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Insurance Policy Pitfalls: Supply Chain Edition

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Let's not sugar coat it – managing risk across supply chains has always been complex but it's become more complex in recent years. Life science companies are expanding their supplier networks and increasingly outsourcing services, with each new connection point introducing new vulnerabilities.

While some companies simply fail to account for the financial losses that could occur in the event of a major supplier disruption, others believe they have sufficient insurance coverage to offset any setbacks. In too many cases, companies learn of vital gaps in their coverage after the damage is done.

Life science firms frequently fall victim to three insurance policy pitfalls related to their supply chain:

PRODUCT SPOILAGE

Many companies assume they are fully insured for spoilage, and can even point to the correct section of their policies. However, there is more than one type of covered cause of loss that needs to be accounted for.

For example, a life science company that experiences a mechanical failure in its refrigerating system may have sufficient coverage for spoilage resulting from "equipment breakdown." But the policy may contain an exclusion for – or not overtly mention – an instance where a power outage beyond the company's control affects the temperature of a warehouse or a work in progress (WIP) manufacturing process and causes an out-of-specification temperature range to the product.

Where "mechanical or equipment breakdown" policy definitions may not be triggered, property policies may have a "change in temperature" exclusion buried within coverage grants for spoilage loss.

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BUSINESS INTERRUPTION TRIGGERED BY NON-PHYSICAL DAMAGE

Particularly if their operations are outsourced, company leaders may not consider the complete scope of their manufacturing risks. Their insurance policies likely include traditional business interruption coverages triggered by physical, accidental damage – such as fire, earthquake or hurricane – but will omit coverage for a disruption caused by a non-physical trigger.

Just in the past few years, insurance companies have begun underwriting coverage for various types of non-physical damage, including for the suspension of manufacturing due to a regulatory shutdown of a facility or production line, or the production or introduction of off-spec materials.

Life science firms should establish a risk management program to identify the manufacturing risks, both physical and non-physical, that could result in a loss and determine if a portion of this risk could and should be transferred to the company's insurance policy.

WIP & FINISHED GOODS

There are different approaches to insuring property throughout the life science supply chain. Some life science companies prefer to include property coverage for WIP and/or Finished Goods within their traditional property insurance policy. Firms that have a separate transit insurance program may prefer to include this coverage on their stock throughput policy, which insures a company's inventory from the manufacturing location through to its final destination.

Regardless of where this coverage appears, firms should pay close attention to the wording of their policies. Most critically, they should look out for coverage exclusion for actual damage to property that occurs while products are being manufactured or processed. Most policies will exclude coverage for damage to property that happens by "errors in process or manufacturing." Others will exclude damage to property "during the state of manufacturing or processing."

The second exclusion is much broader; it refers to *any* damage occurring while the product is in a state of processing. This is particularly crucial for products that are more susceptible to certain types of damage, such as the risk of contamination in biological products. It's also essential for companies that cannot afford to lose a batch of product to monitor for this policy language.

These exclusions could be red flags in your policies, and securing the proper insurance coverage requires working with a broker that understands all moving parts of the supply chain. A broker who keeps apprised of new and leading coverages for the life science industry can help you ask the right questions and facilitate updates with your insurance company.

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