

## **THE ROLE HUMAN RESOURCE PLAYS IN RISK MANAGEMENT**

By John Cummings, PHR

### **The Past, Present, and Future:**

In the not too distance past, an organization's human resource professional handled just the "basics". These basics included recruiting, interviewing, hiring, orientation, payroll and coordinating the annual summer picnic.

Yet in today's increasingly complex business structures, human resource professionals have to step forward and become involved in strategic planning, organizational design and risk management. These are quantifiable areas, better known as human resource (HR) metrics, in which the performance of the human resource department can have an impact on an organization's fiscal bottom line.

Today's human resource risk management function has expanded beyond the monthly safety orientation, to the controlling of worker's compensation claims, risk analysis, corrective action, and the management of employment related lawsuits and charges. These risk management functions have a significant impact on an organization's budget, cash flow and financial success.

The financial impact of "risk" has surged over the past few years due to increased worker's compensation claims and regulations, Title VII, American's with Disabilities Act (ADA), Equal Employment Opportunity (EEOC), wrongful termination exposure and other compliance issues. Quite simply, the risk an organization faces in relation to employment practices is as real an exposure as a vehicle rollover, fire or workplace injury.

In today's litigious environment, organizations need to ensure that their human resource professionals are exercising proactive risk management. The first step in establishing a proactive human resource function is to ask your organization's human resource professionals some pointed questions, including:

- How does our organization ensure compliance with applicable state and federal employment laws, practices, and legal rulings?
- Does our organization track historical employment losses to measure the success of employment practices; similar to accident/injury rates and worker's compensation experience modifiers?
- Does HR have a method of quantifying dollars of exposure the organization may have from wrongful employment practices such as wrongful termination, discrimination and harassment claims?
- Are HR managers assisting insurance carriers identify appropriate reserves to defend wrongful employment practice claims?

- Is our organization able to trend past losses in order to predict possible future losses against some number that management can relate to, such as percent of gross revenue or profit.

In addition, organizations should challenge their human resource professionals to perform a compliance and risk assessment audit of its human resource functions and to explore attaining Employment Practices Liability Insurance (EPLI) if it is not provided in their current liability policy.

### **Performing a Human Resource Audit:**

For most organizations an annual independent audit of the financial records is a necessity, and for many, a requirement to ensure that there are no financial irregularities. Unfortunately, this accepted “audit” practice rarely flows over into an organization’s human resource functions.

Organizations should invest the necessary time and resources to conduct an in-depth human resource audit. Whether performed internally, or by a consultant or legal firm, such an audit has the ability to provide valuable organizational data including:

- Identifying employment practices, procedures and policies that are missing or are not compliant with state or federal statute.
- Developing an ongoing culture of risk analysis and establishing procedures to identify, address and measure the success of the organizations human resource function.
- Evaluate the effectiveness and efficiency of human resource practices in their integration with business planning and strategy.

Quite simply, the organization needs to establish a baseline to evaluate whether or not its human resource function is having a proactive impact on the organization. Areas that should be addressed in a typical human resource audit include:

- Does the organization have up-to-date job descriptions?
- Does the organization have up-to-date personnel policies?
- Wage and hour compliance review
- Is there a clearly defined organizational structure and hierarchy?
- Is the organization’s mission clearly stated and followed?
- Does the organizations goals and philosophy align with its compensation and benefit plans?
- Has the organization established adequate lines and limits of authority?
- Are current communication channels effective?
- Does the organization have a corrective action / discipline policy (through termination) that adheres to applicable state and federal regulations.
- Does the organization effectively utilize a Human Resource Information System (HRIS)?

- Does the organization consistently conduct performance appraisals?
- Do the organization's benefits help attract and retain qualified employees who fit the organizational culture?
- Have supervisors received training on organization policies and employment law?
- Does the organization have a culture of following unwritten policies and procedures instead of what is contained in the actual Personnel Policy Manual.
- Have there been any employment claims filed against the organization in the past two years?
- Is there a routine process for discharging an employee?
- Is the organization having difficulty finding and/or keeping good employees?

A thorough human resource audit will include interviews with key managers and employees. In addition, the process should include reviews of human resource record keeping systems, employee orientation procedures, discipline and grievance resolution procedures, and reviews of the organization's employment application, interview forms, employment tests, job descriptions, performance appraisal systems and personnel policy/procedures manuals.

### **Exploring Employment Practices Liability Insurance (EPL) Coverage:**

As discussed earlier, organizations face an ever-escalating barrage of wrongful employment-related claims. The claims take many forms, from gender, age and other discrimination claims brought under federal and state statutes, to express and implied contract actions, and harassment claims. Even when an organization is able to successfully defend itself from one of these claims, they can still incur substantial defense costs. To help deal with the expenses of employment-related litigation, businesses should explore the availability of EPL coverage.

It is important to note that EPL policy forms vary widely and there is no standard form in use. Thus, it is especially important to check with your insurance professional to make sure that any EPL coverage purchased fits the organization's needs and budget.

A good EPL policy can supplement other liability policies, providing additional coverage for discrimination, sexual harassment and wrongful discharge. Organizations also should seek a policy that covers claims for breach of express and implied employment contracts. They also should ensure that written demands and EEOC charges are claims that are included within the policy. Specific areas of coverage and design an organization should consider include the following:

- **Type of Coverage Provided:** Examine whether the policy provides defense-only coverage or both defense and indemnity coverage. In a defense-only policy, the insurer pays for all or part of the cost of defending a claim, but does not pay for any settlement or judgment. Indemnity coverage includes the coverage.
- **Application and Disclosure Forms:** Many EPL applications contain questions regarding an organization's human resource policies and procedures. In addition, they will also include questions regarding past claims, and regarding facts known

at the time that the application is signed which may lead to a claim. Failure to make such disclosures can jeopardize the insurance. Generally, claims disclosed on the application will not be covered by a new policy.

- **Policy and Procedure Establishment:** Some EPL applications will require the organization to meet specific underwriting criteria. This criteria may require the organization to edit and/or update specific personnel policies and procedures.
- **Legal Council Selection:** Organizations should consider obtaining a "special handling" endorsement offered by many insurance organizations. Such an endorsement allows organizations to choose their own defense counsel. Without such an endorsement, all control over the defense of employment claims rests with the insurer.
- **Coverage Period:** Most EPL policies cover only those claims first asserted during the policy period and reported to the insurer pursuant to the policy's "notice" requirements. Timely notice is a condition precedent to coverage, and failure to comply with the policy's notice requirement may jeopardize coverage altogether. The organization should clarify if the policy is set up on a claims made or per occurrence basis.
- **Deductible or Self-Insured Retention:** Some organizations may wish to manage small claims themselves. A self-insured retention can be an effective tool for price containment. Generally, an insurer will want to see that an insured has effective controls and protocols in place for management of claims within a deductible or SIR.
- **Make sure the policy covers all potential claims.** Employers should review the EPL policy to confirm that it does not contain exclusions for certain categories of potential federal and state law employment claims. It is not uncommon for EPL policies to exclude coverage for claims of assault and battery arising in the harassment context, sexual harassment filed by non-employees, retaliation and negligent hiring, and training and supervision, as well as violation of such laws as the Family and Medical Leave Act ("FMLA"), the Worker Adjustment and Retraining Notification Act ("WARN"), the National Labor Relations Act ("NLRA"), the Fair Labor Standards Act ("FLSA"), and the Occupational Safety and Health Act of 1970 ("OSHA"). Many employers purchase EPL coverage without realizing that the policy provides limited protection and leaves employers vulnerable to a variety of significant employment claims.
- **Reserve the right to control settlement of matters.** Employers may want to negotiate with the insurance carrier to include a "consent to settle" provision in the EPL policy, to prevent the carrier from imposing a settlement without the employer's consent.
- **Make sure the policy covers all appropriate entities and individuals.** If an employer is comprised of several different business units or entities, it is important to ensure that the EPL policy covers all appropriate entities. This is especially significant since individuals filing suit against employers often identify the business unit or entity incorrectly in court documents, which can result in protracted disputes regarding coverage. Similarly, employers should make sure the EPL policy covers all claims filed by applicants or employees.

## Conclusion

Organizations need to ensure that they are making every effort to address the risks faced in the human resource arena. Suits alleging employment-related discrimination and harassment, wrongful termination and a host of state common law claims are at an all-time high and their frequency is increasing. This is not news to human resource professionals. Many have resolved dozens of these claims with properly documented files that show a claimant was treated fairly and objectively. Key steps in preparing for such suits is to “head them off at the pass” by auditing your human resource efforts and making corrections where necessary. The second line of defense should include researching the applicability of Employment Practices Liability Insurance (EPL) coverage for your organization. All organizations need to be aware that nobody does everything right all the time. Even employers that do everything possible to manage risks can still face a claim that could cost tens of thousands of dollars to defend and thousands more in settlements or damages. An effective human resource audit, combined with proactive risk management, and EPL coverage may be just the steps your organization needs to consider implementing today, not in the future.

## Biography

**John M. Cummings, PHR** is the Personnel Director and Employment Practices Specialist for the Montana Municipal Insurance Authority (MMIA). As part of these responsibilities John provides a broad spectrum of human resource consulting, training, and risk management functions for MMIA. His past experiences include providing human resource consulting services to clients including the development of job descriptions, personnel policy manuals, research on Federal and State employment law, conducting salary and benefit surveys, analyzing and designing performance appraisal programs, administering benefit programs, performing health insurance analyses, ensuring wage and hour compliance, managing organizational integration, management incentive plan development, and writing human resource, employee benefit and health plan newsletters. John has provided informational seminars on *Wage and Hour Issues in Montana*, *Personnel Policy Manual Development*, *Sexual Harassment*, *Resume Development*, *Effective Customer Service*, and *Health Care Benefit Management Tools*. John received his M.B.A. Degree from the University of Montana and his B.A. Degree from Gonzaga University, Spokane WA. In addition, John is certified as a Professional in Human Resources by the HR Certification Institute.