

Guideline # 1950

Guidelines for Regulations and Legislation on Workers' Compensation Coverage for Professional Employer Organization Arrangements





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

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Section 1. Authority and Purpose

This regulation is adopted pursuant to [insert applicable statutory authority] to ensure that professional employer organizations (PEOs), and their clients, properly obtain workers' compensation insurance coverage for all of 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.

Drafting Note: These guidelines are presented in the form of a regulation; however, some provisions may be more appropriately enacted as legislation in some states. Agencies promulgating regulations based upon these guidelines should ensure that statutes regulating PEOs or employee leasing arrangements, statutes regulating workers' compensation insurance, or other applicable law grant them adequate rulemaking authority. In states where another agency has regulatory jurisdiction over PEOs, the commissioner should consider jointly promulgating regulations with that agency. Agencies promulgating regulations or drafting legislation based upon these guidelines should also ensure that insurers, PEOs and regulators have adequate resources and infrastructure in place to make compliance feasible, including but not limited to the necessary information systems and the necessary reporting mechanisms for data and proof of coverage.

Drafting Note: The scope of these guidelines is limited to issues related to workers' compensation insurance. It does not provide a comprehensive regulatory framework for the PEO industry. States may wish to consider regulations or legislation based upon these guidelines as part of a more comprehensive registration or licensing regimen for PEOs. In particular, states should take appropriate measures to ensure, to the extent possible, that both a PEO and a client obtaining coverage in compliance with these guidelines are protected by the state's exclusive remedy provisions.

Section 2. Definitions

- A. "Client" means an employer whose work force consists in whole or part of PEO co-employees.
- B. "Designated advisory organization" means the entity designated by the commissioner for the reporting of claims and experience data and for the administration of the workers' compensation experience rating system.

Drafting Note: If state law or practice uses different terminology or an inconsistent definition, make the appropriate substitution. Where the term “commissioner” is used, states should substitute the title of their chief insurance regulator, if different.

- C. “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 Subsection J.
- D. “Direct purchase basis” means an arrangement in which all contractual obligations under the insurance policy run directly between the insurer and the client without the involvement of the PEO, whether the arrangement is negotiated solely between the client and the insurer or is negotiated with the assistance of the PEO on terms that might not be available to the general public.
- E. “Full work force PEO agreement” means a PEO agreement under which the PEO agrees to assume specified employment responsibilities for all of the client’s employees within the state, except that a full work force agreement may exclude by name one or more owners and/or officers who have demonstrated that they are excluded from state workers’ compensation benefits.

Drafting Note: States that permit the “Designated Workplaces Exclusion Endorsement” to be used in a master policy certificate or coordinated policy should add the following sentence: “A full work force PEO agreement may also exclude employees at one or more named workplaces that are subject to a Designated Workplaces Exclusion Endorsement issued in compliance with this regulation and other applicable legal and procedural requirements.”

- F. “Master policy basis” means an arrangement under which a single policy issued to the PEO provides coverage for more than one client, and provides coverage to the PEO with respect to its direct hire employees. Two or more clients that are insured under the same policy solely because they are under common ownership are considered a single client for purposes of this definition.

Drafting Note: States that prohibit master policies should omit this subsection and all other references to master policies in regulations or legislation based upon these guidelines.

- G. “Multiple coordinated policy basis” means an arrangement under which a separate policy is issued to or on behalf of each client or group of affiliated clients but payment obligations and certain policy communications are coordinated through the PEO.
- H. **[Option 1]** “Professional Employer Organization” or “PEO” means a business entity that enters into agreements with other businesses, whether under a formal contract or otherwise and regardless of the terminology used by the parties to describe the relationship, under which the PEO assumes or shares employment responsibilities for all or a significant number of the worksite employees of the other business. However, “PEO” does not include a business entity that recruits and hires its own employees; assigns them to clients on a temporary basis to support or supplement the client’s work force in special work situations such as employee absences, temporary skill shortages and seasonal workloads; and customarily attempts to reassign the employees to other clients when they finish each assignment.
- H. **[Option 2]** “Professional Employer Organization” or “PEO” means a business entity that is required to be *[insert appropriate term]* pursuant to *[insert reference to state’s licensure or registration law for PEOs or employee leasing companies]*.

Drafting Note: Option 1 is for use in those states where these guidelines will not be part of a comprehensive regulatory scheme for PEOs requiring licensure or registration.

- I. “Professional employer agreement” or “PEO agreement” means an agreement between a PEO and a client under which the PEO agrees to assume specified employment responsibilities for all or part of the client’s work force.

Drafting Note: If the state has an existing comprehensive statutory scheme in place regulating PEOs, these guidelines should be reviewed for consistency with that statutory scheme and revisions should be made if appropriate. This may include revisions to the terminology used in this section if state law uses different terminology, including but not limited to “employee leasing company,” to describe some or all of the shared or delegated employer relationships that are the subject of these guidelines. Also, these guidelines presume that the state recognizes some form of employment arrangement under which both the PEO and client are considered employers for purposes of the workers’ compensation laws. States should review this definition for consistency with the applicable statutory or common-law definition and make any revisions that might be necessary.

- J. **[Option 1]** “PEO co-employee” means an individual who is an employee, within the meaning of the Workers’ Compensation Act, of both a PEO and a client.

- J. **[Option 2]** “PEO co-employee” means an individual whose employment responsibilities are shared between a client and a PEO, either by the terms of a PEO agreement or by operation of law.

Drafting Note: Generally, a client’s direct hire employees are reported for tax purposes under the name and identification number of the client, while its PEO co-employees are reported for tax purposes under the name and identification number of the PEO. However, the determination whether the PEO is an employer of an individual for workers’ compensation purposes is outside the scope of these guidelines because employer status is not governed by insurance laws. Although the PEO agreement should provide a clear process for determining which members of the client’s workforce are PEO co-employees and which (if anyone) are direct hire employees, state law must control if the PEO agreement is inconclusive or is inconsistent with the law. If state law does not recognize co-employment, different terminology such as “PEO worksite employee” should be used and the definition should be revised to be consistent with state law.

Section 3. Insurance Coverage on PEO Co-Employees

The following are the methods approved by the commissioner as providing coverage for a client and a PEO that have entered into a PEO agreement, sufficient to meet their statutory obligation for coverage as employers under [insert appropriate statutory reference] of their PEO co-employees:

- A. The client obtains a standard workers’ compensation policy from an insurer on a direct purchase basis, covering all of the client’s PEO co-employees and direct hire employees, subject to the same requirements and conditions as if the client were the sole employer of its PEO co-employees. The policy may name the PEO as an additional insured. If licensed as a producer, and authorized by the insurer, the PEO may negotiate coverage, collect premiums on behalf of the insurer, and otherwise act as an intermediary with respect to direct purchase coverage as permitted by law;

Drafting Note: States whose law uses other terminology such as “agent” or “broker” should modify this provision accordingly.

- B. The client obtains authorization from the [insert appropriate state official] pursuant to [insert applicable self-insurance licensure statutes] to self-insure its workers’ compensation obligations;

Drafting Note: States that allow a PEO as an entity to self-insure should modify this subsection accordingly. However, states considering allowing PEOs to self-insure should seriously consider basing such authorization upon licensure as an alternative risk-bearing entity, similar to laws allowing licensure for multiple-employer welfare arrangements and group self-insurance pools, and upon compliance with standards substantially similar to those established by these guidelines for insurers issuing master policies.

- C. The PEO purchases insurance providing workers' compensation coverage on a multiple coordinated policy basis in compliance with this regulation, with a policy providing coverage to the client and to the PEO with respect to the PEO co-employees at the client; or
- D. The PEO purchases a master policy, with a certificate of coverage issued in compliance with this regulation providing coverage to the client and to the PEO with respect to the PEO co-employees at the client.

Section 4. Requirements for PEOs

- A. A PEO shall be registered as a professional employer organization with the [insert appropriate state official] pursuant to [insert applicable statutes]. An insurer may not enter into or maintain a multiple coordinated policy agreement with, or issue a master policy to, an unregistered PEO. If a PEO providing multiple coordinated policies, or covered under a master policy, ceases to be registered or has been subject to disciplinary sanctions, the [insert appropriate state official] shall promptly notify the insurer of record.

Drafting Note: Substitute "licensed" for "registered" in states with licensing laws. States that have no formal regulatory framework for PEOs may modify this subsection to impose a requirement for registration with or notice to the commissioner, or may omit this subsection entirely.

- B. A PEO may not enter into or remain in a multiple coordinated policy agreement with an insurer or be issued a master policy if it is ineligible for coverage pursuant to [insert appropriate statutory citation here if applicable] as a result of a default on a workers' compensation premium or assessment debt.
- C. If the services that a PEO offers to a client do not include securing workers' compensation coverage on a master policy or multiple coordinated policy basis, the PEO shall provide the client with clear and conspicuous written notice, before entering into a PEO agreement with the client, that the client will remain responsible for obtaining its own workers' compensation coverage for both PEO co-employees and direct hire employees, and the written PEO agreement shall also clearly set forth that responsibility.
- D. If a PEO offers any client services that include securing workers' compensation coverage on either a master policy or multiple coordinated policy basis, the PEO shall have a written agreement with the client, signed by the client before coverage becomes effective, including clear and conspicuous provisions:
 - (1) Explaining that insurance coverage does not take effect until the effective date designated by the insurer on the policy or certificate of coverage;
 - (2) Explaining that while the coordinated policy or certificate of coverage is in force, the PEO will be responsible for paying all premium obligations, including any audit adjustments and policyholder assessments, and will be entitled to any premium refunds. The written agreement shall further explain that although the PEO will charge fees to the client that reflect or include the cost of coverage, these fees are not considered insurance premium obligations of the client. If there is a policy deductible, the written agreement shall further explain that the PEO is responsible

for reimbursing the insurer for the deductible and may not seek recovery from the client;

- (3) Explaining the procedures by which the client or PEO may terminate the PEO agreement, including any fees or costs payable upon termination, and that except as otherwise expressly provided or required by law, all services provided by the PEO to the client shall cease immediately on the effective date of the termination. The written agreement shall explicitly state that the client's coverage under any workers' compensation insurance shall terminate immediately on the termination date of the PEO agreement, subject to the client's right to receive at thirty (30) days' advance notice before workers' compensation insurance coverage may be terminated involuntarily and to purchase an extension of coverage at the client's expense for the remainder of the notice period if the notice period extends beyond the termination date of the PEO agreement;

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

- (4) Explaining that the insurer has the right to inspect the premises and records of the client;
- (5) Explaining that the client's loss experience will continue to be reported in the name of the client to the designated advisory organization, and will be available to subsequent insurers on request;
- (6) If coverage is provided under a multiple coordinated policy arrangement, explaining whether the client may elect to purchase coverage directly from an insurer in lieu of participating in the multiple coordinated policy arrangement;
- (7) If the PEO agreement is a full work force PEO agreement, explaining that the policy or certificate will cover all employees of the client within the state who are not excluded from workers' compensation benefits. If the PEO agreement is not a full work force PEO agreement, explaining that the policy or certificate will cover only those employees acknowledged in writing by the PEO to be PEO co-employees, and that the client shall at all times maintain other valid coverage for its direct hire employees and shall provide evidence of coverage satisfactory to the PEO's insurer; and

Drafting Note: States that permit the "Designated Workplaces Exclusion Endorsement" should add the following additional sentence between the first and second sentences. "If the client's policy or certificate is subject to a Designated Workplaces Exclusion Endorsement, the above disclosure shall be modified to reflect the terms of the exclusion and shall expressly state the client's obligation to provide separate coverage for the excluded workplaces."

- (8) Explaining that the client may take complaints to the [insert applicable regulator] in accordance with [insert applicable law].

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.

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- 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 concise description of the basis upon which it was calculated and the services that are included. Without the prior approval of the commissioner, a PEO may not charge a client an itemized amount for workers' compensation coverage that is:
- (1) Materially inconsistent with the actual amounts charged by the insurer or reasonably anticipated loss-sensitive charges;
 - (2) In conflict with the terms of the uniform classification system; or
 - (3) Materially in conflict with the terms of the uniform experience rating plan.
- G. The PEO shall provide any information requested by the commissioner relating to the provisions of its PEO agreements that relate to or have an impact on workers' compensation benefits or coverage, the methods by which the fees charged to clients are calculated to the extent that they are based upon or attributed to the cost of workers' compensation coverage, and any other information relevant to the PEO's workers' compensation coverage arrangements.
- H. The PEO shall not impose any fee increase upon a client based upon the actual or anticipated cost of workers' compensation coverage without giving the client at least thirty (30) days' advance notice and an opportunity to withdraw from the PEO agreement without penalty.
- I. If a client receives notice of the termination or nonrenewal of coverage, and the client obtains replacement coverage, the client shall have the right to withdraw from the PEO agreement without penalty even if the PEO's coverage has been reinstated or replaced.
- J. Except with prior approval of the commissioner and full written advance disclosure to clients, the PEO shall not impose any fee or other charge upon a client that relates to workers' compensation coverage and could become due after the termination of the PEO agreement, other than:
- (1) Fees and charges due and billed while the PEO agreement was in force, and fees for the final period of PEO services to the extent normally and customarily billed in arrears;
 - (2) Reasonable charges for additional services requested by the former client after termination of the PEO agreement;
 - (3) The cost to the PEO of workers' compensation coverage, including reasonable administrative expense, during any extension of the coverage period after termination of the PEO agreement;
 - (4) Reasonable interest on overdue fees and charges; and
 - (5) Reasonable charges for late payment of fees or early termination of the PEO agreement.

Section 5. Multiple Coordinated Policy Agreement

If a PEO secures workers' compensation coverage on a multiple coordinated policy basis, it shall first enter into a written agreement with the insurer establishing the terms and conditions under which multiple coordinated policies will be issued to the PEO and each client. The agreement may consist in whole or part of an endorsement to the coordinated policy covering the PEO's direct hire employees. The agreement shall include provisions addressing the following issues and such other reasonable provisions as the parties consider appropriate:

- A. A copy of the policy form to be used for each coordinated policy issued under the agreement;
- B. The premium discount, if any, to be applied to policies issued under the agreement, and any other modifications of the insurer's standard underwriting guidelines and rating plan;
- C. The provision of financial and ownership information and coverage history by the PEO to the insurer, the form and amount of security to be held by the insurer, and the conditions under the insurer may draw upon it;

Drafting Note: States with laws limiting an insurer's ability to require prepayment of premium should consider whether it is necessary to clarify that a requirement to post a reasonable level of security under this subsection is not considered a prohibited prepayment requirement.

- D. Whether a client may elect to purchase coverage directly from the same or another insurer in lieu of participating in the multiple coordinated policy arrangement;
- E. The designation of a third-party administrator, if one is to be used. Any third-party administrator must be licensed by the commissioner;

Drafting Note: Omit second sentence if the state does not license third-party administrators, or if workers' compensation insurance is outside the scope of the state's administrator law. States with third party administrator laws that do not encompass workers' compensation coverage should consider amending them.

- F. Provisions for billing and claims reporting and for enforcement of these requirements;
- G. Provisions addressing the obligations of the PEO and the insurer when the PEO acquires a new client or terminates a relationship with an existing client, including notice to the insurer and to the [workers' compensation regulator];
- H. Procedures for termination and renewal of the multiple coordinated policy agreement. Grounds for cancellation by the insurer and procedures for providing notice of cancellation or nonrenewal to the PEO shall be substantially consistent with the restrictions on policy termination set forth in [insert law regulating cancellation of workers' compensation policies]. Termination of PEO registration and continuing material noncompliance with reporting 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.

- (2) Is unable to demonstrate the financial capacity to comply with its obligations under the multiple coordinated policy agreement;
 - (3) [Insert appropriate reference here 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.]; 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. A master policy may not be issued to a PEO in the residual market.

- D. An employer that is a client of a PEO is not eligible for issuance or continuation of a residual market policy, nor is the PEO eligible for issuance or continuation of residual market coverage with respect to PEO co-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, the residual market may deny coverage, or may charge rates reasonably designed to reflect the additional risk assumed, to a PEO requesting coverage on a multiple coordinated policy basis for some but not all of its clients in this state, if the PEO has other coverage on a master policy or multiple coordinated policy basis for other clients in this state.

Section 6. Coverage by the [Statutory Carrier of Last Resort]

[Option Two]: This version of Section 6 is for use by states in which the residual market is a competitive state fund or other statutory carrier of last resort. States should make appropriate revisions if this section is not consistent with the powers and duties of the carrier of last resort; for example, if that carrier does not also compete in the voluntary market.

- A. [Statutory carrier of last resort] may negotiate master policies or multiple coordinated policy agreements with PEOs on a voluntary basis. [Statutory carrier of last resort] 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 a premium discount schedule that appropriately reflects any cost savings created by multiple coordinated policy arrangements.

Drafting Note: Change “shall” to “may” in the last sentence in states where there is no requirement to provide a premium discount to large employers with involuntary coverage, and omit the last sentence entirely where premium discounts are prohibited.

- B. If a PEO is not in good standing, coverage for its clients by [statutory carrier of last resort] 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 [statutory carrier of last resort], 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 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 co-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 last resort] may deny coverage, or may charge rates reasonably designed to reflect the additional risk assumed, to a PEO requesting coverage on a multiple coordinated policy basis for some but not all of its clients in this state, if the PEO has other coverage on a master policy or multiple coordinated policy basis for other clients in this state.

Section 7. Policy Issuance

- A. A master policy or coordinated policy shall unconditionally obligate the insurer to pay all benefits due under the workers' compensation laws, whether or not the PEO and client comply with their obligations under the policy, for all injuries to covered employees occurring while the policy is in force, including any extension of coverage required pursuant to Section 10 of this regulation.
 - (1) If the PEO agreement with a covered client is a full work force PEO agreement, the policy or certificate shall cover all PEO co-employees and shall also cover any other obligations of the client under [insert appropriate statutory reference] to the same extent as if the client had obtained a direct purchase policy in this state.

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 all other applicable legal and procedural requirements, that is properly executed, attached to the policy, specifically identified in 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 co-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 coverage on behalf of the client to the [workers' compensation regulator]. In lieu of providing proof of coverage, an insurer that issues a coordinated policy or a master policy certificate with a direct hire exclusion shall provide notice to the [workers' compensation regulator] in a form prescribed by the commissioner in consultation with the [workers' compensation regulator].

Drafting Note: States with proof-of-coverage reporting systems that are capable of tracking both primary and secondary coverage should replace this provision with a requirement to report PEO coverage with a direct hire exclusion as secondary coverage for the client in order for the exclusion to be enforceable.

- (c) A policy or certificate with a direct hire exclusion shall provide that loss of coverage for direct hire employees is a ground for cancellation, unless the client obtains replacement coverage with no break in coverage.
 - (d) If a client's insurer has issued coverage for direct hire exposure, and an injured employee is entitled to workers' compensation benefits but there is a dispute as to whether the employee is a direct hire employee or a PEO co-employee, the client's insurer shall pay the benefits, subject to reimbursement of claims costs and loss adjustment expenses by the PEO's insurer if it is determined that the claimant is a PEO co-employee.
 - (e) A representation that the client has no direct hire employees does not constitute proof of coverage for direct hire employees. A client representing that its PEO agreement is not a full work force agreement but that it has no direct hire employees within the state must maintain a valid policy of insurance written on an "if any" basis.
 - (f) Upon the termination of separate coverage for PEO co-employees, they shall be considered direct hire employees for purposes of the client's policy, and premium shall be charged accordingly. The client's policy may include an endorsement requiring the client to provide prompt reporting of any notice of termination by the PEO's insurer and advance notice of any voluntary termination, and, if issued in the voluntary market, may provide that termination of the PEO coverage is a ground for cancellation of the client's policy.
 - (g) If the PEO and its client have obtained separate policies in compliance with this subsection, and one of the insurers becomes insolvent, coverage obligations shall be allocated between the solvent insurer and the [guaranty association] in the same manner as if both insurers were solvent.
- B. A master policy shall be issued in the name of the PEO, and shall provide that all clients holding certificates of coverage are additional insureds to the extent provided in the certificate of coverage.
- C. A master policy may cover only one PEO or one PEO group. For a master policy to be issued to a PEO group, all covered PEOs must be combinable for experience rating purposes, each member of the group shall execute a cross-guarantee of the premium payment obligations of the other members, and each covered PEO shall be expressly named as an insured PEO before the effective date of coverage. A PEO, employee leasing company, temporary service agency or other entity in the business of employment services outsourcing may not be covered as a client under a master policy or coordinated policy. Each client's coordinated policy or certificate of coverage, and any policy issued to a PEO for the sole purpose of

covering its direct hire employees, shall include a Labor Contractor Exclusion Endorsement or similar provision excluding coverage for employees furnished by the client to other entities or with respect to whom the client acts as a PEO.

Drafting Note: If applicable state law regulates PEO groups, this subsection should be revised as necessary for consistency, and if applicable should include a provision requiring the PEO group to be registered or licensed as such.

- D. The insurer or its authorized representative shall issue a certificate of coverage to each client covered under a master policy.
- (1) The certificate shall specify the effective date of the client's coverage and the expiration date of the underlying master policy. A renewal certificate shall be issued to each client each time the policy is renewed.
 - (2) The certificate of coverage shall 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, or shall expressly set forth any exceptions.
 - (3) The certificate of coverage shall provide that the client is entitled to thirty (30) days' notice before coverage may be cancelled or nonrenewed without the client's consent, except:
 - (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 co-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) If a client participates in more than one PEO agreement, employees affiliated with different PEOs shall be covered under different policies unless both PEOs, and both PEOs' insurers, agree to the issuance of a single policy providing comprehensive

coverage to the client's entire workforce, comprising direct hire employees and PEO co-employees from all sources.

Drafting Note: If applicable state law specifies a different procedure for designating the named insureds on the policy, this Subsection should be omitted or revised accordingly. States that require coordinated policies to be issued in the name of one of the parties to the PEO agreement should take appropriate measures to ensure that the other party is also adequately protected, particularly on the employer's liability side of the policy.

- F. A coordinated policy shall be issued on a standard workers' compensation policy form, with an endorsement or endorsements clearly describing all variations from the terms of the insurer's direct purchase policy, consistent with the terms of the multiple coordinated policy agreement and this regulation, including without limitation provisions establishing that premium payment is the sole obligation of the PEO and clarifying the client's rights and obligations with respect to policy cancellation and, if applicable, policy conversion.
- G. All policies for clients issued under a multiple coordinated policy agreement with a PEO shall have the same termination date. If a client enters into a PEO agreement during a policy period, the initial policy will be written for less than a twelve-month period. Subsequent policies shall be written with the same effective date as the policies for other clients. Termination of the PEO agreement between the PEO and client shall be grounds for cancellation of the client's coordinated policy or, if agreed between the insurer and the client, for conversion to a direct 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 use its standard underwriting and rating rules for coordinated policies, except as modified by the terms of the multiple coordinated policy agreement.
- J. Regardless of the basis on which coverage is provided, the insurer shall report payroll and claims data for each client to the designated advisory organization in a manner that identifies both the client and PEO, and experience modification factors shall be calculated for each client as if the client were the sole employer of all PEO co-employees. The designated advisory organization may also establish rules for the calculation of an experience modification factor for PEOs which may be used by agreement between a PEO and an insurer in accordance with Section 12A.
- K. Policies for clients issued on either a direct purchase or multiple coordinated policy basis shall be issued with a Labor Contractor Endorsement limiting coverage under the policy to PEO co-employees and those direct hire employees who are not covered under a separate policy.
- L. An insurer, directly or through an advisory organization authorized to act on its behalf, shall file all applicable master policy forms, master policy certificate of coverage forms, multiple coordinated policy agreement forms and coordinated policy forms with the commissioner at least thirty (30) days before issuing master policies or multiple coordinated policies subject to this regulation, or no later than the effective date of this regulation for forms already in use. If a master policy or a multiple coordinated policy agreement is written on a manuscript basis or materially varies from the forms on file with the commissioner, the insurer shall file the contract as soon as practicable, and no later than ten (10) days after the effective date.

Section 8. Premium Payments

- A. The PEO is responsible for payment to the insurer of any premiums, policyholder assessments or deductible reimbursement charges under a master policy or coordinated policy, whether or not the PEO has received timely payment from the client. A client's failure to pay fees when due to the PEO does not constitute nonpayment of premium within the meaning of [insert reference to law regulating cancellation of workers' compensation policies and law or residual market operating rule requiring denial of coverage to employers with outstanding premium debt]. Unless the PEO and client are under common ownership, a client may not be denied coverage pursuant to [insert reference to law or residual market operating rule requiring denial of coverage to employers with outstanding premium debt] on the ground that its PEO has failed to pay premium to the insurer when due.
- B. A master policy or multiple coordinated policy agreement shall include provisions requiring the insurer to take prompt action to cancel a client's coverage or convert it to direct purchase coverage, at the carrier's option, if notified by the PEO that the PEO agreement has terminated.
- C. An insurer may not issue a master policy or multiple coordinated policies with deductibles or with retrospective or other loss-sensitive rating unless the insurer has applicable program policy forms on file with the commissioner.

Drafting Note: If state law prohibits deductibles, omit reference to deductibles.

- D. The client's direct hire employees, if any, shall be included in the client's payroll for rating and classification purposes unless the policy or certificate was issued with a direct hire exclusion pursuant to Section 7A(2).
- E. If a coordinated policy is converted to or replaced with a direct purchase policy, the insurer shall provide clear and timely notice to both the PEO and client explaining when the PEO's premium payment obligations end and the client's premium obligations begin. The insurer shall conduct a premium audit within 120 days to determine the PEO's final premium obligation under the policy. Unless otherwise agreed between the insurer and the former PEO client, a converted policy shall have no deductible and shall be rated according to the insurer's generally applicable rating plan.

Drafting Note: If applicable state law provides a different time frame for premium audits, states may consider modifying this provision accordingly.

- F. If a client's negligence or fraud results in a substantial understatement of the estimated premium for coverage of the client under a master policy or coordinated policy, or if the PEO's negligence or fraud results in a substantial understatement of the estimated premium for a client's direct purchase policy, the PEO and client are jointly and severally liable to the insurer for the premium actually owed.

Section 9. Verification of Classifications and Payroll

- A. At least annually, and more often if reasonably requested by the insurer, a PEO shall furnish to the insurer a complete payroll record of all PEO co-employees covered pursuant to a master policy or multiple coordinated policy agreement, itemized by policy or certificate number and by workers' compensation class code. The insurer may visit the client to review ledger records or may request copies of payroll information from the client to determine the actual amounts paid to PEO co-employees, and to direct hire employees if the direct hire employees are not covered under a separate policy.

- B. An insurer shall be permitted access to inspect the client's workplace to determine the proper classifications for insurance purposes. If either the PEO or client disagrees with the insurer's classification assignment, it may ask the designated advisory organization to do an inspection to determine the proper classification, subject to a further right of appeal to the commissioner. This subsection does not limit the insurer's or PEO's right to conduct safety inspections as appropriate.

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.

Drafting Note: The lawful termination of any essential component of the tripartite agreement among the insurer, the PEO purchasing the coverage, and the client should be a ground for policy termination, especially where the insured risk no longer conforms to the description in the policy. However, in some states the grounds for termination described in this subsection may be prohibited by statute or public policy, and these states should either amend the law or revise this subsection to mandate conversion to direct purchase coverage in lieu of cancellation, and should also make corresponding revisions to subsections 4(D)(3), 7(D)(2) and (7H).

- B. Cancellation or nonrenewal of a PEO's or client's coverage at the initiative of the insurer without the written consent of that party is not effective as to that party unless the insurer has given at least thirty (30) days' advance notice to that party and the [workers' compensation regulator] in compliance with [insert citation to law regulating cancellation of workers' compensation policies].

Drafting Note: If applicable state law permits involuntary termination of workers' compensation coverage upon shorter notice in some or all situations, states may consider modifying this provision accordingly.

- C. Cancellation or nonrenewal of coverage under a master policy or coordinated policy at the initiative of the PEO or client shall be governed by the applicable contractual provisions, except as otherwise provided in this regulation.
- D. Cancellation or nonrenewal of a client's coverage at the initiative of the PEO without the written consent of the client is not effective as to the client unless either:
 - (1) The insurer has given at least thirty (30) days' advance notice to the client and the [workers' compensation regulator];
 - (2) The PEO has given at least thirty (30) days' advance notice by certified mail to the insurer, the client and the [workers' compensation regulator]; or
 - (3) Coverage for all covered clients has been replaced with no break in coverage, and the PEO has given advance notice to the insurer, the clients, and the [workers' compensation regulator].

Drafting Note: If applicable state law permits involuntary termination of workers' compensation coverage upon shorter notice in some or all situations, states may consider modifying this provision accordingly.

- E. A request for termination of coverage by a client, or a client's or PEO's consent to waiver of notice under Subsection B or D of this section, is not effective:
- (1) If the request or consent is executed in blank without specifying the termination date at the time of execution, or is executed in advance as security for a future obligation;
 - (2) If the request is made or the consent is given pursuant to a power of attorney that was executed in advance or by an attorney that was not chosen solely by and acting in the sole interest of the party on whose behalf the request is purportedly being made or on whose behalf the waiver is purportedly being given; or
 - (3) If the request or consent is received by the insurer after the specified termination date, unless the insurer also receives satisfactory evidence demonstrating that coverage has been replaced with no break in coverage.

Section 11. Statistical Reporting and Experience Rating

- A. All loss reporting for injuries to PEO co-employees and all payroll reporting for PEOs shall be conducted in a manner that identifies both the PEO and the client and enables the calculation of experience modification factors in accordance with this section.
- B. The experience modification factor for the client shall be based on all experience of both PEO co-employees and direct hire employees during the experience period.
- C. If some or all of the client's experience is unavailable or unreliable because relevant experience was not reported in the name of the client during all or part of the experience period or in some or all of the states where the client had operations, an experience modification factor shall be calculated in accordance with procedures established by the designated advisory organization and approved by the commissioner.
- D. All domestic insurers providing workers' compensation coverage to PEOs and all foreign insurers providing workers' compensation coverage to PEOs registered in this state shall file an annual report with the commissioner on the coverage provided in this market sector, at a time and in a format specified by the commissioner.

Drafting Note: The information to be collected may vary from state to state according to their respective regulatory needs, and states may wish to specify the information to be collected in more detail when promulgating regulations or drafting legislation based upon these guidelines. The information to be collected could include the following: the number of PEOs and number of clients covered; premium and loss information; the rating methodologies, security arrangements, and reinsurance arrangements used; and cancellations and replacements of coverage.

Section 12. Rating Methodology

The premium an insurer charges a PEO for a client's operations shall be rated using the client's experience modification factor, with the following exceptions:

- A. If an experience modification factor has been calculated for the PEO in accordance with procedures established by the designated advisory organization and approved by the commissioner, the insurer and PEO may agree to use that experience modification factor or, with the approval of the commissioner, a formula that takes into account both the PEO's and the various clients' experience modification factors.

- 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: Section 12 is not appropriate for jurisdictions that have not adopted Section 11, since Section 12 presupposes the existence of an effective mechanism for implementing experience rating at the client level and is not intended as an exemption from the requirements of Section 11. Also, since Section 12 permits the use of a negotiated alternative rating formula, it is not appropriate in jurisdictions that require insurers to adhere to a uniform rating plan.

Section 13. Interstate Coverage

- A. If the PEO or client has its *bona fide* principal place of business outside this state, the insurer may request that the commissioner grant a variance from one or more requirements of this regulation to enable the PEO's or client's interstate operations to be covered under a single policy or multiple coordinated policy arrangement. The commissioner shall have the discretion to grant a variance upon a determination that the coverage arrangement preserves the statutory rights of employees and clients and offers protections substantially equivalent to those required by this regulation, that the risk is appropriately rated and that the loss experience of individual clients in this state is accurately reported.
- B. If the client has operations in multiple states, an interstate experience modification factor shall be used for the client if the client would be subject to interstate modification if it were the sole employer of its PEO co-employees and an accurate loss history is available for the client's interstate operations.

Section 14. Confidentiality

If any information filed with or provided to the commissioner pursuant to this regulation is a trade secret or otherwise exempt from public disclosure under the [insert citation to applicable open records law], the commissioner shall withhold it from public disclosure if the person or entity providing the information makes a written request for confidential treatment that specifies with particularity why the document should be exempt from disclosure under the [insert citation to applicable open records law]. PEO client lists or other information from which the identity of clients may be inferred are presumed to be trade secrets and may not be disclosed to the public except on a finding by the commissioner that the specific information sought to be disclosed is not a trade secret or that failure to disclose the information would tend to conceal fraud or otherwise work injustice.

Drafting Note: In states where residual market employer lists are published, add the following sentence: "If a PEO is covered in the residual market, it shall not be named in the published listing of employers with residual market coverage at any time, and its clients shall not be named until residual market coverage has been in force for sixty (60) consecutive days and shall not be designated as clients of the PEO."

Section 15. Remedies

- A. Violations of this regulation by a PEO, client or insurer are subject to penalties as provided in [insert citation to general disciplinary law or other applicable law]. Disputes involving a PEO, client or insurer arising out of a claimed violation of this regulation may be resolved by an adjudicatory hearing before the commissioner.

Drafting Note: In states where another agency has regulatory jurisdiction over PEOs, there should either be a provision specifying procedures for referring disciplinary actions for PEOs to that agency, or provisions under which regulations are jointly promulgated by the agency regulating PEOs and establishing remedies under that agency's regulatory authority.

- B. It is a deceptive practice in the business of insurance within the meaning of [insert appropriate citation to unfair trade practices act] for a PEO to represent to clients or prospective clients that they have or will have workers' compensation coverage except when a coordinated policy or certificate of coverage is issued in compliance with this regulation or a duly authorized agent of the insurer has issued a valid temporary binder; for a PEO to purport or threaten to terminate workers' compensation coverage except in accordance with this regulation; or for a PEO to knowingly or recklessly fail to provide the notices or disclosures required by this regulation. If the violation is knowing or willful, it is a fraudulent insurance act within the meaning of [insert appropriate citation to insurance fraud act].

Section 16. Effective Date

The effective date of this regulation is [insert appropriate lead time], except that no later than [one month earlier], the [statutory carrier of last resort or residual market manager] shall file its proposed standard multiple coordinated policy agreement with the commissioner, pursuant to Section 6 of this regulation, and the designated advisory organization shall file proposed state special modifications to its experience rating plan if any are required. This regulation applies to all policies issued or renewed and any applications submitted on or after the effective date of this regulation.

Chronological Summary of Actions (all references are to the Proceedings of the NAIC)

2007 Proc. 2nd Quarter (adopted).

2007 Proc. 4th Quarter (amended).

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

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| NAIC MEMBER | RELATED STATE ACTIVITY |
|----------------------|-------------------------------|
| Alabama | NO ACTION TO DATE |
| Alaska | NO ACTION TO DATE |
| American Samoa | NO ACTION TO DATE |
| Arizona | NO ACTION TO DATE |
| Arkansas | NO ACTION TO DATE |
| California | NO ACTION TO DATE |
| Colorado | NO ACTION TO DATE |
| Connecticut | NO ACTION TO DATE |
| Delaware | NO ACTION TO DATE |
| District of Columbia | NO ACTION TO DATE |
| Florida | NO ACTION TO DATE |
| Georgia | NO ACTION TO DATE |
| Guam | NO ACTION TO DATE |
| Hawaii | NO ACTION TO DATE |
| Idaho | NO ACTION TO DATE |
| Illinois | NO ACTION TO DATE |
| Indiana | NO ACTION TO DATE |
| Iowa | NO ACTION TO DATE |
| Kansas | NO ACTION TO DATE |

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

| NAIC MEMBER | RELATED STATE ACTIVITY |
|--------------------|--|
| Kentucky | NO ACTION TO DATE |
| Louisiana | NO ACTION TO DATE |
| Maine | NO ACTION TO DATE |
| Maryland | NO ACTION TO DATE |
| Massachusetts | NO ACTION TO DATE |
| Michigan | NO ACTION TO DATE |
| Minnesota | NO ACTION TO DATE |
| Mississippi | NO ACTION TO DATE |
| Missouri | NO ACTION TO DATE |
| Montana | NO ACTION TO DATE |
| Nebraska | NO ACTION TO DATE |
| Nevada | NO ACTION TO DATE |
| New Hampshire | NO ACTION TO DATE |
| New Jersey | NO ACTION TO DATE |
| New Mexico | NO ACTION TO DATE |
| New York | NO ACTION TO DATE |
| North Carolina | NO ACTION TO DATE |
| North Dakota | NO ACTION TO DATE |
| Northern Marianas | NO ACTION TO DATE |
| Ohio | NO ACTION TO DATE |
| Oklahoma | NO ACTION TO DATE |
| Oregon | OR. ADMIN. R. 436-050-000 to 436-050-0480 (1975/2007). |

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| NAIC MEMBER | RELATED STATE ACTIVITY |
|--------------------|--|
| Pennsylvania | NO ACTION TO DATE |
| Puerto Rico | NO ACTION TO DATE |
| Rhode Island | NO ACTION TO DATE |
| South Carolina | NO ACTION TO DATE |
| South Dakota | NO ACTION TO DATE |
| Tennessee | NO ACTION TO DATE |
| Texas | NO ACTION TO DATE |
| Utah | UTAH ADMIN. CODE r. 31A-40-101 to 31A-40-402 (2008). |
| Vermont | NO ACTION TO DATE |
| Virgin Islands | NO ACTION TO DATE |
| Virginia | W. VA. CODE R. §§ 114-85-1 to 114-85-14 (2008). |
| Washington | NO ACTION TO DATE |
| West Virginia | NO ACTION TO DATE |
| Wisconsin | NO ACTION TO DATE |
| Wyoming | NO ACTION TO DATE |

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