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Research Update:

African Trade Insurance Agency 'A' Rating Affirmed; Outlook Remains Stable

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Overview

- In our view, market penetration and an expanding shareholder base over the past few years points to the African Trade Insurance Agency's (ATI) continued consolidation of its role and relevance on the African continent.
- Despite a recent reduction of sovereign arrears, past episodes of sovereign arrears constrain our view of ATI's preferred creditor status, and commercial arrears have increased recently.
- We are subsequently affirming our 'A' issuer credit rating and financial strength rating.
- The stable outlook reflects our expectation that over the next two years, ATI's preferred creditor status will stabilize with no significant sovereign arrears accruing. Additionally, we expect ATI will continue consolidating its role and relevance on the continent through steady progress expanding its shareholder base and underwriting activities.

Rating Action

On Aug. 27, 2018, S&P Global Ratings affirmed its 'A' issuer credit rating and financial strength rating on the African Trade Insurance Agency (ATI). The outlook remains stable.

Rationale

The ratings on ATI reflect our view of its strong business profile and adequate financial profile. Combined, these factors result in a stand-alone credit profile (SACP) assessment of 'a'. ATI does not benefit from any mechanism for extraordinary shareholder support; therefore we equalize our ratings on the agency with its SACP.

Established by treaty in 2001, ATI supports trade and investments in African member-state nations by providing comprehensive risk solutions such as political risk insurance (PRI) and commercial insurance products.

ATI's growing shareholder base reinforces the agency's role and public policy mandate, underpinning our view of its strong business profile. This is reflected by increased market penetration and membership growth, as well as strong ties with key multilateral development banks.

Gross exposure has grown rapidly, increasing by 23% in 2017 to $2.4 billion, compared to $872 million in 2013. The bulk of ATI's exposure comes from its political risk insurance products relating to sovereign payment obligations and pure political risk, which account for 59.9% of exposure, followed by the single obligor credit risk insurance product, accounting for 32.3% as of December 2017. While exposure remains highly concentrated (36% of gross exposure in Kenya alone), ATI reinsures a significant portion of its exposure and in 2016 began underwriting limited volumes of business in non-member countries, which has gradually supported the diversification of the portfolio.

ATI's expansion and relevance in the region is bolstered by its strong shareholder support. It currently has 23 paid-up shareholders, including the African Development Bank (AFDB), and its shareholder base has grown from seven initial member countries to 14 fully fledged member countries. In the past two years alone, Ethiopia, Côte d'Ivoire, South Sudan, and Zimbabwe joined.

We expect this momentum to continue over the medium term. Currently, ATI has approved the membership application for five prospective members, including Nigeria, which would open up access to West African markets.

In recognition of ATI's role as a catalyst in African economies, several multilateral institutions, such as the World Bank and the AFDB, will continue to offer unsecured concessional loans to eligible low-income African states to finance their acquisition of ATI shares. The European Investment Bank (EIB) has also agreed to financially support prospective members.

ATI's business profile is constrained by somewhat weaker preferred creditor treatment (PCT). ATI's statutes, as well as its participation agreement, confirms that sovereign members are responsible for reimbursing ATI for losses paid by the agency under its political risk insurance contracts. Nonetheless, during 2016 and 2017, ATI experienced growing sovereign arrears from four of its member governments. While most of these were subsequently resolved, the government of Tanzania continues to have an outstanding sovereign arrear with ATI for US$4.2 million, which was deducted from the country's capital contributions.

Following the rise in sovereign arrears, ATI has been proactive in reinforcing its preferred creditor status through a series of measures. Mandatory notifications and no objection requests for PRI transactions were introduced, as well as a sanctions regime involving interest charges on payment delays that exceed 180 days. Furthermore, ATI has worked to strengthen strategic partnerships with members, hiring a full-time membership liaison officer and actively engaging ministers of finance.

While ATI managed to contain sovereign arrears and stabilize its PCT--crucial to its business and competitive advantage over other insurers in the region--the agency experienced a rise in commercial arrears. In 2017, ATI recorded net incurred arrears of $5 million, compared to $1.6 million in 2016.

In part explained by larger underwriting volumes, these levels are commensurate with other private insurers operating in Africa.

We view the agency's governance as prudent and transparent. ATI has been reinforcing its underwriting standards and risk management with an international consultancy enabled by a grant from the EIB. In 2017, the board approved a revision to its credit risk framework and, notably, increased its maximum net exposure from 6x to 8x equity.

While we view this as in line with other peers, relaxing its risk limits to create additional underwriting capacity as a substitute for paid-in capital from new members or a general capital increase could point to weakened risk management standards and support from shareholders. Equally important, large dividend payouts--particularly given ATI's capital consumption trajectory--can, in our view, also weigh on our business profile assessment.

ATI maintains a strong capital and earnings assessment. ATI's capital and reserves are approaching $250 million, a threshold that currently constrains our capital and earnings assessment. Although ATI could lift above this nominal capital threshold, this is balanced by our view of ATI's evolving enterprise risk management framework--which we assess at intermediate--as the entity expands and increases underlying risk exposure.

ATI has plans to hire key personnel to support its risk management capabilities congruent with its growth trajectory. ATI recently hired a claims and recovery officer and is looking to hire more personnel in this area. In 2019, the agency expects to hire a compliance and risk officer. We view the full implementation of these functions as crucial to support a stronger capital and earnings assessment.

We view ATI's liquidity as strong. In our view, liquid assets will remain generously in excess of the likely and stressed claim outflow.

Outlook

The stable outlook reflects our expectation that over the next two years, ATI's PCT will stabilize with no significant sovereign arrears accruing, although we expect that the agency will continue to experience smaller arrears. Additionally, ATI will continue consolidating its role and relevance on the continent through steady progress expanding its shareholder base and underwriting activities.

We could raise the ratings if ATI significantly expands its shareholder base, supporting exceptional market penetration in the region, and maintains a solid record of PCT combined with strengthening key managerial and risk functions to support its growth. Capital injections from new shareholders will likely translate in increases to ATI's total adjusted capital well beyond US$250 million, which could support the rating as long as it is accompanied by substantial improvements to its enterprise risk management framework. This includes ensuring that key functions are in place, such as the compliance and risk officer, as well as internal risk management capabilities aligned with other insurers of similar size and scope.

We could lower the ratings if evidence of weakening shareholder support were to emerge, such as a re-emergence of diminishing preferred creditor status, indicated by sizable or prolonged arrears from sovereign members. Furthermore, ATI's role and ability to fulfil its public policy mandate could be constrained by significant delays in membership growth and paid-in capital installments, which, if not compensated by a general capital increase, could weigh on the rating. Also, relaxing risk constraints, without a more robust risk management framework in place, to support the underwriting business could also lead to a downgrade.

Related Criteria

- Criteria - Insurance - Specialty: Trade Credit Insurance Capital Requirements Under Standard & Poor's Capital Adequacy Model, Dec. 6, 2013
- Criteria - Insurance - General: Enterprise Risk Management, May 7, 2013
- Criteria - Governments - General: Multilateral Lending Institutions And Other Supranational Institutions Ratings Methodology, Nov. 26, 2012
- Criteria - Insurance - General: Refined Methodology And Assumptions For Analyzing Insurer Capital Adequacy Using The Risk-Based Insurance Capital Model, June 7, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed

African Trade Insurance Agency	
Issuer Credit Rating	A/Stable/--
Financial Strength Rating	A/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.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.