

Employment Practices Liability (EPL) policies are now commonplace and available for nearly any firm with employees. But what if your client is considering moving their “employees” to a Professional Employer Organization (PEO) or a leasing firm? There has been rapid growth in the PEO and employee leasing industry, as more companies are trying to reduce their exposure and liability to workers’ compensation and other forms of insurance, benefits management, etc. The typical sales approach with a PEO or leasing firm is to eliminate the administrative and liability issues surrounding the employees by transferring those responsibilities to the PEO. But what happens to the EPL exposure? There is a lot of confusion surrounding the approach to take with an insured that has carried EPL coverage but has reduced employee count, significantly or completely, by moving them to the PEO or leasing firm.

Background

There are specialty policies written and geared towards PEOs and staffing firms, with unique language and endorsements that apply to the specific exposures within this class. But those forms are focused on the PEO and staffing firm and not the exposures for the employers (“Client Company”) that transfer employees to the PEO/staffing firm.

A firm that is transferring employees to a PEO or staffing firm has to consider how its liability and EPL coverage could be affected by this move – and it’s not as simple as transferring the employees and having a clean slate. There may be EPL coverage gaps (as well as Errors & Omissions, or E&O, issues) if the EPL policies are not handled properly. The following provides an overview of some of the key coverage and liability questions and issues to review with a client to ensure that they, and their employees, receive the protection they need.

Responsibility and Liability

- **Who is the employer of record for the employees – the Client Company, the PEO or leasing firm, or both?** Often there is co-employer liability, meaning the Client Company may still have liability even if its workers are considered “employees” of the PEO, so addressing the EPL coverage for the Client Company is important. Many EPL policies include language to cover “leased employees” on the Client Company policy.
- **What’s the difference between legal liability and contractual liability, and how does this impact EPL coverage?** Legal liability is determined by state and federal laws and statutes, regardless of whether there is insurance in place. Contractual liability (such as indemnity provisions or hold harmless) does not in and of itself create legal liability. If insureds rely on this provision, they may discover that their insurance doesn’t respond as intended if there is a lack of legal liability.
- **How should warranties, applications, and known or unknown circumstances be handled?** If the Client Company carries EPL coverage, they should only complete a renewal application, without warranty statements whenever possible. If the PEO requires an application, they should avoid warranty questions. EPL circumstances should be reported during the policy period, not waiting until there is a claim, as it may jeopardize coverage by both the PEO and Client Company EPL carriers.
- **Is your client liable for wrongful termination, discrimination, or harassment lawsuits once the employees are transferred to the PEO or leasing firm?** The question of co-employer and Americans with Disabilities Act (ADA) models can make a difference here. With co-employer liability, the Client Company usually retains liability, as does the PEO, so both insurance policies and carriers could be responsible. ADA responsibilities of the PEO (versus the Client Company) are less stringent since they’re not the operational entity.
- **Are there coverage issues to be aware of if there are two EPL policies in place (one for the client, one from the PEO)?** Yes, if the Client Company drops EPL coverage after transferring employees to the PEO/staffing firm, gaps in coverage arise for former employees of the Client Company. The PEO/staffing firm’s EPL policy is not going to pick up wrongful acts occurring prior to their involvement.
- **Is it possible that the coverage provided by a PEO’s/staffing firm’s EPL program will be less broad, or more limited, than a policy purchased by a Client Company?** Yes. Many PEO EPL programs have a large aggregate limit but smaller sublimits available to Client Companies. The sum of each sublimit will often be a fraction of the total number of Client Companies handled by the PEO firm. For example, a PEO/staffing agency may work with 50 Client Companies, but may only purchase a \$10 million limit with \$1 million per client sublimits. It is much more cost effective for the PEO to purchase coverage this way rather than attempt to buy a dedicated \$1 million limit for each and every Client Company. As a result, a high frequency

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of claims may reduce the insurance available to protect the Client Company. It's also possible that the terms and conditions are not as broad as necessary. That doesn't mean the Client Company's liability goes away; it just means that there will be an uninsured portion that will have to be paid by someone – likely the Client Company.

Claims Made and Wrongful Act Policy Provisions

- **How does the retroactive date (or lack thereof) have an impact on coverage for EPL claims when the claim is made after employees are transferred to the PEO or leasing firm?** PEO and staffing firm policies should include full prior acts coverage, but it is imperative to carefully review how liability from prior acts has been handled for employees before they were a responsibility of the PEO. You may see prior acts coverage on one page of the policy, but only for acts of the employees while under the control of the PEO.
- **How are prior and former employees handled, as well as their prior acts, and how do policies respond?** Moving employees to a PEO/staffing firm may not cover prior acts and related exposures for Client Company employees that retired, quit or were terminated prior to the use of the PEO. Former employees may not be covered under the PEO/staffing policy, so dropping the Client Company policy leaves a gap.
- **What if a claim names the Client Company but it's because of a wrongful act of the PEO?** There are endorsements available that address this situation, but it's important to know how to manage the claims process to ensure both the Client Company insurer and the PEO/staffing company insurer are put on notice and that they work together.

Risk Management Decisions for the EPL Policy of a Client Company and PEO/Leasing Firm

- **Should the Client Company drop its EPL coverage when moving employees to a PEO or leasing firm?** Based on the comments above, it's generally not a good idea to drop coverage.
- **Will the Client Company's EPL coverage premium drop once the employees are on the PEO payroll?** The Client Company should make an effort to negotiate a discount on its policy based upon the employees outsourced to the PEO and the availability of coverage on the PEO EPL program (if one exists). There could be some reduction in premium, but it may not be a direct correlation to the drop in employee count, since some liability remains.
- **How will third-party EPL coverage be impacted after shifting to a PEO or leasing firm?** The third-party exposure and entity liability remains even if 100% of the employees are moved to a PEO or leasing firm. The Client Company is still responsible for the treatment of customers, clients and vendors by its employees and staffed employees under its direction.
- **How will a claim be viewed, if the client's existing EPL retention is different than that of the PEO?** Working with both insurance carriers is important, as the difference in retentions will affect the negotiations, especially depending on which carrier takes the lead in the defense. You will need to review and possibly modify the "other insurance" provision in both policies to determine which EPL policy intends to respond as the primary policy.
- **With regard to EPL exposures, is there anything a client should look for when negotiating their contract with the PEO?** The contracts may affect reporting of claim provisions and who has control of the claim and right to settle. The Client Company may not want to give the PEO the sole right to settle claims on behalf of the Client Company. There can be reputational damage from an employment claim and the Client Company may want to have input on the resolution.

Obviously, if a Client Company has any employees outside of the PEO arrangement, it will need to have its own insurance for the actions of and claims brought by those employees.

Conclusion

As evidenced above, there are many EPL insurance-related questions and issues a company should consider when transferring employees to a PEO or leasing firm. Weighing the advantages and disadvantages of stand-alone EPL coverage, compared to relying on the PEO or leasing firm's EPL policy, or a combination of two policies, can be a complex decision. Coverage gaps can exist if these and other complications are not fully considered during the transition. AmWINS' Financial Services brokers can help navigate through the EPL exposures and decisions and ensure you are adequately informing and assisting your client with their EPL coverage.

This article was authored by Dave Weller, a managing director of the AmWINS Financial Services Practice.