

PROJECT HISTORY – 2010

GUIDELINES FOR REGULATIONS AND LEGISLATION ON WORKERS' COMPENSATION COVERAGE FOR PROFESSIONAL EMPLOYER ORGANIZATION ARRANGEMENTS (#1950)

1. Background

In 1991 the NAIC adopted an Employee Leasing Model Regulation and an Employee Leasing Registration Model Act. However, because of the evolution of this market over the intervening years, the Model Law Review (C) Working Group of the Workers' Compensation (C) Task Force had recommended in 2003 that these models be discontinued, noting that very few states had ever adopted them, and they had become considered seriously out of date. It was believed that only a complete rewrite should be considered. Therefore, during the NAIC 2003 Winter National Meeting, these two 1991 models were discontinued.

The Workers' Compensation (C) Task Force formed the Professional Employer Organization Model Law (C) Working Group¹ during the NAIC 2003 Winter National Meeting to consider the development of new model laws that would be appropriate for this market. Through this working group the *Guidelines for Regulations and Legislation on Workers' Compensation Coverage for Professional Employer Organization Arrangements* (PEO Guidelines) were drafted to serve as a replacement for the 1991 models. The PEO Guidelines were adopted by Executive/Plenary during the NAIC 2007 Summer National Meeting.

The PEO Guidelines were developed to ensure that professional employer organizations (PEOs) and their clients properly obtain workers' compensation insurance coverage for all their employees, including both direct hire employees and persons employed under PEO agreements; that the premium paid is commensurate with the anticipated claim experience; and that an appropriate procedural framework is in place for the inception, continuation, and termination of coverage.

2. Drafting Group Formed

During the Professional Employer Organization Model Law (C) Working Group's June 10, 2006, meeting, it was suggested that a paper be developed to complement the anticipated adoption of the PEO Guidelines. The paper would be drafted to serve as a companion document to assist states, professional employer organizations, and the insurance industry in implementing a regulatory framework consistent with the PEO Guidelines.

The PEO Guidelines Implementation Paper Drafting Group (Drafting Group) was therefore formed during the June 2006 Working Group meeting for that purpose and was composed of the following regulator and interested party members: Bob Wake (Chair—ME), Alan Wickman (NE), Mona Carter (National Council on Compensation Insurance), and Bill Schilling (National Association of Professional Employer Organizations).

¹ Name changed Sept. 22, 2005, from the Employee Leasing Model Laws (C) Working Group to the Professional Employer Organization Model Law (C) Working Group.

4. Parent Committee Charge Authorizing Project

The following is the Workers' Compensation (C) Task Force 2010 charge that pertains:

Appoint a Professional Employer Organization Model Law Working Group to complete development of a paper to be of assistance to states in the implementation of the NAIC Guidelines for Regulations and Legislation on Workers' Compensation Coverage for Professional Employer Organization Arrangements (#1950); to coordinate with other NAIC groups on issues relating to professional employer organizations; and to follow changes in the professional employer organization marketplace. The Working Group is to report the results of their ongoing charge at each national meeting.

5. General Description of Drafting Process

The Drafting Group held its first conference call on Nov. 26, 2007, to review a draft outline of the proposed paper. The Drafting Subgroup's next conference call was held March 25, 2008, in which a number of specific drafting assignments were made to address identified issues. Subsequent Drafting Group conference calls were held on the following dates: Dec. 1, 2008; Feb. 19, 2009; March 17, 2009; April 14, 2009; May 12, 2009; June 1, 2009—in which drafting was completed.

The Working Group first reviewed the draft, now titled "Implementation Commentary: Guidelines for Regulations and Legislation on Workers' Compensation Coverage for Professional Employer Organization Arrangements" (Implementation Commentary) during the NAIC 2009 Fall National Meeting. The Working Group determined in a Nov. 6, 2009, conference call that the draft Implementation Commentary should be moved to the Workers' Compensation (C) Task Force during the NAIC 2009 Winter National Meeting—to receive greater exposure.

During the Dec. 6, 2009, Workers' Compensation (C) Task Force meeting the draft "Implementation Commentary" was transferred to the Task Force's purview, with comments on it requested by Feb. 24, 2010. The exposure draft, dated Sept. 22, 2009, continued to remain² on the NAIC website under Committee & Activities/White Papers during this period and the draft was also distributed for any final comments to members, interested regulators, and interested parties of the NAIC/IAIABC Joint (C) Working Group and the Professional Employer Organization Model Law (C) Working Group.

Few comments were received during the comment period expiring Feb. 24, which were reviewed and considered, but no material changes made to the draft from that of its Sept. 22, 2009, version. Therefore, the Sept. 22, 2009, version was presented for consideration of adoption to the Workers' Compensation (C) Task Force during the NAIC 2010 Spring National Meeting, at which time the Task Force adopted the draft "Implementation Commentary" without changes. The Sept. 22, 2009, draft was next presented for consideration of adoption to the Property & Casualty Insurance (C) Committee on March 28, 2009—also adopted without change. The draft next is to go before the Executive/Plenary for consideration of adoption during the NAIC 2010 Summer National Meeting.

6. Project Description

The draft Implementation Commentary provides a framework for considering the PEO Guidelines and provides additional information concerning:

- The historical background of the PEO Guidelines, including an overview of PEO arrangements;
- Presents differences between the PEO Guidelines and earlier regulatory approaches;

- Discusses statutory and structural considerations for implementation; and
- Considers key issues that might be essential for successful implementation.

Each of its section titles alludes to the information found within. The section titles are the following:

- Executive Summary
- Section I: Historical Background of the Guidelines
- Section II: Some Legal Issues Relating to Implementation (existing law; key issues beyond the scope of the guidelines)
- Section III: Specific Issues Related to the Guidelines (see “Issues Identified” below)
- Conclusion
- Appendices (The PEO Guidelines; National Council on Compensation Insurance “Alternatives and Technical Supplement on Data Reporting”)

7. **Issues Identified**

Among issues identified which were addressed in Section III of the draft “Implementation Commentary” were the following:

- ✓ Statutory-Regulatory Framework for PEOs
- ✓ Master Policies and Client-Level Experience Rating
- ✓ Lack of Coverage, Gaps in Coverage, and Proof of Coverage
- ✓ Notice and Cancellation of Coverage for PEOs and Clients
- ✓ Policy Forms
- ✓ Data Reporting
- ✓ Exclusive Remedy
- ✓ Residual Market Issues
- ✓ Pricing
- ✓ Improper Extensions of Coverage (Piggybacking)
- ✓ Self-Insurance
- ✓ Loss-Sensitive Coverage

8. **Other Pertinent Information**

The PEO business model for employment services outsourcing has continued to expand nationwide. Presently, there is a broad disparity among the states as to how PEO arrangements are being regulated. The existing statutory frameworks in some states might not directly or adequately address issues related to workers’ compensation, while other states are devoid of any significant statutory provisions.

The PEO Guidelines are designed to provide the states with a possible regulatory framework for addressing the most significant workers’ compensation issues that have arisen to date in PEO relationships, with an emphasis on a clear allocation of the respective rights and responsibilities of PEOs, clients, and insurers. The purpose of the “Implementation Commentary” is to provide additional insight from the work group that developed, through its drafting group, the guidelines.

The “Implementation Commentary” is to be a lead document, with the PEO Guidelines included as Appendix A. In this way it is believed the PEO Guidelines will be properly introduced and that the additional information provided may prove useful for successful implementation and oversight.

² The Sept. 22, 2009, version of “Implementation Commentary” was originally placed on the NAIC website shortly after its drafting date.

PROJECT HISTORY – 2007

WORKERS' COMPENSATION COVERAGE FOR PROFESSIONAL EMPLOYER ORGANIZATION ARRANGEMENTS MODEL REGULATION

1. Background

In 1991 the NAIC adopted an Employee Leasing Model Regulation and an Employee Leasing Registration Model Act. However, because of the evolution of this market over the intervening years, the Model Law Review (C) Working Group of the Workers' Compensation (C) Task Force had recommended in 2003 that these models be discontinued, noting that very few states had ever adopted them, and they had become considered seriously out of date. It was believed that only a complete rewrite should be considered. During the NAIC 2003 Winter National Meeting these two 1991 models were discontinued.

2. Working Group Formed

The Workers' Compensation (C) Task Force formed the Employee Leasing Model Laws (C) Working Group during the NAIC 2003 Winter National Meeting to consider the development of new model laws that would be appropriate for this market. On Sept. 22, 2005, the Workers' Compensation (C) Task Force changed the name of the Employee Leasing Model Laws (C) Working Group to the Professional Employer Organization Model Law (C) Working Group, since the term "employee leasing" was considered outdated in most states and the more contemporary term for these services was professional employer organization (PEO).

The following jurisdictions are currently members of the Professional Employer Organization Model Law (C) Working Group, chaired by Bob Wake (Maine): Arkansas, California, Connecticut, Florida, Kansas, Kentucky, Minnesota, Missouri, Nebraska, Nevada, Oklahoma, Oregon, South Carolina, Utah, West Virginia, and Wisconsin.

3. Parent Committee Charge Authorizing Project

The following is the Workers' Compensation (C) Task Force 2004 charge that pertains:

Appoint an Employee Leasing Model Law Working Group to develop new employee leasing/professional employer organization model laws that address issues presented in the June 2002 NAIC "Report on Employee Leasing and Professional Employer Organizations" in addition to later credible concerns. The new model laws are to be designed to replace the previous two NAIC model laws on this subject adopted by the NAIC in 1991: Employee Leasing Model Regulation; Employee Leasing Registration Model Act. Make final recommendations for adoption of the new model laws by the NAIC 2005 Fall National Meeting. Report the results of this ongoing charge on a quarterly basis.

4. General Description of Drafting Process

The Professional Employer Organization Model Law (C) Working Group began to assess current PEO regulatory issues during its first conference call, held Feb. 10, 2004. In developing the new model regulation, the Working Group frequently referenced the "Report on Employee Leasing and Professional Employer Organizations," which was developed through the NAIC/IAIABC Joint (C) Working Group and adopted by the NAIC in June 2002.

The Report on Employee Leasing and Professional Employer Organizations dealt primarily with the ramifications of the “master policy” framework for workers’ compensation insurance coverage. A master policy arrangement is typically characterized by an insurer issuing a single policy covering the employees of all of its clients (employers), including the internal employees of the master policyholder. In most states, the voluntary market allows for master policies to be written at the insurer’s discretion. However, in the residual market each client is required to be insured under a separate insurance policy, referred to as a “multiple coordinated” policy arrangement. A multiple coordinated policy arrangement is characterized by having an insurer issue separate policies, with common policy administration and renewal date, to each client company. The multiple coordinated policy approach raises fewer regulatory problems, but places more administrative burden on insurers and PEOs.

The 1991 models were considered out-of-date by the Professional Employer Organization Model Law (C) Working Group primarily because of their emphasis on residual market issues with only secondary attention to master policy concerns. The Working Group reviewed the two discontinued models for areas in need of improvement. The Working Group made the decision that the new model should pertain only to workers’ compensation, rather than including other insurance lines or non-insurance issues. In developing the draft model, the Working Group obtained information (e.g., charts; surveys; other organization model acts) and comments from a wide number of sources, which included most notably the following: interested insurance regulators that were not members of the Working Group; the International Association of Industrial Accident Boards & Commissions; the National Association of Professional Employer Organizations; and the National Council on Compensation Insurance (NCCI). Additionally, industry responses to PEO questions asked by the Working Group were obtained through an informal ad hoc gathering of various trade associations under the leadership of the Property Casualty Insurers Association of America.

Because of the volume of comments and the importance and complexity of the issues, the Working Group did not adopt the PEO Model Regulation, to be titled the “Workers’ Compensation Coverage for Professional Employer Organization Arrangements Model Regulation,” until the NAIC 2006 Winter National Meeting held in San Antonio, Texas. The draft model regulation required some significant changes from status quo in regard to how coverage is documented under master policies, how some statistics are to be reported, including those for proof-of-coverage, and how experience rating might be utilized. However, the Working Group believed that dynamic changes were needed to find a way to effectively regulate PEOs in today’s marketplace, which encompasses master policies and multiple coordinated policies.

The Workers’ Compensation (C) Task Force also considered the PEO Model Regulation for adoption during the NAIC 2006 Winter National Meeting but determined that more time was needed for public exposure, due to revisions to the draft shortly before its Working Group adoption. However, the Task Force and the Property and Casualty Insurance (C) Committee did adopt the March 11, 2007, draft PEO Model Regulation, without changes, during the NAIC 2007 Spring National Meeting.

General Description of Due Process

The Working Group held 17 conference calls and/or meetings since it conducted its first conference call on Feb. 10, 2004. All conference calls and meetings were open, except for one executive session meeting held on Dec. 5, 2004. Additionally, from Feb. 20, 2004, through March 11, 2007, a dozen drafts of the PEO Model Regulation had been circulated at different times to members and interested parties for comment.

5. Project Description

The draft NAIC PEO Model Regulation was developed to ensure that the following occurs:

- PEOs and their clients properly obtain workers' compensation insurance coverage.
- Premiums paid are to be commensurate with anticipated claims experience.
- Coverage would need to be obtained for all employees—including both direct hire employees and persons employed under PEO agreements.
- Appropriate procedural frameworks would be in place for the inception, continuation, and termination of coverage.

Each of its section titles alludes to the comprehensive information found within. The section titles are the following:

- Section 1: Authority and Purpose
- Section 2: Definitions
- Section 3: Insurance Coverage on PEO Co-Employees
- Section 4: Requirements for PEOs
- Section 5: Multiple Coordinated Policy Agreement
- Section 6: [Option One] Coverage in the Residual Market
- [Option Two] Coverage by the [Statutory Carrier of Last Resort]
- Section 7: Policy Issuance
- Section 8: Premium Payments
- Section 9: Verification of Classifications and Payroll
- Section 10: Policy Cancellation or Non-renewal
- Section 11: Statistical Reporting and Experience Rating
- Section 12: Interstate Coverage
- Section 13: Confidentiality
- Section 14: Remedies
- Section 15: Effective Date

6. Significant Issues Raised

Among key issues identified were the following:

- Experience rating, including but not limited to modification laundering. The primary issues motivating the old model laws continued to be identified as a significant problem both by regulators and the NCCI.
- The need for certainty regarding who is insured, who is the insurer, when coverage begins and ends, and how this is verified with the appropriate regulators.
- Ensuring that all affected parties receive the information they need, and that there is due process before coverage is terminated and adequate opportunity to shop for replacement coverage. Affected parties are PEOs, clients, insurers, statistical organizations, claimants, insurance regulators, and workers' compensation regulators.
- Appropriate procedures in place to deal with insolvencies and the threat of insolvency, and to minimize the risk of harm to claimants and PEO clients.

- Piggybacking: A situation where several PEOs are listed as clients on another PEO's policy and coverage is provided through a master policy.
- Coverage for Direct Hire Employees. A "direct hire employee" of a client or a PEO means an individual who is an employee within the meaning of the Workers' Compensation Act and who is not a PEO co-employee as defined in Section 2, Subsection J of the draft.
- Responsible Party for the Premium. Should the client pay the PEO a fee in exchange for the PEO being responsible for payment of the insurance company premium that provides the client coverage?
- The "unknown employee" exposure. This exposure exists when the client does not have any coverage of its own because it intended to cover its entire workforce through the PEO. However, someone unexpectedly files a claim as an employee of the client—either because the claimant was a new employee who has not yet established a documented relationship with the PEO, or because the claimant was regarded by the client as an independent contractor.

7. Other Pertinent Information

- National Conference of Insurance Legislators (NCOIL) Draft PEO Model Act

NCOIL has been developing its own PEO Model Act. However, the NCOIL model is not expected to be as broad in scope as the draft PEO Model Regulation produced by the Professional Employer Organization Model Law (C) Working Group. During the NAIC 2007 Spring National Meeting the Workers' Compensation (C) Task Force formed the NCOIL PEO Model Focus Group, composed of members who were most involved with PEO activities. The purpose of the NCOIL PEO Model Focus Group was to provide comments regarding the recent NCOIL draft for delivery to that organization by its deadline date of March 30, 2007. The comments were submitted by that date. NCOIL next plans to make a decision on its model during the NCOIL Summer Meeting, to be held in Seattle, Washington from July 19—22, 2007. NCOIL is an organization of state legislators whose primary focus is insurance legislation and regulation.

- Complementary Paper

During the Professional Employer Organization Model Law (C) Working Group's June 10, 2006, meeting, a suggestion was made for a paper to be developed to complement an adopted NAIC PEO Model Regulation. The intent of the paper (not anticipated to be a white paper) would be to help states determine law changes that need to be made and to indicate whether insurers, bureaus and PEOs are ready to handle the data and other needs addressed in the model. The Working Group agreed to develop such a paper and therefore plans to continue meeting after adoption of the model.