3 | Ways to Reduce Management Liability Risk

It’s a difficult time for businesses. Between a fluctuating insurance market and skyrocketing inflation, business leaders are under pressure to make the right financial and employment decisions. Here are 3 ways to reduce management liability risk as business executives navigate this difficult climate.

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Fluctuations are natural for the insurance market, and there have been a few over the last decade. After the longest soft market in living memory, the insurance market started to harden in late 2018 due to higher than projected damages and claims related to climate change. At the same time, years of low interest rates and overall investment returns were negatively impacting profitability, reducing insurance carriers' appetite for risk.

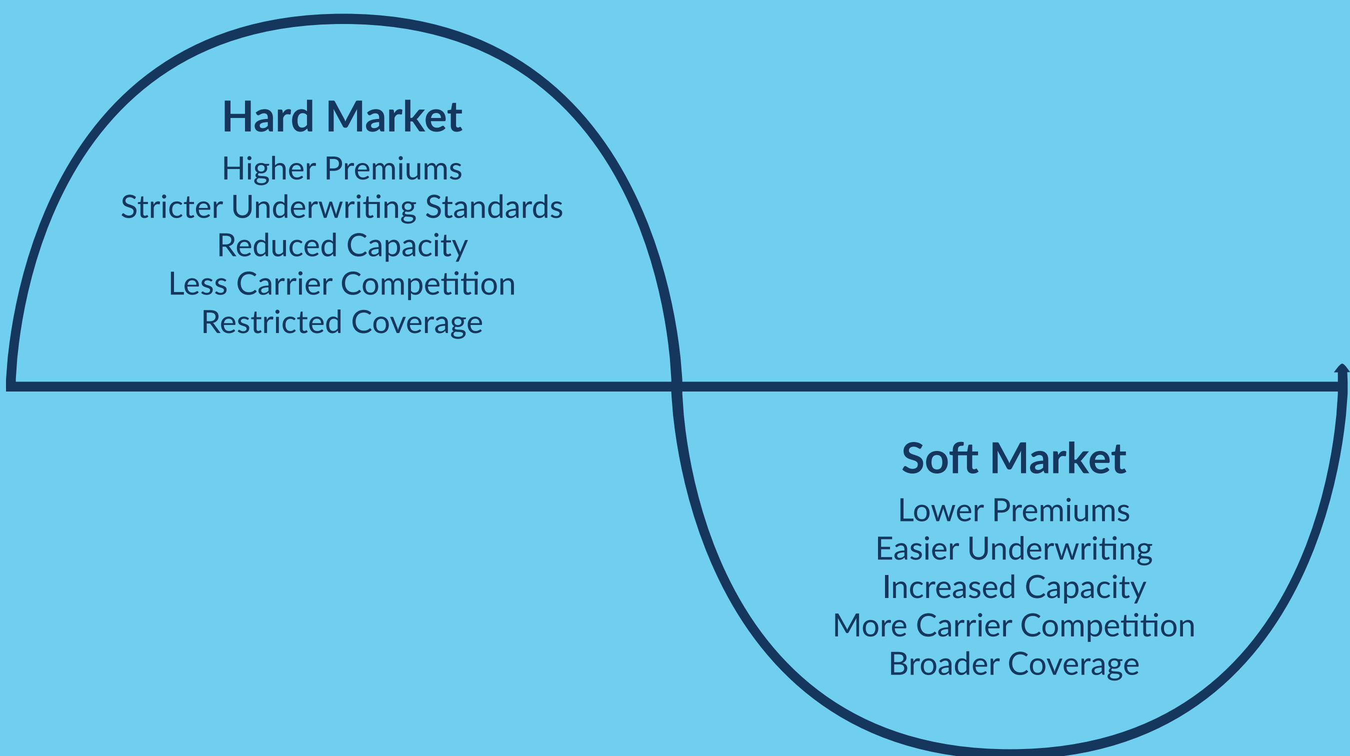
Another wave of increased claims and losses from business interruption and cybersecurity came on, as many companies quickly transitioned to remote operations in 2020, and executives were put in the hot seat while dealing with the pandemic and subsequent events.

The pendulum is swinging the other way yet again.

Today, interest rates are on the rise, and inflation is at a 40-year high.[1] Businesses feeling these pressures are shopping around or considering dropping certain elective insurance coverages altogether. New insurance carriers are entering the market with promises of lower premiums and broader coverage; and while carrier competition softens the insurance market, it also puts businesses in precarious situations where they could be jeopardizing the continuity of their coverage by jumping from carrier to carrier.

Before a business executive seeks lower rates or forfeits protection, these three key factors impacting many businesses' management liability insurance experiences should be considered. Learn what businesses can do to both reduce management liability risk and position themselves to optimize coverage ahead of renewal.

Hard Vs. Soft Market



[1] Bloomberg "*Core US Inflation Rises to 40-Year High, Securing Big Fed Hike*" October 13, 2022

1 | Partner with an Insurance Carrier Who Understands the Level of Coverage Required

The type of management liability claims brought against organizations is changing. Take Employment Practices Liability (EPL) claims, for example. In recent years, a new stream of employer lawsuits regarding sexual harassment, discrimination, benefits, equal pay and return to workplace policies came to light.

It's a new and unfamiliar landscape for many organizations and leadership, and it reinforces the importance of the right coverage partner to ensure all the nuances of future claims are covered.

When determining which insurance carrier to partner with, experienced claims handling and underwriting expertise matter more than price in this market. Carriers with a strong underwriting practice will understand the level of insurance required to protect businesses against this new breed of risks, and many provide free resources such as loss control, specialized claims counsel and more.

Common Management Liability Claims

A strong management liability package is composed of various insurance policies, each designed to protect a business and its executives against specific mismanagement claims. Here are the most common types of management liability policies and the claims they cover:

Directors & Officers Liability
Protects the people who serve as directors or officers of the company against personal losses, commonly due to:

- Failure to adhere to by-laws
- Breach of fiduciary duty
- Misrepresentation
- Challenges to decisions

Employment Practices Liability
Supports coverage of defense costs and damages related to employment related claims, including:

- Retaliation
- Discrimination
- Wrongful termination
- Harassment

Fiduciary Liability
Provides specialized protection against the following types of claims:

- Under-funded 401(k) plans
- ERISA employee-benefit plan issues
- ESOP under funding
- Failure to provide employee benefits

Businesses that demonstrate the following practices are considered a good risk in a high-frequency claims market:

- **Focus on risk management and be prepared to talk about it.** Any carrier worth partnering with will want to know how a company responds to risk. If there is a previous claims history, this is where they'll begin. Business leaders will need to demonstrate an improvement in process or mindset as it relates to the previous incident and how to prevent similar incidents in the future. To prepare for this conversation, consider what could have been done differently to inspire a different outcome.

- **Document more than thought necessary.** Accurate and thorough documentation not only supports strong and consistent decision making, it also ensures a lasting record of the reasons behind the decision. This type of evidence is especially important when disciplining or terminating an employee. For example, a manager who doesn't document performance issues in an employee's annual review to avoid hurting their feelings puts the organization and themselves in a dangerous situation if that person's bad performance leads to termination. Without documentation of the performance issues, there is no evidence to back up the decision to fire and accusations of wrongful termination could be fruitful.

Document, Document, Document

- Always draft documentation for third-party viewing. Describe the situation thoroughly, as if the reader knows nothing about it.
- Draft the documentation as soon as possible after the incident, when details are fresh.
- Name all eyewitnesses and violated work policies in the documentation.

- **Design operating policies to avoid risk.** Even potential claims losses are red flags to underwriters. When a business is shopping for new coverage or it's in an insurance renewal period, its operating risks will be evaluated. If a business has a previous claim that flags a potential operating risk, that could deter strong carriers from offering coverage. For example, a previous age discrimination claim against a business whose current staff is all under the age of 40 could signal future risk during the hiring process.

- **Don't shy away from recent claims.** If a business just had a claim, there is now awareness of areas of improvement in HR policies and procedures. Businesses should take that energy and invest it into tightening procedures and implementing measures that will prevent similar incidents in the future. Instead of shying away from this claim during the renewal process, the narrative can be refocused around remediation efforts.

- **Prioritize continuing legal education and training.** You can't avoid what you don't know. Staying up to date on the nuances of the law — which changes often — can help businesses avoid incidents that can develop into lawsuits. This not only means keeping executives up to date, but regularly training staff. A thorough and evolving training program also demonstrates to underwriters the organization's commitment to a healthy culture in addition to risk management. Many insurance carries offer free services to help with this type of training and development.

2 | Maintain Coverage During High Interest Rates and Rising Inflation

> **"Inflation increases the amount of insurance needed to cover unchanged, existing risks. The monetary costs of litigation alone can be destructive to a business's financials."**

The country is experiencing high interest rates. Coupled with overall inflated operating costs, many business owners are taking a look at their spending and reevaluating their allocation of funds. Additional coverages, such as EPL policies purchased in fear of changing vaccine mandates and remote workforces, may be the first on the chopping block.

When budgets are tight, it can be tempting to forgo insurance policies that are not required by law, but it only exposes businesses more in a time of financial pressure. Skimping on insurance coverage, even temporarily, could put businesses at significant risk. In fact, times of economic uncertainty may require businesses to double down on management liability coverages.

Inflation increases the amount of insurance needed to cover unchanged, existing risks. The monetary costs of litigation alone can be destructive to a business's financials.

Reduce risks with continuity of coverage

The following are a few examples of risks companies would take on with a gap in insurance coverage during times of financial stress:

Claims-made vs occurrence policies

Unlike General Liability (GL) insurance, which is an occurrence policy that covers any incident that takes place during the policy period regardless of when the claim is reported, most management liability coverages, including Errors & Omissions (E&O) and Directors & Officers (D&O), are claims-made policies.

The difference is very important when it comes to uncovering potential gaps in insurance coverage.

Claims-made policies only provide coverage for claims that occur and are reported within the life of the policy, which is stated in the contract. If an organization decides to skip a year of coverage to save on costs, and a claim is made for a new or previous incident during that time, the business is fully responsible for litigation and damages.

Leadership held responsible for inflation-related losses

As inflation continues to strain supply chain and labor costs, revenue retention will be a liability for directors and officers. While companies can combat some of this strain by passing costs onto consumers, consumer spending habits are also negatively impacted by economic inflation, and many companies will absorb losses to retain customers. When companies begin to lose revenue, mismanagement claims can follow.

When salaries increase, so do claims costs

Nearly 25% of U.S. private-sector businesses increased wages and salaries, paid wage premiums, or paid bonuses during the pandemic[2], and in 2021 and 2022 the monthly job growth averaged 562,000 and 392,000 respectively[3]. This means more people are in the market, higher salaries are at stake and the severity of employment practices liability claims is on the rise.

Best practices during times of economic distress

Nothing about inflation or rising interest rates is easy. There are a lot of hard decisions business leaders will make to weather the storm. The following best practices can help along the way:

- **Keep an eye on all potential exposures.** It's a business leader's responsibility to identify exposures and maintain coverage for those areas, regardless of where the economic storm is coming from.

- **Cut corners somewhere other than insurance.** A gap in insurance could be the blow that sinks the ship. Some businesses can't afford to pay millions of dollars for a cyber breach, sexual harassment claim or wrongful termination lawsuit right now. Insurance should be considered non-discretionary. Reduce catering, travel, and other expenses instead.

[2] U.S. Bureau of Labor Statistics *TED: The Economics Daily*, February 18, 2022.
[3] U.S. Bureau of Labor Statistics *The Employment Situation - November 2022*, December 2, 2022.

3 | Implement Strong Human Resources (HR) Controls

A business's HR department is its first line of defense against management liability claims. As such, it is a key component for an underwriter's evaluation of business risk.

Consider the typical responsibilities of an HR team: hiring, onboarding, employee benefits, training, compliance and workplace safety. Starting on an employee's first day, HR provides guidance on behavior and expectations of the new employee and their coworkers.

A business without a strong HR team, or an HR team altogether, presents a higher risk to any insurance carrier and can expect higher priced employment-related coverage (if even offered).

These HR best practices will meet insurance carrier expectations:

Maintain a strong policies and procedures handbook.

At minimum, an HR handbook should be updated every 18 months to two years. Update policies and procedures for everything from onboarding to codes of conduct and how to document formal performance reviews. These updated policies should reflect current case law requirements and be reviewed by an employment lawyer.

Once complete, the handbook should be distributed to all current and onboarding employees. All discrimination policies should be available in visible, accessible areas as a reminder to staff, along with annual harassment and discrimination training.

Provide an avenue for filing internal complaints.

Companies with higher levels of internal reporting are subject to 6.9% fewer pending material lawsuits and face 20.4% less in total settlement amounts than companies with lower levels.[4] Depending on a company's resources, this reporting system could be a hotline or dedicated department that documents and investigates reported incidents.

Have expertise within the HR department.

HR is influenced by both state and federal law on employment issues for a reason. Businesses should hire professionals with degrees in Human Resources, with an understanding of employment law. Insurance carriers will often consider the qualifications of a business's HR staff when assessing risk.

[4] Security *The Value of Whistleblowing and Hotline Reporting*, April 16, 2020.

Allow claims to motivate improvement.

Naturally, the negative attention of claims inspires change. Businesses shouldn't shy away from this. Instead, policies and procedures should be updated to reflect lessons learned. If a business doesn't change post-claim, they both run the risk of future losses and will find it more difficult to find a carrier who will sign them.

Formalize the hiring process.

When done wrong, hiring someone new can create legal trouble for the business. Insurance carriers are going to look for consistency and thoroughness in a business's hiring processes, including background checks, fairness in recruitment and interview stages and due diligence during onboarding when it comes to education around company policies. There is no room for confusion about conduct expectations starting on day one.

Here are Five Ways to Meet Carrier Expectations for HR Controls

Quality carriers will provide organizations *free resources* to help address potential management liability issues. This includes:

1. Policy and handbook reviews
2. Consultations
3. Sample employment contracts
4. Webinars and videos on employment issues
5. One-hour training classes with legal experts

Contact IAT

It's easy to get swept away by the promise of lower rates in a time of high financial pressure and a softening insurance market. After years of watching premiums rise, businesses are looking for a little relief. A partnership with an insurance carrier who can ensure a company is adequately protected when claims are filed is priceless and gives weight to a company's management liability coverages.

Contact IAT for more information about how our team can help protect businesses and leaders.

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