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Claims and the Economy

It appears the U.S. economy is slipping into recession. The Federal Reserve is predicted to be lowering rates. This will impact the Green Back, which some economists say will devalue a further 15% and cause the Canadian dollar to trade in the 1.10 to 1.20 range.

The major factors in the U.S. economy are overcapacity in the housing, automotive, and consumer goods industries, plus it appears that the intrepid U.S. consumer is beginning to wane.

Because of the increase in the value of the Canadian dollar, the effects of a U.S. downturn will be felt in Canada immediately.

As a matter of fact, after 3 years of excellent loss ratios, i.e., claims paid/premium, underwriters are now seeing claims rise significantly in the 4th Quarter. December and the 1st Quarter of the next year are often the

favourite time to file for protection as the banks often re-evaluate their credit positions and may pull the

lines of credit for marginal customers or customers violating financing covenants.

Last year, Millennium's clients filed increasing numbers of claims in the lumber and steel industries, which is not surprising as these sectors often feel the first impact.

What will the next year bring? Are you ready?



The Strategic Use of Credit Insurance

The major feature of the evolution of credit insurance over the last 10 years has been flexibility. More and more clients are identifying particular areas of threat to their business and are seeking credit insurance to meet these specific objectives.

Some examples are:

1. A large conglomerate perceives different risk profiles from operations within the group defined by type of product. They can obtain coverage, at a practical price, to cover the major buyers in each identified operation.

2. A steel company normally makes provisions for US\$2.0 million in bad debts. In a good year, write-offs may be US\$1.8 million. With a possible recession, the regular bad debts may exceed US\$2.0 million, plus if one of the other larger buyers also filed, the impact on the net income would be felt. They can obtain "stop loss coverage" to hold their losses to the provision.

3. Companies with funds tied up in the Asset Backed Commercial Paper market (incidentally, this was a "no risk" market as analyzed by the brightest

young minds) may need to access cash from their receivables. They can obtain coverage on their major buyers and sell or discount their receivables. This is quicker and much less costly than having to put a securitization program together, plus when the ABCP problem ends, there is no need to unwind the securitization.

These are 3 simple examples, however, there are many more. If you want to bounce an idea off someone, please contact us.

The Almighty Loss Ratio

All insurers live or die by their loss ratios, i.e., losses to premium, or more correctly put, their ability to renew their Reinsurance Treaties at reasonable rates is a factor of their Loss Ratios.

For the last 2 years, premium rates have been well below the norm, which used to be 1% of the exposure adjusted for the risk profile and the amount of risk the insured was retaining for its own account. Underwriters also used to correlate the premium revenue for a policy to the largest individual credit exposure or the aggregate liability for a policy.

Given past underwriting experience and having seen recessions or slowdowns in 1991 and 2001 (the steel melt down, no pun intended), the credit insurance underwriters are going to see very unacceptable Loss Ratios if claims even go up marginally because their perception of the competition has forced them to lower premiums.

It must be noted that when underwriters are locked into unrealistically low rates, they may try to control the Loss Ratio by reducing marginal exposures or increasing the deductibles at renewal.

In this environment, the lowest price may not always be the best option. How the individual underwriters will address the higher risk scenario remains to be seen.

The Credit Insurance Industry in Canada

Export Development Canada (EDC) will be subject to a review of its legislative mandate in 2008. The private sector underwriters competing with EDC are contending that it has outlived its mandate to provide short-term insurance for marketable transactions. They are asserting that the Canadian Government should follow the lead of most developed countries around the world and leave the short-term credit insurance field to the private sector companies, which are financially very strong and have comparable products.

In the period up to October 2008, a company, chosen by the Government of Canada, will be putting together a comprehensive report on EDC's mandate and whether any changes are warranted. There will be a strong consultation process and many different civil groups will have their input.

If you have opinions or suggestions relating to EDC's mandate, there will be opportunities to voice them. Don't miss your chance.

A Credit Insurance Policy or a Credit Insurance Contract?

Millennium has been involved with the processing of hundreds of claims on behalf of its clients. Often the claims officer for the underwriter adjusting the claim is located in the U.S. While location where the claim is handled shouldn't impact on the settlement of the claim, one can see that U.S. claims officers tend to treat the policy document as if it were a straight commercial contract. However, in Canada, credit insurance policies are interpreted under insurance law set out in British Common Law or under the Quebec Civil Code.

What is the difference you wonder? Under contract law it is assumed there are 2 equal parties that fully understand each term and condition of the contract. Insurance law on the other hand is consumer protection law and in Canada, it is supported by numerous statutes and hundreds of years of precedent.

If you are doing business in Canada, you should always insist that any insurance policies are issued by underwriters licensed in Canada and the policies are subject to the laws of the province in which you are located.

In Canadian cases involving major publicly traded companies, the courts still proceed as if the policyholder is a poor consumer and the onus is on the insurer to show beyond a doubt that it has done everything possible to protect the insured.



Ask Ron

What are the Risks of Repudiation and Non-Acceptance of Documents?

The Risk of Repudiation and the Risk of Non-Acceptance of Documents are 2 risks that are poorly understood by not only policyholders, but also by some underwriters.

These risks are covered in policies of Export Development Canada (EDC) where coverage begins on shipment, and shipment means the goods have been dispatched to the buyer.

A number of the private sector insurance policies define shipment not only in terms of dispatching the goods to the buyer, but also in terms of the goods having been delivered or the policyholder having surrendered possession of the goods.

It is the question of delivery or loss of possession of the goods that may cause the problem. On terms of payment calling for Documents on Acceptance or payment of either a term or sight draft, by definition the policyholder retains the documents until the draft is paid or accepted. If the buyer does not pick up the documents as per the contract or formally repudiates the contract after shipment, these risks are not normally covered in any policies other than EDC's, unless specifically endorsed to other policies.

If you have a policy from a private sector insurer and export to overseas markets, you should check your policy carefully or contact Millennium to review it for you. Come to the experts.