How to improve Home Foreign Liability Coverage for US Machinery Parts Manufacturers and Automobile Component Suppliers

Over the past decades, US companies who operate internationally do have access to purchase coverage for their premises and product liability for risks abroad through dedicated US brokers in the US market. The product is a Primary Commercial General Liability Policy to cover Home Foreign Liability. The coverage territory definition is reverse to the US Domestic ISO CG 0001 form coverage territory definition, which is as follows:

"Coverage territory" means:

a. The United States of America (including its territories and possessions), Puerto Rico and Canada;

Within the Home Foreign liability master policies, it is typically defined as

“Anywhere in the world excluding The United States of America (including its territories and possessions), Puerto Rico and Canada;”

The US master policy intends to cover the US domestic company for its product liability exposure related to foreign exports, voluntary workers compensation coverage for employees who are sent abroad and hired and non-owned automobile liability for employees renting vehicles or using non-owned vehicles abroad. Also, it includes coverage for foreign parent entities on a Difference in Conditions and Difference in Limits basis[i] in excess of Local liability policies, who are covering the primary portion of the US foreign entities and its vicarious liability for its premises and products liability exposure. For example, Company A has five subsidiaries, B, C, D, E and F who are incorporated abroad. B is a French corporation, C is German corporation, D is a Mexican corporation, E is a Chinese corporation and F an Australian corporation.

For each of those corporations, there will be a local policy issued to the respective company, by a local admitted carrier. For a company with Sales of $ 600 M globally and estimated $ 30 M in sales within respective countries, this would result in the issuance of local policies of at least equivalent to $ 1 M in limits of liability. A US Home Foreign Liability Master program mainly targets liability coverage for Bodily Injury and Property Damage to a third party and related to an occurrence, taking place during the coverage period of the policy where the insured will have acted negligent[ii]. It typically excludes coverage for financial loss except for Personal & Advertising Injury liability, which is only a small financial loss extension as it is a rather narrow coverage, where coverage is provided for Personal & Advertising injury related to an Advertising idea[iii].

Within different countries, you will find certain specialty liability coverage extensions, which have been created over time within those markets and have become market standard locally. In France, it would be the coverage for “fautes inexclusable” for liability. In Germany, the typical extension to a German liability policy is the so-called extended products liability coverage. In addition to coverage for bodily injury and property damage, it includes liability coverage for pure financial loss as per the Products

Liability Coverage Model. For the purpose of this essay, I will describe and focus on the key element of the extended product liability coverage, which is coverage for financial loss related to a product, which is not deemed functional and built into a larger complex product. A smaller component is becoming part of the larger product, but can still be separated, and removed from the larger part and be replaced or repaired. For example: Screws, machine aggregates or prefabricated parts, who become part of a machinery product or an automobile. The key element is that those parts do not become inseparable. It won't work with products such as lacquer or adhesive as they become part of the final product.

The Extended Products liability Coverage was developed in 1974 by the predecessor of the GDV (Gesamtverband der deutschen Versicherungswirtschaft = German National Association of Insurers). It became part of the German Industrial Liability Policy, which was by then standardized and used by all German Insurers providing Commercial General Liability Coverage on the same basis. In 1994, The German Insurance market opened up for more liberal competition, where the necessity of filing and approving standardized forms was no longer necessary before offering such coverage to insureds. As a consequence, commercial liability coverages started to vary among various insurers. This is in particular valid for coverage provided to larger sophisticated insureds that traditionally have been placing Commercial Insurance themselves instead of using the services of an unaffiliated third party broker. On the other hand, all German insurers continue to collaborate and develop guidelines, which insurers can follow, but are not mandated to follow, while providing coverage to commercial insureds. Until today, GDV working groups continue to amend the so-called "Produkthaftpflicht-Modell" (PHM) to provide coverage as intended and to incorporate related case law as decided by the German courts.

As per 4.4. of the PHM indemnification is provided for

1.) Expenses for the exchange of a product, which is deemed to be defective, which means costs for the Removal and Installation of a product without defect except for the product itself.
2.) Expenses for the Transportation of a product without a defect to the place where the contract needs to be fulfilled.
3.) Expenses for the repair of a product defect
4.) Expenses for other items, which lead to the elimination of the product defect

Such coverage elements are particularly valuable for insureds, who are manufacturing Machinery Parts Components and Automobile components suppliers, which products are separable. While Quality control Management has improved over the past years, and most companies have developed and incorporated procedures in which a meaningful number of products are reviewed and tested after they are manufactured against set company quality standards for respective product, there is always the risk that a certain batch of products could be defective and not within set parameters. In such case, the company is exposed to the risk that the defective products are incorporated into a larger third party product. If their product does not cause a third party damage for either bodily injury nor property damage, the respective expenses as listed above would not be covered under a traditional US Commercial General Liability policy, and the insured would have to bear the costs himself.

As of today, Commercial General Liability master coverage for Home Foreign Liability to a US Corporation and its foreign subsidiaries typically does not extend coverage to the Financial Loss components of the German Extended Products Liability coverage. The local German policy being part of a Home Foreign liability program although would give this coverage extension to the German parent corporation only where the US domestic master insured has a majority ownership interest in or exercises managerial control.

For Machinery Parts Manufacturers and Automobile Suppliers with sales of $ 150 M - $ 300 M globally, normally it is customary to carry at least Euro 2 M and up to Euro 10 M in limits of liability. For Companies with sales of $ 300 M - $ 800 M, the limits of liability vary between Euro 10 M - Euro 25 M. It is recommended to analyze the risk exposure as per Loss Control evaluations and upon such completion determine the preferred limits of liability for respective insured. The choice of limits of liability as well as the level of the deductible is within the responsibility of the insured that regularly uses the services of a third party broker.

Many years ago the exposure basis for the calculation of the premium for a German Commercial General Liability was the number of employees. This was complicated and did not include the accurate risk exposure as consists of the extended products liability coverage. The key determining factor for the exposure is the number of sold products to third parties throughout the coverage period. Therefore, the exposure basis for premium calculation was changed and is now based on the sales of the company, which falls within the coverage period. While the sales can vary and be either higher or lower, it mirrors best the real exposure. Under normal circumstances, it does not take long for a third party to discover, whether a component is defective, which would lead to a potential financial loss claim as was described earlier.

Within the German Commercial Insurance market, International liability programs include the extended products liability coverage extension within a German master liability policy as a Difference in Conditions element. Since this coverage feature is currently normally not available in any other markets, it is allowed to provide coverage on a non-admitted basis. German insurers have developed their statistics and are comfortable in calculating a premium, determine the right amount of deductible and limits of liability. It provides a high level of financial protection for the insured, which is in the business of manufacturing machinery parts components or automobile suppliers. The costs to replace a defective product including transportation costs often reach amounts of $ 1,000 for each exchange excluding the product itself. In particular the labor costs for the installation will consist of a major part of the expenses. While this coverage does not work like a recall coverage and the product needs to be proven defective, it is not unusual that a number of more than 1000 component parts are not deemed functional because they originate from a defective batch. This would result in a potential financial loss of $ 1 M and more for the insured, which makes the loss financially significant.

There is no reason, why such extension could not also be provided under a US Home Foreign master policy. The financial risk exposure for US insureds within the same classifications as described above is not different than to the ones of their German competitors. In particular middle market companies with sales of $ 150 M - $ 800 M. could be very interested in receiving such coverage on a global basis, rather than being restricted to the extension of a German local policy being part of a US Home Foreign liability master program. To avoid certain tax or compliance issues, it could be argued, that instead of providing the extension out of the US master policy, it might be better to provide it out of a European Policy under the rules for Freedom of Services (FOS) at least for the EU countries. If payments are made from a FOS European policy, the insurer will need to use the services of a tax representative to make sure that the correct insurance tax is paid to the right authority. Example: A FOS European policy incorporates extended products liability to all local insureds located within the European Community. The policy is issued in Germany, but a claim is now taking place in France. While the policy will pay the claim expenses directly to the French insured, the insurer must use the services of its French Tax representative to make sure that the correct amount of French Insurance tax will be paid to the French authorities.

I personally hope that the US insurance community will continue to improve our coverage standards for US insureds going forward and enable them to receive improved coverage at competitive conditions. At the same time insurers need to be comfortable in calculating premiums and coverage, which complies with their solvency requirements. This is one good example where coverages developed in one territory could benefit insureds in other territories across the globe.

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[i] A larger number of companies have incorporated Financial Interest clauses within that coverage to replace the traditional Difference in Limits coverage portion, where the financial interest of the US Company is covered as per respective definitions in lieu of an interest of a foreign company.

[ii] ISO CG 0001 04 13, Section I, Coverage A Bodily Injury and Property Damage Liability, 1. Insuring Agreement

[iii] Please see Definition of “Personal & Advertising Injury” of ISO CG 0001 04 13, Section V