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The Arab Investment and Export Credit Guarantee Corporation

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Major Rating Factors

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

Strengths:

- Very strong capitalization
- Strong financial flexibility
- Strong liquidity

Weaknesses:

- Industry and economic risks from an under-developed market

Rationale

The ratings on Kuwait-based The Arab Investment and Export Credit Guarantee Corporation (Dhaman) reflect its very strong capitalization, strong financial flexibility derived from its status as a supranational entity, and strong liquidity. A constraint on the ratings is the undeveloped nature of the credit insurance market in the region. Dhaman's key objective is to promote both the flow of Arab investments among member countries and Arab exports worldwide.

As is typical of highly rated supranationals, Dhaman is very strongly capitalized, with very high quality of capital, and no debt finance. Current capital adequacy is extremely strong, with net worth on Dec. 31, 2008 equivalent to 29% of total annual gross insured exposure. We expect capitalization to remain very strong, although it will weaken over time as transaction volume grows.

Dhaman has strong financial flexibility, reflecting its supranational status. The ultimate beneficiaries of its core business activities of political (investment) risk insurance and export credit guarantees are its member government states. Sovereign ratings on the six Gulf Cooperation Council (GCC) countries range from A/Stable/-- to AA-/Stable/--. These countries held 22% of the company's shares directly, and sovereign-owned pan-Arab funds held 53% at year-end 2008. Standard & Poor's Ratings Services expects Dhaman's members to respond to future capital and liquidity needs. Dhaman's ability to demonstrate favorable creditor status in its shareholder relationships helps it recover claims from some of its less creditworthy clients and member states.

At year-end 2008, available liquid assets covered almost 68% of gross outstanding insured exposures (90% in 2007), which is an extremely strong level of cover. This will continue to decline as business volume increases, but will remain strong.

The rating is, to some extent, constrained by the immaturity of Arab region trade markets for the company's services as a political and export credit risk insurer. The potential for adverse economic conditions in some of the target (shareholder) markets is balanced by the structures within Dhaman's convention that provide supranational support and loss recovery.

Outlook

The stable outlook reflects Standard & Poor's expectation that Dhaman will continue to be very strongly capitalized as business volume increases, meeting its primary goal of servicing Arab regional economic growth. It will continue to benefit from shareholder support. Although not a key factor in the rating, the company will use its adequate profitability to support its expansion. Liquidity will continue to be strong and will be reinforced in 2009 by the receipt of outstanding moneys from member countries, but we expect liquidity strength will diminish in the medium to long term as transaction volume rises.

Negative rating action could follow any wavering of shareholder support, or ability, to provide financial flexibility resulting in material weakening of capital adequacy or liquidity. Positive rating action is unlikely in the medium term.

Corporate Profile: Kuwaiti-Based Supranational Investment And Export Credit Guarantee Insurer

Dhaman was created in 1974 as a supranational political (investment) risk insurer and export credit guarantee provider. Its membership comprises all Arab states and certain international Arab organizations, themselves backed by Arab governments in a normal shareholding structure.

Dhaman offers protection for trade and investment flows amongst and from its Arab nation members:

- Noncommercial (investment/political) risk protection (49% exposures in 2008; 3% in 2007);
- Commercial (export credit whole turnover, including inwards reinsurance) insurance (51% exposures in 2008; 97% in 2007);

Claims deriving from non-commercial risks are fully recoverable from the respective member state, with Dhaman in effect acting as funds flow manager, with 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 key role is the encouragement of investments and trade amongst the Arab member countries through its risk management activities. Dhaman also offers protection for exports to non-Arab countries, which in 2008 contributed 23% to gross transaction volume.

At Dec. 31, 2008, GCC states owned 22% (23% in 2007) directly and other pan-regional funds (in which GCC states are key shareholders) 53% (53% in 2007). Dhaman's maximum contract exposure was raised to a cap of 10 times (7.5x in 2007) paid-up capital, which level of business is not expected to be reached until beyond 2012, that is, not in the current rating horizon. Dhaman's exposure to each country is ordinarily limited to a country ceiling equivalent to the institution's paid-up capital. This ceiling can be extraordinarily expanded to the institution's net worth. This acts as an effective limit to potential irrecoverable loss that is within the company's ability to absorb. At that level of capital utilization it is on a par with the likes of peer organizations such as the Multilateral Investment Guarantee Agency (MIGA).

Industry & Economic Risk: Under-Developed Risk Markets

Dhaman's risk matrix derives from the Arab community, ranging from the economically secure, politically stable, and strongly rated GCC region, through the North African region and the less politically stable and economically robust Saharan/sub-Saharan countries. This broad region is substantially under-developed for Dhaman's target risk areas. The rating impact of this under-developed status is mitigated by Dhaman's role in sponsoring cross-regional trade, the implicit backing by member governments, and the lack of a profit imperative in developing Dhaman. Dhaman can demonstrate preferred creditor treatment in its dealings with member countries, under which collateral has been provided for exposure above the levels permitted by Dhaman's membership convention.

Management and Corporate Strategy: A Clear, Focused Strategy

Dhaman's management team has a clear, focused strategy to develop and expand the company's operations across the Arab world. Management has a record of business development and problem resolution within Dhaman, as demonstrated in its favorable negotiation of long-outstanding recoveries from member states.

Its medium-term plan remains to expand the covered gross risk exposure of $1 billion annually by 2014. This gross target amount equates to 3.5x multiple of December 2008 net worth ($309 million), and contrasts with the internal operating target of 7.5x (despite approval to write to a maximum exposure multiple of 10x, set in 2008). Though there is significant execution risk in its business expansion plans, Standard & Poor's views the current actual and medium term exposure limits as conservative.

Dhaman's goal is to promote the flow of investments within the Arab countries, to enhance inter-Arab trade, and Arab countries' exports across the world. This goal is met through its strategy of:

- Controlled expansion of both commercial and non-commercial credit risk portfolios across the region;
- Assuming the leading role in an organization of Arab Export Credit Agencies (ECA), including shareholdings therein;
- Raising the capital base sourced from the member countries/institutions as well as profit retention.

Since 2004, Dhaman has provided commercial underwriting to cover Arab exports to non-Arab states, having previously covered only intra-Arab region exports. Dhaman plans to work with sponsor governments to establish more country-specific ECAs (backed by the relevant government) in which it will take both a significant minority shareholding and underwriting interest. Thus, its business focus for commercial risks will shift somewhat to being a reinsurer of risk in the medium term, as well as primary underwriter for such risks.

Dhaman will remain a supranational, government backed corporation. No dividends will be paid to shareholders until retained surpluses are at least 3x the level of paid-up capital. Paid-up capital in December 2008 contributed 65% (53% in 2007) of total net worth and the 3x level is a medium term target, at best.

Operational management

This is satisfactory for the current operational scale, and Dhaman is investing in it to cope with the targeted increase in flow of commercial (risk-bearing) business. Dhaman has an established risk assessment process for both commercial and non-commercial risks, with monitoring of client and country risks. As well as in-house systems developed through its membership of the Berne Union, it takes risk pricing input from Coface (rated A+/Stable) and its key reinsurers, which currently include Atradius Reinsurance Ltd (rated A-/Watch Neg) and Nationale Borg (rated A-/Stable). Current systems automatically monitor and flag country/client accumulations, with rejection of any nonapproved client business, or limit excess. Dhaman's risk pricing considers (i) country risk factors and (ii) credit term/concentration risk features. Its lawyers monitor all contracts.

Structurally, Dhaman operates on a profit centre, market-focused platform with staff remunerated on a performance-related basis. In implementing operational controls and strategy, Dhaman has sought input from third party consultants such as Mercers (investments), members of the Berne Union, and a London-based consultancy.

The internal audit team conducts its work in cooperation with the external auditors (currently KPMG) and reports directly to the board.

Financial management

Dhaman's financial management is considered adequate for its largely political focus, which is thus focused on volume, rather than profit. The earnings targets for 2008-2010 are to deliver a return on assets of 2% rising to 4% and a return on revenues (net operating income/total revenues) of over 50%. Business growth to 2012 is targeted at 15% per year, and the underwriting loss ratio projections are set at 4% for the five years 2007-2012, before any recoveries for noncommercial business. Despite the adverse impact on investment values and returns suffered in 2008, management has not altered these earnings targets. Standard & Poor's views these targets overall as practical and achievable, but recognizes the potential for high volatility inherent in the credit business.

Competitive Position: Specialist Niche Political Risk Guarantee And Export Credit Guarantee Insurer

Dhaman has a specialist niche competitive position in the provision of political risk guarantee and export credit insurance. It operates in a region still largely undeveloped for insurance risk; its transaction volume is both small and concentrated in terms of client and sector risk, and is constrained by a lack of product awareness. Nevertheless, with a strategy that is fundamentally politically driven, the relevance of the competitive position in sustaining a healthy, financially secure franchise is low. This is particularly so where the ultimate beneficiaries of Dhaman's business are the member countries both directly (as owners of Dhaman) and indirectly (as sources of business and thus regional economic development).

Table 1

Sources Of Business

	2008	2007	2006	2005
Investment guarantee risk (%)	49.0	3.0	23.0	N.A.
Export credit risk (%)	51.0	95.0	77.0	N.A.
Special accounts (%)	0.0	2.0	0.0	N.A.
Gross annual contract exposure (mil. $)	1019.7	505.2	422.3	303.5
Total adjusted shareholder funds (mil. $)	309	350	330	296
Multiple (x)	3.3	1.4	1.3	1.0
Capital exposure ratio (%)	28.70	69.30	78.10	97.50

N.A.--Not available.

Dhaman is planning to increase its operations by:

- Expanding guarantee business to include letters of credit, construction works, pre-shipment, BOT and BOOT contracts;
- Establishing an investment fund to participate in private investment projects and organize an active market for such projects and provide guarantees;
- Factoring;
- Establishing a credit information exchange/network for Arab ECAs;
- Developing and managing debt recovery systems for member countries' ECAs.

All of these activities will reinforce Dhaman's role as promoter of economic regional development and further the diversity of its income streams, but this is inevitably dependant upon the prosperity of the service providers being insured.

Enterprise Risk Management: Adequate For The Current Operational Requirements

We consider Enterprise Risk Management to be adequate for the current operational requirements. Though we do not consider it a key rating factor for Dhaman, the company is investing in risk management techniques to support both its expansion plans and ensure greater recognition of the need for conscious risk monitoring across the company as it grows. The company does not currently employ strategic risk management (optimization of profits relative to capital resources), but a separate management committee is exploring it.

Key risks are those from (i) its commercial underwriting covers, which are expected to form the bulk of business, exposing the company to potential claims, and (ii) credit risk from claims recoveries for non-commercial risks due from member countries.

The company controls investment risks by using securely rated bank counterparties and diverse (rated) investment funds. Although geographic concentration in the Arab region is inevitable, the bulk of investments are in, or managed by, securely rated banks and funds.

The company supports its risk management by using experienced outside consultants, such as Mercers, particularly to reduce volatility of the investment platform.

Accounting & Financial Reporting: Supranational Not Required To Adopt International Insurance Accounting Standards

As a supranational government-owned entity, Dhaman is not required to adopt any international insurance accounting standards. Though it has adopted IFRS, the presentational style of the financial statements does not follow insurance company norms. And though it has a clean audit opinion (KPMG five year rotation), the accounts fall well short of expected insurance company disclosures for technical reserving and technical underwriting reporting. Its internal audit team, which reports to the board, liaises with KPMG over ongoing enhancements to its activities.

Before 2006, accounts were qualified over uncollected member state recoveries, but are now unqualified following implementation of a recovery program. In December 2008 member state receivables were $75.7 million, ($70.4 million in December 2007) and 22% (18% in 2007) of total assets. Dhaman has a negotiated full recovery program for these sums which are expected to be received in 2009.

Operating Performance: Though Poor In 2008, Not A Ratings Driver

Dhaman's earnings are not considered a key ratings driver. As a supranational institution, no profit targets are set by its member countries and no dividends have been, or are expected to be, paid in the medium term. The key metric for Dhaman is therefore business development and trade value added through its activity, rather than returns on equity, or returns on revenue. Earnings will be used to reinforce capital to support growth.

Earnings in 2008 did not meet expectations, however, with a net deficit for the year of $34.2 million ($14.4 million profit in 2007) adversely impacted by investment value losses of $32.4 million ($1.4 million losses in 2007) and foreign exchange losses of $5.8 million (2007 marginal loss). Standard & Poor's expects earnings to be profitable in 2009, with a recovery in real investment returns providing sufficient cover to net underwriting costs.

Investments: Strongly Rated, Geographically And Industry Diverse Portfolio

Dhaman investments are strongly rated, comprising a geographically and industry diverse portfolio of bank deposits, bonds and equities/funds. Nevertheless, 2008 was marked by significant asset valuation falls. At Dec. 31, 2008, total investments were $245 million, compared with outstanding gross commitments of $396 million, which Standard & Poor's believes is a very prudent level in view of the company's past insured loss experience and its targeted loss ratio of just 4% of exposures. Bank funds are invested across regional banks, with 93% of cash/deposits in banks rated 'A–' at year-end 2008.

Though a substantial proportion of investments are held in managed funds, these comprise global portfolios and capital adequacy has proved sufficiently robust to absorb significant fair value volatility in 2008.

Mercer Consulting advise on a investment portfolio strategy for Dhaman to reduce potential volatility and concentration risk (see below). Noncash/bank investments are in funds also managed by international banks with predominantly very strong ratings. Although there is some exposure to poorly/unrated sovereign states, these are also paid-up investors in Dhaman.

Investment strategy

Dhaman's investment strategy is to maintain a stable and growing portfolio to support the liquidity demands of the underwriting business. The portfolio weighting has been developed with assistance from Mercer Consulting and targets this mix to deliver a return of LIBOR plus 200 basis points with a volatility of no more than 4%. Other than for 2008, the historic investment return has largely met these targets. However, the current weakening of global economies means Dhaman will remain overweight in cash for the medium term, or until greater stability returns to the investment markets.

Market risk

Market risk is assessed as relatively high, reflecting fair value losses suffered in the depressed economic climate of 2008. The investment mix is primarily in international funds, and is currently overweight in cash. Though moving to the target asset mix will raise market risk, the capital resources of the entity should be able to absorb likely volatility without impeding business development.

Credit risk

Dhaman's credit risk is considered low, reflecting a diverse counterparty portfolio of predominantly strongly rated regional banks, largely focused on the GCC member states. Capital adequacy is resilient to likely credit strain, particularly in view of the diversity of counterparties used, the government ownership and expected preferred creditor treatment.

Liquidity: Very Strong

Liquidity is very strong. As noted above, on Dec. 31, 2008 available immediate liquid assets represented 68% of total outstanding underwriting commitments. Over the long term, Dhaman has been cash flow positive, when recoveries from member countries are included, but capital raising excluded. Looking to the medium term, the quantum of liquidity cover is likely to reduce as business volume increases to target levels, however, during 2009 Dhaman expects to receive $55 million from two member countries in respect of long-outstanding loss recoveries, and this will further boost liquidity.

Capitalization: Very High Quality Of Capitalization And Extremely Strong Risk-Based Capital Adequacy

Table 2

Financial statistics

	2008	2007	2006
(Mil. KWD)			
Gross annual contract exposure	281.9	138.2	122.3
Outstanding contract exposure	109.6	198.9	134.2
Total adjusted shareholder funds	85.4	101.9	93.4
Cash	20.3	19.1	20.8
Investments at fair value	11.5	17.4	23.6
Investments available for sale	36	43.5	29.5
Total investments	67.8	80	73.9

KWD--Kuwaiti dinar.

Dhaman currently has very strong capitalization, reflecting the very high quality of capital and extremely strong risk-based capital adequacy relative to the risk volumes insured through the rating horizon. Though this strength will reduce as insured volumes increase and the business development plan is achieved, Standard & Poor's expects it to continue to be a key support for the rating. Dhaman is not permitted to use debt finance. Net worth weakened in 2008 by 17% as a result of asset value losses, but capitalization remains very strong.

Our assessment of capital also reflects the nature of Dhaman's membership which has demonstrably offered strong financial flexibility (see below) to support the entity, both as its business activity expands, and in recovering past losses. The balance sheet will remain debt free, so earnings will suffer no strains from debt servicing costs.

Capital adequacy

Based upon its 2008 net worth, relative to maximum forecast exposures, Dhaman's capital adequacy is extremely strong. Dhaman's gross annual exposure (i.e. the total commitments underwritten) in 2008 for all lines of business was $1.020 billion relative to net equity of $309 million (capital utilization of 3.3x) at which level capital is extremely strong relative to gross exposure, i.e. before (a) any contractual recoveries from member states on non-commercial business (some 47% of overall 2008 portfolio) and (b) reinsurance recoveries from the 50% cession of commercial risks (53% of the 2008 portfolio).

Dhaman's convention was revised in 2008 to set its maximum gross underwritten exposure to 10x paid-up capital, but the operated target for the medium term is set at no more than 7.5x. Maximum exposure to each member country is limited to the extraordinary country ceiling (equal to the institution's net worth) while the ordinary country ceiling is the institution's capital only; in all cases the maximum single country exposure cannot exceed 50% of total exposure covered by Dhaman at any one time.

On Dec. 31, 2008, Dhaman had gross outstanding underwritten exposure (i.e. outstanding contracts which could result in loss) of $396 million, relative to a capital base of $309 million and so was able to withstand 78% failure of all outstanding risks at that year end, or well in excess of the maximum 100% loss of gross export credit risks, before calling upon its membership recoveries facility for any noncommercial risks and commercial risk reinsurance. We believe this to be a prudential level of capital.

Although there is some asset risk resident from investments and uncollected member calls, we believe the potential strains from these are controlled and within Dhaman's ability to absorb without meaningful capital strain.

Reserves

Dhaman's exposures are to finite loss values, thus any claims are readily determined, and its approach to reserving is satisfactory in view of the business objectives. Nevertheless, the company only recognizes claims upon agreement of the payment value, and carries no formal reserves in its balance sheet. The business rationale for nonrecognition of claims is to reinforce member state recoveries.

Reinsurance

Dhaman's reinsurance program is considered prudent in value terms, but lacks participant diversity. It is designed to protect volatility on the export credit/inward reinsurance business only. Dhaman is only at risk of loss from its commercial (export turnover) risks, and cedes 50% of this risk through its treaty program. In 2008 Dhaman's treaty set a single-buyer limit of $750,000, negotiable up to $4 million by specific reference to the participating reinsurers--rated 'A' range by Standard & Poor's. Facultative reinsurance is taken for selected risks. No reinsurance is needed for the noncommercial account as losses are expected to be fully recovered from member countries. For 2009, Dhaman is in the process of negotiating reinsurance treaties in the international markets.

Financial Flexibility: A Key Strength For The Rating

Financial flexibility is considered strong and a key support to the rating. Standard & Poor's rates the key government shareholders at least strong ('A' range) and considers they have demonstrable ability and willingness to support Dhaman. In 2008 paid-up capital rose to KWD55.5 million ($201 million) from KWD54.0 million, following full payment of outstanding balances from existing members, except Palestine.

Where underwritten exposures to member states exceed Dhaman's normal limits, it can demonstrate the willingness of governments to deposit funds with Dhaman to finance expansion. Dhaman was also able to negotiate a settlement program with two member governments to clear losses deriving from many years ago and expects to receive full settlement of $55 million in 2009.

Ratings Detail (As Of April 20, 2009)*	
Operating Company Covered By This Report	
The Arab Investment and Export Credit Guarantee Corporation	
Financial Strength Rating	
Local Currency	AA-/Stable/--
Counterparty Credit Rating	
Foreign Currency	AA-/Stable/--
Domicile	Kuwait

*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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