Testimony to the Committee on Consumer Protection and Commerce
Wednesday, February 13, 2013
2:30 p.m.
Conference Room 325

RE: HOUSE BILL 144, HD1 RELATING TO PROFESSIONAL EMPLOYER ORGANIZATIONS

Chair McKelvey, Vice Chair Kawakami, 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 . HOUSE BILL 144, HC1

We offer the following comments on House Bill 144, HD1:

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. HB 144, HD1 – 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. HB 144, HD1 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 HB 144, HD1.

    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.