

# Powers of recall

## **Product recall and liability insurance are currently written separately. Jeremy Golden explores whether there is a case for developing a composite cover**

The revised European Union General Product Safety Directive came into force on 15 January and, despite few countries having enacted the directive to date, all EU member states are expected to over the course of the coming year.

The GPSD applies throughout the EU and enables member regulators to mandate a recall in their territory, as a last resort, for any product that is unsafe. The EU will also communicate their actions beyond the member states to other territories, such as the US and Australia, leading to a possible global recall - substantially raising the risk of corporate bankruptcy.

Actual incidents of product recall in the UK have been comparatively low. But, once the revised GPSD comes fully into force, this number is expected to increase substantially.

### Robust recall

The GPSD requires all manufacturers to have a robust recall procedure to enable them to withdraw a product from the consumer market - not just from the retailer. All parties in the supply chain - manufacturers, parts suppliers, wholesalers, retailers - have a duty to ensure that only safe products are put on the market, keep records, and they must assist in a mandated recall. The GPSD also calls for greater transparency and will make statistics on recall publicly available, as in the US market.

Having said that, product recall insurance is no longer widely available.

Capacity has become limited because exposure is high and, historically, results have been poor. Cover typically includes all costs of recall, such as transportation of defective goods to the original manufacturer, disposal costs and loss of profits. The loss of brand value is generally not insured - although a few insurers are looking to dip their toes in the water with first loss/partial covers.

Product liability insurance does not cover product recall, partly due to a perceived conflict of interest. PL underwriters typically want a recall to try and avoid subsequent claims by third parties based on defective or unsafe products, whereas a recall insurer would want to avoid recalls, that is claims, wherever possible.

However, Tom Battell, director of insurance claims services at Pricewaterhouse Coopers strongly advocates bringing together the two covers under one underwriter by which the whole process could be better managed - ultimately resulting in fewer claims.

He believes PL underwriters should extend their policies to include recall because they have a strong, vested interest in doing so. The product recall cover should not be a one-off but integral to the PL offering, and for longer than a one-year period to make it viable.

As Mr Battell sees it, this extended cover would encourage a closer collaboration between underwriter and manufacturing client, with more rigorous risk management practice at every phase of taking a product to market.

It would, of course, take time for an underwriter to gain an in-depth understanding of the manufacturer but, once they feel reassured on the quality of the goods, they should stay with their client for the long term. If the product is found to be unsafe, the underwriter should cover the cost of the recall because it will avoid subsequent liability payments.

A composite product would be priced at a substantially higher level than standard PL and policies rated differently according to the category of end-user.

One special risks director at a London broker, specialising in product recall would appear to support a composite product. He says: "Common sense dictates that if a product in the stream of commerce is out there with the potential to harm consumers, the only way to contain the impact is by immediate withdrawal of the product. The market needs to understand that, for multinational clients with mass distribution, product recall coverage is a 'natural progression' to a traditional PL policy."

However, PL and product recall policies are typically written by separate markets and he is sceptical that PL underwriters have the expertise or the experience to extend cover to include recall without suffering heavy losses in the short term.

Zurich London provides PL programmes to large domestic and corporate customers, but does not write stand-alone product recall exposures in the UK.

According to John Inwood, manager, casualty corporate: "Most recall markets are already provided through PL capacity. Therefore, what is being suggested here is merely an extension of packaging or grouping of products provided by an insurance company. The question of potential conflict of interest is not a major consideration as procedures and protocols are agreed at inception to manage any potential recall situation."

#### Extension solution

Mr Battell refutes the suggestion that the recall market is sufficiently accounted for by PL. "It seems to me that merely adding a product recall extension to an existing package is not the answer. Typically, cover is limited to legal/contractual liability for the cost of recovering the product from the customers' premises or supply chain, not from the consumer market."

He continues: "It is really just about clearing supermarket shelves or dealing with the returns. What about loss of profit, costs of extraction, loss of brand value, product rehabilitation costs, increased marketing costs, cleaning and disposal costs?"

Mr Battell puts forward two scenarios that he believes enforce his argument.

Firstly, what happens if the regulator enforces a recall? If it is necessary to actually go out and recover the products from the consumer, will the underwriter pick up all the costs even if no injury or damage occurs?

A second scenario could be where the insured has a sub-standard product on the market and needs to withdraw it to protect the company name/brand value. Would the policy pay?

Clearly, weighing up the business rationale for comprehensive product recall cover will be a lengthy and complex process for PL underwriters and, at this stage, it is hard to forecast which, if any, underwriters will consider doing so. But over the coming years, more and more products are likely to be taken off the shelves as a result of the revised GPSD and manufacturers will be looking to their insurers to anticipate and alleviate the potential dire consequences of this on their business.

Potential benefits and drawbacks of composite product recall/liability cover

Key potential benefits to underwriters of the proposed composite product:

- Higher premiums
- Greater industry knowledge on manufacturing would raise risk management standards
- Tighter control on liability claims
- Consolidated and more transparent records on product recall - Initial higher claims on recall compensated for by lower liability claims in the long term

The main threats:

- Potentially higher-than-expected claims in the short term
- Lack of capacity to cover high initial claims will require persuading reinsurers to come on board.