With today’s increasingly global and interconnected marketplace, product recall incidents are getting bigger, more international, and complex to handle. In this paper, we look at the issues facing manufacturing companies, and highlight some of the risk mitigation steps that suppliers should take to help protect their business from the potentially crippling effects of a product recall.

We also examine some insurance misconceptions around product liability cover, and highlight more appropriate insurance solutions that can provide more effective financial assistance for product recalls.

Global Sprawl - The Issues

The benefits of expanding your business into international markets are obvious. But what happens when something goes wrong and products that your company creates, supplies, or relies upon have a problem and have to be recalled? Recalls are complex even when they take place in the country of origin, but these issues multiply dramatically when goods have to be recalled across numerous countries, different time zones, and languages.

Globalization of production has brought enormous benefits to consumers both in terms of lower prices and greater choice, but when a food safety issue is raised, the complex supply chain is put under enormous strain. There is a legal requirement for products to be traced within the supply chain, so that products affected can be monitored and collected. These requirements, if not prepared for, can be an administrative nightmare should a recall occur.

The global nature of today’s supply chains was vividly demonstrated by the Fonterra Group, a New Zealand-based company, which in August 2013 announced that contaminated whey products could have been sold to third parties, which used them to produce infant milk formula and sports drinks. More than 1,000 tons of products were recalled, across seven different countries. China, a major...
importer of dairy products from New Zealand, instigated a temporary ban on imports of powdered milk from New Zealand for a period in the aftermath of the recall. Although the contamination appears to have been a false alarm, Fonterra Group is now facing legal action from companies it supplied, and in particular from French company Danone, which claims that £290m ($500m) of sales were lost due to the recall.

**Fewer Recalls but a Greater Impact**

Another problem compounding the recall issue is that global business means the impact of recalls is growing, with more products in more countries affected by the action. As products in more than one country are being affected more often, there are greater numbers of units being recalled. In the fourth quarter for 2013 in the U.S., the number of food products recalled jumped from 5.4m in Q3 in 2013 to 21.2m in Q4.¹

The issues of handling recalls are being exacerbated by the speed at which information now travels via social media. So, on top of having to deal with the physical logistics of recalling products, there is a significant brand reputation risk to manage, as news of a recall can spread globally in seconds, and once a company has been named and shamed, it is likely to be continually mentioned every time a similar event happens.

**More Complex Regulatory Environment**

Manufacturers and exporters also face a growing list of regulations, the latest of which are new food labelling requirements in the European Union that will apply from December 2014, and will be a mandatory requirement by December 2016. These new regulations require food labelling to provide allergy information on all food products sold in Europe, and this could drive increased exposure for a wide range of businesses involved in the food production and distribution chain.²

Food labelling is also a significant issue for importers to the U.S., and according to USDA (United States Department of Agriculture) mislabelling and undeclared allergens were two of the main reasons for food recalls in the U.S. in 2013.

**Passing the Risk Down the Chain**

Manufacturers and suppliers of goods should be prepared to foot the bill of a recall, and these costs can quickly escalate especially if they are part of a large supply chain. Often, these chains are complex and include multiple suppliers from packaging to raw ingredient companies. Firms need to recognize these risks and plan for them.

A recent example of the independency of supply chains is Heinz in Canada, which has recently had to recall a range of infant food due to defects in the packaging pouches. Heinz will no doubt be looking to pass the recall costs back to the manufacturer of the faulty packaging, but this could become difficult if Heinz has agreed to the specification and tested the new packaging.

**Learning Lessons from the Automotive Industry**

The present dramatic recalls engulfing both General Motors (GM) and Toyota highlight the supply chain exposures in the automotive industry. GM’s recall of 2.6m vehicles stems from a faulty ignition switch supplied by Delphi. The present congressional investigation is examining the way in which the specifications for the product were agreed, tested, and signed off. Toyota has suffered huge brand damage linked to the high-profile nature and scale of recent recalls, which affected more than 6 million vehicles. A recent recall involves a supplier of the spiral cables in the deployment mechanism of the airbags which may have broken. In addition to the recall replacement of these vehicles, Toyota has agreed to pay a fine of $1.2 billion. If a supplier fault can be identified, then it is likely it will be asked to share Toyota’s financial pain. This passing of the risk down the chain is a significant uninsured risk for today’s vast, complex, and often global supply chains.

**Liability Market is Failing to Respond**

Many clients wrongly assume that traditional product liability insurance will provide them with financial protection for a recall. However there is a fundamental structural weakness in the liability insurance products, making it difficult for them to fully address the growing supply chain exposures.

The problem arises because general product liability policies tend to operate on a legal liability trigger when there is an obvious “injured” party. But many recalls are caused by a “fear of a problem” as was the case in the Fonterra recall and in these instances the wording is often unclear as to whether the policy will respond or not. Timing is critical in a recall incident where the brand is at risk, so waiting for a liability insurer to agree a course of action is simply not a viable option.

### Specialist Market Solutions

Due to the inherent problems in traditional product liability covers, there is a burgeoning specialist product recall insurance market. Lockton has been at the forefront of developing this market, with 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 case of food, the trigger will be based around food safety issues allowing the insurer to recall 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 tends to be very broad and will cover:

- Pre-recall expenses including testing, analysis, and specialist adviser costs required to determine whether the risk and the 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
- Balance sheet protection for lost income.

The London market for product recall insurance is world-leading, but it is not for the inexperienced. Capacity for risks up to $100m, and global excess capacity of up to $100m, is available on a worldwide basis. This is where Lockton’s specialist insight and knowledge can assist, by matching a buyer’s requirements to the specialist insurance solution that is most appropriate for the insured, and at a competitive price.

### Protecting Your Business

Clearly, when protecting your brand, insurance is not the first place to look. Companies will have to be able to manage the crisis situation and will depend on good risk management being in place before the event.

Good risk management procedures are paramount for any manufacturer, supplier, or producer. This includes ensuring that strict production standards are adhered to at all times and undertaking regular testing and audits to check the systems in place. Everything must be well-documented, and component parts recorded, 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.

Be prepared for the worst. Recalls need to be handled quickly and appropriately to minimize 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 expanded into new territories.

Suppliers need to be up-to-speed on relevant 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 defense in a recall incidence.

### The Lockton Team

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

In the words of Spanish novelist Miguel de Cervantes “Forewarned is forearmed; to be prepared is half the victory.”