COMMISSION OF THE EUROPEAN COMMUNITIES

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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

on existing legal provisions, systems and practices in the Member States and at Community level relating to liability in the food and feed sectors and on feasible systems for financial guarantees in the feed sector at Community level in accordance with Article 8 of Regulation (EC) No 183/2005 of the European Parliament and of the Council of 12 January 2005 laying down requirements for feed hygiene

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EXECUTIVE SUMMARY

When large-scale incidents occur, society has to bear the costs of withdrawal, transport, storage and destruction of feed, food and animals, as well as the costs of analysis and other administrative outlay. Who should pay?

The principle that feed business operators are liable for any infringements of the relevant legislation on feed safety and for the direct consequences of the withdrawal from the market, treatment and/or destruction of any feed, animals and food produced therefrom is laid down in Article 8 of Regulation (EC) No 183/2005[1] on feed hygiene. However, with regard to financial guarantees in the feed sector, the legislator chose not to make financial provision in the Regulation. The Commission is however required to submit a report to the European Parliament and to the Council and, where appropriate, a legislative proposal. The purpose of this report is to set the scene for an effective system of financial guarantees for feed business operators. **A full version of this report in English is found in the annex.**

Firstly, the report examines the existing legal provisions, systems and practices relating to **liability** and to **financial guarantees** in the feed and other sectors at Community and national level. Secondly, it proposes a feasible and practicable system of financial guarantees at Community level. The report analyses various options for financial guarantees and therefore the analysis may be wider than the options envisaged by Article 8.

Financial guarantees in the feed sector are a technically feasible option, if coverage and a triggering mechanism are clearly established. The financial impact for feed business operators is variable but would depend mainly on the extent of the coverage. However, the introduction of compulsory financial guarantees is not a popular measure amongst feed business operators. Moreover, the insurance sector has not developed products that would satisfy a demand for financial guarantees if this were to become immediately mandatory.

Therefore, due to the complexity of the issue and the difficulty to put it immediately in place, the Commission proposes to launch a broad public debate about the different options within two years of the publication of this report, followed by further analysis of the costs of financial guarantees and the assessment of the possible outcome of such measure. In the meantime, the Member States are not expected to require feed business operators to submit proof that they are covered by financial guarantees. On the basis of experience gained over the coming years, it might be necessary to accommodate unforeseen issues and/or emerging policy. The Commission would then consider the need for legislative proposals to address those issues via the co-decision procedure involving the Council and the European Parliament.

[1] Regulation (EC) No 183/2005 of the European Parliament and of the Council of 12 January 2005 laying down requirements for feed hygiene. OJ L 35, 8.2.2005, p. 1.

LEGAL BASIS

Article 8 of Regulation (EC) No 183/2005 of the European Parliament and of the Council of 12 January 2005 laying down requirements for feed hygiene requires the Commission to "submit to the European Parliament and to the Council […] a report on financial guarantees in the feed sector" in order "to prepare for an effective system of financial guarantees for feed business operators." […] "In addition to examining the existing national legal provisions, systems and practices relating to liability in the feed sector and related sectors, the report shall be accompanied, where appropriate, by legislative proposals for such a feasible and practicable guarantee system at Community level. Those guarantees should provide cover for the total costs for which operators could be held liable as a direct consequence of the withdrawal from the market, treatment and/or destruction of any feed, animals and food produced therefrom."

PRELIMINARY STUDIES AND DISCUSSIONS

In order to help the Commission with this report, an external consultant was commissioned to carry out a study on "Financial Guarantees in the Feed Sector", focusing on:

– a cost analysis of previous incidents when feed, food-producing animals and food produced therefrom had to be withdrawn from the market;

– a review of the existing legal provisions, systems and practices at Community and national level (in EU-25 and one non-EU EEA member[2]) relating to liability and financial guarantees, mainly in the food and feed sector;

– a cost and feasibility assessment of the impact of different options for financial guarantees in the feed sector.

For this study, an extensive stakeholder consultation took place in 2005 in the form of meetings and written questionnaires. The meetings were held with European organisations representative of feed business operators and of the insurance sector. The questionnaires were sent to European and national organisations of feed business operators and to national competent authorities.

In addition to this study, the Commission received comments from several European and national organisations of feed business operators and other interested parties, representing primary feed and food producers, livestock farmers, feed cooperatives, manufacturers of feed additives, premixtures and compound feedingstuffs, cereal millers, storage operators, transport undertakings and the insurance sector.

[2] Answers were received from 24 competent authorities, comprising all EU-25 Member States except Greece and Malta, plus Norway, the only one of the three non-EU EEA members participating in the survey.

LIABILITY IN COMMUNITY LEGISLATION

The **Treaties** do not provide an explicit legal basis empowering the Community to regulate liability. In the absence of such provisions, Community rules related to liability, when available, are based on **sector-specific competences**, such as public health, environment, agriculture and transport.

FORMS AND PROVIDERS OF FINANCIAL GUARANTEES

The potential forms of financial guarantees that have been analysed are: insurance, either as a voluntary insurance scheme or a compulsory one, bank guarantees and bank savings, sectoral pooling systems such as those that can be created into the form of a mutual insurance company, and special funds with public participation or backup. For each of these, it is important to understand the conditions under which the market would be able and willing to provide such a product.

Compulsory solutions mean that there is a need to make sure that all feed business operators obliged to comply with this requirement actually do so. Therefore, enforcement would be the responsibility of the competent authorities, in the framework of the registration process or other official control activities.

A problem such a compulsory insurance scheme would need to resolve would be how to ensure financial guarantees also for those operators who would be perceived too risky to be underwritten by any insurance company or other guarantee provider.

Insurance solutions

Could the recalls be insured?

An insurance can be a solution to cover a risk when the principles of predictability, independence, stability and rarity are fulfilled. Predictability means that the probability of a recall over time and the whole population to be insured can be calculated. This would seem to be the case: statistics exist at least of the major recalls and their reasons. However consequential impacts such as further recalls due to a recalled ingredient would have to be excluded due to their large unpredictability, and would rather then fall to the scope of the insurances taken by the operators down the chain. Independence means that the claimant should not be able to cause a recall himself. This is more difficult: such recalls that are clearly due to the claimant's negligence or other reasons due to him would have to be excluded from the insurance. Stability means that the amount of recalls and their average values should remain rather stable or their changes in time can be estimated. Rarity means that at least very large recalls would be exceptional and rare occasions. The recalls would seem to fulfil both criteria of stability and rarity.

Compulsory or voluntary insurance?

Insurance can be compulsory, which means that all participants have to take an insurance to cover the risks in question. A compulsory insurance is normally substantially cheaper than a voluntary one because it spreads the risk over all actors.

A voluntary insurance solution often includes the difficult problem of anti-selection: the ones that expect that they will need the insurance – that is, they expect to have to recall products – will take the insurances. This will mean that the risk for those insured in general is higher and hence higher premiums. Moreover regarding the financial guarantees, the question is what would a voluntary solution mean for those who would choose not to take the voluntary insurance – what would be accepted as their financial guarantee?

Deductible, reinsurance, risk management

Insurance normally contains a deductible, either as a percentage or an absolute amount, or their combination. This means that the claimant will be responsible for any expenses up to the limit indicated by the deductible and the insurance company will cover the rest of the expenses. Normally the insurance company's part has no upper limit. For very big claims, however, the insurances are usually reinsured by reinsurance companies, which take over the risk of very big claims for the first insurer. Insurance coverage must be well and clearly defined, and any risks where those insured can impact the claim should be excluded, following the principle of independence. Often risk can be mitigated by preventive actions and good risk management by those insured. This is often reflected in the premium level and can be an encouraging factor to reduce the risk of recalls. Finally, sometimes the insurance products include a right to collect additional premiums to cover exceptional losses. This would mean that after a major claim year the premiums would normally be adjusted to meet the new risk level but also an additional payment would be collected to ensure compensation to those claimants with major losses.

Insurance premium

In general the insurance premium is calculated taking into account the factors that impact the risk: some areas of business may have a higher probability for recall, obviously larger business may have larger risks and losses, and for example location may have an impact. Claimless years might mean a lower premium; risk prevention may also reduce the premium level. Naturally the level to which the deductible is set may have a significant impact on the expenses to the insurance company and hence premium. The deductible should normally be set at a level where the expenses due to recalls smaller than that level can be in normal circumstances covered by the operator himself.

How much would an insurance cost?

The feed business operators have a history of handling any smaller recalls themselves, and it would seem that there is no specific reason to change this procedure. However, for the large claims that have significant spread and serious impacts their funds would be insufficient. This would seem to indicate that an insurance solution with a rather large deductible could be an appropriate solution.

At present the cost of an insurance system is perceived by feed business operators as a competitive disadvantage as there are fears of very large expenses. However, if the insurance solution for the financial guarantee would be limited to very high risks, the insurance premiums could very probably be quite reasonable. For example if the level of a deductible was set to the level of an operator's annual income or turnover – it would cover only very major recall losses – the insurance premium would not be significant. At present we are aware of around EUR 3 billion of expenses due to few major recalls, over some 5 million operators during the last 5 to 10 years, in a livestock market with a turnover of about EUR 129 billion in 2005 (EU-25). A rough calculation – it should be noted this should be seen only as a very rough and inaccurate indication of the level of expenses involved – would mean that the actual expenses of major recalls divided equally per operator per year result then only in EUR 60 to 120.

What could be a feasible insurance solution?

As the operators have been able to tackle the smaller risks by themselves up till now, it would seem feasible if they continue to do so also in the future. However, they would need the safeguard of financial guarantees against the expenses and consequences of larger, major recalls. A feasible solution to ensure financial guarantees, should it be based on insurance, could thus be an obligatory insurance, covering all operators, with a significantly high deductible. This solution, however, would need to be accepted by the insurance industry and the reinsurers – there should be insurers offering the products in all relevant countries. In some EU countries such solutions already exist as product liability insurances, but none of them are compulsory. The feed recall insurance could be part of or an extension of scope of such insurance.

Private solutions

If no obligatory solutions would be imposed on the operators, they could for example take voluntary insurance cover as described above. They could also protect themselves simply with bank savings.

Bank savings would however mean economically a significantly larger amount of money set aside into bank accounts or other forms of savings in case of these recalls than the money needed in other alternatives, and would hardly be an efficient solution from the point of view of the society. Moreover no normal savings could cover possible, if not very probable, major recalls. Should savings be sufficient for a financial guarantee, a solution would need still to be found for the cases when the recall expenses exceed the savings amount.

As a combination of an insurance to cover for the rare major recalls and savings to cover the "normal" recalls, this could probably nevertheless be a feasible solution.

A voluntary insurance as a stand-alone product as a solution for financial guarantees would have some obvious problems: firstly, not everyone would take the insurance. What would be the financial guarantees of the rest of the operators? Secondly, a voluntary insurance would probably not be very popular as its insurance premium could prove to be quite high. This is due to the fact that those covering themselves with insurance often are those who have a high probability of needing the insurance cover soon, that is, they have a high probability for a recall. Also the insurance industry would want a wide enough market interest to underwrite such insurance.

Another feasible combination could be that the obligatory insurance with a high deductible would be complemented by a voluntary cover of lower risks. In this case the operator would buy an additional insurance cover with a lower deductible.

Bank guarantees

Providing a bank guarantee is another possibility. This would mean in practice that the operator would purchase a guarantee from the bank to an amount agreed. This amount would be released in those cases predetermined between the operator and the bank. Usually such guarantees tend to be more expensive than corresponding insurance products and availability could prove a problem as banks might not be willing to offer such guarantees.

Pooling

The question is whether the coming together of all feed business operators, or those which are at the same stage in a particular sector, into a pool for the purpose of covering the feed recall costs of members is a suitable financial guarantee within the meaning of the proposed Regulation. If widespread backing could be obtained for such a project and if its effectiveness could be ensured, then it might be implemented in different ways either as an alternative or complementary to mandatory insurance in the market. In practice this would probably mean the establishment of a special mutual insurance company for the purpose of covering this risk in a particular sector. An association of operators could provide the necessary guarantee funds (initial capital) and the management expertise or take on supervisory responsibilities for this pool or mutual company. Such a pool would probably need to be European wide to contain a basis large enough to ensure solvency for the pool. Premiums to be collected from the members of such a pool would be defined more or less similarly to the definition of any insurance premium. Further, contrary to insurances with annual premiums, the money would not be lost in case of "no recall" but would be available in the future. So the fee could eventually be reduced. A pool could also contain obligations to its members for further additional payments in case of very bad claim years.

Special funds

The situation is quite different when public redistribution systems are considered, including the participation of the responsible competent authorities, as has been the case, for example, for the coverage of losses resulting from livestock epidemics in some EU countries. Public-private partnerships can take different forms, ranging from state institutions such as social insurance agencies to privately organised funds with mandatory membership and state supervision. All problems pertaining to insurability are easily eliminated when the state ensures payments from the fund in the event of loss. This can be managed, for example, through state participation, through subventions in the form of partial absorption of the loss, through pre-financing of large losses to be levied later, or through other forms of guarantees.

A problem related to special funds is that they constitute a significant state intervention, which contradicts free market principles and needs to have a clear justification, as is the case with natural disasters or livestock epidemics. Furthermore, the state evens out deficits by assuming uninsurable risks and offering reinsurance cover for peak excess losses, ending up by deploying public funds to remedy damage caused by private operators.

MID-TERM NON-LEGISLATIVE ACTIONS

Due to the complexity of the issue and because **a system of financial guarantees is difficult to put immediately in place**, this report will be followed by a broad public debate. Therefore the Commission proposes:

– to open the debate about the different possibilities of financial guarantees with the operators, the **insurance sector**, Member States and other stakeholders, as well as to encourage **providers of financial guarantees** to **develop products** that could respond to a future increase in demand for financial guarantees, taking into account the **coverage** and **trigger mechanism** suggested in this report;

– to open discussions with the **Member States** in order to promote:

– principles of best practice on **risk management** in respect of feed and food withdrawals, especially in the event of **large-scale incidents**, with a view to developing **guidelines** on this subject; and

– **clarification** on the issue of **liability** related to feed and food withdrawals.

Such intermediate steps should be concluded within a period of 2 years after the publication of this report. Until then, the Member States are not expected to require feed business operators to submit proof that they are covered by financial guarantees. Moreover, the Commission will further analyse the costs of financial guarantees, followed by the assessment of the possible outcome of such measures.

CONCLUSIONS

Food and feed business operators at all stages of production, processing and distribution within the business under their control must ensure that food or feed products satisfy the requirements of food law which are relevant to their activities and must verify that such requirements are met. **Although liability rules concerning food law in general must be adopted at national level, feed business operators are liable under Community legislation for any infringements of the relevant legislation on feed safety**. However, so far they are not required to submit proof of a financial guarantee to ensure that they can pay the costs for which they are liable.

Except for expenses arising from **additional official controls**, **Community legislation** does not specifically govern liability in the food sector, instead requiring the Member States to lay down measures themselves. With regard to the **feed sector**, there are Community-specific grounds for liability in the field of feed hygiene, but the practicability of this depends on national legislation, which determines the legal relationships and obligations that constitute liability as well as the facts, circumstances and conditions under which such relationships and obligations arise. The **national systems** surveyed are characterised by certain differences as regards liability. Moreover, withdrawals ordered by the competent authorities generally depend on the legislation of the Member State, risk assessment and administrative discretion. Consequently this means that the financial risk of a feed business operator related to liability claims for possible feed withdrawals and disposal may differ by country.

Financial guarantees in the feed sector – such as in the form of insurance, bank guarantees, savings, pooling and funds – **are in principle a technically feasible option**. However, the degree to which it would in practice be possible for feed business operators to obtain cover depends on the **design** of any system of financial guarantees. There is a risk that a system of financial guarantees, not appropriately designed and not taking into account **criteria for insurability**, could lead to a situation where cover could be almost unobtainable on the private market or only for prohibitively high premiums. **Limits of coverage** and **trigger of financial guarantees** should be clearly established.

Although product liability insurance exists in some Member States, little practical experience exists especially with **recall insurance in the feed sector**. At present there is no accurate knowledge on where the premium level would be set on such insurance, for example when it would cover events of large-scale feed withdrawal and disposal – that is, the deductible would be set to a considerably high level. Some schemes are nevertheless either already operational or under preparation in the compound feed sector. Most **insurers** are at present very reluctant to enter this market, although some seem to be willing to take this risk under very strict underwriting conditions. The main question therefore is not whether such insurance cover for feed withdrawals and disposal is available (it is in some countries), but how, when and under what conditions would major European insurers be willing to enter this market.

The insurance sector is opposed to a compulsory system of financial guarantees in the feed sector – in general, introduction of any compulsory insurance would be strongly opposed by the insurance sector due to obvious problems related to such solutions. The national insurance associations surveyed the approach some years ago and cautioned against any developments in product recall insurance for the feed sector. Moreover, they doubt that such a system would enable feed business operators to fulfil the requirements as regards financial guarantees or meet the policy objectives of transferring withdrawal and disposal costs from the public to the private sector. Nevertheless, product liability insurances already exist in some Member States and their structure and scope is not far from the coverage sought here.

A large number of representatives of feed business operators are also opposed to a system of financial guarantees and, if such a system were to be set up, they would prefer it to be voluntary. One advantage of a **voluntary system** is the possibility to conclude contracts according to the specific needs and conditions of individual operators, without pushing out of business operators that are not willing or able to participate. The main disadvantages of this option are that the premium would be likely to be high, and if not mandatory, there might be a low percentage of covered operators, even more so due to the high level of the premium. If that were the case, liable operators affected by an incident but not covered by financial guarantees would have to find the means to afford the withdrawal and disposal costs. If they could not afford them or did not pay, this would ultimately compromise the objective of avoiding the spending of public funds for feed safety incidents. Therefore it is unlikely that such a system would reduce the financial burden on public authorities in large-scale crises, and the pressure on governments to support affected businesses would remain.

Some **competent authorities** support, and others could envisage, a system of financial guarantees, but are divided over whether such a system should be compulsory or not.

The revised Lisbon Strategy identified **simplification** as one priority action for the EU. It aims at achieving growth and jobs in Europe and therefore focuses on those elements of the *acquis* that concern the competitiveness of enterprises in the EU. Its overall objective is to contribute to a European regulatory framework that fulfils the highest standards of lawmaking, respecting the principles of subsidiarity and proportionality. In this respect simplification is intended **to make legislation at both Community and national level less burdensome, easier to apply and thereby more effective in achieving the goals**.

The measures laid down in the Regulation on **feed hygiene**, such as provisions for the sourcing of feed, traceability, hygiene, HACCP principles and registration, together with other **food safety legislation**, are important steps taken with the aim of reducing the risks and preventing the occurrence of accidents. **The full implementation of all those measures by feed business operators should help to reduce the likelihood of major feed and food incidents** similar to those witnessed in recent years. The new **official controls** framework, which is currently being implemented by the competent authorities for verifying business operators' compliance with the law, could become another efficient tool for **strengthening feed and food safety**.