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Kuwait Reinsurance Co. K.S.C.

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Major Rating Factors

Strengths:

- Very strong capitalization.
- Adequate risk management.
- Strong investments and liquidity.

Operating Company Covered By This Report

Financial Strength Rating

Local Currency

BBB/Positive/--

[Ratings Detail >>](#)

Weaknesses:

- Underwriting performance resilience not fully proven.
- Execution risk related to rapid growth outside of core markets.

Rationale

The ratings on Kuwait Reinsurance Co. K.S.C. (Kuwait Re) reflect its very strong capitalization, adequate risk management, and strong investments and liquidity. These strengths are partially offset by the unproven resilience of the company's improved underwriting performance and the execution risk posed by the anticipated continued rapid premium growth outside of the core Gulf markets. Kuwait Re is essentially a non-life reinsurer, with gross premiums written (GPW) of about \$65.4 million in 2008.

Standard & Poor's Ratings Services views Kuwait Re's capitalization as very strong. We base this view on the company's excellent capital adequacy, very good capital quality, continued prudent reserving, and appropriate use of retrocession.

Kuwait Re has strengthened its enterprise risk management (ERM) through the continuous enhancement of key risk controls, and the implementation of an internal capital and risk model. In addition, the company has formalized its risk governance framework.

We consider Kuwait Re's underwriting operating performance as good following recent improvements, and the continuation of this will be key to Kuwait Re's future rating level. The company has produced an underwriting profit in each of the last two years with much-improved combined ratios of 97.7% and 98.0% in 2007 and 2008, respectively. Nonetheless, we believe these improvements are largely due to economies of scale and their sustainability is yet to be proven over a meaningful time period.

Kuwait Re has a good regional competitive position. It has recently accelerated its expansion, particularly

outside of its core Middle Eastern markets. This raises some execution risk as the new strategy is implemented; however, given the experience of the executive team and the presence of Transatlantic Reinsurance Co. (Transatlantic Re; A+/Stable/--) as its major shareholder and a business partner, we believe that these concerns are mitigated to some extent.

Outlook

The positive outlook reflects our expectation that the company's improved underwriting performance will be maintained, as reflected in the company's continued ability to produce a sub-100% combined ratio. Kuwait Re's ability to demonstrate a track record of profitable growth outside of its core markets would be viewed by Standard & Poor's as evidence of an enhanced competitive position.

Capitalization should remain at least strong, driven principally by an excellent (although falling) capital surplus at the 'AAA' level. We also expect investments and liquidity to remain strong.

Failure to successfully maintain underwriting profitability, or a negative shift in the competitive environment for Kuwait Re would likely put downward pressure on the ratings.

Corporate Profile: Evolving Into A Recognized Regional Reinsurer Through Growth And Discipline

Established in 1972, Kuwait Re is a small, regional, predominately non-life reinsurer, focused on offering treaty and facultative capacity for most non-life classes. In 2008, the company wrote a blend of fire & engineering (52% of net premiums written), marine (19%), and accident (29%).

Kuwait Re's relative lack of scale somewhat constrains its leadership credentials. The company leads proportional and nonproportional treaty programs for only a small percentage of its clients and offers lead lines on a limited proportion of its facultative property, construction, and cargo risks. Life and medical expenses proportional treaty capacity is also offered, although this line of business is extremely small and is not reported as a separate business line. The company wrote gross premiums of Kuwaiti dinar (KWD) 18.1 million in 2008, an increase of 66% on 2007.

For 2009, the significant premium growth is expected to continue, primarily driven by expansion outside of the Middle Eastern region following the establishment of a regional office based in Labuan (Far Eastern Regional Office or FERRO). Future growth is expected to be most pronounced in the Fire & Engineering book of business. The forecast geographic diversity for 2009 is: Middle East and North Africa (MENA) 40% of net premiums written (NPW) (46% in 2008), Far East 24% (14%), and other Afro-Asian business 36% (40%). This split is expected to remain broadly stable over the next 2–3 years.

The company's key shareholders include Transatlantic Re (40%) and seven Kuwaiti companies, principally comprising insurance companies and banks (56%), with the remaining 4% held by private investors.

Competitive Position: Driven By Regional Relationships Founded On Service Quality

Table 1 | [Download Table](#)

Kuwait Reinsurance Co. K.S.C./Business Statistics

(Mil. KWD)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
Non-life gross premiums written	18.1	10.9	9.2	8.4	6.9
Non-life annual change in gross premiums written (%)	65.4	18.1	9.9	21.3	23.5
Non-life net premiums written	16.9	10.0	8.4	7.6	6.1
Non-life annual change in net premiums written (%)	69.6	18.6	10.3	25.2	34.9

KWD--Kuwaiti dinar.

We consider Kuwait Re's competitive position as good, reflecting the company's ability to maintain robust longstanding relationships with both its local and regional clients. The company has also demonstrated an ability to increase its presence in the Gulf region through its enhanced technical abilities, and increased underwriting capacity. In our opinion, the company's ability to grow strongly across Asia and, to a lesser extent, Africa demonstrates an increased level of acceptance of the security offered by Kuwait Re. Given Kuwait Re's limited pricing power, we believe that superior risk selection will be critical to the company's ability to continue to grow profitably.

Kuwait Re's main competitive advantage is its strong relationships with its Middle Eastern cedents, who continue to make use of local reinsurers, in addition to international capacity. Kuwait Re aims to provide a superior level of service, based on a swift turnaround of quotations, rapid response times, and a

reputation as a quick settler of claims. Transatlantic Re's presence as a major shareholder and an active business partner has assisted the improvement we have seen in the company's competitive position in recent years. The relationship is increasingly active in the Far East where Kuwait Re (through its FERO) and Transatlantic Re's Hong Kong office often conduct joint marketing trips and have, in the past, offered a limited amount of co-insurance. In our opinion, Kuwait Re's competitive position has improved as a result of the establishment of the FERO. Kuwait Re is expected to remain a relatively small reinsurer, writing a treaty-dominated book of non-life business.

Increased broker acceptability has led to a shift away from the direct business-dominated model. Direct business now accounts for about 35% of the portfolio, down from more than 70% in 2001.

GPW have grown over 5x since 2001, which has helped the company reduce its client concentration, with the top-five clients accounting for less than 10% of 2008 GPW.

Management And Corporate Strategy: Rapid Premium Growth Reflective Of New Strategy, But Raises Some Concerns

We regard Kuwait Re's corporate strategy as appropriate, albeit somewhat aggressive, for the company at its current stage of development. This is primarily due to the implementation of a management plan to accelerate the company's goals of enhancing its recognition as a regional reinsurer and of underwriting profitably through more rigorous risk selection.

Following the rapid growth experienced since 2001, the company is forecasting further growth through to 2011, of nearly 100% from 2008 levels. This growth, predominantly from areas outside of the historic core region of the Gulf, raises concerns over the sustainability of the emerging profitable underwriting track record.

In 2007, changes were made to the management structure, following the appointment of a new Manager of Technical Operations. In our view, this appointment, and the implementation of a formal ERM function, has given Kuwait Re's management team a stronger understanding of the risk profile of the company.

Mutual benefit from relationship with Transatlantic Re

In 2000, Kuwait Re's management acknowledged that it needed to alter its strategy in order to achieve its long-term goals, and approached Transatlantic Re with a view to it becoming a strategic partner. Although Kuwait Re might have achieved its goals unaided, in our view Transatlantic Re's involvement accelerated its development.

The two companies aim to continue to expand within the Far East, making Kuwait Re increasingly less dependent on the Kuwaiti and Arab markets. The companies conduct joint marketing trips, and each company derives benefit from the other's presence: Transatlantic Re from having a well-connected and respected Arab partner; and Kuwait Re from having an internationally recognized strategic backer.

Adequate financial management

Although Kuwait Re's financial management lacks sophistication, we consider it to be adequate for the company's size and risk profile.

In terms of financial risk, Kuwait Re is relatively conservative, but suitably flexible. This is particularly evident in its management of underwriting cycles. Kuwait Re maintained a laudable focus on underwriting discipline during the "soft" reinsurance market. This resulted in a slight decline in gross and net premiums written in 1999-2001. With the return of a "hard" market, Kuwait Re rapidly accelerated its growth, especially on a net basis, where it has sought to use its balance-sheet strength to retain more risk.

The high level of premium growth expected over the next three years will be primarily driven by access to new business following the formation of FERO.

Kuwait Re aims to use its balance sheet strength more effectively by slightly increasing its financial risk tolerance. This can be seen in its use of debt to help finance the construction of a property, the first venture Kuwait Re has made into direct property investment.

Enterprise Risk Management: Simple, But Adequate For The Company's Present Size

We consider Kuwait Re's ERM as adequate. ERM responsibility is centered on the general manager and his senior management team, and administered via the Risk Management Committee, formally established during 2007. Through the ongoing development of key risk controls, and the implementation of an internal capital and risk model, Kuwait Re is continuing to develop the company's risk management capabilities.

Despite Kuwait Re's very strong capital position and recent operating performance improvement, we believe ERM will become an increasingly important driver of the company's ability to continue to grow profitably. This is because the company's growing position as a reinsurer in the Far East is expected to expose the company to more volatile risks.

Accounting: Prepared Under IFRS, With Adequate Disclosure

The accounts are prepared in accordance with IFRS, and contain adequate disclosure including the breakdown of the income statement by line of business and by territory.

In 2006, the carrying value of the freehold land asset was revalued and transferred to a fair-value estimate of the investment value of the property owned by Kuwait Re. This change has been reflected in our investment analysis.

We include all expenses reported by the company, including unallocated expenses and Director's fees as technical expenses, and therefore include them in the calculation of the combined ratio.

Operating Performance: Sustainability Of The Improved Underwriting Performance Will Be A Key Ratings Driver

Table 2 | [Download Table](#)

Kuwait Reinsurance Co. K.S.C./Operating Statistics

(Mil. KWD)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
ROE (adjusted equity) (%)	(2.8)	19.1	26.2	11.2	9.5
Change in adjusted equity/total adjusted equity (%)	(12.9)	17.4	13.2	11.3	2.2
Non-life gross loss ratio (%)	69	58.2	62	68.6	52.7
Non-life gross combined ratio (%)	98.1	89.4	93.4	104.2	90.7
Non-life net loss ratio (%)	66.4	63.9	67.5	66.5	61.4
Non-life net expense ratio (%)	31.2	34.2	34.5	39.4	43.7
Non-life net combined ratio (%)	97.6	98.1	102.1	105.9	105
Non-life reinsurance result	0.0	(0.9)	(0.8)	(0.1)	(0.9)
Total investment return (incl. unrealized and realized) (%)	(2.4)	13.8	19.1	9.2	7.7

KWD--Kuwaiti dinar.

For both 2007 and 2008, Kuwait Re made an underwriting profit across all lines of business, marking a significant change from previous years. Historically, the company's marine accounts have been profitable, but its Accident (pre-2004) and Fire & Engineering (pre-2007) accounts have underperformed. Including the addition of unallocated expenses, Kuwait Re achieved a full-year combined ratio of 97.7% (2007: 98.0%). Due to investment losses, the company reported a negative overall return on equity for 2008 of negative 2.8%.

For 2009 and 2010, it is expected that the company will maintain a combined ratio between 95% and 98%. In first-half (H1) 2009, Kuwait Re achieved a combined ratio of 96.8% (H1 2008: 97.1%).

The improvement in operating performance has been largely driven by economies of scale, demonstrated by the reduction in the expense ratio from over 80% in 2002 to a more manageable level of 31.6% in 2008. The expense ratio is expected to be broadly stable at this level prospectively. The company has also reduced its expenditure on reinsurance protection over the same period while maintaining a relatively stable net loss ratio. This has allowed Kuwait Re to better use its high capital base and aligns the net performance with the historically good gross performance, as demonstrated by a five-year average gross combined ratio of 95.1%.

The investment performance in 2008 suffered primarily as a result of unrealized losses arising from the equity portfolio. Kuwait Re suffered a negative total return on investments of negative 1.9%.

Investments: Equity Impairments Incurred In 2008, Property Holdings Add Risk

Table 3 | [Download Table](#)

Kuwait Reinsurance Co. K.S.C./Investment Statistics

(Mil. KWD)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
Portfolio Composition					

Total investments	54.5	59.3	54.3	45.1	41.6
Bonds and other fixed-interest securities (%)	12.2	11.2	12.9	15	6.7
Equities and other variable-interest securities (%)	27.4	34.3	32.7	43.6	34.1
Property (%)	26.7	22.7	21.6	5.5	6.0
Cash and bank deposits (%)	33.6	31.8	32.8	35.9	53.2
Total nonlinked investments (%)		100	100	100	100
Liquidity					
(Insurance and reinsurance receivables)/total assets (%)	10.1	6.9	5.5	6.2	5.6
Adjusted liquid assets/technical reserves (%)	174.5	206.6	231.9	250.5	318.3

KWD--Kuwaiti dinar.

We consider Kuwait Re to have strong investments, despite the losses incurred during 2008 as a result of impairments to its equity portfolio. The company has consistently maintained a very liquid investment portfolio, with a material but acceptable equity exposure, and relatively low credit and market risk.

As for many of its peers, Kuwait Re experienced significant investment losses in 2008 principally owing to the write-down of its equity investments. This drove an overall investment loss for the year.

Investment strategy targets diversified investment earning streams

Kuwait Re historically targeted a split of bonds to equities and funds of 65% and 35%, respectively; however, following the write-downs incurred in 2008, the company has reduced its equity exposure to approximately 17% at June 30, 2009. Kuwait Re also has a large investment in a single property in Kuwait, as well as substantial fixed deposit and cash holdings.

Given the strength of Kuwait Re's capital adequacy, this blended approach is not of great concern, and the portfolio risk may be raised if opportunities arise for a reinvestment in equities.

Kuwait Re's credit risk is low. The company's cash deposits are placed with six investment-grade banks, nearly all local, which reduces concentration risk.

The bulk of its bond investments (12% of invested assets in 2008) are in Kuwait, and rated 'BBB' or higher. Concentration risk is reduced by some sector diversification and the use of international bond funds.

The single property investment creates a significant concentration risk, although this is mitigated to some extent by the long-term nature of the occupancy contracts, and Kuwait Re's own occupancy of a proportion of the building.

Kuwait Re's market risk is also low. Kuwait Re's time and call deposits and its bonds are all interest sensitive, but the impact is reduced as some of the deposits have a maximum maturity of three months, and all bonds have a maximum maturity of five years. Kuwait does not yet have an established secondary bond market, which may lead to some additional pricing and liquidity risk.

Equity price risk is more significant, but reduced following the reallocation during 2009, and is mitigated by a spread of investments within Kuwait, Europe, and the U.S. In addition to individual shareholdings, Kuwait Re also uses a variety of funds. These include international hedge funds, which have their own pricing and liquidity risks. Kuwait Re is not exposed to subprime or other asset-backed securities.

Kuwait Re has a basic, but appropriate, approach to asset-liability management as the high degree of liquidity in the portfolio makes a more sophisticated approach unnecessary.

Liquidity: Strategy To Maintain Strong Liquidity To Back Policy Of Quick Settlement

Kuwait Re's liquidity is strong, in line with its strategy to differentiate its service by offering quick settlement to clients. Owing to the strong focus on liquidity in its investment strategy, Kuwait Re has had a consistently very high ratio of liquid assets to technical reserves, at a five-year average of 228% (174.5% in 2008). The weakening in liquidity post-2006 has been primarily due to the construction of a property, accounting for 27% of total investments at H1 2009. In our analysis of Kuwait Re, we treat such construction projects as investments. In 2006, Kuwait Re started to repay the term loan it used to help finance the construction, but the repayment of that loan is not expected to have a major impact on the overall liquidity profile.

Capitalization: Very Strong, A Key Rating Strength

Table 4 | [Download Table](#)

Kuwait Reinsurance Co. K.S.C./Capitalization Statistics

(Mil. KWD)	--Year ended Dec. 31--				
	2008	2007	2006	2005	2004
Capital Adequacy					
Total adjusted equity	33.5	39.9	33.9	30.0	27
Change in adjusted equity (%)	(16.1)	17.6	13.1	10.9	2.4
Total capital	36.4	44.1	39.4	34.0	30.1
Reinsurance exposure ratio (%)	5.9	2.4	3.2	5.0	5.8
Investment leverage (incl. all quasi capital) (%)	60.3	60.9	63.2	44.8	42.1
(Debt + preferred stock)/capital (excl. policyholder capital) (%)	8.0	9.5	14	11.7	10.2
Reinsurance					
Non-life: Reinsurance Utilisation Ratio (%)	6.2	8.5	8.9	9.2	12
Reserving					
Non-life net technical reserves/gross technical reserves (%)	90.5	92.5	90.4	87.5	86.2
Non-life technical reserves/net premiums written (%)	135.1	175.7	176.9	177.2	200.5
Non-life loss reserves/net premiums written (%)	99.5	132	131.3	131.5	152.7
Non-life Net claims reserves/net claims incurred (%)	167.1	218.5	202	212.3	273.1

KWD--Kuwaiti dinar.

We view Kuwait Re's capitalization as very strong, and therefore a key rating strength.

The company's capital adequacy is excellent, according to our risk-based capital model. Kuwait Re's capital adequacy shows a material surplus above the 'AAA' range, which is in line with Kuwait Re's past capital adequacy. We expect capital to remain above this level, despite strong net premium growth, for at least the next two years. Although Kuwait Re acknowledges that it is overcapitalized, we do not expect capital to be returned to shareholders other than by way of the established dividend policy, as growth is continuing to be targeted.

Reserves remain prudently set, with no strengthening expected

Kuwait Re has prudent reserves. Its ratio of net technical reserves to NPW was 147% in 2008--lower than in previous years due to the extremely rapid premium growth experienced by the company. We consider this reserve level to be relatively conservative, but appropriate given the risk management profile of Kuwait Re. Kuwait Re has reasonably good visibility with regard to the adequacy of its reserves, as it writes mainly property business. The average claim duration ranges from two years for fire, its largest line of business, to five years for marine hull and engineering. As a result, significant reserve strengthening is not expected. The company subjects its reserves to an annual independent analysis (conducted by Watson Wyatt), which has identified material surpluses.

Reinsurance utilization down on historic highs, in line with strategy

Kuwait Re's use of reinsurance has decreased as the company seeks to expand its underwriting operations, with utilization below 7% for 2008, down from 55% in 2001. This increased risk appetite is in line with our expectations, and is viewed as a positive development.

Kuwait Re purchases mainly excess-of-loss protection. Given the strength of its capital and the hard reinsurance market, the trade-off between increasing net premium income and decreasing capital protection appears sensible, and has contributed to the improved operating performance.

Nevertheless, in our view, Kuwait Re is still well protected, as its net maximum retention is less than 2% of its year-end 2008 shareholder equity. Kuwait Re's largest historical gross loss, which was the result of a fire at a refinery in 2000, exceeds the current maximum gross probable maximum loss (PML) due to the increased risk control of the gross account. However, the largest net loss, relating to the Indian Ocean tsunami in 2004, remains within the largest net PML.

Kuwait Re uses reinsurers rated above 'BBB' by Standard & Poor's, with most rated 'A' or higher.

Transatlantic Re does not participate in the reinsurance program.

Financial Flexibility: Good, With No Capital Needs Expected

Financial flexibility (defined as the ability to source capital relative to capital requirements) is considered good. In our opinion, the company currently has no need for additional capital or liquidity, and is highly unlikely to require any in the foreseeable future. If the need arises Kuwait Re currently has satisfactory access to external sources that can supply it with capital or liquidity through either an equity issue or borrowing.

Ratings Detail (As Of 05-Oct-2009) *

Operating Company Covered By This Report

Kuwait Reinsurance Co. K.S.C.

Financial Strength Rating

Local Currency

BBB/Positive/--

Counterparty Credit Rating

Local Currency

BBB/Positive/--

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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