SB 510

Measure Title:	RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS.
Report Title:	Professional Employer Organizations; Registration; Fees
Description:	Repeals chapter 373L, Hawaii Revised Statutes. Clarifies professional employer organization responsibilities with respect to meeting the statutory requirements of the repealed chapter 373L, Hawaii Revised Statutes, and the nexus between the registration of professional employer organizations and qualification for the state general excise tax exemption.
Companion:	
Package:	None
Current Referral:	CPN, WAM
Introducer(s):	BAKER, CHUN OAKLAND, GREEN, KEITH-AGARAN, Ruderman, Shimabukuro

Sort by Date		**Status Text**
1/18/2013	S	Introduced.
1/22/2013	S	Passed First Reading.
1/22/2013	S	Referred to CPN, WAM.
1/29/2013	S	The committee(s) on CPN has scheduled a public hearing on 02-08-13 9:00AM in conference room 229.

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

February 6, 2013

To: The Honorable Rosalyn H. Baker, Chair,
The Honorable Brickwood Galuteria, Vice Chair, and
Members of the Senate Committee on Commerce and Consumer Protection

Date: Friday, February 8, 2013
Time: 9:00 a.m.
Place: Conference Room 229, State Capitol

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

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

I. OVERVIEW OF PROPOSED LEGISLATION

The intent of S.B. 510 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. 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 is a collaborative effort, including between the Department of Taxation and the Department of Labor and Industrial Relations 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, that the registration requirements for PEOs should be less burdensome and that essential information should be included in the notification to DLIR and to covered employees in PEO agreements.

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 Rosalyn H. Baker, Chair
and Members of the Senate Committee on Commerce and Consumer Protection

Date: Friday, February 8, 2013
Time: 9:00 a.m.
Place: Conference Room 229, State Capitol

From: Frederick D. Pablo, Director
Department of Taxation

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

The Department of Taxation (Department) appreciates the intent of S.B. 510 and defers to the Department of Labor and Industrial Relations (DLIR) on 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 is effective upon approval.

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

Thank you for the opportunity to provide comments.

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

INTRODUCED BY: Baker, Chun Oakland, Green, Keith-Agaran and 2 Democrats

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: Upon approval

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 2/6/13

EMPLOYER SERVICES
ASSURANCE CORPORATION

E·S·A·C

The Foundation for
Integrity Trust Growth

Three Financial Centre
900 S. Shackleford Rd., Suite 401
Little Rock, Arkansas 72211-3849

Phone: (501) 219-2045
Fax: (501) 219-2603
Web: www.ESACorp.org
E-mail: info@ESACorp.org

Sent February 7, 2013 via Email to CPNtestimony@Capitol.hawaii.gov
and via US Mail to:

The Honorable Rosalyn H. Baker, Chair
The Honorable Brickwood Galuteria, Vice Chair
Senate Committee on Commerce and Consumer Protection
State Capitol
415 Beretania Street
Honolulu, HI 96813

Re: Testimony of Employer Services Assurance Corporation concerning the Committee on Commerce and Consumer Protection's February 8, 2013 hearing on S.B.510 & S.B.813 relating to Professional Employer Organizations.

Dear Chair Baker and Vice Chair Galuteria,

On behalf of the Employer Services Assurance Corporation ("E·S·A·C"), the only national accrediting and financial assurance organization for Professional Employer Organizations ("PEOs"), I applaud your past efforts to join the majority of states in regulating the PEO industry by establishing Chapter 373L, Hawaii Revised Statutes ("HI's PEO law").

Effective regulation of PEOs will benefit both small businesses and workers in PEO arrangements, as well as PEOs that operate in a responsible manner. It is important that such regulation be done effectively, but not in an unnecessarily burdensome manner.

We understand your desire to balance important consumer protection goals with the goal of allowing good PEO operators to continue to provide important benefits and services to Hawaii business owners and employees. However, ESAC strongly urges you to require all PEOs to meet meaningful financial requirements.

Just as with banks, insurance companies and other industries that aggregate client cash flow and assume fiduciary responsibility, PEOs must be effectively regulated to protect clients, employees, taxing authorities, insurers and the PEO industry. Ensuring financial responsibility and solvency is just as important in regulating PEOs as it is for banks and insurance companies.

This is not about establishing a barrier to entry, because the PEO industry provides valuable benefits to its business clients and employees. It is about establishing a reasonable threshold for entry and a right to continue operations in a manner that protects the public.

I have been associated with the PEO industry for almost 40 years, first as a PEO owner and officer/director of the national PEO industry trade association and then as CEO of ESAC and also as a PEO client and employee. I have seen many unexpected PEO failures occur involving both small and large firms. Every PEO failure that I have seen was directly the result of either: (a) insufficient capitalization coupled with poor management decisions regarding pricing, credit risks or excessive expansion into too many markets without the resources to sustain operations when something went wrong; or (b) employment tax or insurance-related arbitrage or fraud.

ESAC has been successful in preemptively detecting these problems for 18 years without a single accredited PEO default. In several cases, when ESAC declined accreditation to a PEO applicant for financial reasons, the PEO failed within 1 to 3 years while being registered or licensed in good standing in multiple states on the date of failure.

The vast majority of PEOs are owned and operated by honest people just as is the case with banks and insurance companies. But thresholds to entry and the right to continue to operate must be based on requirements that will preemptively detect the unqualified operators.

It is imperative that PEOs be required to provide reliable financial statements prepared in accordance with generally accepted accounting principles (GAAP). PEOs must be able to demonstrate positive working capital and positive net worth in an independently verifiable manner in order to provide a basic level of protection to the end consumer. Requiring audited financial statements is the only reliable and cost effective way to provide the Department with assurance that the financials received are free from material error, and that a PEO's working capital and net worth have not been materially overstated, whether due to error or fraud.

Additionally, financial statements require a number of estimates related to future and unknown events that can dramatically influence a PEO's reported financial position. It is important that an independent auditor verify that these estimates are reasonable and adhere to GAAP.

For example, it is common for PEOs to share in the risk of their workers' compensation insurance plans or to assume responsibility for other employer liabilities. If PEOs do so, GAAP requires the PEO to make estimates of future liabilities in order to demonstrate their ability to settle these liabilities as they become due. It is easy to see if a PEO were to drastically understate this estimated liability, its financial strength would be overstated, offering the Department no warning of the PEO's potential for financial distress. Requiring audited financial statements will ensure that these estimates have been reviewed by an independent auditor, and that, based on the auditor's independent and expert opinion, the estimates are reasonable and adhere to the relevant accounting standards.

Likewise, a reasonable bonding requirement has more protective value than the tangible value of the bond. A bonding requirement will ensure a surety underwriter independently verifies the PEO's financial reliability at least annually. Surety underwriters are trained to approach the evaluation of an applicant's financial condition with the goal of avoiding a financial loss. This underwriting process, coupled with the annual audit by an independent CPA, will provide the Department with a reasonable basis for confirming the financial reliability of PEO applicants for registration.

ESAC has been verifying PEO financial reliability for 18 years without a single default by an accredited PEO or a single claim against the $40 million of surety bonds that ESAC holds in a national bank trust on behalf of its covered PEO clients and employees. The PEOs covered by ESAC's program have ranged from new startups, to small local or regional companies, to large national companies. Together accredited PEOs make up over 50% of the total PEO industry service volume.

During the past 18 years, ESAC has analyzed the financial statements and verified the state and federal regulatory compliance of a large number of PEOs of all sizes from new startups to national companies. During that time ESAC would have experienced the unexpected failure of a significant number of PEOs involving millions of dollars of losses had we not required audited financial statements covering all PEO entities under common ownership control, as well as the independent evaluation of these financial statements by an experienced surety underwriter, along with ESAC staff.

With respect to your efforts to improve HI's PEO law, ESAC respectfully requests that you also consider the fact that ESAC is currently providing PEO Assurance Organization and Electronic Compliance Reporting services to 14 other states, including the Departments of Labor in Colorado, Connecticut and Nebraska. ESAC would welcome the opportunity to work with you and HI's Department of Labor to make your PEO registration process more efficient and less burdensome. These services are available at no cost to the State and can be customized to meet your requirements.

I hope you find this information helpful as you strive to create the best possible PEO law and regulatory structure for Hawaii. If you would like to discuss this further, ESAC will be glad to help.

Sincerely,

Rex Eley

Rex Eley
President & CEO, ESAC

ALTRES

February 7, 2013

The Honorable Rosalyn H. Baker, Chair
The Honorable Brickwood Galuteria, Vice Chair
Committee on Commerce and Consumer Protection
State Capitol
Honolulu, Hawaii 96813

Subject: SB 510, February 8, 2013, 9:00am, CR229
Support with Modifications

Dear Senator Baker and Senator Galuteria:

My name is Barron Guss, President and second-generation owner of ALTRES, Inc., a 43-year old Hawaii company and Hawaii's oldest Professional Employer Organization (PEO). I am writing you today in support of SB 510, with modifications.

For nearly 20 years, I have been a familiar face at the legislature, advocating on behalf of the PEO industry. Working collaboratively with legislative leaders, department directors, various administrations and interested community leaders, we have brought about regulatory change and policy to help create a framework for a positive environment for PEOs and consumers in the State. Most recently, in 2010, the legislature passed Act 129, a law that requires PEOs to register with the DLIR, provide a financial bond and undergo a financial audit.

Before you today is testimony from well-intended individuals who, too, believe that they are advocating in the best interest of PEOs and the community. Specifically, they believe that the current laws have become over-burdensome and anti-business, and favor large PEOs.

Act 129 is a well-vetted consumer protection act and was not created to influence consumers to choose a large or small PEO. Demand creates the market, but it's up to consumer protection measures to ensure that the expectation of competency will be met. When a consumer learns that a service provider is licensed, it gives them assurance that they will receive the goods and services they are paying for from a competent provider.

Act 129 is doing what it was designed to do -- create a *threshold of entry* into the industry and not an "*anti-competitive" barrier*, as suggested by those seeking its repeal. How many times have you heard about a law school graduate failing to pass the Bar and retaking it multiple times? Some never pass and do not go on to become practicing attorneys. How do you think this legislature would respond if those who did not pass sought to lower the minimum standards of competency? How would you feel about having a physician that couldn't make it through medical school but argued that the world needed more doctors and that they had a right to practice? This might have been okay in the 1700's but in 2013 you would never hear of it. The PEO industry moves over $1 billion of other people's money in the State. Should we relax the laws so everyone can proclaim their competency?

The ALTRES Building
967 Kapiolani Boulevard
Honolulu, Hawaii 96814
Tel 808.591.4900
Fax 800.373.1955
Honolulu • Pearl City • Kahului
Kailua-Kona • Waimea • Hilo
altres.com
simplicityHR.com

Today the DLIR estimates that there are approximately 40 PEOs operating in the state. Of this number, more than half are mainland based. Of the locally based PEOs, only six are registered with the Department of Labor, with the balance failing to file, either under protest of the law or claiming that the bond and audit requirements are too costly. Although not perfect, the current law provides a strong foundation to ensure proper oversight. A small handful of PEOs should not be allowed to ignore the law just because they don't agree with it. Allowing them to do so sends the wrong message to all law abiding citizens – especially consumers.

SB 510 is the next logical step in a long legislative history of refining Hawaii's statutes to better reflect the PEO industry and how it operates. With this in mind, I offer the following comments.

Sincerely,

Barron L. Guss
President and CEO

BLG:lo

Modifications

Section 2. Chapter 373L-B.

In this section, the proposed language attempts to define the obligations of the PEO but unfortunately does not reflect the way PEOs operate, not only in Hawaii, but across the nation. This section makes the PEO solely responsible for what traditionally would be the responsibility of the work site employer. It promotes the concept that the work site employer simply contracts out their liabilities and responsibilities with no regard for the law or their conduct. The PEO client service agreement always states that regardless of the contract, the client company is responsible for adherence to all federal and state laws that applied to them prior to the execution of the agreement. In other words, just because there is a contract in place, it does not exclude them from adherence to the law.

With the preceding in mind, may I offer the following language for insertion into the Bill:

Section 373L-B - **Professional employer agreements; notification to covered employees; notification to department.** (a) The agreement between a professional employer organization and its client company shall state that the professional employer organization shall be deemed the employer for the purposes of unemployment insurance, workers' compensation (and the exclusive remedies provision of Chapter 386 shall apply to both the client and the professional employer organization with respect to workers' compensation coverage secured by the professional employer organization), temporary disability insurance, and prepaid health care coverage, providing the client company meets its obligations under the Professional Employer Organization agreement.

Section 4. Section 373L-1.

There has always been some confusion regarding who "assigns" the employees to the client company dating all the way back to the original tax bill (Act 225). Over the years, we have tried to clarify this and eliminate the confusion, and would like to make one more effort here. The PEO does not assign the workers and simply employs the workers already assigned to the work site employer (the client company) upon commencement of the agreement. Because of this, please consider the following modification:

Section 4. Section 373L-1. "Assigned employee" means an employee who is co-employed by the professional employer organization and client company who is assigned to perform services at the worksite of a client company and who is under the direction and control of the client company.

Section 4. Section 373L-2. "Client company" means any person or company that enters into a professional employer agreement with a professional employer organization to co-employ its assigned employees at its worksite.

(1) The co-employment of the covered employees at the client's worksite.

The new proposed language is appropriate with the insertion of the following at the end of the paragraph:

(3) ...providing the client company meets their obligations under the professional employer agreement.

In addition, under "Professional Employer Organization" the use of the word "assigns" on line 20 is inaccurate and should be changed to the following:

"A business entity that co-employs the workers at the worksite of its client companies on a long-term, rather than temporary or project-specific basis. The term does not include temporary help services or other similar arrangements."

Section 3: Taking into consideration the new additions in Sections (12) and (13), the deletion of definitions of "co-employment" and "covered employee" should be reinstated to be consistent with the preceding modifications regarding co-employment.

Section 5. 373L-2.

In Section (12) I understand the groundswell of support to eliminate the bond requirements. As stated in my previous testimony over the years, the idea of a bond is not so much about the amount, but the process of Surety. The Surety carrier makes certain that the PEO has proper operating systems in place and the financial stability to make the obligation of providing a bond for the performance of the PEO a "good bet" for the Surety. It may surprise you to know that the PEO industry in Hawaii moves more than $1 billion annually and, as a result, the consumer protection measures afforded by Act 129 are more relevant than ever.

In the spirit of compromise, I believe there could be a sliding scale or de minimis provision which would allow the smaller PEOs to circumvent this requirement if their volume remained below a certain threshold. To eliminate any form of financial responsibility would simply be unthinkable.

Testimony to the Committee on Commerce and Consumer Protection
Friday, February 8, 2013
9:00 a.m.
Conference Room 229

RE: SENATE BILL 510 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Chair Baker, Vice Chair Galuteria, and Members of the Committee:

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. We believe our PEO registration laws should recognize that PEOs operate under a co-employer model with 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 support 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. SB 510 removes the financial audit requirement

    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 the bonding requirement in SB510.

    a. A surety bond is needed to protect consumers and the State from poor business practices by a PEO. Maintaining a bond will ensure that PEOs act in the best interest of their Client Companies. In the event that a PEO does not act in the best interest of consumers, for example, collecting workers' compensation insurance premiums but not remitting the premiums to an insurance carrier and a claim is incurred, both the consumer and the State may be indemnified by the bond, and therefore, allowing the injured worker to receive workers' compensation coverage. A bond keeps PEO clients and their employees safe in the event the PEO engages in unlawful business practices.

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 testimony.