

**Before the Texas Sunset Advisory Commission
Testimony on Behalf of the National Association of
Professional Employer Organizations (NAPEO)
Garry Bradford, Chair, NAPEO Texas Leadership Council
RE: Continued Licensure of Professional Employer Organizations By
Texas Department of Licensing & Regulation
December 7, 2020**

Chair Cyrier, Vice Chair Buckingham and Members of the Sunset Commission:

On behalf of the National Association of Professional Employer Organizations (NAPEO)¹ and its Texas Leadership Council, I want to thank you for the opportunity to provide testimony in response to the Sunset Advisory Commission staff's recommendation regarding the professional employer organization industry and its regulatory status with the Texas Department of Licensing & Regulation (TDLR). NAPEO is the largest trade association for professional employer organizations (PEOs), which provide comprehensive HR solutions for small and mid-sized businesses. NAPEO represents approximately 300 PEO member companies that provide services to over 156,000 businesses employing more than 2.7 million workers nationwide. NAPEO disagrees with the recommendation submitted by the Sunset staff. We support the work of the TDLR in our industry, and respectfully request that our industry continue to be regulated and licensed by TDLR for the reasons set forth below.

The PEO Industry Has Encouraged and Supported Regulation Nationwide

Since its inception, the industry has sought to create and cultivate a legislative and regulatory climate in all 50 states that recognizes the key role PEOs play in supporting small and mid-size businesses by delivering statutory recognition, legal certainty, and important protections to industry participants, clients and worksite employees. Currently, there are over 40 states that regulate our industry. The industry believes its growth is due – in part – to this certainty.

Under this regulatory framework, PEOs are held accountable for the critical human resource services they provide to the small and medium-sized business community. For the client

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and worksite employee, it means an agency conducting oversight, whom they can contact should there ever arise any problems. As noted in the staff's recommendation, PEOs provide a variety of services and assume responsibility for paying their worksite employees – the liability for which can be in the billions. Licensing of PEOs by TDLR allows vetting of the entities that assume this responsibility and removing oversight by TDLR could result in fractured regulation and enforcement, leaving clients and worksite employees at risk. The regulatory framework in place in Texas and in many states is a valuable protection for all parties.

The PEO Industry Has Grown, Clients Have Thrived Under Regulation

The Sunset staff report accurately indicates that the PEO industry in Texas has flourished since the industry became regulated in the state. Over 27 years ago, Texas became one of the first states to create a regulatory framework for PEOs providing services within its borders when the Texas PEO Act was passed in 1993. Since then, similar PEO licensing regulations have expanded to many other states around the country. Today, 396 entities are licensed as PEOs with TDLR,² providing services to thousands of businesses and over a quarter of a million co-employees. Indeed, every year, PEOs in Texas handle over \$18 billion in worksite employees' wages. A handful of licensed PEOs are even publicly-traded. The industry would point to the current regulatory framework as a large part of the reason that the industry is enjoying this success and one of the primary reasons that there have been limited to no enforcement actions against PEOs in Texas. This is because it provides assurance to the small business marketplace in Texas that they can rely on the fact that PEOs meet specified financial and operational requirements before they can offer services to such businesses.

Client employers have also thrived as a result of a regulated and burgeoning PEO industry in Texas. Our research shows that employers that partner with PEOs have a higher growth rate, experience a lower turnover rate, and are 50% less likely to fail when compared to similar companies. Removing licensure could erase gains for Texas employers made since the state implemented licensure for all PEOs.

Texas Licensure versus Voluntary Programs

From the beginning, PEO licensing has been administered by the TDLR and includes numerous safeguards to protect all stakeholders, including worksite employees. The Sunset staff offers in its report that accreditation by the Employer Services Assurance Corporation (ESAC) or certification by the Internal Revenue Service (IRS) would provide the same protection to clients and worksite employees as the current TDLR regulatory and licensing structure. This observation, however, does not fully account for the entirely voluntary nature of both ESAC accreditation and

² Based on information provided by the TDLR's License Data Search, available at <https://www.tdlr.texas.gov/LicenseSearch/>

IRS certification programs. Additionally, there are significant costs associated with PEOs that choose to be accredited by the ESAC or certified through the IRS, especially for smaller PEOs, which may present a barrier to entry in the state. Only a fraction of PEOs have chosen to undergo these processes. Relying on these programs alone would potentially expose clients and worksite employees to entities that have not been subjected to any type of vetting. The mandatory statutory requirement that all PEOs be licensed and regulated by TDLR is a primary contributing factor to the low incidence of complaints filed with TDLR involving PEOs. We think the low incidence of PEO complaints is directly attributable to the thorough, yet reasonable, PEO licensing requirements.

Further, PEOs must renew their license annually to ensure continued compliance. Annual license renewals include the submission of audited financial statements and working capital requirements.

Licensing also provides a public benefit in that it clearly conveys which entities are approved to operate as a PEO and are subject to oversight and which are not. This clarity benefits the PEO industry by removing ambiguity about compliance obligations. More importantly, this clarity also benefits the customers of PEOs by providing a clear indicator of which entities are actually covered by the law.

Similarly, licensing serves an important role in making clear for other state agencies as to whether an entity is a PEO and thus covered by Texas Labor Code Chapter 91 or not. One example is the Texas Workforce Commission (TWC), which administers the unemployment benefits and tax programs in the state. Under current law, a PEO is the employer of its covered employees for the purposes of unemployment taxes for wages paid to the covered employees by the PEO. During these unprecedented times, the TWC, which is already hampered by the overwhelming influx of COVID-19-related unemployment claims, would have no mechanism to track whether a PEO is a licensed entity if the staff's recommendation to remove TDLR's oversight of PEO licensure is approved. Because the TWC relies heavily on licensure so they can track and define who is licensed and responsible for filing claims and remitting employment taxes for unemployment purposes, the agency would be further strained.

Texas Legislative Budget Board Strategic Fiscal Review

In October 2020, the Texas Legislative Budget Board released its Strategic Fiscal Review which noted the adverse effects of discontinuing certain licensing programs, including businesses licensed and regulated under Chapter 91 of the Texas Labor Code, and specifically drew attention to the TDLR's License Businesses and Facilities program, under which PEOs are licensed. The Review specifically stated that "Consumers would be at risk of financial harm without the program verifying these proper business practices," and further declared that "Discontinuance of this

program would diminish the protection of public health and safety and limit the agency's ability to respond to emergencies and disasters.”

Accordingly, NAPEO respectfully requests that PEOs doing business in Texas continue to be regulated by the Texas Department of Licensing & Regulation and the PEO licensing program remain intact. PEOs, small and mid-sized employers, and Texas workers have all realized the benefits of being regulated and licensed by TDLR. Removing this regulatory structure places these gains at risk.

Thank you again for the opportunity to provide this testimony.

Sincerely,

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