CRC Group
Wholesale & Specialty

Product Recall & Contamination Insurance: What Your Clients Need to Know

Recall and contamination insurance have never been more essential to business stability. Yet many companies fail to understand how important this type of coverage is. How can retail insurance agents help their clients make wiser decisions?

Insurance solutions are constantly evolving because the environment in which companies do business is always changing. The regulatory environment, technological progress, global trends, and consumer preferences and expectations are just a few factors that can impact an insured's viability and reputation. The future is unpredictable, but clients look to insurance professionals to help them identify and mitigate emerging risks. And in the case of product recalls, the risks have continued to climb year over year.

Many factors make product safety, as well as recalls, more challenging and more costly to insure, including closer public scrutiny, tighter regulations, globalization, and business complexity. For businesses in a wide range of industries, there is increasingly no way to completely protect against the risk of one day releasing a defective or contaminated product into the market.

RECALLS ARE ON THE RISE

In many industries, including food production, pharmaceuticals, automotive, and consumer goods, the number of recalls is on the rise. On the food and beverage side, the U.S. Department of Agriculture (USDA) annual data tells us that the number of meat and poultry recalls saw a sharp decline in 2020. However, they are on the rise again. The most serious recalls continue to make up the majority. The USDA recalled 65 products in 2023, compared to 45 in 2022. The majority of those were Class I recalls that the government defines as "a health hazard situation in which there is a reasonable probability that eating the food will cause health problems or death." [1]

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Auto recalls have also risen sharply. The number of auto units recalled in 2023 rose 23% over 2022. Furthermore, total product recalls saw a 7-year high in 2023, an 11% increase over 2022. The penalty costs associated with those recalls also increased significantly. A record $55.3M in fines was issued in 2023. The U.S. medical device industry saw 975 recalls in 2023 as well. The silver lining is that the number of total units impacted was lower.[2]

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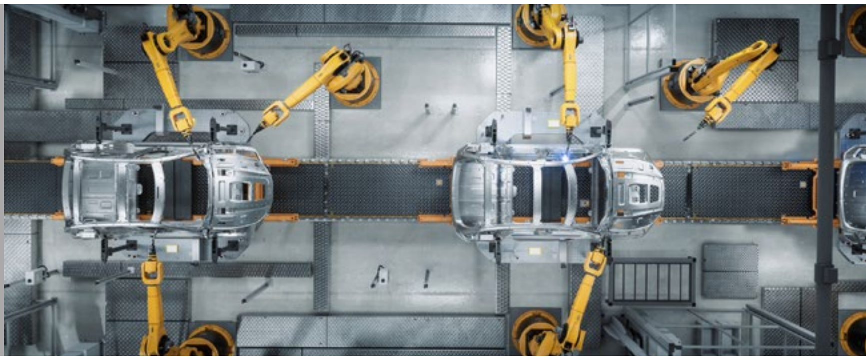

FOOD ALLERGIES

One of the factors that may also be driving up recall activity is allergic reactions. Data from the US Center for Disease Control and Prevention (CDC) show that the number of consumers with food allergies is 6%.[3] This is further reflected in the fact that there are nearly 30,000 emergency room visits per year related to food allergies and allergic reactions.[4] A recent survey indicated 10% of respondents reported a food allergy. Regardless of the precise number, the annual economic cost of food allergies is estimated at $24.8B per year.[5] The high prevalence of allergies places an additional burden of oversight on the food industry: unlabeled allergens are now the leading reason for an FDA-regulated food to be reported for recall.[6]

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CONSUMER AWARENESS

Consumer awareness about potential product risks is also playing a role in driving up product recall activity. Due to the wider availability of product information, new information technologies, and consumer protection bodies that encourage consumers to empower themselves, consumers are much more likely than ever before to report or act on product issues. However, much work remains to be done to increase consumer awareness. On average, there are 46,200 deaths and 40 million injuries yearly due to product recalls in the United States. Furthermore, response rates for recalls can be as low as 3 percent.[7] Unfortunately, such low response rates can incentivize companies to bring products to market that they know have a high potential for recall.

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SPIRALING COSTS

The astronomical cost of recalls is causing companies to take action. In the food industry, the average recall cost is $10M.[8] In the auto industry, recalls ran up a $20B bill for automakers in North America alone.[9] However, it's not simply the cost of the recall causing costs to skyrocket. Loss of reputation prompts many consumers to look to a company's competitors to fill their needs. It makes little sense for auto consumers to purchase a more expensive luxury vehicle if it will be subject to many of the same problems as a less expensive counterpart. Automakers, particularly in the luxury space, have strong incentives to improve quality assurance and reduce recalls in the future.

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Regulators are also attempting to encourage manufacturers to properly address recalls using heavy fines. The CSPC reported in 2023 that Peloton had been issued a $19M fine for failure to report hazards and recalls regarding their treadmills. The charge indicated Peloton knowingly distributed defective treadmills that posed a risk of serious injury to the end user. According to the report, many people suffered broken bones, lacerations, and other injuries. It was also reported the defect resulted in the death of a child.[10] The recall was officially announced in 2021. Peloton shares became essentially a penny stock soon after.[11]

COMMUNICATING THE RISKS

For manufacturing and processing clients, product contamination and recall risks are very real and potentially devastating. But the risk often goes misunderstood or ignored—even by established companies with years of experience in a specific industry. Until an organization goes through a major recall, they may have no idea of the short- and long-term repercussions that can jeopardize their reputation, financial stability, and basic viability.

Retail insurance agents are in the business of adding value—a goal that is increasingly challenging as it becomes tougher to compete strictly on price. While talking to clients about recall insurance can be challenging, clearly understanding their risk profile is one of the best ways to add value by enhancing and protecting their business.

Starting a conversation about a client's recall risks is an opportunity to show clients that you understand their business and are committed to ensuring they are prepared for issues they may not have fully considered. Dispelling the myths and misunderstandings surrounding product recall and contamination insurance is critical: making the right decision can mean the difference between a company's continued survival or total extinction.

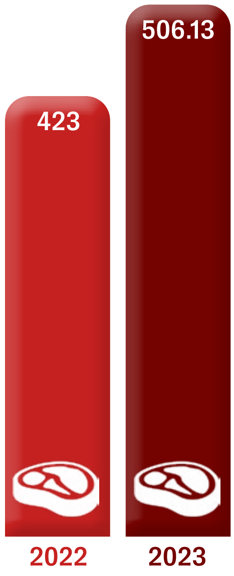
Professional insights are especially critical in the standalone recall and contamination market, where the forms are manuscript, and each carrier uses its own form and wordings. Without extensive expertise in this area, it's easy to misinterpret the coverage offered or overlook the various enhancements. In some cases, critical coverage is not included in a program, while others are packed with costly enhancements that are irrelevant to a specific client. This is one of the areas where the agent role has the potential to deliver incredible value to the client at every step in the process. Too often, the importance of a well-crafted recall insurance policy is overlooked and undervalued. Let's look at some of the misconceptions that may need to be overcome with clients.

"RECALL INSURANCE IS A 'NICE TO HAVE'."

While many companies see contamination and product recall insurance as optional, declining it creates a significant gap in the insurance program. Within a general liability policy sits the premises/operations coverage. In this cover, a manufacturing client is insuring against the risk that someone who does not work for them gets injured while on their premises. This is certainly a risk worth guarding against. But how does it compare to the risk that an error in their process results in a flawed product that needs to be recalled and replaced? How about the business interruption risk that could come from this kind of situation? When comparing the possible severity of a typical slip-and-fall situation to the costs and disruption a recall event is likely to incur, this type of insurance makes a lot of risk-management sense.

Recall coverage also dovetails with product liability insurance, which transfers the risk of the actual bodily injury or property damage that a product might cause a person or their property. With recall, the policy generally covers all of the first-party expenses that a client could incur when dealing with a situation where they are forced to remove a product from the marketplace.

Meat & Poultry Recalls

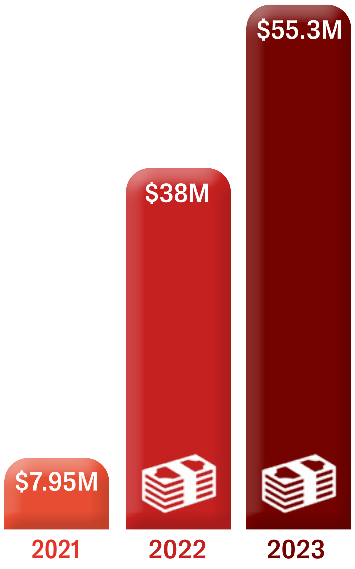


FDA recall events rose 19.6% from 423 to 506.[13]

Automotive Recalls

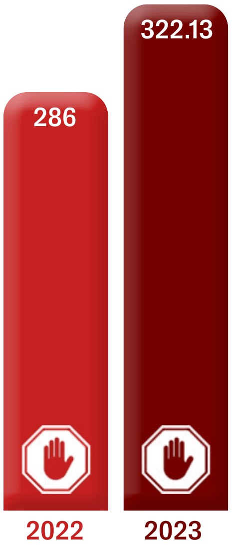
Fell from 955 to 916. However, the total number of impacted units increased from 31.2M to 38.4M.[13]

Consumer Product Penalties



The CSPC issued $55.3M in fines in 2023 compared to $38M in 2022 and $7.95M in 2021.[13]

Total Recalls



Consumer product recall events increased 12.6% from 286 to 322.[13]

Many **clients assume** that their general liability **(GL) policy covers** the **first-party expenses** incurred by a recall, but in fact, **it does not.**

"GENERAL LIABILITY COVERS RECALLS."

Many clients assume that their general liability (GL) policy covers the first-party expenses incurred by a recall, but in fact, it does not. The GL is, by definition, a liability policy. It pays for third-party sums that the manufacturer is liable for because their product caused harm. However, it will not cover first-party expenses or compensate the organization for business interruptions. In fact, most GL policies specifically contain an exclusion for product recall, an exclusion that is sometimes listed as an impaired property exclusion.

"THE 'FREE' COVERAGE IS ADEQUATE."

If your client's insurance policy includes free recall coverage, it's essential to communicate that this type of coverage is guaranteed not to cover their real risk. Clients often misunderstand the coverage and consider the recall (or withdrawal) expense form included in a standard-line carrier GL coverage to be adequate in covering their risk for recall or contamination. The truth is that these forms do not typically cover the most costly components of a recall or contamination event.

For food companies, the loss of gross profit (business interruption) and the value of the contaminated products are the two leading components in most losses. With non-food risks, the leader is the cost of replacing the recalled products (including the cost of labor). By contrast, a stand-alone recall and contamination policy will cover these areas and offer significantly broader protection in numerous other ways. For example, stand-alone policies include crisis-management response as part of the policy.

"WE DON'T NEED CRISIS MANAGEMENT."

Crisis management is essential to any product recall and one of the most valuable elements of a contamination and product recall policy. If a company experiences a recall without recall insurance, it will undoubtedly need to engage the services of outside professionals to help carry out the recall. This could include media professionals to communicate with customers and the public, lab professionals to test and analyze products, legal professionals to coordinate with government agencies, and a crisis-management service to coordinate these efforts. The costs of this type of response can be significant, and in an era where public trust is a business's most valuable asset, it's the last place clients should consider cutting costs.

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"WE'RE TOO CAREFUL FOR RECALLS."

Product recalls don't just happen to careless companies; some of the most conscientious organizations can be affected by recalls. The firms that purchase recall insurance are generally best-in-class in their dedication to safety and quality control. For example, the grocery store Albertson's voluntarily recalled five products due to possible listeria contamination.[12] Companies that carefully guard their reputations often experience product recalls more frequently because they're more likely to issue voluntary recalls as a protective or pre-emptive measure. Clients who prioritize safety and quality control and feel they are protected by the amount of time, money, and resources they spend to ensure that they have good systems and practices in place need to understand these facts to make an informed decision.

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BOTTOM LINE: RECALL INSURANCE IS A UNIQUE OPPORTUNITY

Insurance professionals are responsible for helping clients understand the risk and the impact that one of these events can have on their business. Recall and contamination insurance protects a client's balance sheet and provides the professional assistance needed to successfully navigate one of these events. It's not just a question of immediate costs and lost productivity. Suppose a business experiences a recall event, and it's mishandled because of a lack of funds or access to crisis-management experts. In that case, it can trigger a loss of trust in the marketplace and among members of the public that is potentially devastating to the company's long-term prospects. Communicating the true value of this type of insurance—and the real consequences that a lack of coverage can have gives retail agents an opportunity to build trust, demonstrate expertise, and ensure companies have the information they need to make better decisions.

CRC Group offers specialized industry and product knowledge that enables retail agents to navigate complex insurance landscapes confidently. With a wide network of market and underwriter access, Team CRC provides unparalleled opportunities for securing the best coverage options for your clients. Our access to capacity facilitates handling large, complex placements, ensuring that even the most challenging risks are adequately addressed. Reach out to your local CRC Group producer today.

CONTRIBUTORS

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