Kuwait-Based Warba Insurance 'BBB+' Ratings Affirmed; Outlook Stable

- Warba Insurance Co. K.S.C.P., the third-largest insurer in Kuwait, has extremely strong capital adequacy and an adequate competitive position, but a somewhat elevated investment risk profile, which results in earnings volatility.
- Given the increase in Warba's stressed liabilities relative to liquid assets, we now regard the company's liquidity as strong rather than exceptional.
- We are affirming our 'BBB+' ratings on Warba.
- The stable outlook reflects our expectation that Warba will maintain its extremely strong capital adequacy and gradually derisk its investment portfolio over our two-year outlook horizon.

DUBAI (S&P Global Ratings) July 11, 2017--S&P Global Ratings said today that it has affirmed its 'BBB+' long-term counterparty credit and insurer financial strength ratings on Kuwait-based Warba Insurance Co. K.S.C.P. The outlook is stable.

Warba remains a key player in Kuwait's overcrowded and competitive insurance market with a share of approximately 10% in terms of gross premiums as of year-end 2016. Warba operates solely in the domestic market, writing predominantly non-life insurance business, and benefits from a countrywide network of branches and sales outlets that allows close control over distribution. Certain core shareholders also facilitate introductions to local commercial business.

The company's operating performance weakened in 2016 when its combined (loss and expense) ratio rose to 106.8%, while the five-year average net combined ratio remained at 100.5%. This relative weakening of earnings reflects very competitive market conditions in Kuwait at present, particularly for medical and motor insurance, where Warba is especially active, and fluctuating investment yields last year. On the investments side, although the net investment yield remained at 1%-2% over the past five years, the

net results were regularly affected by unrealized losses from investment revaluations.
This means Warba continues to report break-even underwriting results and is dependent on highly volatile investment income.

Warba's capital adequacy (by our measures) remains extremely strong. This assessment is underpinned by our modelling of Warba's current and prospective capitalization and probable risk exposures, which together lead us to conclude that Warba will continue to enjoy extremely strong risk-based capital adequacy, despite expected business growth and relatively low retained earnings. We expect Warba will maintain extremely strong capital adequacy over the next two years, supported by break-even technical results and modest investment income.

Warba's risk tolerance continues to improve steadily as the company gradually lowers its exposure to high-risk investments, comprising equities (both listed and private) and real estate. The company's exposure to these assets has declined continuously over the past five years, and stood at 42.7% in 2016 compared with 76.5% in 2012. However, given the competitive nature of Kuwait's insurance market, we also consider the possibility that management may seek to expand into new markets, which may help long-term diversification but increase near-term operational risk.

We assess Warba's enterprise risk management as adequate in the context of its relatively simple business model and single-market focus. The company's risk management and development department defines and monitors its risk appetite, and executive committees set and periodically update risk limits. An overarching risk appetite statement defines required capital adequacy as a minimum of 110% of the risk-based capital adequacy requirement for an entity rated 'A' by S&P Global Ratings. Warba's senior management and corporate
governance practices and procedures are fair, in our view. Management is stable, experienced, technically proficient, and well-equipped for current commercial and operational challenges.

We now regard Warba's liquidity as strong, compared with exceptional previously, due to a marginal increase in the proportion of liabilities to liquid assets. While the investment portfolio has remained similar to previous years, Warba took out a bank overdraft of Kuwaiti dinar 2 million, which we consider to be a liability in our calculation of the liquidity ratio.
Nevertheless, Warba's liquidity position reflects that its stressed assets are still robust and adequately cover stressed liabilities by a very comfortable margin of 195%.

In terms of Warba's accounting records, the 2016 audited financial statements included three qualifications with respect to deferred commission expense, life and medical reserves, and impairment on investments. Considering Warba has extremely strong capital adequacy, which acts as a buffer against unexpected losses, we believe the impact of these qualifications is not material and does not change our assessment of the rating components at this time. However, we recognize that these qualifications are potentially indicative of a management and governance framework that is evolving and still to reach steady maturity.

The stable outlook indicates that we do not expect our ratings on Warba to change over the next two years.

Beyond our two-year outlook horizon, we could raise the ratings if, in our view, Warba's risk position had improved to intermediate from moderate and other analytical factors remained at least stable.

We could lower the ratings if Warba experienced significant earnings volatility, either from underwriting or investments, which could lead us to revise our assessment of its competitive position below adequate or capital and earnings below moderately strong. We could also lower the ratings if we consider that Warba had severe governance deficiencies, which is however not our base case.