



## CREDIT OPINION

29 May 2019

### New Issue

### Rate this Research

#### RATINGS

##### The African Trade Insurance Agency

|                  |   |
|------------------|---|
| Domicile         | Kenya                                   |
| Long Term Rating | A3                                      |
| Type             | Insurance Financial Strength - Fgn Curr |
| Outlook          | Stable                                  |

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## African Trade Insurance Agency

New Issuer - Strong balance sheet and preferred creditor status offsets high-risk insured exposures

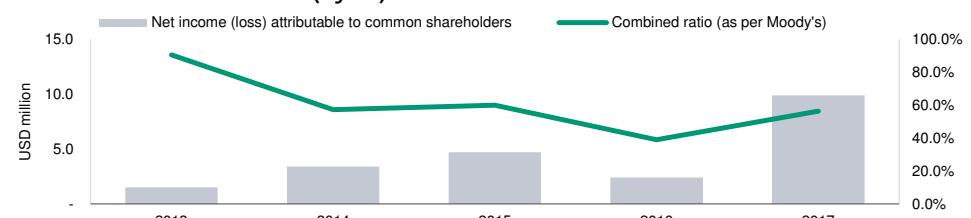
### Summary

The African Trade Insurance Agency's (ATI) A3 IFS rating reflects (i) its strong capitalization and liquidity relative to its insured exposures, (ii) high quality and conservative investment portfolio, (iii) strong relationships with a number of global reinsurers that provide significant risk-bearing capacity, (iv) good market position and reputation in originating credit and political risk insurance on a pan-African basis, and playing a key role in facilitating investment into Africa, and (v) strong underwriting profitability. In addition, Moody's noted that ATI benefits from preferred creditor status (PCS) with all of its member sovereigns, which moderates its exposure to defaults on a large portion of its portfolio. These strengths are partially offset by (i) the high risk nature of its insured exposures and the related weak operating environments, (ii) still developing risk management infrastructure and capabilities, and (iii) limited financial flexibility, given its lack of established access to capital markets and dependence on low-rated sovereign members for access to additional funding in case of need.

Being a development institution, ATI's primary focus is on facilitating investment into Africa, while pricing appropriately for the risk it assumes, and generating a sustainable return on its capital. In line with this development focus, ATI's return on capital has been relatively low, at around 2% on a five year average basis through 2017 – primarily due to its conservative capitalization. However, return on capital has been on an improving trajectory, with the metric above 4% in 2017 and 2018, which we expect will improve the five year average return on capital metric over time. ATI's strong combined ratio (around 67% of a five year average basis through 2017, and 47% in 2018, see exhibit 1) demonstrates the strength of ATI's underwriting and risk pricing capabilities.

Exhibit 1

### Net income & combined ratio (1 year)



Sources: Moody's Investors Service; Company Filings

## Credit strengths

- » Strong capitalization and liquidity relative to its insured exposures
- » High quality and conservative investment portfolio
- » Strong relationships with a number of global reinsurers
- » Good market position and reputation on a pan-African basis
- » Strong underwriting profitability

## Credit challenges

- » The high risk nature of its insured exposures and the related weak operating environments
- » Still developing risk management infrastructure and capabilities
- » Financial flexibility partially constrained by no established access to capital markets and reliance on member states for access to capital

## Rating outlook

The outlook for ATI is stable, reflecting its strong capitalization and track-record of underwriting profitability, along with its growing importance in facilitating investment into Africa.

## Factors that could lead to an upgrade

- » Increased membership base and participation by larger African countries, that results in higher capitalization and greater portfolio diversification
- » Continued demonstration of strong underwriting performance and ability to recover claims under the preferred creditor arrangements
- » Enhancement of ATI's enterprise risk management framework and capabilities

## Factors that could lead to a downgrade

- » An increase in net insured portfolio leverage to be consistently above 5x shareholders' equity
- » A sustained decrease in underwriting profitability, with combined ratios in excess of 90%
- » Significant reduction in reinsurance availability or quality of reinsurers
- » Evidence of difficulty in securing reimbursement of claims from member states through ATI's preferred creditor status, including deterioration in ATI's standing with member states
- » A reduction in shareholders' equity of more than 10% over a one-year basis

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moodys.com](http://www.moodys.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

| African Trade Insurance Agency [1][2]                 | 2017   | 2016  | 2015  | 2014  | 2013  |
|---|--------|-------|-------|-------|-------|
| <b>As Reported (US Dollar Millions)</b>               |        |       |       |       |       |
| Gross Premiums Written                                | 45     | 30    | 23    | 17    | 12    |
| Net Premiums Written                                  | 14     | 13    | 10    | 8     | 6     |
| Net income (loss) attributable to common shareholders | 10     | 2     | 5     | 3     | 1     |
| Total Shareholders' Equity                            | 242    | 208   | 186   | 181   | 175   |
| <b>Moody's Adjusted Ratios</b>                        |        |       |       |       |       |
| High Risk Assets % Shareholders' Equity               | 3.2%   | 3.6%  | 8.1%  | 6.0%  | 7.8%  |
| Reinsurance Recoverable % Shareholders' Equity        | 14.9%  | 14.4% | 5.2%  | 5.2%  | 4.2%  |
| Goodwill & Intangibles % Shareholders' Equity         | 0.5%   | 0.6%  | 0.5%  | 0.4%  | 0.3%  |
| Net Total Exposure % Shareholders' Equity             | 3.6x   | 4.2x  | 4.0x  | 3.3x  | 2.7x  |
| Net Underwriting Leverage (Credit Insurers)           | 11.6%  | 13.0% | 13.0% | 7.4%  | 5.6%  |
| Combined Ratio (1 yr.)                                | 56.4%  | 39.0% | 59.9% | 57.2% | 90.5% |
| Sharpe Ratio of ROC (5 yr. avg)                       | 158.3% | NA    | NA    | NA    | NA    |
| Financial Leverage                                    | 4.0%   | 5.5%  | 5.1%  | 5.2%  | 5.8%  |
| Total Leverage  | 4.0%   | 5.5%  | 5.1%  | 5.2%  | 5.8%  |
| Earnings Coverage (1 yr.)                             | 109.9x | 29.0x | 57.2x | 38.4x | 16.8x |

[1] Information based on IFRS financial statements as of Fiscal YE December 31. [2] Certain items may have been relabeled and/or reclassified for global consistency.

Sources: Moody's Investors Service; Company Filings

## Profile

Established in 2001, ATI is a pan-African financial institution that provides credit and political risk insurance to companies, investors and lenders undertaking transactions in Africa. ATI, headquartered in Nairobi, Kenya, is a supranational organization, established by international treaty, and owned and governed by its members, predominantly a number of African sovereigns.

## Detailed credit considerations

### Insurance Financial Strength Rating

#### Market position: Good market position in Africa, driven by local expertise and strong relationships

ATI has a good market position in Africa, based on its scale and the depth and breadth of its underwriting penetration. In terms of scale and market share, while ATI is significantly smaller than the large global credit insurers, it is estimated to be one of the top five credit insurers in terms of African exposure. In addition, ATI benefits from significant local expertise and understanding in a number of African countries, and underwrites a range of exposures of varying sizes and industry sectors, demonstrating its solid expertise and strong relationships. This is supported by the fact that it is owned by a number of African sovereigns, which have an interest in supporting ATI's operations in their respective economies.

Notwithstanding its good position in the African market, its predominant focus on the region weakens its market position relative to its global credit insurance peers, that write business in a number of countries across the globe, and are therefore less exposed to competitive and market pressures in any one particular region. In addition, while ATI writes business in a large number of African countries, its exposures are primarily focused on its member countries, which currently exclude some of the largest African economies. That said, ATI has steadily added new member countries to its ownership base, and certain large African economies - most prominently, Nigeria - are in the process of becoming members. We believe that the addition of more key African states as members will enhance ATI's relevance and further strengthen its market position.

ATI's primary means of originating new insurance business is through direct interaction with insureds and intermediaries, such as lenders. ATI's strong relationships across the continent, and increasing membership base amongst African states support its

direct origination strategy. In addition, ATI increasingly distributes through a number of insurance brokers, which provide access to transactions outside of ATI's direct relationships.

#### **Product Risk and Diversification: High risk exposures moderated by good sector diversification**

ATI's primary products are political risk insurance and medium-term credit insurance, with a small amount of traditional whole-turnover trade credit insurance, and political violence and terrorism risk insurance. It benefits from good diversification of exposures by industry sector and geography, although geographic diversification is constrained by its focus on Africa, where Kenya is its highest country exposure at 20% of total insured exposure in 2017. ATI has steadily been expanding its exposure in non-member countries, although this accounted for less than 5% of gross exposures in 2017. Over time, as ATI expands its member base, we expect it to benefit from increased geographic diversification.

We evaluate product risk as being high, due to the high-risk nature of ATI's insured exposures, generally being to lower credit-quality sovereigns and corporates, as well as the medium term (3 to 5 years) duration of its insured portfolio. This is a key difference to ATI's global credit insurance peers, which predominantly provide very short-term whole-turnover trade credit insurance, that allows significant flexibility in managing their exposures, to buyers of significantly higher credit quality. ATI's product risk is somewhat offset by its preferred creditor status with member sovereigns. This status, which applies to approximately 70% of ATI's insured exposures, is a legal obligation of member sovereigns to reimburse ATI for claims it pays on obligations of sovereign-related debtors in each respective country.

#### **Asset Quality: Conservative fixed income focused portfolio with limited African exposure**

As concerns the investment portfolio, asset risk is modest, mainly due ATI's high quality and conservative investments, comprised predominately of hard-currency cash and short-term instruments, and investment grade fixed income securities. At year-end 2017, approximately 97% (2018 unaudited: 96%) of ATI's investment portfolio was rated single-A and above with the majority held outside the African continent. ATI's high risk assets % shareholders' equity was very low at 3.2% at YE2017 (YE2016: 3.6%) and compares favorably to our rated credit insurance peers. ATI's policy of holding its invested assets predominantly in developed countries reduces the level of correlation between its assets and its insured exposures, which are all Africa-based

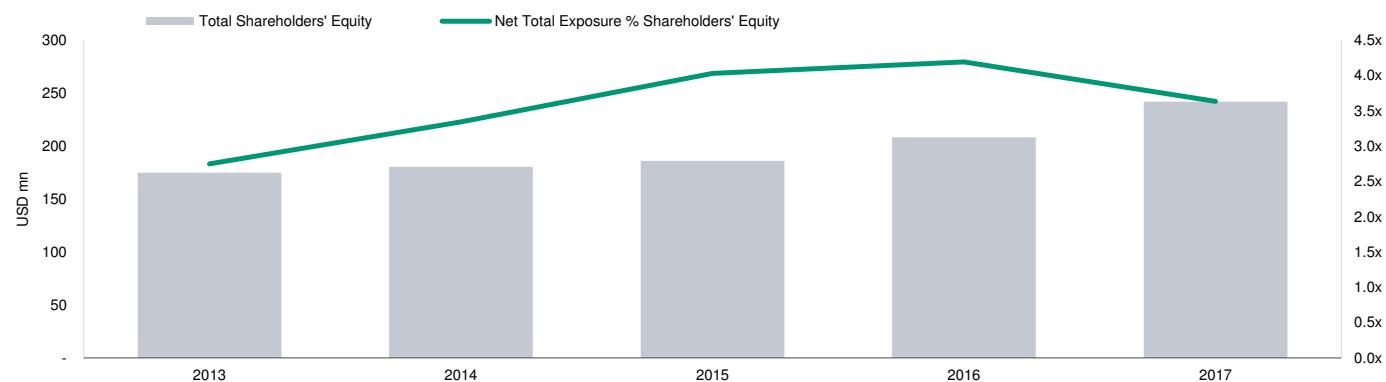
While ATI's high reliance on reinsurance to support its underwriting capacity places it at risk in case of dislocation in the reinsurance market, the high quality of its reinsurance panel serves to moderate counterparty risk associated with its elevated reinsurance cessions. While ATI's extensive use of reinsurance does expose them to changes in supply and price of reinsurance, their long-track record with reinsurers, and strong reputation in underwriting African PRI and Credit risk, positions them as a strong partner to reinsurers, and somewhat mitigates this risk. In addition, approximately 92% of its reinsurance cessions were to reinsurers rated A1 or higher as at YE2017 and despite the high reinsurance reliance, the recoverable from reinsurers were modest at 14.9% of shareholders' equity at YE2017, primarily owing to ATI's strong underwriting performance and low claims ratio.

#### **Capital Adequacy: Strong capital adequacy driven by low portfolio leverage and preferred creditor status**

Regarding capitalisation, ATI's strong capital adequacy is driven by its high level of capital relative to insured exposures, with net portfolio leverage of approximately 3.6x at year-end 2017 (2018: 3.8x based on unaudited figures). Its high capital levels mitigate some of the risk associated with its higher risk, both in terms of credit quality and exposure duration, insured portfolio. In contrast to its global credit insurance peers, ATI's portfolio exposures are geographically concentrated in one region, Africa, and are mainly to lower credit quality entities than is the case with its global peers. In addition, the majority of its exposures are medium-term in duration and with higher single risk exposures due its portfolio being comprised of less granular exposures than a typical trade credit insurance book. Nonetheless, good diversification amongst African countries and industry sectors to some extent mitigates ATI's exposure to single obligors or events.

Supporting its own capitalisation, ATI has strong and long-standing relationships with a number of large global reinsurers that enable it to increase its underwriting capacity while retaining conservative levels of capitalisation. At year-end 2017, its net insured exposures amounted to \$878 million (2018 unaudited: \$1 billion), representing approximately 37% of its total \$2.4 billion gross exposures (2018 unaudited: \$4.8 billion).

Exhibit 3

**Total shareholders' equity and portfolio leverage on a net basis**

Sources: Moody's Investors Service; Company Filings

Similar to other multilateral development institutions, ATI benefits from preferred creditor status (PCS) with its member sovereigns. This PCS, which is required to be enacted into local laws of each member state, gives ATI priority above other creditors and requires the related sovereign to reimburse ATI for any claims paid on behalf of that sovereign or its related sub-sovereign entities. ATI's good track-record of recoveries from sovereign members – albeit with some delayed payments in recent years - and its increasing prominence as a key player in facilitating investment into Africa - demonstrates the effectiveness of the PCS protections as a means to limit its exposure to losses. Strengthening the PCS protections is ATI's ability to write-off member capital to cover losses that have not been reimbursed in line with the PCS requirements. The ability to write off capital - which ATI has recently used - increases the incentive for member sovereigns to honour their obligations under the PCS.

#### **Profitability: Strong underwriting profitability despite greater emphasis on development impact compared to profitability**

Being a development institution, ATI's primary focus is on facilitating investment into Africa, while pricing appropriately for the risk it assumes, and generating a sustainable return on its capital. In line with this development focus, ATI's return on capital has been relatively low, at around 2% on a five year average basis through 2017 – primarily due to its conservative capitalization. However, return on capital has been on an improving trajectory, with the metric above 4% in 2017 and 2018, which we expect will improve the five year average return on capital metric over time. ATI's strong combined ratio (around 67% of a five year average basis through 2017, and 47% in 2018) demonstrates the strength of ATI's underwriting and risk pricing capabilities.

#### **Reserve Adequacy: Prudent reserving approach balances reserving risk that is elevated relative to typical credit insurers**

Reserving risk at ATI is elevated by the longer duration of exposures relative to a typical credit insurer. However the low frequency nature of its losses mean that management can spend more time assessing the reserves (as opposed to reliance on actuarial reserving for very large portfolios), reducing the risk of reserve development. ATI calculates reserves based on case reserves, an IBNR, and also a more forward-looking Statistical reserve that takes into account historical claims frequency and severity to predict expected portfolio losses, and provides an additional level of prudence.

#### **Financial Flexibility: Strong leverage and coverage metrics, but partially constrained by dependence on low-rated member states**

ATI's financial leverage and coverage metrics are very strong, given that it is predominantly equity funded with only a small amount of debt. Despite very strong metrics, Moody's considers ATI's overall financial flexibility to be constrained by its lack of established access to capital markets and the limited financial flexibility of many of its member states.

Offsetting these limitations, we note that large development finance institutions - notably the [World Bank](#) (Aaa stable) and African Development Bank ([AfDB](#), Aaa stable) - have regularly funded a portion of the capital contribution required for countries to become members of ATI, or to increase the size of their membership. As such ATI is indirectly supported by these institutions, although there is no formal guarantee or agreement for the institutions to continue with this practice, or more important, to contribute new capital in the event of capital erosion. In addition, we believe that because ATI is a key organization that supports trade and investment into

their economies, member countries would be incentivized to support ATI in the event needed, albeit that their ability to do so may be limited in certain instances.

#### **Operating Environment: Negligible exposure to Kenyan operating environment given supranational status**

ATI is a supranational entity and, as such, not subject to local regulation or economic constraints, with the majority of its invested assets and cash reside offshore. As a result we believe that the Kenyan operating environment does not have a meaningful impact on ATI's credit profile. The extent to which its insured exposures are impacted by the weaker operating environments in which they are located is reflected in our assessments of ATIs scores for Product Risk and Capital Adequacy.

The Operating Environment factor and score serves to capture relevant economic, social, judicial, institutional and general business conditions in a particular country as regards the insurance sector, and therefore the extent to which external conditions can exert a meaningful influence on an insurer's credit profile. The operating environment score in Kenya is suppressed by relatively low insurance penetration and density, as well as weaker economic and institutional strength at the national level and elevated susceptibility to event risk.

#### **Support and structural considerations**

Although ATI receives no explicit support from its member sovereigns or other third parties, it does benefit from preferred creditor status (PCS) with its member sovereigns, and receives indirect support from certain development banks in the form of them funding new member capital contributions.

Preferred creditor status, which is required to be enacted into local laws of each member state, gives ATI priority above other creditors and requires the related sovereign to reimburse ATI for any claims paid on behalf of that sovereign or its related sub-sovereign entities. ATI's good track-record of recoveries from sovereign members – albeit with some delayed payments in recent years - and its increasing prominence as a key player in facilitating investment into Africa - demonstrates the effectiveness of the PCS protections as a means to limit its exposure to losses. Strengthening the PCS protections is ATI's ability to write-off member capital to cover losses that have not been reimbursed in line with the PCS requirements. The ability to write off capital - which ATI has recently used - increases the incentive for member sovereigns to honour their obligations on the PCS.

In addition, because ATI's aim is to facilitate trade and investment for member sovereigns, we believe that member sovereigns are incentivised to ensure that ATI is appropriately supported. We expect this level of implicit support to increase as more and larger states become ATI members, further increasing ATI's relevance as a development finance institution.

## Rating methodology and scorecard factors

Exhibit 4

| Financial Strength Rating Scorecard [1][2]                        | Aaa    | Aa | A | Baa | Ba | B | Caa | Score   | Adj Score |
|---|--------|----|---|-----|----|---|-----|---------|-----------|
| <b>Business Profile</b>   |        |    |   |     |    |   |     | Ba      | Baa       |
| <b>Market Position and Brand (10%)</b>                            |        |    |   |     |    |   |     | Ba      | Baa       |
| - Relative Market Share Ratio                                     |        |    |   |     |    | X |     |         |           |
| - Distribution and Access to New Markets                          |        |    |   |     | X  |   |     |         |           |
| <b>Product Focus and Diversification (20%)</b>                    |        |    |   |     |    |   |     | Ba      | Baa       |
| - Business Diversification  |        |    |   |     |    | X |     |         |           |
| - Flexibility of Underwriting                                     |        |    |   |     |    | X |     |         |           |
| - Risk Diversification  |        |    |   |     |    | X |     |         |           |
| <b>Financial Profile</b>  |        |    |   |     |    |   |     | Aa      | A         |
| <b>Asset Quality (15%)</b>  |        |    |   |     |    |   |     | Aaa     | Aa        |
| - High Risk Assets % Shareholders' Equity                         | 3.2%   |    |   |     |    |   |     |         |           |
| - Reinsurance Recoverable % Shareholders' Equity                  | 14.9%  |    |   |     |    |   |     |         |           |
| - Goodwill & Intangibles % Shareholders' Equity                   | 0.5%   |    |   |     |    |   |     |         |           |
| <b>Capital Adequacy (20%)</b>                                     |        |    |   |     |    |   |     | Aaa     | A         |
| - Net Total Exposure % Shareholders' Equity                       | 3.6x   |    |   |     |    |   |     |         |           |
| - Net Underwriting Leverage (Credit Insurers)                     | 0.1x   |    |   |     |    |   |     |         |           |
| <b>Profitability (20%)</b>  |        |    |   |     |    |   |     | A       | A         |
| - Combined Ratio (5 yr. avg)                                      | 60.6%  |    |   |     |    |   |     |         |           |
| - Sharpe Ratio of ROC (5 yr. avg)                                 | 158.3% |    |   |     |    |   |     |         |           |
| <b>Reserve Adequacy (5%)</b>                                      |        |    |   |     |    |   |     | Aaa     | A         |
| - Worst Reserve Development for the Last 10 Years % Beg. Reserves | 0.0%   |    |   |     |    |   |     |         |           |
| <b>Financial Flexibility (10%)</b>                                |        |    |   |     |    |   |     | Aaa     | Baa       |
| - Financial Leverage  | 4.0%   |    |   |     |    |   |     |         |           |
| - Earnings Coverage (5 yr. avg)                                   | 50.3x  |    |   |     |    |   |     |         |           |
| <b>Operating Environment</b>                                      |        |    |   |     |    |   |     | Aaa - A | Aaa - A   |
| <b>Aggregate Profile</b>  |        |    |   |     |    |   |     | A1      | A3        |

[1] Information based on IFRS financial statements as of Fiscal YE December 31. [2] The Scorecard rating is an important component of the company's published rating, reflecting the stand-alone financial strength before other considerations (discussed above) are incorporated into the analysis.

Sources: Moody's Investors Service; Company Filings

## Ratings

Exhibit 5

| Category                           | Moody's Rating |
|------------------------------------|----------------|
| THE AFRICAN TRADE INSURANCE AGENCY |                |
| Insurance Financial Strength       | A3             |

Source: Moody's Investors Service

## Moody's related publications

[Government of Kenya](#)

[African Development Bank](#)

[IBRD \(World Bank\)](#)

[Africa Finance Corporation \(AFC\)](#)

[Sovereigns – Sub-Saharan Africa: 2019 outlook negative as fiscal, external challenges persist despite easing pressures](#)

[Atradius, Coface & Euler Hermes: Economic conditions supportive but geopolitics and sharp interest rate rises are downside risks](#)

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