As with many developing niche insurance markets, the product recall market currently faces a potential crisis of confidence. Losses are building, new regulations and political issues are impacting insureds, and pricing competition and wording creep are making the sector less attractive to insurers. There is a spate of client litigation cases linked to nonpayment of claims due to misinterpretation of policy wording, and other incidents linked to lack of clarity over claims triggers are seeing clients and prospects question the value of cover. Many brokers are concerned that client dissatisfaction with wording is making the sector more risky, and they are less keen to invest in expertise and grow their product recall teams. So how do we learn from the mistakes of the past and avoid a potential market dislocation in the future?

**Learning from collective mistakes**

Nearly all emerging insurance classes go through growth and loss cycles. Markets usually learn from their collective mistakes, reset policy language and pricing, and emerge stronger, larger, and more relevant to clients. The product recall market is no different.

In the late '90s, AIG dominated in what was then a highly profitable, burgeoning market. CIGNA (ACE) then attacked AIG’s market dominance by offering higher limits, wider wordings, and attractive premium discounts. The inevitable result was that CIGNA had its fingers burned and exited the market. This exit, combined with resulting higher reinsurer costs, lowering of limits, and tightening of wording, saw a significant reduction in the size of the market in terms of numbers of policies written and premium income.

Since early 2000, the market has grown steadily, and today there are 15 markets, primarily based in London, with new capacity via Barbican and Apollo, recent Lloyd’s syndicates entering the market. Gross premium levels are probably in excess...
of $300 million, policy limits can be purchased above $200 million, and policy language is very broad.

In terms of policy development, once cutting-edge aspects of coverage have become standard and valued parts of recall policies. For example, rehabilitation of product covers the increased marketing costs incurred to help bring sales back to previous levels after a recall, and therefore can help to mitigate loss of profit claims for insurers. Despite initial concerns, insureds have not abused this clause through over-generous sales promotions funded by insurers, and it has benefited all parties.

Customer’s loss of profit (CLOP) is another example, which has become vital cover for private label manufacturers for large retailers. If these manufacturers damage a retailer’s image through contaminated or defective products, the retailer will expect loss of profit reimbursement, threaten or delist the supplier.

Offering CLOP has reduced far more significant losses to insurers and maintained retail trust in their supply chain.

Growing losses

However, there continues to be a number of high-profile recalls—with microbiologists claiming that the CHOBANI yoghurt contamination, which resulted in a significant recall at the end of last year, was not as harmless as claimed—although these claims are denied by the company. The Danone/Fonterra legal action linked to the botulism scare in infant formula continues to rumble on, as the litigation case has been put on hold by the High Court in New Zealand pending arbitration in Singapore.

New risks in the form of politically motivated recalls are also emerging. Russia recently banned the import of European fruit and vegetables as part of its “tit for tat” response to increasing European sanctions linked to Russia’s activity in Ukraine. Russia also banned imports from the Ukrainian President’s sweet company.

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China has been increasing its regulatory scrutiny of international companies operating in a number of industries. One particularly high-profile case is the OSI Group, whose subsidiary company, Shanghai Husi, has been accused by the Chinese authorities of selling meat beyond its shelf life. This accusation, in addition to a media exposé, has resulted in OSI’s operations in China facing serious difficulties.

In the U.S., a number of requirements linked to the Food Modernisation & Safety Act are coming into law; catching insureds unprepared for the changes. Ministers in the U.K. have just backed the setup of a Food Crime Unit in the wake of the horse meat scandal. This will no doubt bring in tighter scrutiny and greater food labelling requirements in the U.K. and potentially across Europe.

Understanding the cover

Insureds have been gravitating towards the stronger insurers, who appear to be committed to the class; others are now looking to spread limits across a number of insurers. Many clients are also seeking out brokers with specialist product recall expertise as they realise they need advice and clarification around a number of contentious areas of cover, which can end up as disputed claims.

Adverse publicity has become a major part of the insurance offering over the last five years but is giving rise to much discussion at present. Adverse publicity is a well understood term—negative media coverage—but the actual wordings on offer often seek to link that adverse publicity back to a very specific trigger, such as an actual contaminant event of an identified product. That restriction may not be fully understood by buyers of the product.

Current high-profile disputes, such as Foster Farms and OSI, could result in better clarification of coverage. However, it might also result in this important and innovative aspect of cover being removed from policies all together.

There is obviously a need to develop clarification over this element of the wording, and insurers often link these phrases back to main insurance clauses. For example, Houston Casualty appears to offer wide policy wording, but then requires a standard accidental contamination trigger. This creates an iterative loop, which does not play out well in court.

There are other areas of cover that are of benefit to insureds and insurers; however, they are not risk free for insurers, and there is room for better clarification of wording and coverage. But there is a caveat—and changes or restrictions must be of benefit to all parties—as restrictions in cover could put buyers off this form of insurance.
Growth via Segmentation

The more sophisticated insurers have developed new areas of products lines that move away from core food and beverage recall lines. For example, Catlin is focused on the automotive supplier segment, Liberty on the packaging sector, and AIG on seeking new uninsured risks directly via Novi, an online platform for calculating exposure to recalls. Other insurers, such as XL, have reduced capacity, but strengthened the crisis consultancy assistance service elements within their product.

Another way forward could be to recognise that demand for coverage is driven at the board level. Recall and brand damage are very high-profile and most risk purchasers have to confirm that coverage is in place.

There is a lot we can all learn from the mistakes of the past, and we need to work together to apply what’s been learned to strengthen the market for the future. However, with the product recall market at a tipping point, it is important for clients to realise that they need expert, independent advice to help guide them through the issues and policy wording complexities to ensure that their insurance programmes deliver the coverage they anticipate when they need it. This is where specialist brokers increasingly play a vital role.

Lockton’s specialist market solutions

Lockton has been at the forefront of developing the product recall insurance market, offering an enhanced product recall policy specifically designed for companies with exposure across the supply chain for a variety of materials and goods. These policies have specific trigger events designed for each consumer industry faced with a recall. For example, in the food-production industry, the trigger is based around food safety issues, allowing the insurer to recall a product if there is a likelihood of harm, whereas in the automotive industry, it will be linked to a part failing to meet specifications.

The recall policy will cover:

- **Pre-recall expenses**, including testing, analysis, and specialist adviser costs required to determine the severity of risk and crisis issues surrounding it
- **First-party recall costs**, from advertising the recall through to removing, warehousing, and destroying problem products
- **Third-party losses**, including gross earnings losses by third party suppliers, impaired products, defence costs, and manufacturers’ errors and omissions

Protecting your business

Insurance is only half the story. Companies must also be able to manage a crisis situation, and doing so is dependent on good risk management being in place.

Robust risk management procedures are paramount for any manufacturer, supplier, or producer. This includes ensuring that strict production standards are in place and adhered to at all times, and that regular testing and audits are undertaken to check the systems in place. Everything must be well-documented to help suppliers isolate a problem batch of goods or components before they reach the market, or to help identify them, should a problem arise post-distribution.

Clients need to be prepared for the worst to happen. Recalls need to be handled quickly, and in an appropriate manner, to minimise the damage to both the first and third parties involved. Contingency plans must include all elements of the supply chain, as well as crisis communications assistance and legal advice. The plan should be regularly tested, especially if the company has recently expanded into new territories.

Suppliers also need to be up to speed on regulations across all jurisdictions where the products are being used, and ensure that these regulations are adhered to. Many a supplier has inadvertently fallen foul of packaging rules by assuming that packaging for one country will be appropriate for another. Ignorance is no defence in a recall incidence.

The Lockton team

Our specialist team works with manufacturers, suppliers, and packaging companies across a wide range of industries all over the world. Our collective expertise and market relationships mean that we are perfectly positioned to offer risk mitigation advice and information on how to protect your organisation from the financial, operational, and reputational risks that can arise from a recall incident.
Our Mission

To be the worldwide value and service leader in insurance brokerage, employee benefits, and risk management

Our Goal

To be the best place to do business and to work