GUIDELINES FOR REGULATIONS AND LEGISLATION ON WORKERS' COMPENSATION COVERAGE FOR PROFESSIONAL EMPLOYER ORGANIZATION ARRANGEMENTS

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Appendix A: The NAIC PEO Guidelines

Appendix B: NCCI Alternatives and Technical Supplement on Data Reporting

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Nonetheless, the movement of workers' compensation responsibilities for these employees from client to a leasing company and back or from leasing company to leasing company, may have a major impact on the experience rating system.

Under traditional rating rules, a client customarily lost its experience factor because its entire workforce was absorbed into the leasing company's larger workforce a master policy covering the leasing company.

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and other states allowed master policy arrangements in the name of the PEO or leasing company. The Joint Working Group decided to provide guidance that could be adapted and used for any or all of these situations.

3. Voluntary vs. Residual Markets – The Joint Working Group, recognizing the peculiar responsibilities of the residual market, opted to maintain the requirement of a multiple coordinated policy or client-based policy in the residual market. Greater flexibility is allowed under the Guidelines for insurers and insureds in the voluntary market, as long as essential requirements for coverage, experience, and notice are met.

4. Implementation Commentary – Because of the complexity of the Guidelines, the need to address a number of issues legislatively, and the fact that the Guidelines address only the workers' compensation aspects of PEO arrangements, it was decided to issue a companion paper to the Guidelines to give state insurance regulators and legislators additional context for implementation.

Significant changes occurred in the PEO industry and in state insurance regulation between

- Experience must be reported at the client level on an ongoing basis, not just when the client leaves the PEO

- An experience modification factor will be calculated for all experience rated clients, even in situations where the insurer and PEO choose to calculate premium on the basis of the PEO's experience.

- Disclosure requirements so that clients clearly understand their rights and responsibilities.

II.

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- Concerns raised by cross-ownership of insurers and PEOs.
- Whether adjustments need to be made in existing state law for taxes and assessments when large deductible policies are issued to PEOs.
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Some of these issues are within the purview of other NAIC committees or the IAIABC, and the NAIC/IAIABC Joint Working Group has briefed those bodies and encouraged them to stay involved in these matters. Other essential elements of comprehensive PEO oversight are beyond the jurisdiction of both insurance and workers' compensation regulators. Therefore, the Guidelines are based on the premise that some sort of legislation already exists—as it does in most states—that defines what a PEO is, requires PEOs to be registered or licensed by the state, and recognizes some form of co-employment relationship (either by statute or case law). Section 4 of the Guidelines then provides that workers' compensation coverage may only be provided through a PEO arrangement if the PEO is properly registered, and insurers are prohibited from issuing master policies to unregistered PEOs or entering into multiple coordinated policy agreements with them, and Section 15 provides for administrative enforcement by the insurance commissioner.

The Guidelines attempt to recognize the diversity of state laws currently regulating PEOs, and include a number of drafting notes to provide guidance. Drafting notes to Sections 1 and 15 suggest that if a different state agency has regulatory jurisdiction over PEOs, then the provisions

For this reason, the Working Group gave serious consideration to recommending that master policies be prohibited entirely. However, because of the potential efficiencies that could be realized from the master policy model, representatives of the PEO and insurance industries strongly urged the Working Group to consider whether there was a way to permit master policies that could satisfy regulatory concerns. The Working Group, therefore, took as its starting point the recommendation in the 2002 NAIC/IAIABC Joint Working Group report that the only acceptable alternative to prohibiting master policies would be:

> … allowing master policies but with client-specific notice requirements and payroll, loss and other data reporting requirements that would give the client a status similar to that of an individual insured under a group policy.

If the latter approach is taken, careful attention must be paid to the need to guarantee that coverage cannot be terminated or materially altered by the insurer or by the employment services outsourcing company without reasonable advance notice to the client. It is also important to maintain and report accurate and up-to-date information in sufficient detail to permit the calculation of meaningful client-specific experience ratings and verification of proof-of-coverage on the client level. In practice, this may be a moot point, since insurers and employment services outsourcing companies may not consider the master policy a worthwhile option if client-by-client recordkeeping and reporting are unavoidable.[10]

Despite the skepticism that had been expressed, the Working Group and the interested persons were able to reach consensus on a regulatory framework for master policies. In particular, the Guidelines require experience reporting at the client level and the production of experience ratings on an ongoing basis for every client of sufficient size to be eligible for experience rating. This requires two essential enhancements to the current system. One is the ability to identify each client workforce as a discrete unit of coverage, even if coverage is provided to the PEO on a master policy and the client does not purchase a separate policy.[11] This is primarily a regulatory issue, and is one of a number of reasons the Guidelines have adopted a "certificate of coverage" requirement, under which each client is issued a coverage document outlining its rights and obligations under the master policy and clearly establishing both the identity and status of the client and the inception and termination dates of coverage.[12] This has occasionally been a source of misunderstanding because of the traditional usage of the term "certificate of insurance" in the context of the property/casualty insurance industry. Like the certificates issued by insurers under group life and health policies, this is a legally binding coverage document, not just a representation of the status of coverage at some point in time, and has the effect of making the client an additional insured under the policy.[13]

[10] NAIC/IAIABC Joint Working Group Report on Employee Leasing and Professional Employer Organizations at 32.

[11] Section 11 of the Guidelines requires that all loss reporting be conducted in a manner that will allow for the experience of the client to be maintained on a stand-alone basis.

[12] Specifically, the certificate must: 1) specify the effective date of the client's coverage and the expiration date of the master policy (with a renewal certificate issued when the master policy is renewed); 2) provide that coverage shall continue as long as the master policy and the PEO agreement between the PEO and the client both remain in force, spelling out any exceptions; and 3) state that termination of coverage without replacement requires 30 days' advance notice to the client. Subsection 7D.

[13] Subsection 7B.

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the PEO's co-employees. However, because there is only one policy, if there is anyone who is not covered through the PEO, then

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Two important new safeguards against coverage failures established by the Guidelines are:

- The certificate of coverage mechanism discussed earlier, which when properly implemented by insurers and regulators ensures that even under a master policy, each client's coverage has a clearly established inception and termination date, with adequate advance notice to both the client and the POC system before a client's coverage can be terminated or replaced.[16]

- A presumption that a PEO's policy ordinarily provides full workforce coverage to all covered clients, meaning that coverage during the relationship is equivalent to the coverage a client would have under a stand-alone policy.[17] The PEO's insurer does have the right to issue a policy that limits the scope of coverage to PEO co-employees, but only a full-workforce policy can be used to satisfy the clients' coverage obligations.[18] Thus, there is an expectation that PEOs and their clients will only be interested in non-full-workforce coverage when they intend from the outset that the PEO arrangement will only cover a portion of the client's workforce.[19]

The provision making full-workforce coverage the norm and more limited coverage the

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This means that fee disputes and termination disputes between clients and PEOs cannot be resolved through the insurance department's administrative process. The nature of the PEO-client relationship makes it unrealistic to require good cause for termination, let alone to require the PEO to maintain a client against the PEO's will if good cause is lacking. Without regulated fees or pass-through billing of insurance premium, the complexity of the claims and counterclaims that might occur makes it inappropriate to treat fee disputes as similar to premium disputes. Accordingly, the Working Group did not adopt the PEO industry's request to allow expedited cancellation for nonpayment of PEO fees, in those states that allow expedited cancellation for nonpayment of premium. However, some states allow expedited cancellation for fraud, and those states should consider whether cases involving fraud committed by the client would be within the scope of the Drafting Note on expedited cancellation.

Another termination issue that the 1999 model does not address is the nature of the insurer-employer relationship under a multiple coordinated policy arrangement. Should the client have the right to convert its policy to a direct purchase policy if it leaves the PEO, or should leaving the PEO be a valid ground for terminating the client's coordinated policy? Some regulators felt that an insurer ought to make the same 1-year commitment when it issues a coordinated policy covering a business as it does when it issues a direct purchase policy. However, insurers replied that in the voluntary market, participation in a multiple coordinated policy arrangement through a PEO is often an essential condition for their acceptance of the risk, and termination of that arrangement represents a material change in circumstances that justifies termination of coverage. The ins

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E. Policy Forms

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There was significant debate as to the nature of the data reporting issue, who was responsible, and how to resolve the difficulty. Various carriers said they were able to the n

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One solution might be to develop some form of system for master policy situations that parallels the multiple coordinated policy framework for reporting data. This would require both carriers and rating agencies to be able to segregate data for clients of PEOs as if each had an individual policy. Carriers that are engaged in PEO coverage indicate a willingness to provide this client level data, as do the PEOs themselves. NCCI has provided a technical supplement outlining various alternative mechanisms for reporting and compiling this information.[33]

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Given that a large majority of states now statutorily recognize PEOs as employers for workers'

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- If the PEO or an affiliate owes past due premium or otherwise does not meet the general qualifications for residual market coverage;

- If the PEO is unable to demonstrate the financial capacity to comply with its obligations under the multiple coordinated policy agreement; or

- If the PEO has been barred by regulators or found to have unfit management or ownership.

In addition, as discussed above in "Experience Rating," an impaired ability to enter into split-workforce PEO arrangements might give the PEO and client an incentive to "dump" the riskiest components of the client's workforce into the residual market, or for a PEO to buy voluntary market coverage for its best clients and "dump" the others. Therefore, Subsection 6D of the Guidelines makes split-workforce arrangements ineligible for residual market coverage, and gives the residual market the authority to deny or surcharge coverage if a PEO splits its client base.

A final issue that needed to be addressed in order to construct a nationwide model is that different states make residual market coverage available in different ways. Therefore, the Guidelines include two different versions of Section 6, one to be used in states with an assigned risk/servicing carrier program, the other to be used in states with a single statutory carrier of last resort. The Guidelines presume that such a carrier also has the authority to write voluntary market coverage, so states with a single carrier that only provides involuntary coverage should adjust the language accordingly.

I. Pricing

The Guidelines impose no requirement that the PEO itemize the workers' compensation portion of its billings to its clients.[28] Paragraph 7 (31)

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Likewise, when the client has paid the appropriate fees up front, the PEO is not permitted to hit the client with additional charges down the road if claims experience goes beyond those restrictions, the focus is on transparency, making sure that all parties have all the information they need to make an informed decision. Transparency extends to regulatory reporting as well. Subsection 11D of the Guidelines requires specific reporting by all insurers (foreign as well as domestic) in the domestic PEO market, and by domestic insurers on their nati

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Guidelines For Regulations And Legislation On Workers' Compensation Coverage For

(2) Explaining that while the coordinated policy or certificate of coverage is in force, the

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Drafting Note: A state that does not have an established regulatory process for complaints by clients against PEOs should consider adding a provision establishing a complaint process for workers' compensation issues.

E. The PEO shall promptly notify the workers' compensation insurance carrier of the termination of any PEO agreement with a client that is covered on a master policy or multiple coordinated policy basis.

F. The PEO shall not make any materially inaccurate, knowingly or recklessly misleading, or fraudulent representations to the client of the cost of workers' compensation coverage. If the PEO charges the client an itemized amount for workers' compensation coverage, the PEO shall provide the client with a good faith estimate of the actual cost of coverage and an accurate and

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requirements shall be mandatory grounds for cancellation. The PEO shall have the right to a hearing before the commissioner upon a claim that the insurer has cancelled the agreement unlawfully or has failed to provide proper notice of cancellation or nonrenewal;

I. Provisions establishing the conditions and procedures, if any, under which a specific policy may be cancelled or nonrenewed while the multiple coordinated policy agreement remains in force; and

J. Provisions, if any, for conversion of coordinated policies to direct purchase policies upon termination of a PEO agreement, or upon termination of the multiple coordinated policy agreement between the PEO and the insurer.

Section 6. Coverage in the Residual Market

[Option One]: This version of Section 6 is for use by states where the residual market is an assigned risk plan or pooling mechanism. States should make appropriate revisions to the extent that this section is not consistent with the state's residual market structure.

A. The [residual market manager] shall file with the commissioner a standard multiple coordinated policy agreement that shall be made available to all registered PEOs in good standing. The terms of the standard agreement shall be subject to approval by the commissioner and shall include:

(1) Provisions under which, to the extent feasible, the policies covering all clients of the same PEO within this state shall be assigned to the same servicing carrier, and reasonable efforts shall be made to assign a common servicing carrier on an interstate basis;

(2) Provisions under which any client that is otherwise eligible for coverage may obtain direct purchase coverage with no break in coverage if the coordinated policy covering the client terminates for any reason; and

(3) A premium discount schedule that appropriately reflects any cost savings created by multiple coordinated policy arrangements.

Drafting Note: Omit Paragraph (3) in states where there is no premium discount available to large employers in the residual market.

B. If a PEO is not in good standing, residual market coverage for its clients shall be issued in the name of the client on a direct purchase basis. A PEO is not in good standing for purposes of this section if the residual market manager, subject to the PEO's right of appeal to the commissioner, determines that the PEO, an entity that controls or is controlled by the PEO, or an entity in which the PEO or an entity controlling the PEO directly or indirectly holds a 25% or greater ownership interest or actively manages:

(1) Is in default on an undisputed workers' compensation premium or assessment, either for its own coverage or for its clients' coverage, or otherwise fails to qualify as an eligible employer under the terms of the residual market plan;

Drafting Note: Omit the word "undisputed" in states that allow the denial of coverage while a dispute is pending.

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(1) Is in default on an undisputed workers' compensation premium or assessment, either for its own coverage or for its clients' coverage, or otherwise fails to qualify as an employer eligible for coverage as of right with [statutory carrier of last resort];

Drafting Note: Omit the word "undisputed" in states that allow the denial of coverage while a dispute is pending.

(2) Is unable to demonstrate the financial capacity to comply with its obligations under the multiple coordinated policy agreement;

(3) [If state has a disciplinary provision in its PEO laws that when triggered would restrict a PEO's ability to provide workers' compensation coverage to clients, insert appropriate reference here]; or

(4) Has, or is owned or managed by persons who have, a history of material noncompliance with the law or with contractual obligations, including but not limited to a felony conviction, multiple criminal convictions, judgments of liability for fraud or material representation, or multiple cancellations of insurance policies or multiple coordinated policy agreements.

C. The terms of any master policy issued or multiple coordinated policy agreement entered into by [statutory carrier of last resort] shall include provisions under which any client that is otherwise eligible for coverage may obtain direct purchase coverage with no break in coverage if the coordinated policy covering the client or the client's coverage under the PEO's master policy terminates for any reason.

D. An employer that is a client of a PEO is not entitled to issuance or continuation of coverage as of right by [statutory carrier of last resort], nor is the PEO entitled to issuance or continuation of coverage as of right by [statutory carrier of last resort] with respect to PEO employees at that client, if there is voluntary market coverage with respect to some other portion of the client's work force. With the approval of the commissioner, [statutory carrier of l3 (o)4.3 (ry)ri93 (o).6 (f)10

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Drafting Note: States that permit the "Designated Workplaces Exclusion Endorsement" should add the following language at the end: " ... or subject to the terms of a Designated Workplaces Exclusion Endorsement in a form approved by the commissioner, consistent with other applicable legal and procedural requirements, that is properly executed, attached to the policy, specifically identifies the PEO agreement and contingent upon the client's obligation to maintain coverage at the designated workplaces and upon the insurer's obligation to give notice of the exclusion to the [workers' compensation regulator] when filing proof of coverage."

(2) If the PEO agreement is not a full work force PEO agreement, the policy or certificate may exclude coverage for direct hire employees and may specify that only those employees acknowledged in writing by the PEO as PEO employees shall be covered, subject to the following conditions and requirements:

(a) A PEO's insurer may not issue or renew coverage with a direct hire exclusion unless it obtains satisfactory evidence demonstrating that the client has coverage for all of its other workers' compensation liabilities under [insert appropriate statutory reference]. A direct hire exclusion is not valid if the insurer issues the policy or certificate without first obtaining evidence of coverage for the client's other workers' compensation liabilities, or if the coverage for the client's other workers' compensation liabilities has terminated and the PEO's insurer has failed to act promptly to cancel the policy or certificate after learning of the termination.

(b) A direct hire exclusion is not valid if the PEO's insurer has provided proof of

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(a) When replacement coverage is provided by the PEO with no break in coverage; or

(b) When the insurer has notified the client and the [workers' compensation regulator] at the time the certificate is first issued that the master policy will be cancelled or nonrenewed in less than thirty (30) days.

Drafting Note: In states where Section 10 is revised to permit shorter notice in some or all situations, this provision should be modified accordingly.

E. Coordinated policies, except for the policy covering the PEO's direct hire employees, shall be issued in a manner that clearly specifies the identities of the PEO and client and clearly describes the scope of coverage:

(1) Coverage may be issued in the name of "[PEO] and [client] as co-employers," or substantially similar language, as long as the policy clearly indicates which named insured is the PEO and which named insured is the client.

(2) Coverage may be issued in the name of "[PEO] as labor contractor for [client]," or substantially similar language, as long as the policy clearly provides coverage for the client's obligations as employer under the workers' compensation laws.

(3) Coverage may be issued in the name of "[client], for employees employed with [PEO]," or substantially similar language, or in the name of the client with the PEO as an additional insured, as long as the policy clearly provides coverage for the PEO's obligations as employer under the workers' compensation laws.

(4)

purchase policy.

H. The insurer shall send each coordinated policy to the PEO, and shall send the client a certificate adopting by reference the policy form attached to the multiple coordinated policy agreement together with any amendments that may be expressly set forth in the certificate, and providing a method by which the client may obtain a copy of the entire policy on request.

I. The insurer shall-3 (2D)-3 (in)( )10.9 (l)-3.0 Tc.sn tndrdundretin32.2 (g5)-1 (an)2.3 (h)13.13 (r)1a

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Section 10. Policy Cancellation or Nonrenewal

A. A master policy or a coordinated policy may be cancelled or nonrenewed by the insurer on the same grounds and subject to the same conditions as any other workers' compensation insurance policy. In addition, the insurer shall cancel or nonrenew a coordinated policy covering a client, or may at its option convert it to a direct purchase policy, if the multiple coordinated policy agreement is cancelled or nonrenewed, voluntarily or involuntarily, or if the PEO agreement between the PEO and the client terminates for any reason. The termination or conversion of coverage shall be concurrent with the termination of the multiple coordinated policy agreement or PEO agreement if adequate advance notice can be given in compliance with this regulation and applicable contractual provisions.

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B. If coverage is rated on the basis of the client's experience and some of the client's operations are to be covered under one or more policies issued by a different insurer, the insurer may, as one of the terms under which it offers to issue or renew coverage and separate from any other applicable credits or surcharges, either:

(1) Use an experience modification factor based on the portion of the client's operations that are covered by that insurer if such a factor can be calculated with reasonable accuracy; or

(2) Adjust the premium in a manner that in the insurer's reasoned underwriting judgment appropriately reflects the difference in risk between the insured operations.

Drafting Note:

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Appendix B

NCCI Alternatives and Technical Supplement on Data Reporting

Purpose of Proof of Coverage (POC) and Experience Rating Data

Workers' compensation administrators and insurance regulators rely on and use POC statistical data to enforce and monitor the workers' compensation system. For states that recognize the PEO and their clients as co-employers, compliance programs and regulations need to consider the impact of insurance coverage as it relates to the PEO and the client employer. Regardless of the existence of a PEO or employee leasing arrangement, the integrity of experience rating and POC programs must be effectively maintained with statistical data that is:

- Sufficient to enable the state's compliance administrator to efficiently track and identify whether an employer within the state has the coverage required by law to ensure that injured employees' claims will be processed and the required benefits paid. At a minimum, POC data must identify the worksite employer's name, location, covered work units, and date of

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