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EPLI — STATUS, OPPORTUNITIES AND CONCERNS

Pick up virtually any insurance trade publication these days and you'll find an article on employment practices liability insurance (EPLI). The subject is ubiquitous, with seminars being offered on a seemingly regular basis from coast to coast and in between.

Although the need for EPLI is greater than ever, several insurers have withdrawn from the market because of inadequate pricing and mounting loss ratios. Still others are tightening underwriting and increasing premiums and deductibles. Because it is a relatively new line of insurance, predicting EPLI losses can be difficult; as a result, insurers that write the coverage are regrouping and reassessing their strategies.

Despite the uncertainty, however, with proper preparation the line can be profitable. EPLI is a coverage that warrants the attention of any agency that is interested in growing its book and protecting its preferred accounts against emerging liability exposures, regardless of the size of the insured business. However, there are caveats!

- If an insurer or a producer is not committed to learning about the line and developing a specific plan of action regarding its underwriting approach, it may be ill-advised to enter the line, according to insurance practitioners who write the coverage.

- In addition, underwriters and claim representatives need special training in employment law. Support services, such as HR consultants and loss prevention specialists, as well as defense attorneys who specialize in employment law, are available to assist and counsel insurers when the need arises. They can provide training and assist with developing employment manuals, sexual harassment policies, and a detailed application questionnaire. Internet "help lines" also are available for advice and counseling to help prevent losses or to assist with handling and concluding a claim.

Many insurers, but not all, find the line profitable. Why? Because they follow strict underwriting guidelines, avoid certain classes, and understand the risk categories they write. To some extent the EPLI exposure can be controlled by deductibles and limits.

Background

Virtually nonexistent before 1990, EPLI was developed in response to the growing number of employment-related lawsuits and, some contend, the accompanying media attention. Heightened public awareness was generated by several high-profile cases involving sexual harassment, such as the Anita Hill/Clarence Thomas proceedings, in which the subject of work-related sexual harassment

became a national preoccupation, and the Paula Jones/Bill Clinton incident. Other cases that received notable attention in the media are the Navy's "Tailhook" scandal, the Mitsubishi Motors sexual harassment case, and the Home Depot sex discrimination class action settlement.

Size doesn't matter. It would be a mistake, however, to assume from these cases that only high-profile individuals or large businesses are exposed to EPLI claims. These cases created a new consumer awareness of wrongful employment practices that eventually spawned a blaze of claim and litigation activity. Small to medium-sized firms are becoming

increasingly vulnerable and litigation costs, which can be absorbed by large companies, can financially devastate a smaller firm.

Several additional factors have contributed to the increase in claims in this area. Employers are subject to a variety of federal laws such as Title 7 of the Civil Rights Act, the Americans with Disabilities Act (ADA), the Age

Discrimination and Employment Act (ADEA), and the Family and Medical Leave Act, to name a few. In addition, employers are affected by a number of state and municipal laws that deal with employment situations. Changing economic conditions as a result of global competition, downsizing, and mergers and acquisitions have all led to workforce reductions that spur wrongful termination claims. The September 11 attack on the World Trade Center, and its economic ramifications, only served to exacerbate the problem.

Other factors include:

- an aging workforce means an increase in the number of individuals who might bring age-related discrimination cases;
- more women are in the workforce and will bear children in their 30s and 40s, likely resulting in an increase in cases alleging discrimination based on pregnancy and failure to provide time off under the Family and Medical Leave Act, and other unlawful practices under Title 7;
- more attorneys are entering the fray, as employment litigation is seen as a lucrative field of law;
- large awards and settlements.

Minimum legal costs to defend such suits, even if the employer prevails, can be as much as \$25,000. According to a research article by the Presque Isle CPCU Chapter, Erie, Pennsylvania, titled *Employment Practices Liability Increasing Exposure, Insurance and Risk Management Considerations*, average defense costs for litigated cases from 1994 to 1997 were reported to be \$125,000 to \$150,000. Employers must carefully consider the litigation costs involved in defending such claims. In view of these legal costs, and because it is impossible to predict what a jury will do,

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many businesses wisely choose to reduce uncertainty by purchasing EPL insurance.

The risk management/underwriting component

Risk management measures are essential to minimize claims frequency and prevent the catastrophic claim. Especially important is management and employee training conducted by human resource specialists, including sensitivity training, to heighten employee awareness concerning appropriate workplace behavior.

It is important to emphasize that support services are available for smaller business firms that do not have a human resources department or a structured employment manual or handbook. These resources will help management develop an employee handbook as well as provide counseling and compliance training to the firm.

Equally important is the insurer's underwriting approach to writing this line. Most EPLI insurers require the prospective insured to complete a detailed application questionnaire. The questionnaire addresses a wide range of information that gives the insurer a comprehensive picture of the applicant's employment situation. Areas of paramount importance are loss history, including current and anticipated claims, financial condition, and the firm's human resources practices. The answers to these questions help the insurer make a well-reasoned decision about the acceptability of the risk and the premium charge.

Frequently asked questions about EPLI

1. What kinds of employee lawsuits are covered?

Many kinds of lawsuits can be covered, but EPLI policies vary somewhat in this regard and must be carefully reviewed. Many policies typically include coverage for:

- wrongful termination
- unlawful discrimination by race, gender, or age
- work-related harassment, including sexual harassment
- employment-related defamation
- wrongful demotion
- negligent evaluation

2. Do small firms with only a few employees need EPLI coverage?

The businesses that can least afford to pay claims out of their own pockets are often the most reluctant to buy EPLI coverage. As noted earlier, large firms can absorb these costs, whereas small firms usually

What Is Your Employment Practices Liability Risk Exposure (EPLRE)?

(This test will help you assess your exposure.)

Enter the point value for each exposure factor.

- _____ 1 point if you have 15 to 49 employees
- _____ 2 points if you have 50 or more employees
- _____ 1 point if you have more than one worksite in a single state
- _____ 2 points if you have worksites in more than one state
- _____ 2 points if you allow supervisors and managers to make independent hiring and firing decisions
- _____ 1 point if you have not standardized your hiring and firing process
- _____ 2 points if you don't have a well-publicized Equal Employment Opportunity Statement
- _____ 2 points if you don't have a well-publicized Sexual Harassment Policy
- _____ 2 points if you have not conducted training sessions for your employees on sexual harassment
- _____ 1 point if you have not reviewed and updated your employee handbook and employment policies in the last 12 months
- _____ 1 point if you have had one or more discrimination, sexual harassment, or wrongful discharge claim in the last year
- _____ **Total Points**

If your total is

- 0 to 4 points = Your current exposure is low. You can keep your exposure under control by annually assessing your employment risk factors.
- 5 to 8 points = You may be unnecessarily at risk. You can reduce risk factors by conducting an HR audit and taking proactive measures.
- 9 to 15 points = You need to take immediate action to reduce factors. Contact us for information about **ELLA Assistance**.

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cannot. Aside from damages, defense costs alone can financially devastate a small business firm.

In addition, many smaller employers have the mistaken impression that they run an amiable business that is staffed with friendly employees who would never sue their employer. Experience suggests that this is simply not the case.

3. Do nonprofits have the same exposure as for-profit companies?

Nonprofits have the same exposure and face the same kinds of claims as for-profit companies. The potential for claims against employers alleging sexual harassment, wrongful termination, discrimination, etc., exists equally for nonprofit and for-profit companies.

4. What about coverage for

former employees and part-time, temporary, or leased employees?

Specifically who is insured under an EPLI policy will vary by policy. A key issue is whether former employees are covered. Employees who were terminated months or even years ago can often be the cause of wrongful employment practices claims that may not be initiated until long after the alleged offense was committed. In some policy forms, only full-time employees may be covered, leaving part-time, temporary, or leased workers uninsured. It is important to recognize these nuances in policy provisions if sufficient insurance protection is to be obtained.

5. Is EPLI coverage written on a claims-made or an occurrence basis? What is the difference?

EPLI policies typically are written

on a *claims-made* basis. With a claims-made form, coverage is triggered when the claim is first made, provided the offense leading to the claim took place sometime between the retroactive date and the expiration date of the policy. (A retroactive date eliminates coverage for injuries that occurred prior to a specified date, even if the claim is first made during the policy period.) With a claims-made form, insurers are aware of all claims made during the policy period, and usually can determine how much it will cost to settle the outstanding claims. Most insurers provide EPLI coverage on a claims-made basis; however, occurrence forms are available.

6. Is coverage for defense costs provided above policy limits or included within the limit for damages?

Defense coverage typically is provided *within limits* in EPLI policies, but it depends on the policy and the state involved. Some policies provide defense coverage *in addition* to the limit for damages, usually by an optional endorsement. The premium cost for such coverage ordinarily is considerably higher than the cost for policies that include defense coverage within the limit for damages. (Some states require that insurers provide defense cost coverage in addition to the limit for damages. In those states, insurers must modify their policies to comply.)

7. What about deductibles?

Deductibles are common in EPLI policies, and higher deductibles can reduce the cost of insurance. Deductibles vary by policy and typically range from \$2,500 to \$25,000 or higher. In many policies, the deductible applies to both damages and defense costs. Again, policies must be reviewed carefully to determine how the deductible is applied.

8. If an employer buys EPLI insurance on a claims-made basis, is "prior acts" coverage available?

Generally, yes. A first-time buyer of EPLI may require coverage for incidents that may have taken place prior to the beginning of its first policy, but have not yet led to actual claims. Recall from the meaning of "retroactive date" in Question 5 above that with a claims-made policy, coverage is triggered (or responds) when the claim is first made, provided the offense leading to the claim took place sometime between the retroactive date and the expiration of the policy. In order to have prior acts coverage, the policy must be written without a retroactive date, or with a retroactive date earlier than the inception date of

the policy. Underwriters may be unwilling to do this for fear that an employer is aware of prior incidents that could lead to future claims. However, prior acts coverage is often available for an additional premium.

9. What if a claim is made by a third party, such as a customer or vendor who claims an employee committed a wrongful act involving harassment or discrimination? Is coverage available?

In the absence of a specific endorsement for third-party claims, EPLI forms usually do not cover this exposure. However, some insurers will provide this coverage via endorsement for an additional premium.

Businesses that have heavy customer traffic, such as retailers, restaurants, and airlines, are vulnerable to third-party claims and should seriously consider buying this coverage.

10. What about coverage for punitive damages?

When EPLI insurance was first introduced, coverage for punitive damages was generally excluded. However, the coverage is becoming more available today. It is usually provided by endorsement for an additional premium, unless a particular state does not permit offering coverage for punitive damages. Punitive damage awards can be staggering, as multi-million dollar verdicts, virtually unheard of years ago, are commonplace today. Even though it can be expensive, employers should seriously consider purchasing coverage for punitive damages.

11. What does EPLI insurance typically cost?

The cost of coverage depends on the kind of business, number of employees, deductible selected, and other risk factors such as loss history, turnover rate, human resources practices and training, and so on.

12. Are statistics available that provide a breakdown of claims by type?

A survey of publicly owned companies, privately held firms, and public entities, conducted by Sedgwick Financial Risk Specialists in 1998, revealed the following with regard to claims:

Percent of claims by type	
Age discrimination	23.5%
Gender discrimination	17.4%
Wrongful termination	14%
Racial discrimination	11.8%
Sexual harassment	10.6%
Retaliation	5.1%
National origin	4.5%
Workplace harassment	3.9%
Breach of contract	2.8%

ADA	2.2%
Defamation	1.7%
Religious discrimination	1.1%
Miscellaneous	1.1%

For the year that began October 1, 2000, and ended September 30, 2001, the EEOC reported that total discrimination charges filed against private employers increased 1% from the previous year to 80,840—the highest level since the mid-1990s.

Of the 80,840 total charges filed with EEOC, the most frequent types of discrimination alleged were:

• Race	28,912 or	35.8%
• Sex/gender	25,140 or	31.1%
• Retaliation	22,257 or	27.5%
• Age	17,405 or	21.5%
• Disability	16,470 or	20.4%
• National origin	8,025 or	9.9%
• Religion	2,127 or	2.6%
• Equal pay	1,251 or	1.5%

Note that the specific types of discrimination and their percentages of total charges add up to more than 100% because multiple types of discrimination are often alleged in individual charges.

The American Association of Insurance Services (AAIS) currently offers employment practices liability coverage, which it refers to as employment related practices liability (ERPL) insurance, as an endorsement to its Businessowners and Artisans programs (the latter designed for small to medium-sized contractors). It is also developing a monoline or stand-alone ERPL policy with broadened eligibility.

To summarize, no one seems to doubt the need for this coverage, not only for large employers but for smaller firms as well. However, a well-designed underwriting strategy is essential if an insurer is to be profitable. Insurers need to establish strict underwriting guidelines, avoid unfamiliar classes, and understand the risk categories they write. Exposure can be controlled somewhat by deductibles and limits. In addition, it may be necessary for smaller employers to take advantage of the many readily available risk management and loss prevention support services.

Through loss experience with this line, sound actuarial data is being developed; and as this process continues, more accurate pricing will result. The line can be profitable with the proper underwriting approach.

Do your preferred commercial accounts have an employment practices liability exposure?

Find out by having them take this short test (see above) prepared by the human resources consulting firm of Laurdan Associates, Potomac, Maryland (reprinted by permission). ■