of April 2013.

Outlook

The outlook is stable. We believe 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.

Should pressure on the rating begin to emerge, it would likely first develop in the SACP, as the rating is not dependent on any callable capital. The SACP on Dhaman could weaken if management--contrary to our expectations--adopts more aggressive capital utilization policies, or if the insurance activities generate operating losses, or if members cease supporting Dhaman, either as a member state or as preferred creditor.

Stand-Alone Credit Profile: 'aa'

We assess Dhaman's stand-alone credit profile (SACP) at 'aa'. This assessment combines our opinion that both Dhaman's business profile and financial profile are "very strong" as defined by our criteria.

Business Profile: Very Strong

In our opinion, Dhaman has a very strong business profile. This opinion is based on our assessment of (i) Dhaman's policy importance to shareholders and (ii) Dhaman's governance and management expertise.

Policy Importance

Standard & Poor's assesses Dhaman's business profile as very strong. Our assessment is based on our view of Dhaman's strong role, very strong public policy mandate, and very strong and stable relationship with shareholders and adequate preferential creditor treatment (PCT). We also view the agency's governance and management expertise as strong.

- While we believe the private trade credit insurer sector has the ability to fulfill Dhaman's role, our assessment of the agency's role as strong reflects the effective absence of such entities operating in Dhaman's target geographies and attaching lines of business. Dhaman has preferred access to such risks through its supranational status.
- Dhaman's very strong public policy mandate reflects its operational track record of almost 40 years, and its mandate to facilitate development of Arab states' economies. Dhaman was created in 1974 as a supranational political (investment) risk insurer and export credit guarantee provider with a mandate to facilitate the development of Arab economies.
- Dhaman was established by a convention signed by all Arab states and has no history of shareholder withdrawals, so we are able to assess its relationship with shareholders as very strong and stable. GCC states own 22% of Dhaman directly, and other pan-regional Arab funds (in which GCC stares are key shareholders) own 53%. In addition, the agency is exempt from paying any corporation or income taxes and is not currently permitted to pay dividends.
- In our opinion, Dhaman has a track record of generally benefiting from PCT, and we expect this to remain so.

Governance And Management Expertise

With regard to Dhaman's management & governance expertise, we note the following strengths:

- No private sector shareholding.
- Senior staff with considerable expertise and experience, and in sufficient numbers that key-person risk is not material.
- Strong financial policies. Dhaman can distribute no dividends until retained surpluses (currently only 39% of subscribed capital) are at least 3x paid-up capital, and are then limited to 10% of annual profits. In addition, the expectation of additional capital support from member states in 2013/2014 further limits the likelihood of dividend payments in the medium term.
- Adequate risk management policies demonstrating clear risk appetites and tolerances, with effective risk controls for its underwriting and investment activities. Dhaman has an established internal risk assessment process for both commercial and noncommercial business that monitors client and country risks. Current systems automatically monitor and flag country/client accumulations, and reject any nonapproved clients, or those who exceed limits.

Dhaman is a specialist underwriter of political (investment) risk guarantees and export credit insurance to the Arab world, sourced from the private sector. Dhaman's mandate is to support the social and economic development of Arab nations, particularly the less economically strong member countries, with no operational emphasis on either minimum profitability or market share. The ultimate beneficiaries of Dhaman's business are its member countries, both directly (as owners of Dhaman) and indirectly (as sources of business and thus regional economic development). Standard & Poor's believes that its supranational ownership and the support available to Dhaman are real competitive advantages, and serve to support its financial strength.

Table 1

Dhaman -- Sources Of Business					
	2012	**2011**	**2010**	**2009**	**2008**
Investment guarantee risk (%)	11	21	36	16	53
Export credit risk (%)	89	79	64	84	47
Gross annual contract exposure ($ mil.)	1,723	1,441	1,198	701	1,076
Growth (%)	19.6	20.3	70.9	(34.9)	113.1
Total adjusted shareholder funds ($ mil.)	326	318	318	303	309
Capital utilization multiple	5.29	4.53	3.77	2.31	3.48

The compound annual growth rate in total insured contracts has been 28% per year since 2006, but the nature and scale of Dhaman's investment guarantee business makes for a naturally lumpy flow. 2012 was under target because of the decline in insurable investment risks but Dhaman has been able to increase the volume of short-tail (up to one year cover) export credit and letter of credit confirmation insurance. Dhaman also reinsures credit risk from national export credit agencies and, while relatively limited in volume, expects this to increase as more ECAs are established across the target region.

Claims deriving from noncommercial political (investment) risks are fully recoverable from the respective member state, with Dhaman effectively acting as funds flow manager. There is no theoretical insured loss risk, but a potential credit/timing risk from non- or delayed recovery. Commercial risks and inwards reinsurance losses are for Dhaman's account and protected in part by appropriate reinsurance.

Dhaman's current maximum annual contract commitment was raised by members in 2008 to a cap of 10x (2007: 7.5x) net worth, which they do not expect to reach until after 2015. However, Dhaman's management works to a maximum annual commitment ceiling of 7.5x capital, which we view as an appropriate and conservative level of commitment control, in line with our capital adequacy modeling. Dhaman's business mandate exposes it to less economically and politically secure states, so there is some execution risk in its business expansion plans. However, we consider the company's commitment control limits as very conservative, particularly relative to comparable capital/commitment leverage ratios maintained by private-sector credit insurance sector companies.

Dhaman's potential commitment to each member country is ordinarily limited to a country ceiling equivalent to the institution's paid-up capital. This ceiling can be expanded to the institution's net worth under extraordinary circumstances. This acts as an effective limit to potential irrecoverable loss that is within the company's ability to absorb. We note that outstanding commitments at the end of 2012 of US$418 million are more diverse by country than at December 2011. Only the commitments to Algeria (19%), Sudan (15%), Egypt (12%) and Syria (10%) exceeded 10% in value, over more than 22 countries. The other countries therefore averaged below 3% share of gross commitment, giving a simple average territory commitment of less than 5% of shareholder funds.

Dhaman continues to work with its member states to establish more country-specific ECAs (backed by the relevant government) in which it may consider both a minority shareholding and underwriting interest. An example is its 25% holding of Cotunace (Tunisia) since 2009. While Standard & Poor's does not foresee great advances in this area, in the longer term we expect Dhaman's commercial risks business focus to shift somewhat toward reinsurance of Arab region domestic ECAs, as well as continuing as primary underwriter for such risks.

Enterprise Risk Management: Adequate

Dhaman's ERM framework is adequate. It shows clear risk appetites and tolerances with effective risk controls for its underwriting and investment activities. Underwriting controls are to preset country-commitment and overall capital limits, system-monitored in accordance with convention. Investment returns are monitored against benchmarks both internally and by Dhaman's external advisers. The company is not directly exposed to property catastrophe loss events. All business is monitored on an individual transaction basis. There is limited use of aggregate risk modeling; however, the company is working with advisors to develop a capital modeling application to better cope with the growing operational scale, and to optimize capital leverage.

Accounting And Financial Reporting

Dhaman is a supranational government-owned entity, and reports under IFRS. Its financial statements follow accepted insurance company norms for presentational style. Ernst & Young are the external auditors (appointed on a five-year rotation) and Dhaman's internal audit team liaises with KPMG over ongoing enhancements to its activities. Standard & Poor's considers the financial disclosures made to it as wholly sufficient to support its analysis.

Financial Profile: Very Strong

We assess Dhaman's financial profile as very strong. This reflects very strong capitalization, very strong liquidity, strong investments, and strong financial flexibility.

Table 2

Dhaman -- Contract Exposure And Loss Ratios

	2012	2011	2010	2009	2008
Gross annual contract commitments ($ mil.)	1,723	1,441	1,198	701	1,076
Gross premium ($ mil.)	4.9	4.9	5.0	3.4	3.0
Claims settled ($ 000s)	0	73	36	30	370
Total shareholder funds ($ mil.)	326	318	318	303	309
Capital utilization multiple	5.29	4.53	3.77	2.31	3.48
Contract loss ratio	0.00	0.01	0.00	0.00	0.03
Gross losses as % of capital	0.00	0.02	0.01	0.01	0.12
Gross loss ratio as % of premiums	0.00	1.80	0.71	0.90	8.90

Capitalization

Dhaman has very strong capitalization, which we expect it will maintain. This reflects extremely strong risk-based capital adequacy and very high quality of capital. A key influence in our assessment of capital strength is the capital utilization mandate set within Dhaman's convention of a maximum of 10x, and the 7.5x internal limit currently employed. The balance sheet will remain debt free, as Dhaman is not permitted to use debt finance, so earnings will bear no debt servicing strains. Because of the scale of balance sheet assets relative to the underwritten risks, the quality of capital does reflect a measure of sensitivity to asset pricing volatility. We do not expect shareholder funds to decline by more than 10% in any one year, before adjusting for any new capital injections.

Capital adequacy

Standard & Poor's assesses Dhaman's capital adequacy as extremely strong. Dhaman's gross annual commitments underwritten in 2012 for all lines of business were US$1,723 million (2011: US$1,441 million), relative to net equity of $326 million, giving capital utilization of 5.3x. At this level Standard & Poor's assesses capital as extremely strong relative to gross commitments. That is, before (a) any recoveries from member states on non-commercial business (some 11% of overall 2012 portfolio) and (b) any reinsurance recoveries. Dhaman's business plan to 2015 envisages contract commitments growing to approximately US$1.8 billion. Assuming zero growth in shareholder funds at Dec. 31, 2012, this would give capital leverage of 5.5x, still well within the current mandate.

We have modeled capital adequacy to a gross commitment loss ratio of 4% of annual commitments, some 2.4x the highest commitment loss ratio suffered in 12 years by the company. Assuming a maximum capital utilization of 10x, we estimate the uncharged capital in our model at the 'AAA' redundancy level would equate to a commitment loss ratio of 7.65%. This compares to a 12-year average loss ratio of 0.5%, and a high (in 2001) of 1.7%. At 7.65%, the incurred loss, before any recoveries due from reinsurers or member countries, if a non-commercial risk, would be equivalent to a maximum loss of 3x the two largest outstanding commitments (to Algeria and Egypt) at Dec. 31, 2012.

Reserves

Dhaman's commitments are to finite individual contract loss values, therefore any claims are readily determined. Its approach to reserving is satisfactory in view of its business objectives. Prudential loss event reserves are currently kept (about US$3 million) and the levels of capital and liquidity give strong support to absorb loss volatility.

Reinsurance

Dhaman's reinsurance program is considered prudent, and is designed to protect all business written from volatility. Dhaman's protection is led by strongly rated reinsurers and Lloyd's syndicates. It is a 50% quota share treaty for all risks accepted by Dhaman over $1 million, and facultative reinsurance is taken for selected risks. Under the quota share treaty, limits for banks' risk have been raised from $2 million to $20 million in 2013.

Investments

We view Dhaman's investments as strong, comprising a geographically and industry diverse portfolio of bank deposits, bonds, and equity funds. Although the diversity of bank counterparties is very limited, with the bulk of cash deposits held at one Kuwait bank, we recognize the presence of an active government guarantee (from Kuwait) on deposits held at the bank. Overall, 59% of total investments at Dec. 31, 2012 were in instruments that benefit from active support of governments rated in the 'AA' range. Investments in equity/fixed interest/real estate funds are managed by international banks with predominantly high ratings. In 2012, Dhaman's investment portfolio grew in value by 4.4%, with a shift in mix from equity funds (down 11%) to cash deposits (up 33%), thereby further reducing pricing volatility at the expense of yield points.

Investment strategy

Dhaman's over-riding investment strategy is to maintain a stable and growing portfolio to support the liquidity demands of the underwriting business. Funds are invested internationally to reduce Arab-region correlations with their core insurance business. The portfolio structure is designed to deliver a specified return and volatility profile and is regularly reviewed for performance against these expectations.

Table 3

Dhaman -- Investment Portfolio Weightings

	Actual Distribution	Actual Distribution	Target	Range
(%)	Dec'12	Dec'11		
Cash	25.0	34.2	12.5	12.5-65
Fixed Income	16.0	21.6	30.0	10-35
Equities	44.0	20.0	12.5	0-17.5
Real estate	5.0	7.1	5.0	0-25
Alternative	10.0	17.1	20.0	0-25
Opportunistic	0.0	0.0	0-20	0-20
Total	100.0	100.0	100.0	

Market risk

We assess market risk as moderate. The portfolio comprises a diverse mix of international equity and interest funds, with no sector/entity concentrations. Dhaman's capital utilization controls fully recognize the impact of asset pricing volatility.

Credit risk

We view credit risk as low-to-moderate, reflecting the government guarantees on deposits at certain Kuwaiti banks. Capital adequacy is very resilient to credit strain, particularly in view of Dhaman's government ownership and expected (and demonstrable) PCT.

Operating Performance

We do not consider Dhaman's earnings to be a key ratings driver. Dhaman expects to deliver a return broadly in line with inflation and at least preserve capital. No core profit targets are set by the investing member countries and no dividends will be paid in the medium term. The key metric for Dhaman is therefore business development and trade value added through its activity, rather than profit measures. Surpluses will be used to reinforce capital to support growth.

Earnings in 2012 showed a return on equity of 1.4% (2011 1.8%) and a return on assets of 1.3% (2011 1.7%). This reflected the change in average risk pricing for the current business mix, where short-tail risks now outweigh longer tail. Salient points were operational costs of Kuwaiti dinar (KWD) 2.5 million (2011: KWD2.5 million), covered by net insurance revenues of KWD0.6 million (2011: KWD1.5 million) and net investment returns of KWD3.1 million (2011: KWD2.6 million), giving a net surplus of KWD1.3 million (2011: KWD1.6 million). As required, the investment portfolio delivered returns to fully cover net costs, although not at the level targeted. Standard & Poor's expects Dhaman to be profitable in 2013, subject to unpredictable claims, with investment returns covering operating costs.

Funding And Liquidity: Extremely Strong

We view liquidity as extremely strong. Total outstanding contractual commitments at Dec. 31, 2012 were KWD98 million (37% investment, 63% export credit) and bank deposits covered 51% before any recoveries from member states (on investment business) and/or reinsurance. In the medium term, liquidity cover to potential liabilities is likely to reduce, as business volume increases to target levels, but remain at least very strong and supportive of the rating. Dhaman bears no collateral posting risk in its insurance or investment operations.

Financial flexibility is considered strong and a rating strength. Key member state shareholders are all rated highly by Standard & Poor's and have demonstrated their ability and continuing willingness to support Dhaman's development. Standard & Poor's believes the internal control framework limits the need for corrective capital support. There is a track record, albeit limited, of recovering losses on political risks from relevant member governments. Also, where underwritten commitments to member states exceed Dhaman's normal limits, it can demonstrate the willingness of member states to engage in special fund management and guarantee arrangements with Dhaman to finance business expansion.

Likelihood Of Extraordinary Shareholder Support

We note the agreement in April 2013 for all member countries to inject new capital to Dhaman in the years up to 2017, however we incorporate no uplift from extraordinary shareholder support into our 'AA' ratings, since all subscribed capital is currently fully paid-in.

Related Criteria And Research

- Principles Of Credit Ratings, Feb. 16, 2011
- Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Interactive Ratings Methodology, April 22, 2009
- Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010

Ratings Detail (As Of April 30, 2013)	
Operating Company Covered By This Report	
The Arab Investment and Export Credit Guarantee Corp.	
Financial Strength Rating	
Local Currency	AA/Stable/--
Counterparty Credit Rating	
Foreign Currency	AA/Stable/--
Domicile	Supranational

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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