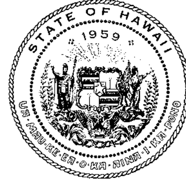
NEIL ABERCROMBIE
GOVERNOR

SHAN TSUTSUI
LT. GOVERNOR

FREDERICK D. PABLO
DIRECTOR OF TAXATION

JOSHUA WISCH
DEPUTY DIRECTOR



STATE OF HAWAII
DEPARTMENT OF TAXATION
P.O. BOX 259
HONOLULU, HAWAII 96809
PHONE NO: (808) 587-1530
FAX NO: (808) 587-1584

To: The Honorable Mark M. Nakashima, Chair
and Members of the House Committee on Labor & Public Employment

Date: Tuesday, March 12, 2013
Time: 9:00 a.m.
Place: Conference Room 309, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

Re: S.B. No. 0510, S.D.2 Relating to Professional Employer Organizations

The Department of Taxation (Department) **supports** the tax-related amendments proposed in S.B. 510, S.D.2. The Department provides the following information and comments for your consideration, and defers to the Department of Labor and Industrial Relations as to the merits of this measure

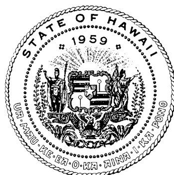
As it relates to tax, this measure amends the general excise tax exemption for professional employer organizations that is set forth under section 237-24.75, Hawaii Revised Statutes (HRS) to provide that the exemption is not applicable upon the occurrence of certain specified events. The measure has a defective effective date of July 1, 2050.

With respect to the general excise tax exemption, the Department supports the suggested changes, as they will clarify the timing and circumstances under which the exemption will be denied to a professional employer organization.

The Department estimates that the bill will have no material effect on tax revenues.

Thank you for the opportunity to provide comments.

NEIL ABERCROMBIE
GOVERNOR



DWIGHT Y. TAKAMINE
DIRECTOR

AUDREY HIDANO
DEPUTY DIRECTOR

STATE OF HAWAII
DEPARTMENT OF LABOR AND INDUSTRIAL RELATIONS
830 PUNCHBOWL STREET, ROOM 321
HONOLULU, HAWAII 96813
http://labor.hawaii.gov

March 11, 2013

To: The Honorable Mark M. Nakashima, Chair,
The Honorable Mark J. Hashem, Vice Chair, and
Members of the House Committee on Labor & Public Employment

Date: Tuesday, March 12, 2013
Time: 9:00 a.m.
Place: Conference Room 309, State Capitol

From: Dwight Y. Takamine, Director
Department of Labor and Industrial Relations

Re: S.B. No. 510 S. D. 2 Relating to Professional Employer Organizations

I. OVERVIEW OF PROPOSED LEGISLATION

The intent of S.B. 510 S. D. 2 is to rectify the conflict between existing statutory requirements relating to professional employer organizations (PEO) by: 1) repealing Chapter 373K, HRS; and 2) amending Chapter 373L, HRS, and Section 237-24.75, HRS, to clarify PEO responsibilities for purposes of qualifying for the state general excise tax exemption and requires PEOs to obtain a bond on a sliding scale that is based on total payroll amount. This measure seeks to balance PEO business interests with state regulatory oversight by establishing a resolute and balanced registration process to qualify for tax incentives while protecting employees' rights and benefits.

The Department strongly supports this measure, which retains the essential elements and objectives of current PEO laws but facilitates compliance by identifying and overcoming those barriers that have frustrated efforts to fully implement those laws. This proposal includes the recommendations of the various stakeholders, following internal deliberations and discussions since the veto of SB2424 in 2012.

II. CURRENT LAW

Chapter 373K was enacted in 2007 to allow PEOs to become eligible for the tax exclusion under section 237-24.75, whereas Chapter 373L was adopted in 2010 to regulate the PEO business by enforcing registration and bonding requirements. Effective implementation of both laws has been hampered by incompatible language, ill-defined goals and a lack of a common appreciation of the benefits intended or results to be realized.

III. COMMENTS ON THE SENATE BILL

S.B. No. 510 S. D. 2 is a collaborative effort, endorsed by its legislative sponsor, the Department of Taxation, Department of Labor and PEOs to enhance implementation by clarifying inconsistencies between two separate but interrelated chapters in the HRS and limiting regulatory controls to only those critical to maintaining the integrity of the PEO industry and the statutorily mandated benefits and protections of Hawaii's labor laws. DLIR believes that the stakeholders with interest in current PEO legislation are mostly in agreement with the needed changes to reconcile the two PEO chapters. All parties are in accord with the concept that the monitoring functions required by Chapter 373L would be best enforced by tying compliance to the general excise tax exemption and, implementing a sliding bonding scale tied to the PEO's total payroll.

March 11, 2013

Honorable Mark M. Nakashima, Chair
Honorable Mark J. Hashem, Vice-Chair
House Committee on Labor and Public Employment
State Capitol, Room 309
Honolulu, HI 96813
Hearing Date: March 12, 2013
Time: 9 a.m.

Re: <u>Senate Bill 510 SD2: related to Professional Employer Organizations</u>

Dear Chair Nakashima, Vice-Chair Hashem, and members of the committee,

My name is Matthew S. Delaney, President of the Hawaii Association of Professional Employer Organizations ("HAPEO"). On behalf of HAPEO, I would like to thank you for this opportunity to share with you and the committee HAPEO's comments as they relate to S.B. No. 510 SD2. While HAPEO supports the intent of this measure, as noted in our testimony, HAPEO requests the Committee's consideration of certain amendments to insure fairness and clarity in the definitional section. HAPEO believes that this measure will generate new registration fees for the state and will not burden the state with any additional expense. HAPEO has been working with Senator Baker's Office and Committee, as well as working very closely with DLIR. Our group supports the intent of SB510 SD2; however, we recommend the bill to be rewritten as HB No.144 HD2. HAPEO looks forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry.

<u>Background of PEOs</u>

By way of background, PEOs are businesses that partner with existing small businesses to enable them to cost-effectively outsource the management of human resources, employee benefits, payroll, and workers' compensation. This allows PEO clients to focus on their core competencies to maintain and grow their bottom lines. By forming an employment relationship with these small businesses and their employees, PEOs are able to offer enhanced access to employee benefits, as well as helping small businesses be in compliance with federal and state payroll tax laws, insurance laws, employment laws, and many other required mandates of employers.

<u>History of HAPEO</u>

The people and businesses of Hawaii have a long history of working together, the islands offer a warm and welcoming environment energized by aloha and collaboration. True to this heritage, the Hawaii Professional Employer Organization ("PEO") industry has evolved a positive culture of shared ideas and goodwill. In 2012, a core group of smaller and medium sized Hawaii PEO's formalized their alignment with the establishment of the Hawaii Association of Professional

Employer Organizations ("HAPEO"). Our organization was founded on the principles of transparency and supporting the thousands of small businesses in Hawaii.

HAPEO Membership

HAPEO represents approximately twenty (20) local members, which collectively service over 1,000 small to medium sized businesses in Hawaii and represent over 10,000 worksite employees. HAPEO represents approximately ninety-three percent (93%) of the State's PEOs.

HAPEO's Priorities

Overall, HAPEO supports the intent of S.B. No. 510 SD2, but has concerns about provisions pertaining to the scope of the regulatory functions and the allocation of responsibilities regarding compliance with labor laws that may be out of our direct control.

HAPEO has the following three (3) priorities regarding the proposed PEO legislation:

(1) We agree with the Scalable Bond in S.B. No. 510 SD2– It is HAPEO's priority to have a scalable bond as we have detailed out in our prior testimony to equitably represent the sizes of PEOs in annual taxable payroll.

Letter of Credit

HAPEO suggests that a Letter of Credit may be used as a substitute for a surety bond.

(2) Removal of the Audit – We and the DLIR strongly supports S.B. No. 510 SD2 as currently written with the elimination of the audited financial statements.

(3) Amendments to the "definition" section – HAPEO has been working diligently with DLIR on suggested language changes. DLIR has been open and agreed to some of the suggested changes and has disagreed with other changes. Our dialogue and interaction has been very professional and with the same intent of clearly defining the rights and responsibilities between the DLIR, the PEO and their clients.

Suggested Definitional Changes:

(i) The definition of assigned employee should be amended to add language that equates an assigned employee with a leased employee as defined in Section 414(n) or the IRS Code.

(ii) Clarify that "Offsite employer of record" means a professional employer organization pursuant to a professional employer agreement to which is contractually assigned the financial and administrative duties of a client company, including human resources administration, payroll and payroll taxes, workers' compensation and temporary disability coverage, state unemployment, and prepaid health care coverage of assigned employees.

(iii) "<u>Work site employer</u>" mean the client company, pursuant to a professional employer agreement, that retains workplace management and supervisory control and responsibility of the assigned employees including compliance with labor or employment laws, collective bargaining rights, anti-discrimination provisions, or other laws with respect to the protection and rights of employees under the Hawaii Employment Relations Act and the Employment Practices laws of chapters 377 and 378.

2013 Legislative Session

We will continue to work collaboratively with all stakeholders to improve the current laws that were passed back in 2010, and which have still not been implemented in their entirety as a result of challenges with bonding requirements, audited financials, and some other factors. HAPEO is also committed to working with both the DLIR and DCCA to assist in the implementation of the registration process.

HAPEO is also committed to working together with the larger PEOs in the State to insure that consumers are protected by some measure of financial responsibility coupled with healthy competition in the industry. Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Matthew S. Delaney
President of the Board
HAPEO

March 11, 2013

Honorable Mark M. Nakashima, Chair
Honorable Mark J. Hashem, Vice-Chair
House Committee on Labor and Public Employment
State Capitol, Room 309
Honolulu, HI 96813
Hearing Date: March 12, 2013
Time: 9 a.m.

Re: Senate Bill 510 SD2: related to Professional Employer Organizations

Dear Chair Nakashima, Vice-Chair Hashem, and members of the committee,

Our names are Matthew S. Delaney, Co-Founder, CEO and President and Scott Meichtry, Co-Founder and Executive Vice-President of Hawaii Human Resources, Inc. ("HiHR"), a locally owned and operated Professional Employer Organization ("PEO"). On behalf of HiHR, we would like to thank you for this opportunity to share with you and the committee HiHR's comments as they relate to S.B. No. 510 SD2.

While we support the intent of this measure, as noted in our testimony, we request the Committee's consideration of certain amendments to insure fairness and clarity in the definitional section (please reference testimony submitted by HAPEO for definition amendments). My company, represented by HAPEO, has been working with Senator Baker's Office and Committee, as well as working very closely with DLIR. Our group supports the intent of S.B. No. 510 SD2; however, we recommend the bill to be rewritten as H.B. No.144 HD2 because of its definitional clarity. We believe that this measure will generate new registration fees for the state and will not burden the state with any additional expense.

HiHR is one of the 3 largest PEOs in the State of Hawaii. We currently service 385 different businesses and approximately over 7,000 client worksite employees on all of the major Hawaiian Islands. We formed this company in January 2009 to provide an alternative option for small and medium-sized businesses of Hawaii to outsource their human resource needs and focus on their core businesses. Prior to HiHR entering the market, the market was controlled by two large companies. HiHR is a member of the Hawaii Association of Professional Employer Organizations ("HAPEO").

Mahalo for your time and consideration. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Matthew S. Delaney
CEO/President

Scott Meichtry
Executive Vice-President

Hawaii Human Resources, Inc.
Topa Financial Center, 745 Fort Street, Penthouse, Honolulu, HI 96813
P 808.695.2222 **F** 808.695.2353 **W** www.hihrhawaii.com

L E G I S L A T I V E

TAXBILLSERVICE

126 Queen Street, Suite 304 TAX FOUNDATION OF HAWAII Honolulu, Hawaii 96813 Tel. 536-4587

SUBJECT: GENERAL EXCISE, Professional employer organizations

BILL NUMBER: SB 510, SD-2

INTRODUCED BY: Senate Committee on Ways and Means

BRIEF SUMMARY: Amends HRS section 237-24.75 to replace the term "professional employment organization" with "professional employer organization." Clarifies that the general excise tax exemption shall not apply to a professional employer organization if: (1) the professional employer organization fails to properly register with the department of labor and industrial relations (DLIR); or (2) the professional employer organization fails to pay any tax withholding for covered employees or any federal or state taxes for which the professional employment organization is responsible.

Makes other nontax amendments to simplify the regulation of the professional employer organization law and clarify the application of existing laws.

EFFECTIVE DATE: July 1, 2050

STAFF COMMENTS: In 2007 the legislature, by Act 225, established HRS chapter 373K to provide that amounts received by a professional employment organization from a client company in the course of providing professional employment services that are disbursed as employee wages, salaries, payroll taxes, insurance premiums, and benefits are exempt from the general excise tax. Act 129, SLH 2010, established registration requirements for the professional employment organizations and established a new HRS chapter 373L. However, this measure repeals HRS chapter 373L and strengthens the provisions of HRS 373K and also clarifies the general excise tax exemption for professional employment organizations.

Digested 3/11/13

LATE TESTIMONY

March 11, 2013

Honorable Mark M. Nakashima, Chair
Honorable Mark J. Hashem, Vice-Chair
House Committee on Labor and Public Employment
State Capitol, Room 309
Honolulu, HI 96813
Hearing Date: March 12, 2013
Time: 9 a.m.

Re: Senate Bill 510 SD2: related to Professional Employer Organizations

Dear Chair Nakashima, Vice-Chair Hashem, and members of the committee,

My name is Jennifer Brittin-Fulton, President/Owner of Exceptional Inc, dba Employers Options. I have lived in Hawaii for over 40 years, and have been in the Employment Agency business for over 30 years. I have owned and operated Employers Options for over 20 years. Employers Options is a small, local, woman owned business. Employers Option's employs over 500 people on the island of Maui. PEO business allows us to operate in the black and make a profit. Employers Options and myself are current members of HAPEO. I would like to thank you for this opportunity to share with you and the committee our comments as they relate to S.B. No. 510 SD2.

While we support the intent of this measure, as noted in our testimony, we request the Committee's consideration of certain amendments to insure fairness and clarity in the definitional section (please reference testimony submitted by HAPEO for definition amendments).

My company, Employers Option, represented by HAPEO, has been working with Senator Baker's Office and Committee, as well as working very closely with DLIR. Our group supports the intent of SB510 SD2; however, we recommend the bill to be rewritten as HB No.144 HD2 because of its definitional clarity. We believe that this measure will generate new registration fees for the state and will not burden the state with any additional expense.

I would like to mention, speaking on my company's behalf, that in our thirty years in this industry, my company has never failed to meet all of its payroll obligations, to include all federal and state payroll requirements. Furthermore in the thirty years in business my companies have never had a complaint filed against us by either a client, employee, federal or state regulatory agency for non-payment of payroll, taxes or insurance.

111 Hana Highway, Suite 111 • Kahului, HI 96732 • (808) 877-6555 / (808) 667-2500 • Fax: (808) 871-2493

Mahalo for your time and consideration. I appreciate you considering the effects that this legislation will have on small business like mine as well as the many others that are coming forward at this time. We look forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry. We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

Jennifer Brittin
President Exceptional Inc. D.B.A. Employers Options
Board member of HAPEO

111 Hana Highway, Suite 111 • Kahului, HI 96732 • (808) 877-6555 / (808) 667-2500 • Fax: (808) 871-2493

Proservice HAWAII
HR ADMINISTRATION

LATE TESTIMONY

Comments to the Committee on Labor & Public Employment
Tuesday, March 12, 2013
9:00 a.m.
Conference Room 309

RE: SENATE BILL 510 SD2 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Chair Nakashima, Vice Chair Hashem, and Members of the Committee:

We appreciate your efforts to assure there are reasonable regulations in place to protect our small business and working families who rely on Professional Employer Organizations (PEO) for payroll and mandated insurance and employment benefits. Thank you for the opportunity to submit comments.

SUMMARY OF CONCERNS

- Co-employment language – Based on testimony previously submitted on SB 510, the Hawaii's PEO industry has fundamental concerns about imposing liabilities on the PEOs on activities PEOs are unable to control on the Client Companies worksite. This concern stems from the current language in SB 510, which defines PEOs as "leasing companies", who hires employees and then assigned them to the client's worksite. This is an inaccurate and antiquated depiction of the PEO's current business model. Today's PEOs operate on a co-employment model in which employer responsibilities are shared between the PEO and client company. HAPEO (representing many small PEOs in Hawaii), ProService, and Altres share this concern. .

- Bond amounts – the $25,000 and $75,000 sliding scale bond amounts are insufficient to trigger a thorough review by an independent third party. An independent review is paramount ensuring the PEO is responsibly handling client company funds. The lower bond amounts provides little consumer protection, therefore we respectfully suggest the minimum bond amount should be $100,000.

- Audit requirement – If the Legislature prefers not to increase the bond amounts in SB 510 SD2, we ask that the financial audit requirements in HRS 373L be incorporated into the bill. A financial audit requirement will ensure that all PEOs have been reviewed thoroughly by independent third party, a goal that this measure's minimal bond

requirement will fail to achieve. As explained below, a financial audit requirement is a power tool for regulators to protect our consumers.

SB 510 SD2 is a compromise to address the concerns of smaller PEOs. We appreciate the efforts to incorporate the ideas and opinions of PEOs of all sizes, but in the attempt to placate smaller PEOs, the bill made adjustments to the registration law (i.e., lowering the bond amount) to the detriment of our small business, working families, and the PEO industry.

I. BACKGROUND

ProService Hawaii provides employee administration services to over 1,000 small businesses in Hawaii, representing over 13,000 employees in Hawaii. As a professional employer organization (PEO), we ensure that our clients remain compliant with Federal and State employment and labor laws, while allowing them to focus on their core business, providing needed and valuable services to the people and the economy of the State. In addition, we ensure that our clients' employees receive timely payment of wages, workers' compensation, TDI and benefits coverage. We also provide HR training and services, dispute resolution, and safety services to our clients and our clients' employees.

Despite some PEOs' claims that there is no need for regulation of the industry, or minimal regulation at best, when PEOs are handling large sums of client funds, the opportunities for misuse or error are present, and such behavior (while fortunately rare), has happened both on the mainland and in Hawaii – in Hawaii as recently as 2007 with a start up PEO. In fact, a simple Google search of the phrase, "fraud PEO" returns a number of instances where PEOs have abused their fundamental responsibilities. Some areas of common abuse are; collecting insurance premiums but not remitting them to the insurance carrier, not paying employees on time, closing business without remitting final paychecks to employees. Because our clients deserve the peace of mind that they have contracted with a reputable PEO, ProService has been voluntarily regulated by the Employer Services Assurance Corporation (ESAC), the gold standard for national independent oversight, auditing, and bonding, since 2006.

We support the efforts of this legislative body to regulate the PEO industry, as it is in this state's and our industry's best interests to have well-functioning firms serving the community. We support the intent of ensuring that only compliant and well-managed PEOs operate in Hawaii.

Under the nationally established PEO Model, there is a co-employment relationship of shared responsibilities between the client company and PEO. The client company, or "worksite" employer, maintains the control of day to day management. The client generally hires and terminates its employees, and not the PEO. The PEO serves as the client's administrative employer - providing payroll services, administering employment benefits – Workers' Compensation Insurance, Health Care Insurance, Unemployment Insurance, and Temporary Disability Insurance. <u>We believe our PEO registration laws should recognize that PEOs operate under a co-employer model with</u>

shared responsibilities. Holding the PEO solely liable for any and all conduct by the client company and/or worksite employee is not good public policy and inconsistent in the way other jurisdictions and federal agencies regulate PEOs. For example, both OSHA and EEOC, along with many state jurisdictions, hold the client or "worksite employer" responsible for conduct at the workplace and limit the PEOs responsibility to the scope of their services provided to the client company under the PEO services agreement.

There is an important distinction between a PEO model and a leasing model. Under an Employee Leasing model, the HR Agent hires and then leases the employees to Client Company. Under a PEO Model, all hiring, termination, and day to day control of the employees are generally in the sole responsibility and discretion of the Client Company.

It is our understanding that most, if not all of Hawaii PEOs operate under a PEO/co-employment Model. Therefore, ProService generally opposes any legislation that does not take this critical factor into account.

II . SENATE BILL 510

We offer the following comments on Senate Bill 510:

A. **Current Law – HRS 373L.** We recommend that the legislature allows the current law, HRS 373L to be fully implemented and enforced before taking any action on any proposed amendments to the current law. We should look to maintain consumer protections by enforcing the existing law rather than repealing and implementing a new law that has fewer consumer protections.

   1. **The Bonding Requirement in the Current Legislation is Reasonable.**

      a. The bond requirement in HRS 373L is reasonable and is not anti-competitive to smaller PEOs. For example, ProService secured a bond at the required amount of $250,000 for less than $2,000. This cost is nominal for the surety that it provides the Client Companies of the PEO and the State of Hawaii. The bond fee is not a barrier to entry into the marketplace.

      b. We have learned that only two Hawaii based PEOs – Altres and the ProService entities - are in compliance with the bonding requirement of the current law.

      c. HRS 373L-3(3) explicitly provides, "*Failure to have in effect a current bond shall result in automatic forfeiture of registration*

pursuant to this chapter shall require the professional employer organization to immediately cease doing business in the State."

d. We have learned that many PEOs continue to operate in our state in violation of the HRS 373-3(3). We are not privy to our state government's efforts in enforcing our current PEO registration laws.

2. The Financial Audit Provision Provides Needed Consumer Protection.

a. PEOs handle significant amounts of client funds. A financial audit provides regulators a fundamental tool in protecting our small business and their employees who have relied on PEOs. A financial audit can raise red flags on PEOs that are underfunded or improperly using clients' funds. The financial audit requirements in our current law is not cost prohibitive if the PEO is adhering to general accepting accounting principles, properly funded, and handling clients funds in accordance with best practices. Financial audits are part of PEO registration regulations in most states. It should be viewed as best practice in an industry that handles significant amount of client funds, rather than a hindrance to doing business in Hawaii. Proof of financial stability is imperative given the critical responsibilities that PEOs maintain.

b. According to court documents, in 2007 a start-up Hawaii PEO, Mainstay defrauded its clients by collecting $1,068,579 from its clients in payroll taxes and workers compensation premiums, and not using the funds for their intended purposes. Fortunately for its clients, Mainstay partnered with a Texas company who was financially able to cover those expenses. The Texas company subsequently sued Mainstay for fraud and theft.

c. As the Table A below indicates, even a "small" PEO handles a significant amount client funds. For example, a PEO that has 250 worksite clients will handle approximately $12 million dollars in client funds on annual basis.

Table A

Summary of PEO Pass-Through Funds

By Number of Employees

PEO Pass-Through Funds	**250 EEs**	**500 EEs**	**1000 EEs**	**2500 EEs**
Covered Employee Annual Payroll	11,150,000	22,300,000	44,600,000	111,500,000
Covered Employee Health Care Premiums	586,307	1,172,613	2,345,226	5,863,065
Client/Worksite Employee State Unemployment Taxes Due	265,085	530,169	1,060,338	2,650,846
Client Company Work Comp Premiums Due	189,550	379,100	758,200	1,895,500
Client Company TDI Premiums Due	44,470	88,939	177,879	444,697
Total Pass-Through Client Funds	**12,235,411**	**24,470,822**	**48,941,643**	**122,354,108**

B. SB 510 – Three Significant Areas of Concern:

1. Removal of Co-employment Language. As discussed above, PEOs do not “assign employees” to client worksites, but rather enter into co-employment agreements with client companies in which employment responsibilities are shared between parties. The current language inaccurately classifies PEO as “Leasing Companies” by removing the provisions and definitions relating to “co-employment”.

   Accordingly, we request the following:

   - The definition of “client company” in Section 373L-1 to remain as follows:

     “Client Company" means any person who enters into a professional employer agreement with a professional employer organization.”

   - The definitions of “co-employment” and “covered employee” not be deleted as the worksite employer maintains responsibility for statutory compliance and oversight at the worksite. This definition also supports the fact that it is the Client Company’s responsibility to hire employees and that said employees are not “assigned” to the worksite by the PEO.

- The current definition of "Professional Employer Organization" to remain in place rather than deleting the existing definition and replace it with language about employee assignment. Emphasizing employee assignment or leasing could create confusion by inaccurately depicting the PEO model that most Hawaii PEOs operate under.

- The current language in Sec. 373L-B will allow client companies to contract out their liabilities and responsibilities as an employer. Allowing client companies to completely transfer their liability to a PEO will deteriorate self-enforcement that will negatively affect the worksite employees and their families. For example, it will exacerbate the cash-paying economy, which will negatively impact state taxation revenues, unemployment contributions, and the health of the workers' compensation, temporary disability and health care systems.

- Section 373L-B should be amended to state: "During the term of the agreement between a professional employer organization and its client company, the professional employer organization shall be deemed the employer for all assigned employers as defined in section 373L-1, <u>providing the client company has met its obligations and responsibilities under the agreement</u>."

  ProService is agreeable to the PEO being the employer of record for Unemployment Insurance, Workers' Compensation, Temporary Disability Insurance, and Health Care to the extent the client company performs its obligations and responsibilities under the PEO agreement.

2. <u>SB 510 removes the financial audit requirement</u>

   a. An independent financial audit by a CPA is necessary to verify financial stability and the ability to meet financial obligations. We respectfully ask that the financial audit requirement (373L-2(b)(12) be maintained. The financial audit requirement is reasonable and necessary to provide our regulators a tool to ensure a PEO is financially sound to meet its obligations. Financial audits are part of PEO registration regulations in most other states and are a best practice rather than a hindrance to doing business in Hawaii.

   b. Even small PEOs handle large amounts of client funds. Please see Table A, above. Oversight through a financial audit is proof that a PEO is maintaining financial integrity in the handling of client funds.

c. The cost of an audit is reasonable and in the best interest of protecting consumers.

3. We support a sliding scale bonding requirement.

a. A 3-tier sliding scale in which the amount of the bond will be based on the number of employees listed on the PEO's Unemployment Insurance Quarterly Filings (UC-B6).

b. The amount of the bond will range from $100,000 to $500,000. We believe the amount of the bond should be significant enough to require an independent review of the PEO's practices by a third-party. If the bond requirement is nominal (e.g., $25,000) a medium-size PEO will likely choose to self-fund the bond without going through a third-party's underwriting or review process. Doing so will bypass the protection afforded to consumers through the bond requirement. Accordingly, if the bond requirement is insignificant, we would like you to consider not repealing the financial audit requirement in our current law.

The table below outlines our proposed sliding-scale bonding requirement and the estimated costs for the bond based on Alpha Surety & Brokerage's testimony for 2012's SB 2424.

Number of Employees	Bond Amount	Cost of Bond (1-2% of bond amount)	Pass-through annual payroll
1,000 EEs	$100,000	**$1,000-$2,000**	$44,600,000
5,000 EEs	$250,000	**$2,500-$5,000**	$223,000,000
7,500 EEs	$500,000	**$5,000-10,000**	$334,500,000

We believe our proposal is fair and reasonable in light of: (i) the estimated amount the PEO will likely pay for such bond and (ii) the protection the bonding process will provide our consumers.

III. Conclusion

We respectfully ask that: (1) the current law be enforced; (2) the bonding and financial audit requirements are maintained; and (3) any amendments to the current law take into account the "co-employment" relationship between a PEO and client company. Thank you for the opportunity to submit comments.

LATE TESTIMONY

March 11, 2013

Honorable Mark M. Nakashima, Chair
Honorable Mark J. Hashem, Vice-Chair
House Committee on Labor and Public Employment
State Capitol, Room 309
Honolulu, HI 96813
Hearing Date: March 12, 2013
Time: 9 a.m.

Re: Senate Bill 510 SD2: related to Professional Employer Organizations

Dear Chair Nakashima, Vice-Chair Hashem, and members of the committee,

My name is Sanjay Mirchandani, and I am the owner of Talent HR Solutions LLC, a locally owned and operated Professional Employer Organization. I am also a founding member of the board of directors for HAPEO. I would like to thank you for this opportunity to share with you and the committee our comments as they relate to S.B. No. 510 SD2.

Scalable Bonding:
We are in full support for scalable bonding. The 250K bonding is the highest in the country and not obtainable by smaller PEO's. The larger PEO's do 20-30 times in payroll per year than your average boutique, therefore a scalable bond would be fair and keep small PEO's in business. It's healthy to have friendly competition and it would make it difficult for entrepreneurs to start a business if they had to put up 250K in collateral to start a PEO. There are only (4) states in the entire United States that require mandatory bonds. Hawaii, North Dakota, New Mexico, and South Carolina. The other states only require a bond if the PEO does not meet a minimum net worth of working capital requirements(on average, the net worth or working capital requirement is $50,000 to $100,000)

No Financial Audit:
The annual audit would cost approximately $25,000/annually and is unaffordable by small PEO's. Only large PEO's would be able to afford it.

Co-Employment Definitional Language:
Co-Employment needs to remain. Business owners who execute a PEO in a co-employment relationship transfer a substantial portion of the risk and responsibilities associated with employees to the co-employer. The structure of the relationship allows the PEO to offer better benefits and benefit options, handling of wage and employment tax responsibility, freedom from the responsibility of reporting,

collecting and depositing the taxes with state and federal authorities, and assistance with workers' compensation coverage and claim management.

There are a number of misconceptions about co-employment that exist because of pre-conceived notions about outsourcing in general. The most common is the belief that contracting with a PEO will result in a loss of control for the business owner. The structure of a co-employment relationship allows client owners to retain control over staffing and business decisions, while the PEO assumes certain employer responsibilities and risks. Many business owners also worry that their employees will not get adjusted to the new arrangement. They may think workers will be considered temporary or non-permanent, or that their existing HR staff will be terminated. A co-employment relationship is administrative in nature and is beneficial to employees because it extends a greater depth and breadth of benefits and services than could typically be offered by the client owner alone. There is little, if any, disruption to existing employees when the relationship is established, and at no time is employee "leasing" involved in the agreement.

The existing laws do not promote competition and it stifles innovation and entrepreneurship. There are many Hawaii small and medium sized businesses that prefer working with boutique PEO's rather than a large PEO where they would not get as much as personalized attention.

While we support the intent of this measure, as noted in our testimony, we request the Committee's consideration of certain amendments to insure fairness and clarity in the definitional section (please reference testimony submitted by HAPEO for definition amendments).

My company, represented by HAPEO, has been working with Senator Baker's Office and Committee, as well as working very closely with DLIR. Our group supports the intent of SB510 SD2; however, we recommend the bill to be rewritten as HB No.144 HD2 because of its definitional clarity. We believe that this measure will generate new registration fees for the state and will not burden the state with any additional expense.

Mahalo for your time and consideration. We look forward to working with all stakeholders to implement effective and reasonable registration and regulations for the PEO industry We very much appreciate being part of this process and having our voice be heard during this 2013 Legislative Session.

Respectfully submitted,

DocuSigned by:
Sanjay Mirchandani 3/11/2013
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Sanjay Mirchandani
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