CRC Group
Wholesale & Specialty

State of the Market

Product Recall & Contamination

November 2016

Product Recall & Contamination

Overview

Product recall and contamination liability insurance is critical to ensuring financial stability for businesses that manufacture, process and distribute products — from food to consumer goods to component parts. Many businesses have misconceptions about this type of insurance, however, and incorrectly believe that other programs will cover their recall exposures. At a time when recall expenses and regulatory requirements are on the rise, retail agents and brokers need to better understand recall insurance to enhance the value they bring to their clients. This report from CRC/ CRC Swett discusses major trends in product recall and the insurance marketplace, and the value that experienced wholesale partners bring to managing this and other risks, to assist retailers and their clients.

Recall Risks On The Rise

In many industries, including food production, automotive and consumer goods, the number of recalls is on the rise. Food-related recalls are responsible for much of this increase.

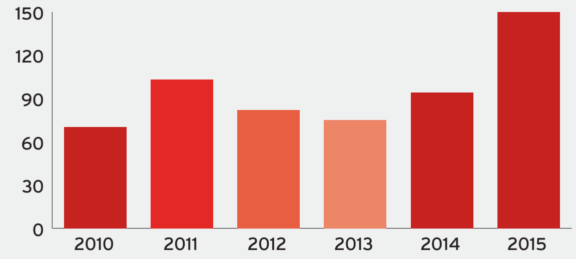
On the food and beverage side, the number of meat and poultry recalls has generally increased over the past decade, and most of those have involved significant health risks, according to the U.S. Department of Agriculture. In 2015, two-thirds of the 150 food recalls recorded by the USDA were Class I, the highest-hazard classification, in which "there is a reasonable probability that eating the food will cause health problems or death." Of the recalls, the single most common reason -- almost 39% -- was the presence of undeclared allergens.[1]

The prevalence of food allergies is increasing liability exposure for food manufacturers, packagers and distributors. In 2015, the U.S. Department of Agriculture's Food Safety and Inspection Service issued guidelines on identifying, controlling and labeling food and food products containing allergens.[2] According to the FSIS, four in every 100 children have a food allergy, and the number of recalls of FSIS-regulated products due to undeclared allergens has more than tripled since 2008. FSIS noted that the "Big Eight" allergens, which account for about 90% of all food allergy reactions, are: wheat, crustacean shellfish, eggs, fish, peanuts, milk, tree nuts and soybeans.

Automotive product recalls have increased sharply. For example, a recall affecting air bag inflators in tens of millions of vehicles was commenced in 2015 and expanded further in 2016. The National Highway Traffic Safety Administration issued its biggest-ever civil fine on the air bag manufacturer and said the safety recall was the largest and most complex in U.S. history.[3]

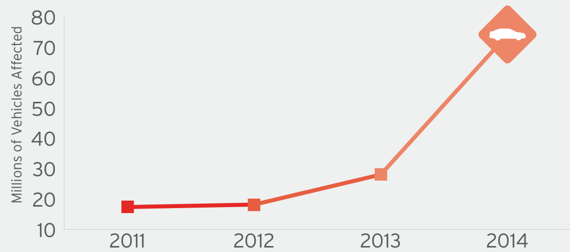
Several factors are contributing to the increase in recall activity across the major classes of products. These factors include:

Food Recalls Increasing



Source: USDA

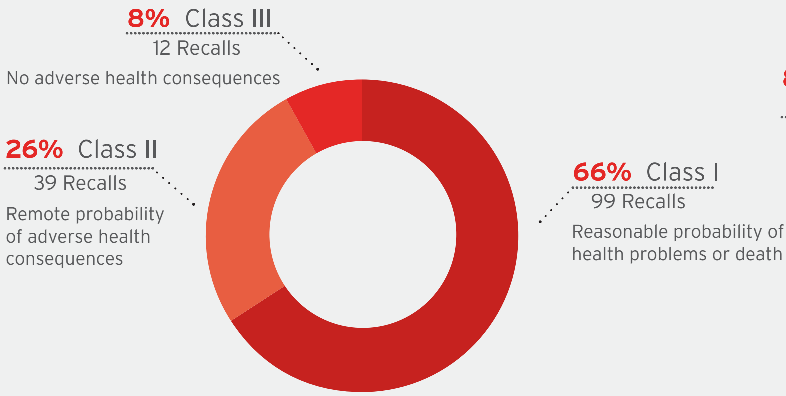
Automotive Recalls Accelerating



Source: NHTSA

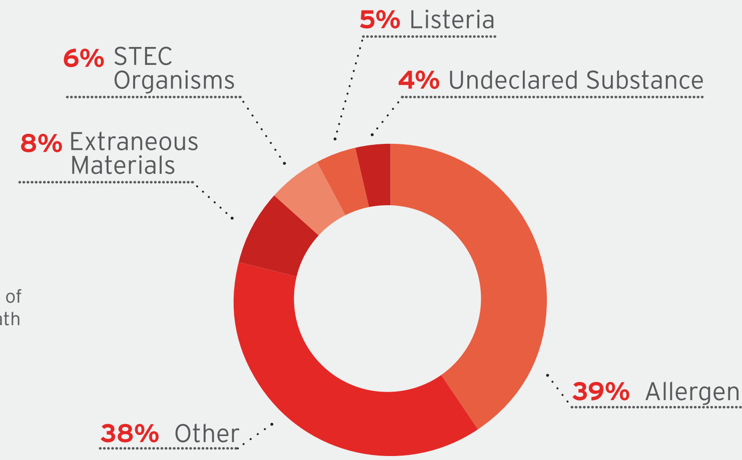
- **Complexity of supply chains.** Sourcing material and labor in a variety of markets is reducing manufacturers' visibility of risks.
- **Technological advances in products.** A growing number of products have more sophisticated component parts, sourced from different suppliers. When coupled with greater complexity in supply chains, seeing product risks more clearly is becoming a big challenge.
- **Scale of production and distribution.** More goods are made and shipped around the world, increasing manufacturers' and distributors' exposure to differing regulatory and legal systems.
- **Consumer awareness of product risks.** Due to the wider availability of product information, new information technologies and consumer protection organizations that encourage consumers to empower themselves through knowledge and action, people are much more likely than before to report or act on product issues.

Majority of Recalls in Highest-Risk Class



Source: USDA

Top Reasons for 2015 Food Recalls



Source: USDA

The growing number of product recalls is outpaced by the spiraling costs of managing them. The need to involve more internal and external resources, often conducting recall activities in multiple languages, inevitably increases expenses. As an example of the higher impact of recalls, consider a six-month outbreak of listeria from a single source of produce. The recall spanned 24 states, affected six brands and resulted in at least 19 reported illnesses, according to Stericycle ExpertSOLUTIONS, a product recall specialist.[4] On top of this, penalties by consumer protection organizations are skyrocketing. Through the first quarter of 2016, fines levied by the Consumer Product Safety Commission totaled $15.4 million, compared with $18.8 million from the CPSC for all of 2015. Even without penalties and third-party litigation, the costs of removing, repairing and/or replacing products in the marketplace are considerable.

Myths and Misconceptions

Recall and contamination insurance is an area where retail insurance agents and brokers can enhance their value in serving clients. Demonstrating a clear understanding of clients' risk profiles and pointing out issues they may not have considered are good ways to add value. So is seeking the right resources to ensure that the client's interests are protected. Starting a conversation about recall risks is an opportunity to show that the agent or broker understands the client's business and is committed to helping the client succeed by accessing and applying appropriate expertise. It's important, therefore, to dispel the myths and misconceptions that many companies have about product recall and contamination insurance. Below are some common myths about this specialized and complex coverage:

"Recall coverage is optional. It's a 'nice to have.'"

- Choosing not to buy recall liability insurance can create costly gaps for a business that has a recall exposure. Until an organization goes through a major product recall, it may have no idea of the short- and long-term repercussions that can jeopardize its reputation, financial stability and basic viability. Recall insurance often is required of organizations that supply ingredients and component parts to manufacturers. Having this coverage can provide a strategic competitive advantage, especially for smaller and midsize businesses.

"My general liability insurance covers recalls."

- Many organizations mistakenly assume that their GL policies will cover the first-party expenses incurred in a recall. In fact, GL coverage does not. General liability is, by definition, a liability policy that pays for third-party sums that a manufacturer may become legally responsible for if a product causes harm. GL will not compensate an organization for business interruption or first-party expenses relating to a recall. Most GL policies have exclusions for product recall, which are sometimes called "impaired property" exclusions.

"Embedded or 'free' coverage is enough for us."

- Sometimes standard-lines policies offer endorsements for product recall. This embedded form of coverage is usually not adequate to cover the most expensive parts of a recall or contamination occurrence. Add-on coverage is most often very narrow, unlike stand-alone recall and contamination insurance, which is much broader. For example, stand-alone policies typically include crisis-management response, one of the most valuable protections following a recall.

"We don't need crisis management."

- Crisis management is an essential component of product recall, and access to professional crisis management expertise is a valuable part of recall insurance. A client that does not have such coverage will very likely need to engage outside professionals to conduct and coordinate a host of activities, including: communicating with customers and the public, performing laboratory testing on affected products, and engaging with government agencies. Access to these various services at discounted rates is a key part of recall insurance, which can help a business regain the public's trust.

"Recall coverage is standard and easy to figure out."

- Quite the opposite is true. Unlike many standard-lines policies, there are no common forms, definitions, or terms and conditions for product recall and contamination insurance. The majority of forms are manuscript and tailored to each insured. As insurers seek growth, more of them are looking at offering product recall coverage, including some markets that have not written it before. Navigating a marketplace of brand-new and established insurers takes specialized knowledge, to ensure that all the relevant risks are covered and claims are handled appropriately.

"We're too careful to have any recalls."

- Carelessness is seldom why most recalls occur. Recalls affect even the most conscientious organizations with dedicated quality control and risk management programs. The most diligent organizations know that even when they do everything right, they still have risks, and recall losses can be severe. Whole Foods Market, an upscale supermarket that sells organic and natural products, led a list of companies issuing the most food recalls in 2014, according to an analysis of U.S. Food and Drug Administration data reported on Yahoo.com.[5]

"Expenses related to a recall claim, if we have one, should be reimbursed quickly."

- A misconception among many businesses and even some retail agents is that recall and contamination insurance is a simple product to understand and that recall claims are straightforward. In fact, product recall is more complex than other forms of coverage because the risks are themselves more complicated. Expenses from a recall claim can quickly spiral beyond initial expectations. Getting those expenses reimbursed hinges on policy wordings as well as forensic accounting professionals who have experience with product recall claims. What may seem like an unusually long time to obtain payment is often due to the complexity of assessing the claim. The appropriate partners with specific recall expertise can help smooth this process.

Conclusion

Retailers Can Help Insureds

Recall and contamination insurance is a prime opportunity for retail agents and brokers to demonstrate their value and enhance their client relationships. By understanding clients' businesses and their risks, seeking expert partners and recommending coverage solutions that they might previously not have considered or even been aware of, agents and brokers can reinforce their clients' trust. The worst time to discover that any insurance policy is inadequate is during a claim. A larger-than-expected loss with minimal or no coverage can result in the loss of a client's business – and potentially an errors and omissions liability lawsuit for the retail agent or broker.

To get the best protection, seek specialized insights and market solutions from an experienced wholesale partner. CRC and CRC Swett have deep expertise in product recall liability as well as the market relationships to deliver solutions that non-specialists simply can't. Securing broad coverage in a fragmented market is challenging. CRC and CRC Swett help retail agents and brokers to navigate the marketplace and evaluate the offerings of both new and established insurers. To be effective, a recall policy must be designed for an insured's particular risks. Claims for product recall and contamination incidents are complicated; experience and expertise count in providing the best outcomes.

For more information, contact your CRC, CRC Swett or SCU broker.
To find a conveniently located broker visit us on the web at:
crcins.com, crcswett.com or scui.com.

Endnotes

1. http://www.fsis.usda.gov/wps/portal/fsis/topics/recalls-and-public-health-alerts/recall-summaries/recall-summaries-2015

2. http://www.fsis.usda.gov/wps/wcm/connect/f9cbb0e9-6b4d-4132-ae27-53e0b52e840e/Allergens-Ingredients.pdf?MOD=AJPERES

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4. http://www.stericycleexpertsolutions.com/wp-content/uploads/2016/05/STCExpertSOLUTIONS-RecallIndex-US-Q12016-FINAL.pdf

5. https://www.yahoo.com/beauty/whole-foods-tops-list-of-companies-forced-to-117606410767.html