SUBCHAPTER G. WORKERS' COMPENSATION INSURANCE
DIVISION 2. GROUP SELF-INSURANCE COVERAGE
28 TAC §§5.6401 – 5.6405, 5.6408, 5.6409, and 5.6411 - 5.6413

1. INTRODUCTION. The Commissioner of Insurance adopts amendments to §§5.6403, 5.6405, 5.6408, and 5.6411 and new §§5.6401, 5.6402, 5.6404, 5.6409, 5.6412, and 5.6413, concerning workers' compensation group self-insurance coverage. Sections 5.6403, 5.6408, 5.6411, and 5.6412 are adopted with changes to the proposed text published in the July 25, 2008 issue of the *Texas Register* (33 TexReg 5836). Sections 5.6401, 5.6402, 5.6404, 5.6405, 5.6409, and 5.6413 are adopted without changes.

2. REASONED JUSTIFICATION. The adopted amendments to §5.6403 and §5.6411 and adopted new §5.6402 are necessary to clarify and implement House Bill (HB) 472, enacted by the 80th Legislature, Regular Session, effective September 1, 2007, which amends the Labor Code Chapter 407A and the Insurance Code Chapter 4151. The remaining adopted amendments and new sections are adopted under the Labor Code Chapter 407A to better regulate the solvency and financial stability of workers' compensation self-insurance groups (groups); to ensure that workers' compensation benefits are available on a timely basis; to provide for greater flexibility and innovation; to more strictly conform to the statutory requirements of the Labor Code §407A.051(c)(12) and (13) and §407A.057; and to require additional oversight of a group's administrator, service

companies, and third party administrators (delegated entities). Simultaneously with the adoption of the amendments and new sections, the Department has adopted the repeal of existing §5.6401 (relating to Purpose and Scope), §5.6402 (relating to Definitions), §5.6404 (relating to Notification to the Department), and §5.6409 (relating to Books and Records), which is also published in this issue of the *Texas Register*.

The Department posted an informal working draft of the proposed amendments and new sections on the Department's internet website from November 26 to December 14, 2007, and invited public input. The Department received several written comments regarding the informal working draft of the proposed amendments and new sections. Further, pursuant to the Labor Code §407A.455(3), the Department met with representatives of the Texas Self-Insurance Group Guaranty Fund (Fund) in January and February, 2008, to discuss the Fund's recommendations and concerns regarding the proposed amended and new sections. The Department also discussed the informal working draft of the proposed amendments and new sections with representatives of the Fund and industry in a small workgroup. The Department exchanged at least two separate informal working drafts of the amendments and new sections with the small workgroup. As a result of the written comments provided by industry representatives and the collaborative discussions with the small workgroup, the Department modified several sections of the informal working draft of the proposed amendments and new sections to (i) clarify

definitions; (ii) better define the roles and responsibilities of groups' delegated entities and their downstream subcontractors; (iii) clarify the information that must be submitted to the Department upon application for a certificate of approval; (iv) reduce unnecessary and duplicative administrative burdens related to bonds, biographical affidavits, and membership cancellation and termination notifications; (v) clarify contracting requirements; and (iv) permit the industry to take advantage of innovative, cost-saving methods of storing and maintaining books and records. Finally, the Department provided a copy of these final amendments to the small workgroup for further consideration in April, 2008. The Department formally proposed the amendments and new sections in the July 25, 2008 issue of the *Texas Register* (33 TexReg 5836). A public hearing on the rule proposal was held on October 8, 2008.

A public hearing on the rule proposal was held on October 8, 2008. In response to written comments on the published proposal and comments made at the hearing, the Department has changed some of the proposed language in the text of the rule as adopted. Additionally, this adoption includes minor clarification changes to several proposed provisions. None of the changes made to the proposed text, either as a result of comments or as a result of necessary clarification, materially alter issues raised in the proposal, introduce new subject matter, or affect persons other than those previously on notice.

The following changes are made to the proposed text as a result of comments. Section 5.6403(c)(12)(B) as adopted requires a group to identify in

its business plan any of its service companies, excluding any person identified pursuant to §5.6403(c)(12)(C), that perform one or more of the following services: (i) provide cash and asset management services to the group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. This will result in the notification, bonding, contracting, and reporting requirements of the adopted rules applying *only* to a group's service companies that are third party administrators or perform one or more of the services specified in §5.6403(c)(12)(B)(i) – (iv) as adopted. Additionally, §5.6403(c)(12)(C) as adopted is changed to require the identity of certain parties in a group's business plan that are not considered service companies under §5.6403(c)(12)(B) as adopted. These parties include the group's accountant and actuary. These §5.6403(c)(12)(B) changes are the result of commenters objecting to what the commenters characterized as "the broad and unclear language" in proposed §5.6403(c)(12)(B). The commenters stated that the language "any service company that has management or discretionary decision making authority" does not clearly delineate which service companies must be included in the plan of operation. Commenters requested that proposed

§5.6403(c)(12)(B) be clarified to apply to service companies with ultimate authority over payment of claims or that handle member contributions or distributions and with access to the group's accounts. According to the commenters, because the proposed language in §5.6403(c)(12)(B) is not clear, it may result in noncompliance and arguments at examination as to which entities have "management or discretionary decision making authority." Commenters also expressed concern that §5.6403(c)(12)(B) determines not only who must be included in a group's original business plan, but also which entities must have an individual written contract under proposed §5.6411 and also affects what notifications of changes in the information must be provided to the Department over time.

Section 5.6403(e) is changed to specify that the required biographical affidavit is the affidavit specified in §7.1604(b)(1)(C) of Title 28 of the Texas Administrative Code. This change is the result of a commenter recommending that the form of the affidavit be specified in the rules.

Section 5.6403(h) is changed as adopted to provide that “any other relevant information” required by the Commissioner to be submitted for purposes of determining whether to approve or disapprove an application for a certificate of approval must be relevant information that is “reasonably required” for the determination. This change is in response to a commenter that suggested that the statutory reasonableness requirement in the Labor Code §407A.051(b)(7) be included in §5.6403(h).

Section 5.6408(a) is changed as adopted to provide that fidelity bonds required of an administrator and a service company must protect against *loss caused directly by* an act of fraud or dishonesty by *the employees of* the administrator or service company *and to provide that the group shall be the loss payee.* This adopted provision is in lieu of proposed §5.6408(a) that provided that fidelity bonds required of an administrator and a service company must protect against an act of fraud or dishonesty by the administrator or service company in exercising its powers and duties as an administrator or service company and the fidelity bonds shall be made payable to the group. The change was prompted by a commenter who objected to proposed §5.6408(a). According to the commenter, the coverage specified in the proposal is likely not available. According to the commenter, the coverage exceeds the type of risks that can effectively be underwritten and covered by a fidelity bond. The commenter stated that a fidelity bond does not provide coverage for losses caused by the dishonesty of the business itself or the dishonesty of those that control the business. Additionally, references to the bond requirements of the Labor Code Chapter 407A and §5.6403(c)(6), (7), and (8) have been added in §5.6408(a) and (b), and (c) for purposes of clarity and readability. Therefore, §5.6408(a) has been revised to include a reference to the fidelity bond requirements of §5.6403(c)(6) and (7) as adopted. Section 5.6408(b) has been revised to include a reference to the performance bond requirements of the Labor Code §407A.057(a) and §5.6403(c)(8) as adopted. Section 5.6408(c) has also been

revised to include a reference to the performance bond requirements of §5.6403(c)(8) as adopted.

Other necessary clarification changes to the proposed text include the following. The Department has also made clarification changes to proposed §5.6403(e) to clarify the requirements for biographical affidavits required from each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the executive officers of a person identified pursuant to §5.6403(c)(12)(A) or (B). As proposed, §5.6403(e) provided an option in certain circumstances under which the Department could accept a biographical affidavit from these individuals that was already on file with the Department. As proposed, §5.6403(e) provided that (i) a biographical affidavit is not required if a biographical affidavit from the individual has been filed with the Department within the prior three years and contains substantially accurate information and (ii) a biographical affidavit contains substantially accurate information if the response given by the individual in the affidavit on file with the Department continues to indicate sufficient experience, ability, standing, and good record to make success of a group probable. Section §5.6403(e) as adopted has been clarified to read: “A biographical affidavit is not required if a biographical affidavit from the individual has been filed with the department within the prior three years and contains substantially accurate information. A biographical affidavit must demonstrate that the affiant has sufficient experience, ability, standing, and good record to make success of a group probable.”

The Department has also made clarification changes to proposed §5.6411(b) to clarify the contracting requirements applicable to subcontractors and for consistency with the changes made to proposed §5.6403(c)(12)(B). As proposed, §5.6403(c)(12)(B) required a group to identify in its business plan any service company that had management or discretionary decision making authority relating to a function the group retained ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder. This same language was also incorporated into the requirements of §5.6411(b). As proposed, §5.6411(b) required a person identified pursuant to §5.6403(c)(12)(A) or (B) who delegated to another party any of its management or discretionary decision making authority relating to a function a group retained ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder to execute a written agreement with that delegated party. To clarify this contracting requirement and for consistency with the changes made to proposed §5.6403(c)(12)(B) in this adoption, §5.6411(b) as adopted reads: If a person identified pursuant to §5.6403(c)(12)(A) or (B) of this division delegates any of the services that it has agreed to provide on behalf of a group to another person, the delegating person shall execute a written agreement with the person to whom the services are delegated. The written agreement must meet the requirements of this section." In addition, the Department has determined that changes to the proposed text in §5.6411(e)(3)(A), (B), and (C) are necessary for clarification purposes, including clarification of the requirements to comply with

other statutes and rules that address the transfer of a group's books and records. This clarification is added as a new §5.6411(e)(3)(C) in this adoption. Also, §5.6411(e)(3)(B) as adopted has been changed to specify the parties entering into the written agreement pursuant to subsection (a) or (b) of §5.6411. A minor clarification has been made to move the word "upon" that in the proposal was in subsection (e)(3) to subparagraph (e)(3)(A). Section §5.6411(e)(3) as adopted reads: A written agreement entered into pursuant to subsection (a) or (b) of this section shall also ensure that the books and records of the group . . . (3) will be timely transferred to the group or its designee: (A) upon request of the group; (B) at the termination or cancellation of a written agreement entered into by an administrator, service company, or third party administrator pursuant to subsection (a) or (b) of this section; and (C) in compliance with all applicable statutory and rule requirements.

Section 5.6412(a) and (b)(2) as proposed have been clarified in the adoption to specify "any person that is required to enter into a written agreement" pursuant to §5.6411(a) or (b) of this division with regard to oversight of such person in subsection (a) and with regard to submission of quarterly reports by such person in subsection (b)(2). The proposal was more general, applying the requirements to any person entering into a written agreement. Section 5.6412(a) as adopted reads: "A group shall annually adopt an operational review plan that provides for sufficient oversight of any person who is required to enter into a written agreement pursuant to §5.6411(a) or (b) of this division (relating to

Contract Provisions). The group may modify the operational review plan at any time in order to meet the group's needs." Section §5.6411(b)(2) as adopted reads: (b) The operational review plan shall, at a minimum: . . . (2) require any person that is required to enter into a written agreement pursuant to §5.6411(a) or (b) of this division to submit quarterly reports to the group containing the following information, as applicable:".

Also, one minor change has been made to correct a typographical error. In adopted §5.6412(a), the word "relating" was misspelled in the published proposal and has been corrected in this adoption.

The following paragraphs provide a brief summary as well as an analysis of the reasons for the adopted amendments and new sections, with specific emphasis on: (i) significant definitional changes to the Labor Code §407A.001 resulting from the enactment of HB 472 and the Department's clarification of these definitional changes; (ii) the significance and method of properly categorizing a delegated entity under the adopted amended and new sections; and (iii) the significance of ensuring the financial solvency of groups, including excess insurance, contracting, and oversight and operational review requirements.

Definitional Changes and Related Implementation Matters. HB 472 enacts two significant changes to the Labor Code Chapter 407A that affect the regulation of a group's delegated entities. First, HB 472 amends the Labor Code §407A.001 to include the definition of the new term *managing company*. This

new definition duplicates the definition of the term *administrator* in the Labor Code §407A.001(a)(1), which existed prior to the enactment of HB 472, but was not amended by HB 472. As a result, the Labor Code Chapter 407A contains two separate terms with the same definition. The terms *administrator* and *managing company* are both defined in the Labor Code Chapter 407A to mean "an individual, partnership, or corporation engaged by the board of trustees of a group to implement the policies established by the board of trustees and to provide day-to-day management of the group." HB 472 also amends the definition of the term *service company* in the Labor Code §407A.001(a)(8), which existed prior to the enactment of HB 472, by replacing the reference to *administrator* with a new reference to *managing company*. Second, HB 472 enacts the Labor Code §407A.009, which creates a new substantive licensing requirement for administrators and service companies performing the acts of an administrator, as that term is defined in the Insurance Code Chapter 4151. The adopted amendments to §5.6403 and §5.6411 and adopted new §5.6402 are necessary to clarify the meaning of and requirements relating to *administrators* and *managing companies* and to implement the other amendments enacted in HB 472.

First, the addition of the term *managing company* to the Labor Code Chapter 407A is addressed to clarify the statutory responsibilities of a group's delegated entities. For example, while an administrator and managing company are identically defined in the chapter, the Labor Code §407A.009 requires only an

administrator under the Labor Code Chapter 407A performing the activities of an administrator, as that term is defined under the Insurance Code Chapter 4151, to hold a certificate of authority under the Insurance Code Chapter 4151. Additionally, although an administrator and managing company are identically defined in the Labor Code §407A.001(a)(1) and (5-a), the amended definition of the term *service company* in the Labor Code §407A.001(a)(8) only references the term *managing company*. The Labor Code §407A.001(a)(8) defines the term *service company* to mean a person that provides services to the group, other than services provided by the managing company, including claims adjustment; safety engineering; compilation of statistics and the preparation of premium, loss, and tax reports; preparation of other required self-insurance reports; development of members' assessments and fees; and administration of a claim fund. The delineation of the roles and associated responsibilities of a group's delegated entities under the Labor Code Chapter 407A are of particular importance because the Labor Code Chapter 407A prescribes certain requirements that apply only to one type of delegated entity or the other. As such, it is necessary to clarify the roles and responsibilities of each type of delegated entity, while remaining consistent with the provisions of the Labor Code Chapter 407A.

Clarification Related to Prior Treatment of Administrators and Service Companies. Prior to the enactment of HB 472, the Labor Code Chapter 407A recognized only two types of delegated entities of a group--an administrator and

a service company. Accordingly, the Labor Code Chapter 407A prescribed specific requirements applicable to either an administrator or a service company. For instance, pursuant to the Labor Code §407A.152, a group was required to engage an administrator to perform its day-to-day management. However, while a group was permitted to also engage the services of a service company, it was not required to do so. Additionally, the Labor Code §407A.051(c)(12) required an administrator to obtain a $250,000 fidelity bond, while under the Labor Code §407A.051(c)(13) and §407A.057, certain qualifying service companies were required to obtain a $250,000 fidelity bond and a $250,000 performance bond. Further, prior to the enactment of HB 472, neither an administrator nor a service company under the Labor Code Chapter 407A was required to hold a certificate of authority to perform the acts of an administrator, as that term is defined in the Insurance Code Chapter 4151, with respect to workers' compensation benefits. Thus, the Labor Code Chapter 407A required categorization of an entity as an administrator or a service company, and each entity was subject only to the requirements of the Labor Code, the Insurance Code, and Department regulations that applied to an administrator or service company, in accordance with such categorization.

The adopted amendments and new sections address the need for clarification of these previously distinct categorizations and associated obligations that arose subsequent to HB 472. HB 472 specifically applies requirements to certain delegated entities of a group, such as administrators and

service companies, but does not address the application of these requirements to a managing company, another delegated entity of a group. Further, HB 472 defines an administrator and a managing company identically. This identical definition for these two separate terms raises the question of whether a requirement of HB 472, that by the plain language of the statute applies to an administrator, but not to a managing company, also applies to a managing company under the Labor Code Chapter 407A. For instance, HB 472 requires an administrator or a service company under the Labor Code Chapter 407A performing the acts of an administrator, as that term is defined in the Insurance Code Chapter 4151, to hold a certificate of authority under the Insurance Code Chapter 4151. Under a literal interpretation of this requirement, an individual, partnership, or corporation engaged by the board of trustees of a group to implement the policies established by the board of trustees and to provide day-to day management of the group could arguably opt to call itself a managing company, thereby escaping this additional licensing requirement. However, if the same entity opts to calls itself an administrator, the statute plainly requires its licensure under the Insurance Code Chapter 4151. A determination of whether the entity is subject to the licensing requirements of the Insurance Code Chapter 4151 based upon the entity's own categorization of itself, either as an administrator or a managing company, may result in unintended public policy concerns, such as inconsistent application of the licensing requirements of the Insurance Code Chapter 4151. If an administrator and a managing company are

identically defined under the Labor Code §407A.001, it would be inconsistent to interpret the statute to apply one requirement under the Labor Code Chapter 407A to an administrator while not applying the same requirement to a managing company. Because of the identical statutory definitions and the lack of any further differentiating delineations in the Labor Code Chapter 407A, the Department is unable to make any distinction between an administrator and a managing company to determine which requirements, functions, or exemptions should apply to one and not the other. Therefore, the Department has determined that, if a requirement applies to either an administrator or a managing company under the Labor Code Chapter 407A, then it must necessarily apply to both, by virtue of the fact that the two entities are identically defined and perform the same services for a group. This interpretation is consistent with the requirements of the Government Code Chapter 311. Further, a service company is statutorily defined in the Labor Code §407A.001(a)(8) by referencing a managing company. However, this definition must also intuitively include a reference to an administrator, as well. If the usage of the terms *administrator* and *managing company* in the Labor Code Chapter 407A are not clarified so that reference to one term necessarily includes reference to the other term, then the requirements of the Labor Code Chapter 407A cannot be given their intended effect. The chapter's requirements will result in inconsistent application, as determinations regarding whether a particular requirement applies to a specific

delegated entity may be based upon how that entity categorizes itself--as an administrator or as a managing company.

Adopted Provisions to Clarify and Effectuate Legislative Intent. The adopted amendments to §5.6403 and §5.6411 and new §5.6402 are necessary to effectuate the legislative intent of HB 472 and to provide uniform application of the requirements of the Labor Code Chapter 407A. First, adopted new §5.6402 clarifies the meaning of the term *administrator* to include and have the same meaning as the term *managing company* in all contexts. Further, there are no other references to the term *managing company* in this division. Thus, to the extent that the requirements of the Labor Code Chapter 407A apply to either an administrator or a managing company, this division implements those requirements with respect to an administrator, which necessarily encompasses a managing company in all contexts and without distinction. To this end, adopted new §5.6402 also provides a definition of the term *service company* that includes a reference to the term *administrator*, which necessarily encompasses a managing company in all contexts and without distinction. Because HB 472 subjects a group's delegated entities that perform the acts of an administrator, as that term is defined in the Insurance Code Chapter 4151, to the requirements of the Insurance Code Chapter 4151, adopted new §5.6402 also prescribes a definition for the new term *third party administrator*. This definition is necessary to implement the portions of HB 472 that specifically relate to a group's administrator, which also encompasses a managing company in all contexts and

without distinction, and its service companies. This definition is used throughout this division to refer to a group's delegated entities that also perform regulated services under the Insurance Code Chapter 4151.

Categorization of Delegated Entities Under Adopted New §5.6402. In general, the applicability of this division to a particular delegated entity depends entirely upon that entity's categorization under adopted new §5.6402. The categorization of an entity under adopted new §5.6402 is based upon the services performed by the particular entity on behalf of a group. First, an administrator under adopted new §5.6402(a)(2) is defined as an individual, partnership, or corporation engaged by the board of trustees of a group to implement the policies established by the board of trustees and to provide day-to-day management of the group. Adopted new §5.6402(a)(2) also identifies several of the functions that may be performed by a group's administrator. However, the enumerated functions are illustrative only and are not an exhaustive listing of the functions that an administrator may perform on behalf of a group. In other words, adopted new §5.6402(a)(2) does not, in any way, prohibit an administrator from performing functions that are not specifically enumerated in adopted new §5.6402(a)(2). Second, adopted new §5.6402(a)(12) defines a service company as a person that directly or indirectly provides services to or on behalf of a group, other than the services provided to the group by an administrator. Like adopted new §5.6402(a)(2), adopted new §5.6402(a)(12) also identifies several of the services that may be performed by a

service company on behalf of a group. Again, however, the enumerated services are illustrative only and are not an exhaustive listing of the services that a service company may perform on behalf of a group. In other words, adopted new §5.6402(a)(12) does not prohibit a service company from performing services not specifically enumerated in adopted new §5.6402(a)(12), provided that those services are not already being performed by the group's administrator. Adopted new §5.6402(a)(12) makes clear that a service company may not perform a service on behalf of a group that is already being performed by an administrator for that same group. Lastly, adopted new §5.6402(a)(13) defines a third party administrator as an administrator or service company, as those terms are defined in this division, who holds itself out or acts as an administrator, as that term is defined in the Insurance Code §4151.001(1). This definition is necessary to provide the proper identification of administrators or service companies that collect premiums or contributions from or adjust or settle claims for residents of this state that are related to workers' compensation benefits. While third party administrators, as defined in adopted new §5.6402(a)(13), will also be subject to separate Department regulations applicable to all administrators, as that term is defined in the Insurance Code §4151.001(1), this division prescribes the requirements that will only apply to third party administrators performing delegated services on behalf of groups. Thus, the adopted requirements in this division will not generally apply to all administrators, as that term is defined in the Insurance Code §4151.001(1). Rather, the adopted requirements in this division

will apply only to those administrators, as that term is defined in the Insurance Code §4151.001(1), that are also third party administrators, as defined by adopted new §5.6402(a)(13).

Finally, it is important for a group to become familiar with the characterizations of its delegated entities under adopted new §5.6402 because a group's responsibilities under the adopted amended and new sections will often depend upon the appropriate identification of its delegated entities. For example, adopted amended §5.6403(c)(6), (7), and (8) require an applicant to submit fidelity and performance bonds for its administrator, service companies, and service companies performing claims services with its application for a certificate of approval. The specific amount and format of these bonds differ depending upon whether the delegated entity is categorized under the Labor Code Chapter 407A as an administrator, a service company, or a service company providing claims services. Thus, in order to comply with the adopted amendment to §5.6403(c)(6), (7), and (8), an applicant must properly categorize its delegated entities under adopted new §5.6402. This division also requires groups to comply with certain contracting, reporting, oversight and operational review requirements, all of which depend upon the specific categorization of a group's delegated entities. Without properly categorizing its delegated entities under adopted new §5.6402, a group cannot fully comply with the requirements of this division.

It is also significant to recognize that an entity may be categorized differently depending upon the services that entity is performing and on whose behalf those services are being performed. For example, adopted new §5.6402(b) - (e) makes clear that an entity may act as: (i) an administrator for more than one group, in which case the entity would be subject to the requirements of this division that apply specifically to administrators; (ii) the administrator for one group and a service company for another group, in which case the entity would be subject to the requirements of this division that apply to administrators and service companies; or (iii) the administrator or service company for one group and a third party administrator for another group, in which case the entity would be subject to the requirements of this division that apply to administrators or service companies, and third party administrators, as well as other Department regulations relating to administrators, as that term is defined under the Insurance Code Chapter 4151. In instances where a single entity performs various services for more than one group or performs various services for the same group, it is imperative for that entity and group to properly categorize the entity under adopted new §5.6402 in order to fully comply with the requirements of this division.

It should also be noted that adopted new §5.6402(e) prohibits an individual, partnership, or corporation from acting as an administrator and a service company for the same group at the same time. This limitation is based on the definition of *service company* in the Labor Code §407A.001(8) and the

clarified definitions of *administrator* and *service company* in adopted new §5.6402(a)(2) and (12) of this division, which define a service company as a person that directly or indirectly provides services to or on behalf of a group, *other than those services provided by an administrator*. While both an administrator and a service company may provide the same kinds of services to a group, a group must designate an individual, partnership, or corporation to serve as its administrator pursuant to the Labor Code §407A.152. The group may delegate any service it is responsible for performing to its administrator. Any service that is not delegated to or performed by a group's administrator may be delegated to a service company directly or indirectly. This interpretation is consistent with the statutory definition of *service company* in the Labor Code §407A.001(a)(8), which contemplates such an arrangement. Adopted new §5.6402(e) does not, in any way, limit the services that may be performed by either an administrator or a service company. Rather, adopted new §5.6402(e) clarifies that an entity may not be categorized as an administrator and a service company for the same group at the same time.

Examples of Categorizing Delegated Entities Under the Adopted Sections. The complexity of categorizing a group's delegated entities can be best illustrated through a series of examples. For instance, in example number one, if an entity (Entity 1) is engaged by a group to perform safety engineering services, compilation of statistics, and day-to-day management functions for a group (Group 1), Entity 1 is categorized as an administrator under adopted new

§5.6402(a)(2). This is because Entity 1 is engaged to perform day-to-day management functions of Group 1, which is the defining characteristic of an administrator under the Labor Code §407A.001(1) and adopted new §5.6402(a)(2). Adopted new §5.6402(a)(2) also clarifies that an administrator may perform a wide variety of services and/or functions on behalf of the group, including safety engineering and compilation of statistics. In example number two, however, if Entity 1 performs safety engineering services and compilation of statistics for another group (Group 2) which are not being performed by any other entity for Group 2, but is not engaged by Group 2 to provide day-to-day management functions and/or services, Entity 1 is categorized as a service company for Group 2 under adopted new §5.6402(a)(12), but retains its categorization as an administrator under adopted new §5.6402(a)(2) for Group 1. This is because, in example number two, Group 2 did not engage Entity 1 to provide day-to-day management functions and/or services. Because Entity 1 is not engaged by Group 2 to act as its administrator, Entity 1 is performing services on behalf of Group 2 *other than* those performed by the group's administrator. As such, Entity 1 meets the definition of a service company under adopted new §5.6402(a)(12) with respect to Group 2. However, because adopted new §5.6402(d) specifically permits an entity to act as an administrator for one group and a service company for another group, Entity 1 also retains its categorization as the administrator of Group 1. In example number three, if Entity 1 is not engaged by Group 3 to provide day-to-day management functions,

but performs safety engineering services, compilation of statistics, and also performs the acts of an administrator, as that term is defined under the Insurance Code Chapter 4151, on behalf of Group 3, and assuming that none of these services are being performed by another entity on behalf of Group 3, Entity 1 is now categorized as a service company and a third party administrator under adopted new §5.6402(a)(2) and (13) for Group 3. However, Entity 1 also retains its categorization as the administrator of Group 1 and the service company of Group 2. Thus, in order for delegated entities and groups to fully comply with the requirements of this division, each delegated entity must be properly categorized under adopted new §5.6402 based upon the delegated services the entity performs on behalf of each group.

Downstream Subcontractors. Lastly, the adopted amendments and new sections do not prohibit an administrator, service company, or third party administrator from further delegating the performance of a specific service to another administrator, service company, or third party administrator (downstream subcontractors). In these situations, however, it is still necessary for each delegated entity and its downstream subcontractors to comply with the applicable requirements of this division. Thus, each downstream subcontractor is subject to categorization under adopted new §5.6402, based upon the services the downstream subcontractor is directly or indirectly performing on behalf of a particular group. Because adopted new §5.6402(b) makes clear that a group may engage only one administrator, any further delegation of a service of an

administrator, service company, or third party administrator to a downstream subcontractor will necessarily categorize the downstream subcontractor as a service company or a third party administrator--even if the downstream subcontractor is originally categorized as an administrator under adopted new §5.6402(a)(2) with regard to other delegated services performed for another group. For example, if the administrator (Administrator 1) of Group 1 further delegates services to another administrator (Administrator 2) of another group (Group 2), Administrator 2 is categorized as a service company or third party administrator, depending upon the nature of the services delegated, for Group 1. Administrator 2 retains its categorization as an administrator for Group 2. Likewise, if a service company of Group 1 further delegates services to another entity, that entity is also categorized as a service company for Group 1.

Adopted Financial Solvency Requirements, Including Excess Insurance, Contracting, and Oversight and Operational Review Requirements. The adopted amendments to §§5.6403, 5.6405, and 5.6411, and adopted new §§5.6404, 5.6412, and 5.6413 are necessary to augment a group's solvency and financial requirements, to require oversight of a group's delegated entities, to ensure that workers' compensation benefits are available on a timely basis, and to earlier detect a group's potential hazardous financial conditions. Because Texas had little experience with workers' compensation group self-insurance before 2003, many of the existing initial regulations were modeled after general regulatory requirements applicable to either individual self-insured employers or other

workers' compensation insurers. However, several factors unique to the workers' compensation group self-insurance market have since highlighted the need for additional excess insurance requirements and stricter oversight and monitoring of a group's delegated entities. As a result, the Department is adopting amendments to §§5.6403, 5.6405, 5.6411, and new §§5,6404, 5.6412, and 5.6413.

Pursuant to the Labor Code §407A.051, the adopted amendment to §5.6403(c)(12) requires a group to submit a general business plan or plan of operation describing the group's general business activities, safety program, and organization to the Department as part of its application for a certificate of approval. Additionally, the adopted amendment to §5.6403(c)(12)(A) requires a group's business plan or plan of operation to include the identity of the group's administrator and any third party administrator that provides services to or on behalf of the group. Under this requirement, a group's business plan or plan of operation must also identify a delegated entity's downstream subcontractors, if those downstream subcontractors are categorized as third party administrators under adopted §5.6402(a)(13) of this division for that group. The adopted amendment to §5.6403(c)(12)(B) requires a group's business plan or plan of operation to provide the identity of any service company that performs one or more of the following services: (i) provides cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintains the group's

accounting records or organizational documents; (iii) stores or maintains the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provides management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. The adopted amendment to §5.6403(c)(12)(B) also applies to any downstream subcontractor that is categorized as a service company under adopted §5.6402(a)(12) and meets the requirements of §5.6403(c)(12)(B).

Pursuant to the Labor Code §407A.051(d), adopted new §5.6404 is necessary to clarify a group's ongoing maintenance of qualification requirements. Adopted new §5.6404(a) requires a group to provide written notice to the Department of any change in the information filed by the group under the Labor Code §407A.051(c) or adopted §5.6403 of this division (relating to Application for Initial Certificate of Approval) or the group's manner of compliance with the Labor Code §407A.051(c) or adopted §5.6403 of this division no later than 30 days after the effective date of the change. For example, if a group files its initial application for a certificate of approval with the Department and identifies Administrator A as its administrator, but later wishes to engage the services of Administrator B in lieu of Administrator A, adopted new §5.6404(a) requires that group to notify the Department of such a change, because proper identification of a group's administrator is required pursuant to adopted §5.6403(c)(12)(A) of this division. Adopted new §5.6404(b) clarifies that a group must meet the

requirements of the Labor Code §407A.051(c) and adopted §5.6403 of this division, as those requirements apply to any change of information identified by a group under adopted new §5.6404(a) of this division. This provision makes clear that any change a group makes with regard to the information it files with the Department pursuant to adopted §5.6403 of this division or the Labor Code §407A.051(c) must still comply with the requirements of adopted §5.6403 of this division and the Labor Code §407A.051(c). For example, if a group changes its administrator, the group must still meet the requirements of adopted §5.6403 of this division and the Labor Code §407A.051(c) that relate to a group's administrator, such as providing an appropriate fidelity bond for the new administrator. This is because a fidelity bond for an administrator is required under adopted §5.6403(c)(6) of this division and the Labor Code §407A.051(c), and the group must meet such requirement in its initial filing with the Department. Finally, adopted new §5.6404(e) requires a group to maintain the qualifications necessary to obtain a certificate of approval under the Labor Code Chapter 407A at all times. For example, pursuant to the Labor Code §407A.053(a), a group must meet the requirements of the Labor Code §407A.053(c) in order to obtain a certificate of approval under the Labor Code Chapter 407A. The Labor Code §407A.053(c) requires a group to post security in the form and amount prescribed by the Commissioner, equal to the greater of $300,000 or 25 percent of the group's total incurred liabilities for workers' compensation. Under one example, it is assumed that an applicant posts security in the amount of

$300,000 at the initial time of application for a certificate of approval under the Labor Code Chapter 407A, and at that time, $300,000 is greater than 25 percent of the group's projected total incurred liabilities. One year later, however, under the example, it is assumed that 25 percent of the group's total incurred liabilities for workers' compensation is $500,000. Adopted new §5.6404(e) makes clear that, in this example, the group is now required to post security in the amount of $500,000, because this amount is greater than the original $300,000 posted by the group, and the group must meet the requirements of the Labor Code §407A.053(c) in order to obtain and maintain its certificate of approval under the Labor Code Chapter 407A.

Pursuant to the Labor Code §407A.054(b), the adopted amendment to §5.6405(a) requires a group to obtain specific excess insurance for losses that exceed a group's retention in an amount that will pay all benefits required under the Labor Code and rules adopted thereunder for a compensable claim. A group obtaining an excess insurance policy meeting this requirement is responsible for paying workers' compensation benefits up to a certain, stated retention amount under the policy. If a claim requires benefit payments beyond the stated retention amount in the policy, the excess insurance carrier is responsible for reimbursing the group for the payment of the benefits that exceed the group's stated retention amount, through the life of the claim. This requirement serves two important purposes. First, it increases the likelihood that an injured worker's claim will be paid timely and that sufficient funding will be available to pay the

required benefits for the claim, even if the total amount of the claim, over the life of the claim, is extraordinarily high. Second, it enhances a group's financial health by reducing the financial impact of a catastrophic claim on a group's financial resources. For example, §5.6405(a) prior to this adoption required a group to obtain specific excess insurance in an amount of at least $5 million per occurrence. In one example, it is assumed a group obtains a specific excess insurance policy in the amount of $5 million per occurrence with a $1 million retention amount. If a group's member's employee sustains a catastrophic injury that totals $15 million in benefits payable over the life of the claim, the group, after paying the policy's retention amount of $1 million, remains responsible for paying the remaining $9 million for that claim, without reimbursement from the excess insurer. This effect is amplified each time a member's employee sustains a catastrophic injury. So, in this example, if the group sustains two separate catastrophic claims, each totaling $15 million in benefits payable over the life of each claim, the group may not be able to withstand the financial burden of $20 million in total benefits payable over the lives of those two claims. A group's potential financial peril is further highlighted in this example when considering that the group remains responsible for paying all compensable benefits accruing below its stated retention amount of $1 million, in addition to the compensable benefits that exceed its specific excess insurance policy limits of $5 million. In such an event, a group's reserves may become depleted, thereby requiring the group to assess its members for the shortfall. Further, if a particular member of

the group is unable to meet the additional assessment obligations, the other members of the group could be required to make up the difference because of their joint and several liability. This could result in some members paying a disproportionate share of the group's assessment. If the group in this example is still unable to collect the necessary assessments from its members, and is declared insolvent, the Texas Group Self-Insurance Guaranty Fund will be responsible for the additional funds necessary to cover the incurred liabilities of the insolvent group. If the Fund is unable to cover these incurred liabilities from the funding available to it from its trust fund, pursuant to the Labor Code §407A.458(e), the Fund is then authorized to assess all other groups for the remaining deficiency. Thus, where a group does not have adequate excess insurance coverage, the financial implications of a catastrophic claim can be devastating and far-reaching, effecting interests far beyond that of the individual group sustaining the claims. A group may obtain additional aggregate excess insurance coverage to lessen the financial impact of the compensable claims accruing below the group's stated retention amount in its specific excess insurance policy. However, because the Labor Code Chapter 407A does not require a group to obtain such aggregate coverage, a group not voluntarily obtaining such coverage is still subject to the financial risks highlighted in the previous example.

The adopted amendment to §5.6405(a) reduces these financial risks, however, by requiring a group to obtain specific excess insurance for losses that

exceed a group's retention in an amount that will pay all benefits required under the Labor Code and rules adopted thereunder for a compensable claim. This requirement should better protect the financial solvency and operating condition of the group, as well as provide additional assurance that workers' compensation claims are able to be timely and prudently paid. For example, under this requirement, assume that a group obtains a specific excess insurance policy that complies with the adopted amendment to §5.6405(a) and that the group is responsible for paying a $1 million retention amount under the policy for each claim. In this example, if an employee of a member of a group sustains a compensable injury totaling $15 million over the life of the claim, the group's specific excess insurer is responsible for reimbursing the group for the payment of benefits for the claim that exceed the group's $1 million retention amount under the policy. In that event and under the terms of the specific excess insurance policy, the group should not be responsible for paying the additional $14 million in benefits payable for that compensable claim without receiving reimbursement from the excess insurer. This heightened excess insurance requirement in the adopted amendment to §5.6405(a) is intended to provide an enhanced mechanism that will allow a group to satisfy its financial obligations associated with catastrophic claims, while mitigating the risk of endangering or creating a hazardous condition for the group. This should also ensure an overall healthier workers' compensation system in Texas.

The Department recognizes, however, that specific excess insurance policies meeting the requirements of the adopted amendment to §5.6405(a) may not always be necessary. Thus, the adopted amendment to §5.6405(c) permits a group to petition the Department to obtain excess insurance in a different amount than the amount required by the adopted amendment to §5.6405(a), subject to a minimum floor of $10 million per occurrence. Under the adopted amendment to §5.6405(c), a group must submit an analysis prepared by an actuary of the group explaining the appropriateness of the requested level of specific excess insurance coverage for the group. Additionally, pursuant to the Labor Code §407A.054(b), the Commissioner must consider the current market conditions; a group's size, types of employment, years in existence, and risk exposure; other forms, if any, of additional financial security available to the group; and any other relevant factor in determining whether to grant a group's petition filed under the adopted amendment to §5.6405(c). However, the adopted amendment to §5.6405(c) also provides that in no event will the Commissioner approve a group’s petition for specific excess insurance coverage that is less than $10 million per occurrence. This prohibition establishes the minimum amount of specific excess insurance coverage that a group must obtain and provides a minimum level of protection for a group against its exposure to catastrophic compensable claims. Overall, the adopted amendment to §5.6405 achieves an appropriate balance between ensuring the success of the workers' compensation system by reducing a group’s unlimited exposure to catastrophic compensable

claims payments and providing groups with a certain level of flexibility to tailor their excess insurance needs to their unique circumstances in the appropriate instances.

The adopted amendment to §5.6411 and adopted new §5.6412 apply to the oversight of a group's delegated entities. While a group's use of delegated entities may provide cost savings and access to entities with specialized management skills, it also presents special challenges. Because a group's delegated entities often have access to, or control of, the group's funds, accounts, claims files, and records, there is a greater opportunity for fraud and mismanagement by the delegated entities. For example, the Department is aware of an instance where an administrator failed to timely inform a group that the group was operating in a potentially hazardous financial condition. In that instance, the group was not made fully aware of the financial statement and its operational implications for a prolonged period of time. Further, the Department has been informed of instances where a group's administrator poorly monitored group membership, to the point that certain members did not properly execute indemnity agreements. Lastly, the Department is aware that some groups lack sufficient internal oversight processes over their delegated entities, making it difficult for these groups to adequately oversee the performance of their delegated entities. As a result, the adopted amendment to §5.6411 and adopted new §5.6412 require a group to implement and maintain a minimal level of oversight and responsibility for the actions of its delegated entities. These

requirements are especially important because a group retains the ultimate responsibility and accountability for each service its delegated entities perform. Thus, it is imperative that a group monitor the activities of its delegated entities to ensure their compliance with the Insurance Code, the Labor Code, and the regulations adopted thereunder.

To this end, the adopted amendment to §5.6411 imposes minimal contracting requirements between: (i) a group and its delegated entities; and (ii) between a delegated entity and its downstream subcontractors in certain circumstances. The adopted amendment to §5.6411 first requires a group to enter into a written agreement with any person identified pursuant to §5.6403(c)(12)(A) or (B). Additionally, the adopted amendment to §5.6411 requires the written agreement to contain certain provisions that clearly delineate the roles and responsibilities of the contracting parties. These requirements ensure that both the group and its delegated entity understand their responsibilities under the agreement. Additionally, these requirements establish a group's expectations related to the performance of the delegated duties. For example, the adopted amendment to §5.6411(d) requires a group to describe the specific duties or services the delegated entity is expected to provide on its behalf, including any applicable instructions related to the performance of those duties or services. The adopted amendment to §5.6411(d) also requires each written agreement to contain a provision requiring each delegated entity to hold the appropriate licenses or certificates of authority required under the Labor

Code or the Insurance Code. These minimal requirements serve an important purpose. Because a group retains ultimate responsibility and accountability for all of its delegated services, each group should be familiar with its delegated entities and the services they are performing on the group's behalf. In order for a group to exercise appropriate oversight over its delegated entities, it must first identify: (i) its delegated entities; (ii) what services those delegated entities will be performing; and (iii) what its expectations are with respect to the performance of those services. Once those expectations are memorialized in a written agreement between the group and its delegated entities, it is easier for the group to monitor and ensure that its delegated entities are, in fact, performing those services in accordance with the terms of the written agreement.

The adopted amendment to §5.6411 also addresses continuity of services and continuing access to a group's books and records. The Department is aware of situations where administrators, as that term is defined under the Insurance Code Chapter 4151, have refused to timely return the books and records of an insurer or have denied access to an insurer's books and records. These situations typically involved an insurer that decided to end the employment of one Chapter 4151 administrator and employ the services of another Chapter 4151 administrator. These situations also usually occurred when there was an inadequate written agreement between the parties, or where the written agreement between the parties did not sufficiently address transition and ownership issues. While these particular instances involved insurers, the

regulatory concern for groups is the same. A delegated entity's refusal to provide a group with access to its own books and records may result in a potentially hazardous condition and have widespread negative results, especially with regard to the payment of workers' compensation claims. A group may not be able to comply with the requirements of the Insurance Code or the Labor Code without knowing which of its claims has been paid or which of its claims remain outstanding. Additionally, a group may be put into a hazardous financial condition if it is unable to access its financial books and records. In an effort to prevent these situations, the adopted amendment to §5.6411(d) requires a written agreement between a group and its delegated entities to include a provision addressing continuity of services, including run-off fee schedules and the transfer of the books and records of a group from one administrator, service company, or third party administrator to another administrator, service company, or third party administrator. Additionally, the adopted amendment to §5.6411(e) requires that each written agreement between the group and its delegated entities ensure that the group has ongoing, continuing access to its books and records at all times.

The adopted amendment to §5.6411(b) also requires a group's delegated entities to execute written agreements with their downstream subcontractors. The written agreement between the group's delegated entity and its downstream subcontractor must meet the same requirements as a written agreement between a group and a delegated entity. This requirement is necessary to

ensure continuing oversight of a group's delegated entities. The more times that a particular service is delegated from one entity to another, the greater the risk of non-performance or inadequate performance of that service becomes. A group retains ultimate responsibility and accountability for each service regulated under the Labor Code, the Insurance Code, or regulations adopted thereunder, regardless of the number of times the performance of that service is delegated from one entity to another. Requiring a written agreement between a group's delegated entities and their downstream subcontractors assists a group in exercising oversight over these downstream subcontractors to ensure that: (i) the delegated services are being performed accurately, timely, and in accordance with the group's instructions and expectations; (ii) the group knows which entity is responsible for performing the delegated services at all times; (iii) the group knows which entity has possession of, or access to, its books and records; and (iv) the group retains the ownership of, and access to, its books and records at all times.

To further emphasize the importance of a group’s regular oversight over its delegated entities, adopted new §5.6412 requires the board of trustees of a group to adopt an annual operational review plan that provides for sufficient oversight of a group's delegated entities and their downstream subcontractors. Adopted new §5.6412 highlights the types of information that a group should request from its delegated entities and their downstream subcontractors and review on a regular basis. Reviewing this information should enable a group to

better assess its ability to meet its obligations under the Labor Code, the Insurance Code, and regulations adopted thereunder. Additionally, it is anticipated that a group's regular review of the required information will enable the group to foresee potential financial problems, management issues, or solvency issues at a much earlier date, so that corrective action can be taken immediately. Further, adopted new §5.6412 emphasizes the importance of each group establishing its own performance goals and reviewing the performance of its delegated entities and their downstream subcontractors to determine if those goals are being met. Lastly, adopted new §5.6412 requires the board of trustees of a group to consider the information submitted by the group's delegated entities and their downstream subcontractors pursuant to the group's operational review plan and to make appropriate recommendations based upon that information. By regularly monitoring and overseeing its delegated entities and their downstream subcontractors, a group will obtain a better idea of its own capabilities, strengths, and weaknesses, which should result in financially healthier groups.

Pursuant to the Labor Code §407A.201(c), adopted new §5.6413 specifies the notification requirements for when a group experiences a reduction in its membership. Adopted new §5.6413(a) requires a group to notify the Commissioner only if the group experiences a reduction in its membership caused by either cancellation or termination, resulting in a cumulative reduction of 10 percent or more of its annual written premium, not later than the 10th day after the date on which the cumulative reduction in membership takes effect.

Clarification of Existing Rules. The remaining adopted amendments and new sections are a result of collaborative discussion with industry representatives and stakeholders regarding the clarification and reconsideration of the existing regulations.

First, the adopted amendment to §5.6403 is necessary to clarify the bonding requirements of the Labor Code Chapter 407A for administrators, service companies, and service companies providing claims services. The adopted amendment to §5.6403(c)(6) requires an administrator to obtain a fidelity bond in the amount of $250,000. Additionally, the fidelity bond must meet the requirements of adopted §5.6408 of this division (relating to Fidelity and Performance Bonds), which further specifies the required content and form of the bond. If an entity acts as an administrator for more than one group, that entity must obtain a new fidelity bond in the amount of $250,000 that meets the requirements of adopted §5.6403(c)(6) of this division for each group for which the entity acts as an administrator. The adopted amendment to §5.6403(c)(7) requires each service company identified pursuant to adopted §5.6403(c)(12)(A) or (B) of this division, if there is one, to obtain a fidelity bond in the amount of $250,000. The adopted amendment to §5.6403(c)(7) also requires this fidelity bond to meet the requirements of adopted §5.6408 of this division. If an entity acts as a service company for more than one group, that entity must obtain a new fidelity bond in the amount of $250,000 that meets the requirements of adopted §5.6403(c)(7) of this division for each group for which the entity acts as

a service company and is identified by that group under adopted §5.6403(c)(12)(A) or (B) of this division. Lastly, the adopted amendment to §5.6403(c)(8) requires each service company identified pursuant to adopted §5.6403(c)(12)(A) of this division that provides claims services to or on behalf of a group, if there is one, to obtain a performance bond in the amount of $250,000. The adopted amendment to §5.6403(c)(8) makes clear that this performance bond is in addition to the fidelity bond required in adopted §5.6403(c)(7) for a service company. Further, the adopted amendment to §5.6403(c)(8) requires this performance bond to be in the form prescribed in adopted §5.6408 of this division. A service company qualifying under adopted §5.6402(a)(13) of this division as a third party administrator will, in all cases where the service company is performing claims services, be subject to the performance bond requirements of adopted §5.6403(c)(8) of this division because a third party administrator providing services to or on behalf of a group must always be identified pursuant to adopted §5.6403(c)(12)(A) of this division. On the other hand, an administrator qualifying under adopted §5.6402(a)(13) of this division as a third party administrator is not subject to the additional performance bond requirement of adopted §5.6403(c)(8) of this division. The additional performance bond requirement applicable to service companies providing claims services is a direct result of the Labor Code §407A.057(a), which specifically refers to a service company providing claims services to a group. The Labor Code §407A.057(a) does not prescribe requirements for an administrator providing claims services to

a group, so the bond requirements of adopted §5.6403(c)(8) of this division do not apply to administrators providing claims services. The requirements of adopted §5.6403(c)(7) and (8) of this division do apply, however, to each entity that is categorized under adopted §5.6402(a)(12) or (13) of this division as a service company or as a service company that is also a third party administrator. For example, if an entity is categorized under adopted §5.6402(a)(2) of this division as an administrator (Administrator 1) for Group 1, but also performs delegated services for another group (Group 2) that categorize Administrator 1 as a service company under adopted §5.6402(a)(12) of this division for Group 2, Administrator 1 is subject to the bond requirements of adopted §5.6403(c)(6) and (7) of this division. If Administrator 1 also performs delegated claims services for Group 2, Administrator 1 is also subject to the bond requirements of adopted §5.6403(c)(8) of this division because Administrator 1 is categorized as a service company that is also a third party administrator under adopted §5.6402(a)(13) of this division for Group 2. In another example, if an entity qualifies as a service company for Group 1 and as a service company for Group 2, the entity is subject to the bond requirements of adopted §5.6403(c)(7) of this division for both groups. If the same entity retains its categorization as a service company, but also qualifies as a third party administrator for one of the groups, the entity is subject to the bond requirements of adopted §5.6403(c)(8) of this division, as well. The bond requirements of adopted §5.6403(c)(7) and (8) of this division

also apply to a delegated entity's downstream subcontractors in the same manner.

Second, the adopted amendment to §5.6403(g) eliminates the dual bonding requirement applicable to those *administrators* and *service companies* under adopted §5.6402(a)(2) and (12) of this division that also qualify as *administrators* under the Insurance Code Chapter 4151. The Insurance Code §4151.055 requires an administrator, as that term is defined under that chapter, to obtain a fidelity bond. Additionally, the Labor Code §407A.051(c)(12) and (13) requires a group's administrator and service company to also obtain a fidelity bond. As a result, one entity might be subject to the fidelity bond requirements of both the Insurance Code and the Labor Code if that entity is categorized as: (i) an administrator under adopted §5.6402(a)(2) of this division and as an administrator under the Insurance Code §4151.001(1), resulting in that entity being subject to the requirements of both adopted §5.6403(c)(6) of this division and the Insurance Code §4151.055; or (ii) a service company under adopted §5.6402(a)(12) of this division and as an administrator under the Insurance Code §4151.001(1), resulting in that entity being subject to the requirements of adopted §5.6403(c)(7) of this division and the Insurance Code §4151.055. The amount of the fidelity bonds required under the Labor Code §407A.051(c)(12) and (13) will be higher than the amount of a fidelity bond required under the Insurance Code §4151.055 in the majority of circumstances, and the requirements for the content of the fidelity bonds are virtually the same under

adopted §5.6403(6) and (7) of this division and the Insurance Code §4151.055. Thus, the interest of the public is not negatively affected by the adopted §5.6403(g) elimination of the duplicative fidelity bond requirement for administrators and service companies, and the benefit to these affected administrators and service companies may be significant.

The remaining adopted amendments and new sections provide additional flexibility for groups and their delegated entities, reduce certain regulatory filing requirements, and provide greater guidance regarding the expectations of the Department with regard to industry compliance with the rules in this division.

3. HOW THE SECTIONS WILL FUNCTION.

§5.6401. Purpose and Scope. Adopted new §5.6401 defines the purpose and scope of the division, which is to establish the licensing, contracting, reporting, and financial requirements, procedures, responsibilities, and obligations applicable to applicants and workers' compensation self-insurance groups holding a certificate of approval issued under the Labor Code Chapter 407A.

§5.6402. Definitions. Adopted new §5.6402(a) defines the terms used in the rules. Under adopted new §5.6402(b), a group shall engage only one administrator to implement the policies established by the board of trustees and to provide day-to-day management of the group. Also, under new §5.6402(b) a group may engage more than one service company to provide services to the

group. Adopted new §5.6402(c) permits an individual, partnership, or corporation to act as an administrator for more than one group. Adopted new §5.6402(d) permits an individual, partnership, or corporation to act as an administrator for one group and as a service company for another group. Adopted new §5.6402(e) prohibits an individual, partnership, or corporation from acting as both an administrator and a service company for the same group at the same time.

§5.6403. Application for Initial Certificate of Approval. The adopted amendment to §5.6403(a) requires an unincorporated association or business trust composed of five or more private employers that proposes to organize as a workers' compensation self-insurance group to file an application for a certificate of approval with the Department. The adopted amendments to §5.6403(c) specifies application requirements that are in addition to the information required under §5.6403(b). The adopted amendment to §5.6403(c)(6) requires an applicant to provide a fidelity bond that meets the requirements of adopted §5.6408 of this division (relating to Fidelity and Performance Bonds) for its administrator in the amount of $250,000. The adopted amendment to §5.6403(c)(7) requires an applicant to provide a fidelity bond that meets the requirements of adopted §5.6408 of this division for each of its service companies identified pursuant to adopted §5.6403(c)(12)(A) or (B) of this division in the amount of $250,000. The adopted amendment to §5.6403(c)(8) requires an applicant to provide a performance bond for each of its service companies identified pursuant to adopted §5.6403(c)(12)(A) that provide claims service to or

on behalf of the group in the amount of $250,000. Further, the adopted amendment to §5.6403(c)(8) makes clear that the performance bond required by adopted §5.6403(c)(8) is in addition to a fidelity bond required by adopted §5.6403(c)(7) of this division for a service company. Additionally, the performance bond required by the adopted amendment to §5.6403(c)(8) must be in the form prescribed by adopted §5.6408 of this division. The adopted amendment to §5.6503(c)(9) provides that an indemnity agreement executed by the members of the group binding (rather than “indemnifying” as stated in the section prior to this adoption) the members, jointly and severally, for the obligations of the group. Section 5.6503(c)(9) continues to require that, at a minimum, the agreement shall include the provisions described in §5.6406 of this division (relating to Indemnity Agreement). The adopted amendment to §5.6403(c)(10) requires an applicant to provide an acknowledgement, in the form prescribed in adopted §5.6407 of this division (relating to Acknowledgement of Indemnity Agreement), executed by each member of the group that it is aware that it can be called upon to pay the workers' compensation claims of another member of the group pursuant to the Labor Code Chapter 407A (rather than “as a result of executing the indemnity agreement in §5.6406 of this title” as stated in the section prior to this adoption). The adopted amendment to §5.6403(c)(11) requires an applicant to provide the statement required by adopted §5.6404 of this division (relating to Notification to the Department and Responsibility for Continued Compliance). The adopted amendment to §5.6403(c)(12) requires an

applicant to provide a business plan or plan of operation that describes a group's business activities, safety program, and organization. The plan must include: (i) the identity of the administrator of the group and any third party administrator that provides services to or on behalf of the group; (ii) the identity of any service company that performs one or more of the following services: (a) provides cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (b) maintains the group's accounting records or organizational documents; (c) stores or maintains the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (d) provides management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder; (iii) the identity of the accountant and actuary of the group; (iv) a general description of the experience, qualifications, facilities, and personnel of a person identified pursuant to adopted §5.6403(c)(12)(A) or (B); and (v) the identity of the affiliates of a person identified pursuant to adopted §5.6403(c)(12)(A) or (B). Additionally, the adopted amendment to §5.6403(c)(12) permits a group to identify such affiliates in an organizational chart. The adopted amendment to §5.6403(c)(13) requires an applicant to provide a copy of each written agreement required under adopted §5.6411 of this division (relating to Contract Provisions). The adopted amendment to §5.6403(c)(14) requires an applicant to provide a statement that a third party administrator identified pursuant to adopted §5.6403(c)(12)(A) of this

division either holds the required authorization from the Department or has applied for the required authorization from the Department and that the group will verify that such authorization has been granted by the Department before the group allows the third party administrator to provide services to or on behalf of the group. The adopted amendment to §5.6403(e) requires each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the executive officers of a person identified pursuant to adopted §5.6403(c)(12)(A) or (B) of this division to provide to the Department a completed biographical affidavit in accordance with §7.1604(b)(1)(C) of this title (relating to Application Denial, Suspension, Cancellation, or Revocation). Further, a biographical affidavit is not required if a biographical affidavit from the individual has been filed with the Department within the prior three years and contains substantially accurate information. A biographical affidavit must demonstrate that the affiant has sufficient experience, ability, standing, and good record to make success of a group probable. The adopted amendment to §5.6403(f) requires each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the executive officers of a person identified pursuant to adopted §5.6403(c)(12)(A) or (B) of this division to comply with the requirements of Chapter 1 Subchapter D of this title (relating to Effect of Criminal Conduct). The adopted amendment to §5.6403(g) permits a person subject to this division and to the requirements of the Insurance Code §4151.055 to satisfy the requirements of §4151.055 by obtaining a fidelity bond that meets the

requirements of adopted §5.6403(c)(6) or (7) of this division, as applicable. Finally, the adopted amendment to §5.6403(h) provides that, pursuant to the Labor Code §407A.051(b)(7), the Commissioner may require the submission of any other relevant information reasonably required to determine whether to approve or disapprove an application for a certificate of approval.

§5.6404. Notification to the Department and Responsibility for Continued Compliance. Adopted new §5.6404(a), pursuant to the Labor Code §407A.051(d), requires a group to provide written notice to the Department of any change in the information filed by the group under the Labor Code §407A.051(c) or adopted §5.6403 of this division (relating to Application for Initial Certificate of Approval) or the group's manner of compliance with the Labor Code §407A.051(c) or adopted §5.6403 of this division no later than 30 days after the effective date of the change. Adopted new §5.6404(b) clarifies that a group must meet the requirements of the Labor Code §407A.051(c) and adopted §5.6403 of this division, as those requirements apply to any change of information identified by a group under adopted new §5.6404(a). Adopted new §5.6404(c) requires a group to provide written notice to the Department no later than 10 days of first becoming aware that any hazardous financial condition exists, or that, in the opinion of a group's administrator, that any hazardous financial condition is likely to occur. Adopted new §5.6404(c) also defines a hazardous financial condition to include the conditions described in the Labor Code §407A.355(a) and (b), as well as any event, series of events, or negative trend which may affect the

group's ability to continue as a viable group. Adopted new §5.6404(d) requires a group to execute a written statement acknowledging its responsibilities under adopted new §5.6404. Lastly, adopted new §5.6404(e) requires a group to maintain the qualifications necessary to obtain a certificate of approval under the Labor Code Chapter 407A at all times.

§5.6405. Excess Insurance. The adopted amendment to §5.6405(a) requires a group to obtain specific excess insurance for losses that exceed a group's retention in an amount that will pay all benefits required under the Labor Code and rules adopted thereunder for a compensable claim, unless otherwise approved by the Commissioner. The adopted amendment to §5.6405(c) permits a group to petition the Department to obtain specific excess insurance in an amount that is different than the amount required by adopted §5.6405(a). The adopted amendment to §5.6405(c) also enumerates the factors the Commissioner must consider in determining whether to grant a group's petition, including current market conditions; a group's size, types of employment, years in existence, and risk exposure; other forms, if any, of additional financial security available to the group; and any other relevant factors. Lastly, the adopted amendment to §5.6405(c) prescribes that, in no event, may a group's excess insurance coverage be less than $10 million per occurrence. The adopted amendment to §5.6405(d) requires a group to submit to the Department, at a minimum, an analysis prepared by an actuary of the appropriate level of specific

excess insurance for the group to assist the Commissioner in determining whether to grant a group's petition under adopted §5.6405(c).

§5.6408. Fidelity and Performance Bonds. The adopted amendment to §5.6408(a) requires a fidelity bond required of an administrator under the Labor Code §407A.051(c)(12) and §5.6403(c)(6) of this division (relating to Application for Initial Certificate of Approval) and a service company under the Labor Code §407A.051(c)(13) and §5.6403(c)(7) of this division to protect against loss caused directly by an act of fraud or dishonesty by the employees of the administrator or service company. Additionally, the fidelity bond must include the group as a loss payee. The adopted amendment to §5.6408(b) requires a performance bond required under the Labor Code §407A.057 and §5.6403(c)(8) of this division to be in the format prescribed in adopted §5.6408(c). The adopted amendment to §5.6408(c) provides the format and content for a performance bond required under the Labor Code §407A.057 and §5.6403(c)(8) of this division. The adopted amendment to §5.6408(d) prohibits an administrator or service company from obtaining a fidelity bond or performance bond required under adopted §5.6403(c)(6), (7), or (8) of this division from any person except a surety company authorized to engage in business in this state as a surety or an eligible surplus lines insurer in compliance with the Insurance Code Chapter 981 and regulations adopted thereunder. Finally, the adopted amendment to §5.6408(e) requires an administrator or service company to immediately inform the Commissioner and the group, in writing, if a fidelity or

performance bond required under adopted §5.6403(c)(6), (7), or (8) of this division is cancelled or terminated, and is not replaced with new coverage that meets the requirements of the Labor Code Chapter 407A and this division and that is effective concurrently upon the date of the cancellation or termination. Further, the adopted amendment to §5.6408(e) provides that the required notification shall not, in any event, be given later than five business days from the date the administrator or service company first becomes aware of the cancellation or termination of the fidelity or performance bond.

§5.6409. Books and Records. Adopted new §5.6409(a) establishes the scope of the adopted new section and clarifies that the adopted new section applies to all books and records of a group, including both written and electronic, regardless of whether those books and records are located within the State of Texas or outside the State of Texas. Adopted new §5.6409(b) permits a group to locate its books and records outside of the State of Texas, provided certain requirements are met. Specifically, in order for a group to locate its books and records outside the State of Texas, adopted new §5.6409(b) requires a group to submit prior written notice to the Department that: (i) provides the specific address outside the State of Texas where the group's books and records will be located; (ii) identifies the types of books and records that will be located outside the State of Texas, including those that will be maintained in an electronic format; (iii) identifies the vendor of a leased or purchased software or electronic platform who will provide services to the group related to the maintenance of the group's

books and records, if applicable: and (iv) includes the group's continuity plan in the event of cancellation of termination of the arrangement with a vendor identified by the group pursuant to adopted new §5.6409(b)(3), if applicable. Adopted new §5.6409(c) requires all books and records of a group to be electronically or physically accessible to the Department, upon the Department's request, and to be maintained in a manner that provides an audit trail between the group's general ledger and the group's source documents. Adopted new §5.6409(d) requires a group's electronic books and records to be maintained with reasonable controls to ensure the integrity, accuracy, and reliability of the electronic storage system and to prevent the deterioration of the electronic books and records. Pursuant to adopted new §5.6409(e), a group must ensure a weekly backup of its electronic books and records. Additionally, adopted new §5.6409(f) requires a group to be able to access a complete and current set of its electronic books and records or a complete and current backup of its electronic books and records from a location in the State of Texas at all times. Adopted new §5.6409(g) and (h) provide that adopted new §5.6409 does not in any way limit the Commissioner's authority under the Labor Code §§407A.252 and 407A.355, and indicates that, in the event of a conflict between a provision of adopted new §5.6409 and the Labor Code §§407A.252 or 407A.355, the provision of the Labor Code §§407A.252 or 407A.355 prevails. Lastly, adopted new §5.6409(i) provides a 30-day grace period from the effective date of adopted new §5.6409 for a group to comply with its provisions, provided that the group

holds a certificate of approval issued prior to the effective date of adopted new §5.6409.

§5.6411. Contract Provisions. The adopted amendment to §5.6411(a) requires a group to execute a written agreement with any person identified pursuant to adopted §5.6403(c)(12)(A) or (B) that meets the requirements of adopted §5.6411. The adopted amendment to §5.6411(b) requires a group's delegated entities to execute a written agreement with their downstream subcontractors. The adopted amendment to 5.6411(c) provides that a group retains ultimate accountability and responsibility for compliance with all statutory and regulatory requirements, and no written agreement may be construed to limit, in any way, the group's ultimate accountability and responsibility. The adopted amendment to §5.6411(d) enumerates the minimal provisions that must be included in a written agreement under the adopted section, including: (i) a requirement that the delegated entity or downstream subcontractor must comply with the applicable requirements of the Insurance Code and the Labor Code and rules adopted thereunder, including holding the appropriate license or authorization from the Department; (ii) a requirement that the delegated entity or downstream subcontractor must permit the Commissioner or the group to examine, at any time, its financial solvency and ability to perform its responsibilities under the written agreement; (iii) a description of the duties that the delegated entity or downstream subcontractor is expected to perform and any applicable instructions related to the performance of those services, including

references to a group's claims handling practices or procedures; and (iv) a provision relating to the continuity of services, including run-off fee schedules and the transfer of the books and records of a group from one administrator, service company, or third party administrator to another administrator, service company, or third party administrator. The adopted amendment to §5.6411(e) requires a written agreement entered into between a group and its delegated entity or between a delegated entity and its downstream subcontractor to ensure that the books and records of a group remain the property of the group at all times, are available to the group or its designee at any time while in the custody of a delegated entity or downstream subcontractor, and will be timely transferred to a group or its designee upon request of the group, at the termination or cancellation of the written agreement, and in compliance with all statutes and rules. Finally, the adopted amendment to §5.6411(f) provides that a written agreement required under adopted §5.6411(a) or (b) of this division must meet the requirements of adopted §5.6411 of this division no later than June 1, 2009.

§5.6412. Operational Review Plan. Adopted new §5.6412(a) requires a group to annually adopt an operational review plan that provides for sufficient oversight of any person who is required to enter into a written agreement pursuant to adopted §5.6411(a) or (b) of this division (relating to Contract Provisions), which may be modified at any time to meet a group's needs. Adopted new §5.6412(b) prescribes the minimal requirements for a group's operational review plan. Specifically, adopted new §5.6412(b)(1) requires a

group's operational review plan to include the group's estimated projections for the specific information enumerated in adopted new §5.6412(b)(2)(A) – (C) of this division. Adopted new §5.6412(b)(2) requires a group's operational review plan to require any person who is required to enter into a written agreement pursuant to adopted §5.6411(a) or (b) of this division to submit quarterly reports to the group containing the information described in adopted new §5.6412(b)(2)(A) – (C) of this division, which includes projected premium revenue for the current fund year and comparison to premium revenue for the previous fund year, membership counts, and a summary of the performance of the group for each fund year in which the group has been in existence, taking into account the number of claims reported, incurred losses, premium received, loss ratios, expense ratios, and delineations of claims likely to exceed the specific retention and fund years likely to exceed any aggregate retention. Finally, adopted new §5.6412(b)(3) requires a group's operational review plan to provide for corrective action, as determined by the board of trustees of the group, if the performance of the group does not meet its estimated projections required under adopted new §5.6412 of this division. Adopted new §5.6412(c) requires the board of trustees of a group to consider the reports submitted by a group's delegated entities and downstream subcontractors as part of its operational review plan. Additionally, those reports, the board's consideration of those reports, and the board's recommendations for the group based upon those reports must be noted in the

minutes of the board of trustees of the group and must be maintained in the books and records of the group.

§5.6413. Membership Cancellation or Termination. Adopted new §5.6413(a) requires a group to notify the Commissioner pursuant to the Labor Code §407A.201(c) only if the group experiences a reduction in membership, caused by either cancellation or termination, resulting in a cumulative reduction of 10 percent or more of its annual written premium, not later than the 10th day after the date on which the cumulative reduction in membership takes effect. Further, adopted new §5.6413(b) requires the group's notification under adopted new §5.6413(a) of this division to include an explanation of the reason for the cancellation or termination of each member of the group and a statement indicating how the group anticipates addressing the membership loss, including whether or not assessments of the remaining members of the group will be necessary.

4. SUMMARY OF COMMENTS AND AGENCY RESPONSE.

§5.6401. Purpose and Scope

Comment: One commenter suggests adding the following language to proposed §5.6401 to ensure that there are no conflicts between the proposed definitions and those contained in the statute: "Chapter 407A, Labor Code, prevails over this division to the extent of a conflict between this division and Chapter 407A." Though the commenter states general support for proposed

§5.6401, the commenter states that the proposal deletes the reference to terms defined in the statute and the definitions in the proposal are different from those in the statute.

Agency Response: The Department disagrees with the suggested change. The adopted definitions are consistent with the statutory definitions and other provisions in the Labor Code Chapter 407A and are necessary to effectuate the intent of HB 472.

§5.6402(a)(2). Definition of "Administrator"

Comment: One commenter agrees with equating "administrator" and "managing company" and treating the two terms in the same way. The commenter also agrees with the Department's interpretation that this will effectuate legislative intent.

Agency Response: The Department appreciates the comment.

Comment: Two commenters object to the definition of "administrator," as defined in proposed §5.6402(a)(2). One commenter recommends defining the term "administrator" to mean "a person, partnership, or corporation who, in connection with workers' compensation benefits, collects premiums or contributions from or adjusts or settles claims and provides day-to-day management of the group," as defined in the Labor Code §407A.001(a)(1). Both commenters state that the proposed definition is broad and conflicts with the Insurance Code §4151.001(1). One commenter states that it was not the

intention of the Legislature to include in the definition of “administrator” anyone other than the entity that has overall charge of handling a workers’ compensation claim and who has the ultimate decision-making authority on behalf of a workers' compensation insurance carrier on a workers’ compensation claim. The other commenter states that the definition of the term “administrator” does not follow the very clearly stated definition of the term “administrator” set out in the Insurance Code §4151.001(1) and could lead to confusion about what persons or entities are considered, by law, to be an “administrator.”

Agency Response: The Department disagrees that the definition of “administrator” in proposed §5.6402(a)(2) is overly broad or that it conflicts with the Insurance Code §4151.001(1). Therefore, the Department declines to adopt the commenter’s suggested definition. The definition in proposed §5.6402(a)(2), which is adopted without changes, appropriately incorporates the definition of the term "administrator," as defined in the Labor Code §407A.001(a)(1). The Labor Code §407A.001(a)(1) contemplates that the administrator of a group will be engaged by the board of trustees of the group to implement its policies and to provide day-to-day management of the group. The Labor Code Chapter 407A does not prohibit a group's administrator from handling a workers’ compensation claim and retaining the ultimate decision-making authority on behalf of a group. However, the Labor Code Chapter 407A also does not define a group's administrator as being limited to that role. Therefore, under the Labor Code Chapter 407A, a group's administrator may provide any service to the group, so

long as it has been properly engaged by the group to do so. Pursuant to the Insurance Code §4151.001(1), an administrator under the Insurance Code Chapter 4151 is limited to collecting premiums or contributions or adjusting or settling claims on behalf of residents of this state in connection with annuity benefits, life benefits, accident benefits, health benefits, pharmacy benefits, and workers' compensation benefits. However, the Labor Code §407A.009 makes clear that an administrator or service company under the Labor Code Chapter 407A is subject to the requirements of the Insurance Code Chapter 4151 if the administrator or service company performs the acts of an administrator, as defined in the Insurance Code Chapter 4151. Specifically, the Labor Code §407A.009 provides that an administrator or service company under Chapter 407A that performs the acts of an administrator as defined in Chapter 4151 must hold a certificate of authority under Chapter 4151. The adopted rules are consistent with this statutory scheme.

Comment: A commenter recommends that the term "administrator" be defined as "a person, partnership, or corporation who, in connection with workers' compensation benefits, collects premiums or contributions from or adjusts or settles claims and to provide day-to-day management of the group, as defined in the Labor Code §407A.001(a)(1). Day-to-day management includes claims adjustment; safety engineering; and administration of a claims fund for a self-insured group. For purposes of this division, administrator includes and has the same meaning as managing company, as that term is defined in the Labor Code

§407A.001(a)(5-a). Any reference to the term administrator in this division in all contexts necessarily includes and references both administrator and managing company." The commenter further states that the phrase “administration of a claims fund for a self-insured group” should suffice to make the third-party administrator who performs these duties subject to regulation by the Department.

Agency Response: The Department declines to make the recommended change. The definition of “administrator” in the adopted rules is not meant to supplant the definition of “administrator” in §4151.001(1) of the Insurance Code. The term “administrator” is defined to be consistent with the definition of “administrator” in the Labor Code §407A.001(a)(1). Further, the adopted rule requirements related to an “administrator” implement the requirements of the Labor Code Chapter 407A related to an “administrator.” Whether a person qualifies as an “administrator” under the Insurance Code Chapter 4151 is determined by applying the definition of that term under Chapter 4151 to the person’s activities. If a person holds itself out as or acts as an administrator under Chapter 4151, that person is subject to regulation by the Department as a Chapter 4151 administrator, regardless of whether that person also qualifies as an “administrator” under the Labor Code Chapter 407A or the adopted rules.

Comment: A commenter states that the acts that §5.6402(a)(2) deems to be day-to-day management are often performed as a service to the group by actuarial consultants, certified public accountants, safety consultants, the board of directors of the group, and persons and entities that are exempted under the

provisions of the Insurance Code §4151.002 and thus, cannot be defined to be an administrator for the purpose of these rules.

Agency Response: The Department disagrees. The Labor Code §407A.001(a)(1) defines an “administrator” as an individual, partnership, or corporation engaged by the board of trustees of a group to implement the policies established by the board of trustees and to provide day-to-day management of the group. The Labor Code Chapter 407A does not prohibit a group's administrator from performing the activities included in the adopted definition, such as claims adjustment; safety engineering; compilation of statistics and the preparation of premium, loss, and tax reports; preparation of other required self-insurance reports; development of members’ assessments and fees; and administration of a claim fund. The Labor Code Chapter 407A also does not define a group's administrator as being limited to any of those activities. Therefore, under the Labor Code Chapter 407A, a group's administrator may provide any service to a group, so long as it has been properly engaged by the group to do so. Whether a person qualifies as an “administrator” under the Insurance Code Chapter 4151 is determined by applying the definition of that term under Chapter 4151 to the person’s activities. If a person holds itself out as or acts as an administrator under Chapter 4151, that person is subject to regulation by the Department as a Chapter 4151 administrator, regardless of whether that person also qualifies as an “administrator” under the Labor Code Chapter 407A or the adopted rules. The exemptions contained in the Insurance

Code §4151.002 do not apply to an administrator under the Labor Code Chapter 407A. Rather, those exemptions only apply to an “administrator” under the Insurance Code Chapter 4151. Therefore, a person may qualify as an “administrator” under the Labor Code Chapter 407A and as an “administrator” under the Insurance Code Chapter 4151 for performing the same function on behalf of one group, such as claims administration. However, the separate requirements of the Labor Code Chapter 407A and the Insurance Code Chapter 4151 and the rules adopted thereunder will apply to that person independently of one another.

§5.6402(a)(12). Definition of “Service company”

Comment: Three commenters object to the definition of “service company” in proposed §5.6402(a)(12). Two of these commenters disagree with the use of the words "directly or indirectly" in the definition and recommend striking these words. One of these commenters questions whether there is a specific problem that the term "indirectly" is intended to resolve. The commenter states that the qualifier “indirectly” could be taken to an extreme to mean that anyone who provides services indirectly to the group could be considered a service company with all the attendant requirements, such as a treating doctor who provides health care services for injured workers covered by the group. The other of these two commenters objects not only to the use of the words “directly or indirectly,” in the proposed definition but also disagrees with the phrases “or on behalf of” and “but

not limited to" that are used in the definition. According to this commenter, these phrases are not contained in the statutory definition of "service company." The commenter asserts that these added words could greatly expand the statutory definition. According to this commenter, many different persons provide services directly or indirectly to groups. The commenter states that such persons could include medical bill auditing utilization review companies, case managers, electronic data interchange trading partners, private investigators, forensic engineers, doctors, attorneys, and the phone company and janitorial company for the group. This commenter also states that it does not disagree with the proposed requirements contained in §5.6411 and §5.6412, but it does disagree with the confusion and potentially excessive burdens on groups and service companies if the definition of "service company" in proposed §5.6402 is not limited to the statutory definition.

Agency Response: The Department does not agree that the words "directly or indirectly" in the definition of "service company" in proposed §5.6402(a)(12) are unnecessary or that the definition is inconsistent with the statutory definition in the Labor Code §407A.001(a)(8) in combination with the other provisions of Chapter 407A. Proposed §5.6402(a)(12), which is adopted without changes, defines "service company" as "a person that directly or indirectly provides services to or on behalf of a group, other than the services provided by an administrator, including, but not limited to: (i) claims adjustment; (ii) safety engineering; (iii) compilation of statistics and the preparation of premium, loss,

and tax reports; (iv) preparation of other required self-insurance reports; (v) development of members' assessments and fees; and (vi) administration of a claim fund. The Labor Code §407A.001(a)(8) defines a "service company" as "a person that provides services to the group other than services provided by the managing company, including: (i) claims adjustment; (ii) safety engineering; (iii) compilation of statistics and the preparation of premium, loss, and tax reports; (iv) preparation of other required self-insurance reports; (v) development of members' assessments and fees; and (vi) administration of a claim fund. The definition of "service company" in §5.6402(a)(12) codifies the Department's existing interpretation and application of the definition of "service company" in the Labor Code §407A.001(a)(8) in combination with the other provisions of Chapter 407A. Based on Department experience, when a particular person has provided a service, other than a service provided by a group's administrator, indirectly to or on behalf of a group, including through an agreement or contract with another administrator or service company, the Department has applied the definition of "service company" in the Labor Code §407A.001(a)(8) and any statutory or regulatory requirements concerning "service companies" to that person. For these same reasons, the Department disagrees that the phrases "or on behalf of" and "but not limited to" that are used in the definition are inconsistent with the statutory definition. For these same reasons, the Department also disagrees that the definition of "service company" is confusing or will cause excessive burdens on groups and service companies.

Comment: One commenter suggests deleting the definition of "day-to-day management" referenced in the definition of "administrator" in §5.6402(a)(2) and instead, adding to the definition of "service company" in §5.6402(a)(12) the following phrase: "a person, other than the designated administrator, that. . . ." The commenter alternatively requests a different definition of "day-to-day management" that would lead to more clarity. The commenter states that the additional definition of "day-to-day management," which is defined to include services that are also in the definition of "service company," confuses the management of an administrator with the specific tasks performed by a service company, basically equating the two. The commenter questions whether a person providing loss control or an accountant preparing taxes is an "administrator" because they perform one of these functions.

Agency Response: The Department declines to make the suggested change. Section 5.6402(b) - (e), which are adopted without changes to the proposed text, clarify that a group may engage only one administrator to implement the policies established by the board of trustees and to provide day-to-day management of the group. However, a group may engage more than one service company to provide services to the group. Further, an individual, partnership, or corporation may act as an administrator for more than one group and an individual, partnership, or corporation may act as an administrator for one group and as a service company for another group. However, an individual, partnership, or corporation may not act as both an administrator and a service company for the

same group at the same time. The definition of “administrator” in §5.6402(2) is consistent with §5.6402(b) - (e). Adopted §5.6402(2) clarifies that an individual, partnership, or corporation that is engaged by the board of trustees to implement the policies established by the board of trustees of the group and to provide day-to-day management of the group may, in its role as the group's administrator, perform any function delegated to it by the group, including claims adjustment; safety engineering; compilation of statistics and the preparation of premium, loss, and tax reports; preparation of other required self-insurance reports; development of members’ assessments and fees; and administration of a claim fund. Whether a person is categorized under adopted §5.6402 as an administrator depends upon whether the person has been engaged by the board of trustees to implement the policies established by the board of trustees and to provide day-to-day management of the group.

Comment: Three commenters object to the broadness of the definition of “service company” in proposed §5.6402(a)(12). One commenter suggests modifying the rule to eliminate the possibility that the broadly worded definition of "service company" as proposed, might encompass firms and individuals who provide legal, accounting, or other services that are not typically subject to insurance regulation. A second commenter states that while the commenter has no problem with the requirements that a service company provide a performance bond and a fidelity bond with respect to the entities specified in the statutory definition, the definition of “service company” includes many persons who may

not even suspect that the definition and resulting bonding requirements apply to them. The commenter states that because §5.6404 requires information to be updated within 30 days of any change in the information contained in the group's application for initial certificate of approval, it is crucial for groups and persons who may be considered service companies to know when the information must be updated, to what extent, and whether a fidelity and performance bond will be required. A third commenter requests that some other limitation related to service companies be applied in the rule, such as limiting requirements to service companies that perform management and payment of claims or collection of premiums.

Agency Response: While the Department agrees with the commenters, the Department does not agree that the proposed definition of "service company" in §5.6402(a)(12) should be changed. The Department, however, has addressed these concerns by revising proposed §5.6403(c)(12)(B) in the adoption to provide that the notification requirements of §5.6404 as adopted, the bond requirements of §5.6403(c)(7) and (8) as adopted, the contracting requirements of §5.6411 as adopted, and the reporting requirements of §5.6412 as adopted, apply to a group's service companies that perform one or more of the following services: (i) provides cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintains the group's accounting records or organizational documents; (iii) stores or maintains the group's electronic books and records,

including a person identified by a group under §5.6409(b)(3); (iv) provides management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. Revised §5.6403(c)(12)(B) as adopted, in conjunction with adopted §5.6403(c)(7), (8), 12(A), and (13), §5.6404, §5.6408, §5.6411, and §5.6412, provide that the notification, bonding, contracting, and reporting requirements also apply to a group's service companies that are third party administrators.

Comment: One commenter requests that proposed §5.6402(a)(12) defining a "service company" be amended to clarify that a person or entity exempted from the provisions of the Insurance Code Chapter 4151 by §4151.002 are not included in the definition. The commenter objects to the definition because it attempts to include persons and entities that are specifically exempted from the provisions of Chapter 4151 by the Insurance Code §4151.002. According to the commenter, the term is not mandated by or set out in the Insurance Code Chapter 4151. The commenter states that the definition of the term "service company" is overly broad and, if adopted as proposed, will result in a conflict between the rule and the Insurance Code §4151.002 by including persons and entities that are specifically exempted from the provisions of Chapter 4151. The commenter states that the proposed subsection does not meet the fair, reasonable, and appropriate standards required by HB 472 for the rules to augment and implement the Insurance Code Chapter 4151 in that the definition

of the term “service company” appears to attempt to include persons and entities that are specifically exempted from the provisions of Chapter 4151 by §4151.002.

Agency Response: The Department disagrees that there is a conflict between the definition of “service company” in proposed §5.6402(a)(12), which is adopted without changes, and the exemptions enumerated in the Insurance Code §4151.002. The Department agrees that the term “service company” is not defined in the Insurance Code Chapter 4151. The exemptions enumerated in the Insurance Code §4151.002, however, only apply to an “administrator” under the Insurance Code Chapter 4151. Those exemptions do not apply to an “administrator” or a “service company” under the Labor Code Chapter 407A. A person may perform a function on behalf of a group that qualifies them as (i) an “administrator” under the Labor Code Chapter 407A, (ii) a “service company” under the Labor Code Chapter 407A, (iii) an “administrator” under the Insurance Code Chapter 4151, or (iv) an “administrator” or “service company” under the Labor Code Chapter 407A and an “administrator” under the Insurance Code Chapter 4151. However, regardless of the characterization of a person under the Labor Code Chapter 407A or the Insurance Code Chapter 4151, the requirements of those chapters and the rules adopted under those chapters will be applied to the person independently of one another. For example, a person that qualifies as a “service company” under the Labor Code Chapter 407A will be subject to the requirements of that chapter and any rules adopted thereunder, as they relate to service companies. If that same person also qualifies as an

"administrator" under the Insurance Code Chapter 4151, the requirements of that chapter, including any applicable exemptions, and any rules adopted under that chapter will also apply to that person, regardless of the application of the Labor Code Chapter 407A and rule requirements to that same person also operating as a service company.

§5.6402(a)(13). Definition of "Third party administrator"

Comment: One commenter requests that the definition of "third party administrator" in proposed §5.6402(a)(13) either be amended to repeat the definition set out in the Insurance Code §4151.001(1) or be deleted in its entirety. The reasons specified by the commenter are: (i) the definition of the term "third party administrator" is overly broad; (ii) it does not follow the definition of the term "administrator" as defined by the Insurance Code §4151.001(1); (iii) the inclusion of the phrase "or service company, as those terms are defined under this division, that holds itself out or acts as an administrator" appears to be an attempt to expand the statutory definition of the term "administrator" by rule-making; (iv) state agencies do not have the authority to modify or expand the definition of a term set out in a statute via rule-making in an attempt to expand the meaning of a term; and (v) the rule and its associated definitions of terms must mirror the statute's definition of the term.

Agency Response: The Department declines to make the requested change. The Department disagrees that the definition of "third party administrator" in the

adopted rules is overly broad or conflicts with the definition of “administrator” in the Insurance Code Chapter 4151 in combination with the requirements of both the Labor Code §407A.009(a) and the Insurance Code §4151.001(1) and §4151.001(3). The Labor Code §407A.009(a) requires an administrator or service company under the Labor Code Chapter 407A that performs the acts of an administrator as that term is defined in the Insurance Code Chapter 4151 to hold a certificate of authority under the Insurance Code Chapter 4151. Further, the Insurance Code Chapter 4151 defines an “administrator” as “a person who, in connection with annuities or life benefits, health benefits, accident benefits, pharmacy benefits, or workers' compensation benefits, collects premiums or contributions from or adjusts or settles claims for residents of this state. The term includes a delegated entity under Chapter 1272 and a workers' compensation health care network authorized under Chapter 1305 that administers a workers' compensation claim for an insurer, including an insurer that establishes or contracts with the network to provide health care services. The term does not include a person described by §4151.002. The Insurance Code Chapter 4151 defines a “person" in §4151.001(3) as “an individual, partnership, corporation, organization, government or governmental subdivision or agency, business trust, estate trust, association, or any other legal entity.” Neither the Labor Code Chapter 407A nor the Insurance Code Chapter 4151 exempt a “service company,” as that term is defined in the Labor Code Chapter 407A from being required to hold a certificate of authority under the Insurance

Code Chapter 4151 if the service company is holding itself out as or acting as an administrator, as that term is defined under the Insurance Code Chapter 4151. The Insurance Code §4151.002 does enumerate several exemptions from the requirements of the Insurance Code Chapter 4151. However, those exemptions must be applied on a case-by-case basis to each person qualifying as an "administrator" under the Insurance Code Chapter 4151. A person who qualifies as a "service company" under the Labor Code Chapter 407A is not automatically exempted from the requirements of Chapter 4151 because that person is a "service company" under the Labor Code Chapter 407A. Neither is a person who qualifies as an "administrator" under the Insurance Code Chapter 4151 automatically exempted from the requirements of that chapter because the person also qualifies as a "service company" under the Labor Code Chapter 407A.

§5.6402(a). Additional definitions requested

Comment: Two commenters recommend including in the rules a definition of the term "claims adjustment." One of the commenters also recommends that the rules define the term "settles claims" and "adjusts." The other commenter states that the rule defines the term "service company" as a person that directly or indirectly provides services to or on behalf of a group, other than the services provided by an administrator, including, but not limited to claims adjustment. The commenter states that the rule, however, does not define the term "claims

adjustment," which is one of the most important aspects of the duties performed by a third-party administrator. The commenter recommends that the proposed rule include a definition of the term "claims adjusting" and suggests that "claims adjusting" be defined as "the investigation and management of a workers' compensation claim, settling of disputed claims issues, and determining the appropriate amount and duration of workers' compensation benefits provided for under the Labor Code Title 5 by a licensed third-party administrator."

Agency Response: The Department does not believe that it is necessary to define these terms and that to do so, could result in unnecessary ambiguity. The Insurance Code Chapters 4101 and 4102 address adjusters and adjusting and prescribe the requirements applicable to obtaining an adjuster's license. The Department declines to adopt a more narrow definition of "claims adjusting" than may be contemplated by these chapters. Any definition of "claims adjusting" in the adopted sections may have an unanticipated effect upon the application of the term "adjuster" in these chapters or the interpretation of the term "claims adjuster" in other Code provisions or Department rules.

§5.6402(e). Prohibition on acting as both an administrator and a service company for the same group at the same time

Comment: One commenter objects to proposed §5.6402(e) and suggests that it be changed as follows: "An individual, partnership, or corporation may not [act as] be categorized as but may perform the functions of both an administrator and

a service company for the same group at the same time." The commenter states that this subsection is supposed to clarify that a person will not be *categorized* as both an administrator and a service company, but that one person can do both functions. The commenter suggests that this intent would be better served by the commenter's recommended language.

Agency Response: The Department declines to make this change. The Department does not agree that one person can perform functions as both an administrator and service company for one group at the same time. An administrator is not prohibited under the Labor Code Chapter 407A or the adopted rule from performing any function delegated to it by the group. An administrator is engaged by the board of trustees to implement the policies adopted by the board of trustees and to provide day-to-day management of the group. Day-to-day management may include any delegated function. Any function that is not delegated to the administrator by the group may be performed by a service company. A person is categorized as an administrator or a service company under the adopted sections based on the functions they perform and in the capacity in which they perform them. If a person is engaged by the board of trustees to implement its policies and provide it with day-to-day management, it is categorized as the group's administrator, regardless of the specific functions it then performs. However, a person cannot be a service company for a group unless the group has delegated to it a function that is not being performed by the group's administrator.

§5.6403. Application for Initial Certificate of Approval

Comment: Two commenters objected to the broad and unclear language in proposed §5.6403(c)(12)(B). The commenters request that the language in proposed §5.6403(c)(12)(B) be clarified to apply to service companies with ultimate authority over payment of claims or that handle member contributions or distributions and with access to the group's accounts.

One of the commenters states that this limitation is consistent with the distinction that the Labor Code §407A.057 makes between any service company and a service company "providing claim services." The two commenters object to the qualifier "any service company that has management or discretionary decision making authority." The commenters assert that proposed §5.6403(c)(12)(B) does not clearly delineate which service companies must be included in the plan of operation. The commenters state that this also affects what notifications of changes in the information must be provided to the Department over time. The commenters state that many people who provide services to a group have some discretion and that discretion may affect the adjustment of claims, but they do not have the ultimate authority over payment of the claim. An example, according to one of the commenters, is an attorney at a benefit review conference who has discretion over whether to make an agreement regarding disputed issues. The commenter questions, however, whether the group will have to include the identity of the attorneys it will use and notify the Department every time that a

new attorney is used. The two commenters state that §5.6403(c)(12)(B) determines not only who must be included in a group's original business plan, but also which entities must have an individual written contract under proposed §5.6411. According to the commenters, the proposed language in §5.6403(c)(12)(B) is not clear and may result in noncompliance and arguments at examination as to which entities have "management or discretionary decision making authority." The commenters also state that these requirements will require a group to focus too much on administrative requirements rather than the payment of claims.

Agency Response: The Department agrees with these two commenters regarding the need to clarify the language in §5.6403(c)(12)(B). The Department has revised §5.6403(c)(12)(B) as adopted so that the notification, bonding, contracting, and reporting requirements of the adopted rules apply to a group's service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. Adopted §5.6403(c)(12)(A) and (B), in conjunction with adopted §5.6403(c)(7),

(8), and (13), §5.6404, §5.6408, §5.6411, and §5.6412, provide that the notification, bonding, contracting, and reporting requirements also apply to a group's service companies that are third party administrators.

§5.6403(c)(12)(D). Application for Initial Certificate of Approval: Requirements to submit a general description of the experience, qualifications, facilities, and personnel

Comment: Four commenters object to proposed §5.6403(c)(12)(D) concerning the requirement that an applicant for an initial certificate of approval provide a general description of the experience, qualifications, facilities, and personnel of a person identified pursuant to §5.6403(c)(A) or (B). One of these commenters objects to the §5.6403(c)(12) because it appears to require an applicant for a certificate of approval to include in its business plan or plan of operation a list of all employees, and pursuant to proposed §5.6404(a), to require a group to provide written notice to the Department identifying any change in the information filed under this subsection with the application for an initial certificate of approval. The commenter's reasons are the following: (i) the requirements are unrealistic and overly burdensome; and (ii) the requirements do not comply with the fair, reasonable, and appropriate standards required by HB 472 for the rules which are to augment and implement the Insurance Code Chapter 4151. The commenter states that the requirement to include a list of personnel will result in the Department being inundated with notices as employees leave for other

employment or other reasons or retire. The commenter states that this requirement places an unnecessary burden upon the group, administrator of the group, TPA, service company, and other various persons and entities. The commenter requests that proposed §5.6403(c)(12)(D) be amended to only require the group to include the names of the principal officers of the group, administrator of the group, third party administrator, as well as a general description of the experience, qualifications, and facilities of the group and third party administrator in its business plan or plan of operation, as an alternative to requiring a list of all employees of these entities. This commenter requests that the rule be amended to require the applicant to include a list of service companies and other persons or entities that provide technical or consultative services to the group in lieu of requiring a list of the personnel of these persons and entities**.** The commenter also recommends, as an alternative to requiring the business plan to include a list of all employees and to assist the Department in its auditing and enforcement activities or compliant review processes, that the rule be amended to allow Department staff to request a list of service companies and other persons or entities that provide technical or consultative services to the group or third party administrator on an as needed basis after approval of the application for a certificate of authority for the group. A second commenter states that the requirement in §5.6403(c)(12)(D) of a “general description” is unclear. The commenter states that “general description” gives no guidance on how extensive the description must be. Two other commenters support requiring

an explanation of the experience and qualifications for the contractors subject to their other comments about clearly delineating which contractors are subject to these requirements. Additionally, these two commenters ask what description of personnel is contemplated in proposed §5.6403(c)(12)(D). These two commenters question whether the group would need to notify the Department of changes in the individual adjusters of an adjusting firm and other personnel. One of the commenters suggests this requirement be clarified as to what level of detail is required.

Agency Response: The Department declines to make any change. Section 5.6403(c)(12)(D) as adopted does not require a group to include a list of all the employees of its delegated entities in its business plan or plan of operation. Section 5.6403(c)(12)(D) as adopted requires a group to include in its business plan or plan of operation a general description of the experience, qualifications, facilities, and personnel of its delegated entities. Its delegated entities include its administrator, third party administrator, if any, and service companies, if any, that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group’s electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the

Labor Code, or rules adopted thereunder. The required general description does not need to include a list of each individual staff member of a group's particular delegated entity. Rather, the description should include the key personnel of a group's delegated entity, such as its executive staff, officers, directors, or key managers. The description should also include a broad overview of the experience and qualifications of the delegated entity. This description should be general. The description does not need to include a summary of the experience and qualifications of each individual staff member of a particular entity. Rather, the description should include a general statement of the experience and qualifications of the entity's key personnel and the experience and qualifications of the entity itself. Thus, for example, notices would not have to be filed with the Department for changes in individuals who are licensed, front-line adjusters of an adjusting firm. The Department also disagrees that the requirements of §5.6403(c)(12)(D) will be overly burdensome or unrealistic because the disclosure relates to key personnel, such as executive staff, officers, directors, or key managers, rather than all personnel, and because the number and types of delegated entities subject to disclosure in the group's business plan have been narrowed as a result of changes made to §5.6403(c)(12)(B) and (C). The Department also disagrees that the requirements of §5.6403(c)(12)(D) will be burdensome or unrealistic in conjunction with the notice requirements of §5.6404 as adopted. Section 5.6404 as adopted requires a group to notify the Department: (i) of any change in the information originally filed in the group's

application for a certificate of approval, (ii) if a group retains a new delegated entity after the time of its original application and filing; and (iii) of any change in the group's manner of compliance with the Labor Code §407A.051(c) and §5.6403 as adopted. An example is: If a group identified its administrator's executive officers at the time of its original application pursuant to §5.6403(c)(12)(D) and if one of the administrator's officers resigned and a new officer was hired by the administrator as a replacement, a group would be required to notify the Department of that change pursuant to adopted §5.6404. However, if the administrator's staff member resigned, a group would not be required to notify the Department of that change under adopted §5.6404 because it did not affect one of the key personnel of the administrator. The Labor Code §407A.051(d) requires a group to notify the Commissioner of any change in (i) the information required to be filed under the Labor Code §407A.051(c) or the manner of the group's compliance with the Labor Code §407A.051(c). Sections 5.6403(c)(12)(D) and §5.6404 as adopted are consistent with these statutory requirements.

§5.6403(e). Application for Initial Certificate of Approval: Biographical affidavit

Comment: One commenter suggests using a term other than "substantially accurate" with regard to the fitness of a particular affiant to participate in running a workers' compensation self insurance group. The commenter questions the

use of the term "substantially accurate" and states that someone with absolutely no qualifications to run a group could submit a substantially accurate (truthful) affidavit. According to the commenter, the term should better capture the willingness of the Department to rely on older biographical affidavits when those affidavits demonstrate what the Department deems to be a high degree of fitness.

Agency Response: The Department declines to make the suggested change. The Department believes that the term "substantially accurate" is the proper term because it refers to situations where the Department may elect to rely on a biographical affidavit that is already on file with the Department and a new biographical affidavit is not required. Section §5.6403(e) as adopted provides that a new biographical affidavit is not required to be filed with an application for a certificate of approval if a biographical affidavit has been filed with the Department within the three prior years and contains substantially accurate information. A biographical affidavit on file with the Department will not qualify under §5.6403(e) if it fails to contain substantially accurate information; a new biographical affidavit will be required to be filed under §5.6403(e). Whether an existing biographical affidavit on file contains substantially accurate information, and whether the biographical affidavit reflects that a person is fit to run a group are two different issues. The Department will review each of these biographical affidavits to ensure not only that the originally submitted information remains accurate, but that the originally submitted information indicates sufficient

experience, ability, standing, and good record to make success of the particular group in question probable. While a biographical affidavit already on file with the Department may continue to contain truthful information, the Department will not accept it without further reviewing it to ensure that the person is qualified to be involved with the particular group in question. Thus, the Department does not agree that someone with absolutely no qualifications to run a group could submit a substantially accurate (truthful) affidavit that will be acceptable to the Department because the Department will also require that such biographical affidavit reflect that the person have the sufficient experience, ability, standing, and good record to successfully operate the group.

Comment: One commenter suggests specifying what form of affidavit must be used.

Agency Response: The form of the affidavit is adopted by reference pursuant to §7.1604(b)(1)(C). Proposed §5.6403(e) has been revised in this adoption to specify that the biographical affidavit must be completed in accordance with §7.1604(b)(1)(C).

§5.6403(h). Application for Initial Certificate of Approval: Other relevant information

Comment: A commenter requests that the statutory reasonableness requirement in the Labor Code §407A.051(b)(7) be inserted in proposed

§5.6403(h) to reflect the Legislature's intent that such requests for information are subject to certain limits.

Agency Response: The Department agrees and adopted §5.6403(h) reads: "Pursuant to the Labor Code §407A.051(b)(7), the commissioner may require the submission of any other relevant information reasonably required to determine whether to approve or disapprove an application for a certificate of approval."

§5.6404. Notification to the Department and Responsibility for Continued Compliance.

Comment: Two commenters object to the written notice of change requirement in proposed §5.6404(a) and recommend changes in the proposed requirements. These two commenters specifically object to the requirement to provide notice when there are personnel changes and requests that the requirement be revised to eliminate this requirement. According to one commenter, this requirement appears to include any changes in personnel of the group, administrator of the group, third party administrator, service company, and persons and entities that provide various services to the group or its third party administrator. The commenter states that such a requirement is overly burdensome and does not comply with the fair, reasonable, and appropriate standards required by HB 472 for the rules to augment and implement the Insurance Code Chapter 4151. According to this commenter, this is a very unrealistic and unreasonable rule requirement. This commenter also states that the requirement in §5.6404(a) to

include a list of personnel will result in the Department being inundated with notices as employees leave for other employment or other reasons or retire. The commenter states that this requirement places an unnecessary burden upon the group, administrator of the group, third party administrator, service company, and other various persons and entities that provide services to a group or its third party administrator. The second commenter recommends qualifying the §5.6404 notification requirement by requiring a group to notify the Department of material changes to the information provided. According to the commenter, this would balance getting relevant information that could alert the Department to potential problems with the group and not add unnecessary burden on a group or the Department. According to the commenter, §5.6404 (a) and (b) generally reflect the statutory language, but the broad nature of these requirements may be a substantial burden on both the Department and the group without providing the Department useful information in terms of potential problems with a group. The commenter states that the Department could be inundated with notices of inconsequential changes in this information, raising the concern that important changes could get lost. The commenter further states that, if the group fails to send in any and all information, regardless of its impact on the administration or solvency of a group, the group could be penalized for the failure to report that information. The commenter states that, as a group matures and gets further away in time from its initial application, these subsections will require almost constant reporting to the Department, producing unnecessary work for the group

and useless information that the Department must review. The commenter states that the goal of early warning signs of potential problems with a group would be better served if the rule required substantive information, such as membership losses and gains, classification codes written, or loss ratios to be provided to the Department on a regular basis rather than requiring the group to constantly monitor the information provided in the original application to see if any detail has changed.

Agency Response: The Department declines to make any of the requested changes. The Department disagrees that the requirement that the §5.6404 notice include changes in the list of the employees filed pursuant to §5.6403 is unreasonable and that the requirement does not comply with the fair, reasonable, and appropriate standards required by HB 472 for the rules to augment and implement the Insurance Code Chapter 4151. Section 5.6404 as adopted without changes to the proposal is consistent with the statutory requirements in Labor Code §407A.051(c) and (d). Section 5.6404(a) requires a group to notify the Department: (i) of any change in the information originally filed in the group's application for a certificate of authority, (ii) if a group retains a new delegated entity after the time of its original application and filing; and (iii) of any change in the group's manner of compliance with the Labor Code §407A.051(c) and §5.6403 as adopted. The Labor Code §407A.051(d) requires a group to notify the Commissioner of any change in (i) the information required to be filed under the Labor Code §407A.051(c) or (ii) the manner of the group's compliance with

the Labor Code §407A.051(c). The notification requirements serve the purpose of informing the Department when changes have occurred to a group's operations, business model, or financial condition and health. The notification process allows the Department to monitor a group's compliance with the requirements of the Labor Code §407A.051(c) and to identify potentially hazardous conditions to a group before an insolvency becomes imminent, at which time it may be too late for the Department to effectively take proactive and corrective action to protect the interests of the public. Further, revised §5.6403(c)(12)(B) as adopted, in conjunction with §5.6403(c)(12)(A), clarify which of a group's service companies are subject to the notification requirements in §5.6404, the bonding requirements in §5.6403(c)(7), (8) and §5.6408, the contracting requirements in §5.6411, and the reporting requirements in §5.6412. The Department anticipates that §5.6403(c)(12)(B) as adopted could reduce certain regulatory filing requirements under §5.6404(a) and (b).

Comment: One commenter requests that §5.6404(c) reference only subsection (a) of §407A.355 of the Labor Code. This commenter also requests that the Department determine specific key pieces of information that reflect potential financial problems and require those to be reported. The commenter states that the real substance of this subsection is to gather early warnings of potential problems that would affect solvency, which is defined in subsection (a) of §407A.355. The commenter states that subsection (b) of §407A.355 provides what steps should be taken if those conditions arise. The commenter states that,

while the commenter agrees with the purpose of proposed §5.6404(c), which is to get an early warning of potential financial problems, the language is vague and may not provide information that would serve that purpose. The commenter states that too much information may be provided, running the risk of important information getting lost in the midst of irrelevant information. The commenter states that the kind of information required to be reported under this subsection should be specific and relevant to solvency issues. Additionally, the commenter states that the proposed language that the group report "any event, series of events, or negative trend that may affect the group's ability to continue as a viable group" does not provide adequate guidance to a group as to its responsibilities and could result in arguments during an examination as to whether a specific set of events was a "negative trend".

Agency Response: The Department declines to make the suggested changes. The Department agrees that §5.6404(c) should only reference information related to early warnings of potential problems that could affect solvency. However, the Department's position is that §5.6404(c) as adopted achieves this objective. Making the changes requested by the commenter would have the effect of limiting the early warning information that would be required to be reported to the Department under §5.6404(c), thus limiting the intended usefulness of the reporting requirement. In addition to the enumerated factors in the Labor Code §407A.355(a), the Department believes that the Labor Code §407A.355(b) provides significant guidance in determining early warning signs of a group's

potential financial problems. The Labor Code §407A.355(b) states: “[i]f the assets of a group are at any time insufficient to enable the group to discharge its legal liabilities and other obligations and to maintain the reserves required under this chapter.” Also, the Department considers the early warning factors enumerated in the Labor Code §407A.355(a) and (b) and any event, series of events, or negative trend that may affect the group's ability to continue as a viable group to be sufficient information that will reflect any potential financial problems of a group. It is not possible or feasible to determine specific key pieces of information that reflect potential financial problems because the factors and circumstances that can determine whether a group is viable or not are wide-ranging and broad. The notification process allows the Department to monitor a group’s compliance with the requirements of the Labor Code §407A.051(c) and to identify potentially hazardous conditions to a group before an insolvency becomes imminent, at which time it may be too late for the Department to effectively take proactive and corrective action to protect the interests of the public.

Comment: One commenter recommends that proposed §5.6404(e) be deleted because revocation is provided for in the statute and this does not add to protection of solvency. The commenter asks what will happen if a group does not maintain "the qualifications necessary to obtain a certificate of approval.” The commenter asks if this will result in the revocation of the group’s certificate. The commenter states that the Labor Code §407A.404 provides for the revocation of

a certificate of approval and that compliance with all of the initial qualifications is not enumerated in that section. The commenter states that, under the rule as proposed, some of the initial qualifications could close down an otherwise viable group. The commenter provides the following example. To be certified initially, the net worth of the initial members must be at least $2 million. Once a group is established, the relevant financial marker is the assets of the group, not the net worth of its members. The group could have $5 million in assets with only $2 million in ultimate liabilities but be forced to shut down if at any given time the net worth of its members falls below $2 million. The commenter states that this does not add value to the oversight or solvency of a group.

Agency Response: The Department declines to make the recommended change. The Department disagrees that §5.6404(e) as adopted does not add value to the oversight or solvency of a group. Section 5.6404(e) as adopted requires a group that obtains a certificate of approval to maintain the qualifications that were necessary to obtain the initial certificate of approval issued under the Labor Code Chapter 407A at all times. Section 5.6404(e) clarifies that a group that is issued a certificate of approval based upon meeting the qualifications necessary to obtain a certificate of approval cannot cease to meet those qualifications after the certificate of approval is issued. The Labor Code §407A.051(d)(2) provides that not later than the 30th day after the effective date of the change, a group shall notify the commissioner of any change in: (i) the information required to be filed under Subsection (c); or (ii) the manner of the

group's compliance with subsection (c). Additionally, under the Labor Code §407A.404, the Commissioner may revoke a group's certificate of approval if, after notice an opportunity for a hearing, the group: (i) is found to be insolvent; (ii) fails to pay a tax, assessment, or special fund contribution imposed on the group; or (iii) fails to comply in a timely manner with Chapter 407A, a rule adopted under Chapter 407A, or an order of the Commissioner. After notice and the opportunity for a hearing, the Commissioner also may take action to impose a fine against a group, pursuant to the Labor Code §407A.402, or to issue an order requiring a group to cease and desist from engaging in any act or practice found to be in violation of Chapter 407A or a rule adopted under Chapter 407A, pursuant to the Labor Code §407A.403. Additionally, if the Commissioner determines that the group is in a hazardous financial condition, the Commissioner also may take any action as provided by the Labor Code §407A.355 and the Insurance Code Chapter 441. The Commissioner has the discretion to determine what, if any, action to take against a group that violates Chapter 407A or a rule adopted thereunder. Thus, if a group fails to comply in a timely manner with Chapter 407A, including maintaining the qualifications necessary to obtain a certificate of approval issued under Chapter 407A, the Commissioner has the authority and discretion to take regulatory action under the Labor Code Chapter 407A, including, but not limited to imposition of penalties.

Comment: A commenter requests that proposed §5.6404(e) be withdrawn. The commenter states that there is nothing wrong with the proposed rule as written; it seems to call only for a group to continue to have the qualifications it had when it obtains its certificate of approval. However, the commenter questions whether the rule is being promulgated in an attempt to formalize a misguided interpretation of the statute. Specifically, the commenter refers to the Labor Code's security requirement in connection with a group's initial application in the Labor Code §407A.053. The commenter states that there is nothing in the statute that requires a group periodically to adjust its security amount either up or down. The commenter states that if the Legislature had wanted to require changes in the statutory deposit for groups depending upon changes in the liabilities of the group, it could have made such changes a pre-condition to renewal, as it did with excess insurance requirements. The commenter also states that the Legislature could have specified a certain deposit level for the commencement of operations with different levels required in future years, as it did with premium requirements. The commenter further states that because the Legislature did not do either of these things, adjustments are not required. The commenter states that if the Department has not expressly or impliedly been given the power to require adjustments of the deposit, it cannot do so.

Agency Response: The Department disagrees with the commenter’s interpretation of proposed §5.6404(e) and the Labor Code Chapter 407A and declines to withdraw proposed §5.6404(e). The Labor Code 407A.053(c)

requires a group to post security in the form and amount prescribed by the Commissioner, equal to the greater of $300,000 or 25 percent of the group's total incurred liabilities for workers' compensation. The Labor Code §407A.053 contemplates that the amount of a group's security is risk-based, since an amount equal to 25 percent of the group's total incurred liabilities for workers' compensation will change in proportion with changes in these liabilities, and must be adjusted upward as a group's liabilities increase. The Labor Code §407A.051(c)(2) provides that one of the requirements for a group to be qualified and issued a certificate of approval is proof of compliance with the financial requirements under the Insurance Code §407A.053. Under the Labor Code §407A.051(d), a group is required to notify the Commissioner of any change in (i) the information required to be filed under the Labor Code §407A.051(c) or (ii) the manner of the group's compliance with the Labor Code §407A.051(c). Thus, a group is required to continue to meet the security requirements specified in the Labor Code §407A.053, including increasing the deposit to match the current amount of TCT's current workers' compensation-related liabilities. Section 5.6404(e) is consistent with these statutory requirements. Further, at the point of initial licensure, a group always has zero incurred liabilities for workers' compensation. Thus, the amount of the group's security at initial licensure would never be greater than $300,000. If the security can never be adjusted upward after licensure, it renders the Labor Code §407A.053(c) meaningless. Section 407A.053(c) contemplates that the group's security could be "greater" than

$300,000 based upon 25 percent of the group's total incurred liabilities for workers' compensation.

§5.6408(a). Fidelity and Performance Bonds

Comment: A commenter objects to proposed §5.6408(a) because it does not provide that the required fidelity bond protect against loss caused directly by an act of fraud or dishonesty by the administrator's or service company's employees and does not provide that the bond include the group as a loss payee. The commenter recommends that proposed §5.6408(a) be changed as follows: "Fidelity bonds required of an administrator under the Labor Code §407A.051(c)(12) and a service company under the Labor Code §407A.051(c)(13) must protect against *loss caused directly by* an act of fraud or dishonesty by *the employees of* the administrator or service company*, and such fidelity bond shall include the group as a loss payee* [in exercising its powers and duties as an administrator or service company and shall be made payable to the group]." According to the commenter, the coverage specified in the proposal is likely not available because it exceeds the type of risks that can effectively be underwritten and covered by a fidelity bond. The commenter states that a fidelity bond does not provide coverage for losses caused by the dishonesty of the business itself or the dishonesty of those that control the business. According to the commenter, a fidelity bond is primarily for the benefit of the named insured, the administrator, or service company, and protects the named insured against

loss incurred by the insured. The commenter states that a workers' compensation self insurance group is protected indirectly in the sense that if an employee of an administrator or service company stole funds, the group could make a claim and use the proceeds of the claim to reimburse the group. By requiring the fidelity bond to be “payable to the group,” the proceeds of the claim could be paid to the group under a “loss payee” rider.

Agency Response: The Department agrees with the requested change and §5.6408(a) as adopted has been changed accordingly. Also, references to the fidelity bond requirements of §5.6403(c)(6) and (7) have been added to §5.6408(a) as adopted.

§5.6408(e). Fidelity and Performance Bonds

Comment: One commenter requests clarification on what happens after an administrator or service company reports to the Department and the group that it has lost its fidelity bond. The commenter questions if the administrator or service company must be suspended or if the group must find a new administrator.

Agency Response: The rules do not specifically address what must occur after an administrator or service company reports to the Department and the group that it has lost its fidelity bond. The Department declines to specify prescribed actions that must take place in such an event. Rather, the Department expects a group in such a situation to act prudently for its own protection and to take whatever remedial or corrective actions are necessary to remedy the situation as

quickly as possible. In general, the Department anticipates reviewing such instances that may occur in the future on a case-by-case basis. However, the Department notes that failure to meet the fidelity bond requirements would be considered a violation of Chapter 407A of the Labor Code and could subject a group to regulatory action, including possible disciplinary action under the Labor Code, Chapter 407A, Subchapter I.

§5.6411. Contract Provisions

Comment: Two commenters object to proposed §5.6411(a) and (b) because the qualifier in §5.6403(c)(12)(B) for which vendors will require a written agreement is vague. Both commenters request that §5.6411(a) and (b), in addition to §5.6403(c)(12)(B), be limited to persons handling member contributions and distributions and with ultimate authority over claims. According to one of the commenters, at best, proposed §5.6411(a) and (b) and proposed §5.6403(c)(12)(B) do not provide sufficient direction as to when a contract is required, and at worst, it will result in a group focusing on written agreements with any and all persons that touch the business of the group, creating unnecessary administrative burdens. The second commenter states that the qualifier for which vendors will require a written agreement is vague and does not provide sufficient direction as to when a contract is required. The commenter states that this could result in a group focusing on compliant written agreements with any and all persons that touch the business of a group, a result which is

burdensome and to which many vendors may not be amenable, thus limiting choices of the group and its administrator to obtain the most efficient and cost effective service. Another commenter states that the definition of "service company" will also control who must comply with the contracting requirements of proposed §5.6411. The commenter states that the definition of “service company” includes many persons who may not even suspect that the definition and resulting contracting requirements apply to them.

Agency Response: The Department agrees and has revised §5.6403(c)(12)(B) as adopted in order to specify the parties that are subject to the contracting requirements of §5.6411(a) and (b) as adopted. The revisions to §5.6403(c)(12)(B) as adopted, in conjunction with §5.6403(c)(12)(A) and §5.6411(a) and (b) as adopted, specify that the contracting requirements that apply to a group’s administrator, to third party administrators, or to any service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group’s electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. The Department also revised §5.6411(b) to clarify the contracting requirements applicable to

subcontractors and for consistency with the changes made to the proposed language in §5.6403(c)(12)(B).

Comment: A commenter requests that proposed §5.6411(d)(1) be withdrawn because, according to the commenter, it is pointless. The commenter states that the groups are already required to abide by the laws of the State of Texas and rules promulgated by the Department. According to the commenter, requiring groups to execute statements that they will do so with regard to any portion of the rules does not enhance either the ability of the Department to enforce its rules or the responsibility of a group to follow them. The commenter states it is simply another piece of paper in what is already an extensive set of regulations.

Agency Response: The Department disagrees with the commenter's interpretation of the purpose of §5.6411(d) and declines to delete §5.6411(d)(1). Entities or individuals acting as the administrator, a third party administrator, or a service company for a group may provide functions or services requiring compliance with various provisions of the Insurance Code or Labor Code and obtaining various licenses from the Department. In order to ensure that these entities and individuals operate in a legal and proper manner, it is essential that these entities and individuals understand and agree to comply with the relevant statutory and regulatory requirements related to these functions or services. The purpose of §5.6411(d)(1) is to better ensure that any administrator, service company, or third party administrator that a group is required to contract with under §5.6411(a) or (b) understands, acknowledges and agrees to comply with

the applicable requirements of the Insurance Code and Labor Code and rules adopted thereunder, including holding the appropriate licenses or certificates of authority under the Insurance Code or the Labor Code.

§5.6412. Operational Review Plan

Comment: A commenter states that the definition of "service company" will control who must comply with the quarterly reporting requirements of proposed §5.6412. The commenter states that the definition of “service company” includes many persons who may not even suspect that the definition and resulting reporting requirements apply to them.

Agency Response: The Department agrees that a group should have clarity with regard to the specific service companies that the group will be required to exercise oversight over pursuant to §5.6412. Those service companies are identified in §5.6403(c)(12)(A) and (B). Section 5.6403(c)(12)(B) as adopted is revised to provide that the quarterly reporting requirements of §5.6412 apply to a group’s service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group’s electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for

under the Insurance Code, the Labor Code, or rules adopted thereunder. Section 5.6403(c)(12)(A) as adopted further provides that the quarterly reporting requirements of §5.6412 as adopted apply to a group's service companies that are third party administrators.

Comment: One commenter objects to the quarterly reporting requirement in proposed §5.6412(b)(1) and suggests that the projections be on an annual basis with quarterly reporting for monitoring. The commenter expresses concern that the required quarterly reporting could become "an end in itself rather than a tool, leading to a board being forced to filter through and respond to information which may be irrelevant to monitoring the sound operation of their fund." The commenter suggests deleting "each quarter of" in (b)(1) and inserting in (b)(3) "if any" between "provide for corrective action" and "as determined by the board." According to the commenter, an example is subsection (b)(1), which requires the group to receive estimated projections for each quarter of the upcoming year. Subsection (b)(3) then requires the board to determine corrective action if the performance does not meet projections. The commenter states that quarterly projections are not meaningful in relation to the small size of most groups, and no corrective action may be needed.

Agency Response: The Department declines to make the requested changes. A primary purpose of §5.6412 is to provide a means to conduct effective oversight of a group, including overseeing those functions of a group performed by any person required to enter into a written agreement pursuant to §5.6411(a)

or (b). The Department's position is that quarterly oversight is a prudent business practice that is typically conducted by conservatively run business enterprises in order to timely identify issues that may generate substantial concerns and allow corrective action to be promptly implemented. Quarterly projections are needed for a group to conduct effective quarterly oversight. Review of the quarterly projections will enable a group to better assess its abilities to meet its obligations under the Labor Code, the Insurance Code, and regulations adopted thereunder. Additionally, quarterly review will enable a group to foresee potential financial problems or solvency issues at an earlier date, so that corrective action can be taken immediately. Adopted §5.6412(a) allows a group to exercise discretion in developing an operation review plan that meets its needs. The group is also given discretion in the development of the quarterly projections, subject to the requirements of §5.6412(a). Finally, the group is given discretion in determining what corrective action if any is necessary pursuant to §5.6412(b)(3) as adopted.

General

Comment: One commenter expresses support for the Department's attempt to clarify regulatory issues that have arisen over the last couple of years. Another commenter states support for the need for rules to regulate third-party administrators who manage and adjust workers' compensation claims.

Agency Response: The Department appreciates the comments.

Comment: A commenter states that more clarity as to the responsibilities of the groups will ensure better and more consistent compliance with existing law and regulations. The commenter states it shares the Department's goal of having mechanisms in place to allow early detection of potential financial problems with a group. The commenter further states that these goals have to be balanced with allowing existing groups and the group self-insurance market to be successful and provide a stable and affordable workers' compensation option for Texas small and mid-sized employers.

Agency Response: The Department agrees that clarifying the responsibilities of groups and their delegated entities under the Labor Code Chapter 407A and the adopted rules should ensure more efficient regulation and better industry compliance. The goal of the adopted rules is to better regulate the solvency and financial stability of groups, to ensure that workers' compensation benefits are available on a timely basis, to require appropriate oversight over a group's delegated entities, and to prevent solvency and mismanagement issues similar to those recently experienced in other states' workers' compensation self-insurance group markets from occurring in Texas.

Comment: A commenter states that additional regulations should be narrowly focused on addressing a specific problem not already addressed by rule or to clarify existing rules and the law applicable to groups. The commenter further states that any additional requirements that do not address a specific issue or do not address the issue in the least burdensome way will divert money and

attention from paying claims and into administration. The commenter states that forcing unnecessary focus on administration could result in less attention to the main purpose of paying claims appropriately and may make groups less competitive and successful, which in turn will slow growth and possibly endanger the survival of the group and impact the Texas Self-Insurance Group Guaranty Fund. The commenter states that absent a known specific problem that is narrowly addressed, the commenter recommends not adding more burdens to the groups or the Department.

Agency Response: The Department disagrees that the adopted rules do not address specific issues affecting groups and their delegated entities. Consistent with the statutory requirements in the Labor Code §407A.001, §407A.002, §407A.005, §407A.008, §407A.009, §407A.051, §407A.052, §407A.053, §407A.054, §407A.056, §407A.057, §407A.201, §407A.252, §407A.355, and §407A.455, the adopted rules strengthen the viability of groups, the Texas Self-Insurance Group Guaranty Fund, and the overall workers' compensation system by augmenting groups' solvency and financial requirements, requiring necessary oversight of groups' delegated entities, ensuring that workers' compensation benefits are available on a timely basis, and by detecting groups' potential hazardous financial conditions at an earlier point in time.

Comment: Two commenters raised issues with the Department's statutory authority to adopt portions of the proposed rules and objected to the applicability of these portions of the proposed rules to workers' compensation self-insurance

groups. Both commenters assert that to the extent that these rules apply provisions in the Insurance Code Chapter 4151 required of insurers to groups, the rules are contrary to HB 472. According to one commenter, an amendment made in a Senate Committee to HB 472 very specifically took groups out of the oversight, audit, and other requirements for insurers. The commenter opined that, while the Department has broad rulemaking authority under the Labor Code Chapter 407A, groups are not insurers. The commenter states that rules must not be contrary to the legislative intent to not treat groups as insurers and that groups not be required to comply with the detailed requirements for insurers. The other commenter states that an amendment in the Senate State Affairs Committee specifically excluded groups from these requirements. The commenter states that its interest is parallel to the Department's interest regarding solvency of groups, but some of the proposed regulations arguably go beyond the Department's statutory authority and may not be the most effective and efficient means of alerting the group or the Department to potential solvency issues.

Agency Response: The Department disagrees that the adopted rules exceed the Department’s rule-making authority to adopt rules. The Department further disagrees that it is applying provisions of the Insurance Code Chapter 4151 required of insurers to groups and thus is acting contrary to the legislative intent in enacting HB 472 as relates to the regulation of groups. The Department proposed and adopted the rules under the authority in the Labor Code Chapter

407A, and not under the authority in the Insurance Code Chapter 4151. Specifically, the amendments and new sections were proposed and adopted under the Labor Code §§407A.001, 407A.002, 407A.005, 407A.008, 407A.009, 407A.051, 407A.052, 407A.054, 407A.056, 407A.057, 407A.201, 407A.252, 407A.355, 407A.455, and the Insurance Code §36.001. In pertinent part, the Labor Code §407A.051(e) specifically requires the Commissioner to evaluate the financial information provided with the application for a certificate of approval as necessary to ensure that the funding is sufficient to cover expected losses and expenses and that the funds necessary to pay workers' compensation benefits will be available on a timely basis. Further, the Labor Code §407A.252 provides that the Commissioner shall examine the financial condition of each group to determine the group's ability to meet the group's obligations under the Labor Code Title 5 Subtitle A. Additionally, the Labor Code §407A.252 provides that the Commissioner shall have full access to the records, officers, agents, and employees of a group as necessary to complete an examination under the Labor Code §407A.252. The Labor Code §407A.355 provides that if the Commissioner determines that the group is in a hazardous financial condition, the Commissioner may take action as provided by the Insurance Code Article 21.28-A (enacted without substantive change by the Texas Legislature as the Insurance Code Chapter 443). The Department also is granted rulemaking authority in the Labor Code §407A.008 to implement the Labor Code Chapter 407A. Consistent with this rulemaking authority, the adopted rules strengthen

the viability of groups, the Texas Self-Insurance Group Guaranty Fund, and the overall workers' compensation system by (i) in §5.6405, §5.6411 and §5.6412, augmenting groups' solvency and financial requirements, (ii) in §5.6411 and §5.6412, requiring necessary operational review of groups' delegated entities, (iii) in §5.6404, §5.6405, §5.6411 and §5.6412, ensuring that workers' compensation benefits are available on a timely basis, and (iv) in §5.6404, §5.6411 and §5.6412, by earlier detecting a group's potential hazardous financial conditions. All of these regulations are appropriate exercises of the Department's regulatory authority under the Labor Code Chapter 407A and consistent with the statutory provisions of the Labor Code Chapter 407A and the Insurance Code Chapter 4151. Further, the Department has proposed a completely separate set of rules to implement the provisions of the Insurance Code Chapter 4151 as amended by HB 472. These proposed rules were published in the *Texas Register* on December 5, 2008. Consistent with the statutory provisions of the Insurance Code Chapter 4151, this separate set of rules apply the provisions of the Chapter 4151, as amended by HB 472, to insurers but do not apply these provisions to groups.

Comment: A commenter states that since each of the rules can be the basis for a violation in an examination, it is important that the rules be clear on what the responsibilities are and how those should be carried out.

Agency Response: The Department agrees and believes that the adopted rules achieve this. In part, the Department believes this is achieved as a result of

changes made in response to other comments. Specifically, the Department has revised §5.6403(c)(12)(B) as proposed with respect to a group's service companies. Adopted §5.6403(c)(12)(B), in conjunction with adopted §5.6403(c)(7), (8), (12)(A), and (13), §5.6404, §5.6408. §5.6411, and §5.6412, provide that the notification, bonding, contracting, and reporting requirements only apply to a group's service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder.

Comment: A commenter states that some of the provisions in the rules may be appropriate for entities handling money and processing claims but not necessary for other entities. The commenter states that, for example, the rules allow the Commissioner to examine solvency of a person with "management or discretionary decision making authority" under contract with a group.

Agency Response: The Department agrees that some of the provisions may be appropriate for certain service companies and not for other service companies. In response to comments, the Department has revised §5.6403(c)(12)(B) as

adopted so that the notification, bonding, contracting, and reporting requirements of the adopted rules apply only to service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. These changes have the effect of narrowing the number and types of service companies subject to examination by the Commissioner under §5.6411(d)(2).

Comment: One commenter states that the proposed rules raise questions about the intent of Department staff with regard to the regulation of third-party administrators for self-insured employers and other entities or individuals who provide specific services to a group or a group's third-party administrator. The commenter states that the rules should not treat or classify entities or individuals who provide specific services to a group or the group's third-party administrator as a managing company, administrator, or service company for the purposes of the Labor Code Chapter 407A and the Insurance Code Chapter 4151. According to the commenter, HB 472 requires the rules adopted by the Commissioner to be fair, reasonable, and appropriate to augment and implement the Insurance Code

§4151.006. The commenter states that the Legislature did not intend for rules adopted to implement the Insurance Code Chapter 4151 to subject entities or individuals to dual regulation or subject them to regulation that creates an unreasonable burden. The commenter states that Department staff may not understand how workers' compensation claims are adjusted and managed. The commenter states that Department staff may not be aware of the fact that the entities or individuals who provide specific services to insurers and third-party administrators are already regulated by the Division of Workers' Compensation and that many of these entities are already certified by the Department under other provisions of the Insurance Code and Department rules.

Agency Response: The intent of the rules is to regulate groups and their relationships with administrators and other entities or individuals who provide specific services to a group or a group's administrator in accordance with the Labor Code Chapter 407A and the Insurance Code Chapter 4151. The rules, which are consistent with the statutory scheme, treat or classify entities or individuals who provide specific services to a group or the administrator as a managing company, administrator, or service company in accordance with the Labor Code Chapter 407A and the Insurance Code Chapter 4151. The rules do not subject any persons to dual regulation. Pursuant to the Labor Code Chapter §407A and adopted new §5.6402, a person who is engaged by the board of trustees of a group under the Labor Code Chapter 407A to implement the policies established by the board of trustees and to provide day-to-day

management of the group is subject to the requirements of the Labor Code Chapter 407A and Department rules, as those requirements relate to administrators. Pursuant to the Labor Code Chapter §407A and adopted new §5.6402, a person who provides services to a group, other than those services provided by the administrator of the group, is subject to the requirements of the Labor Code Chapter 407A and Department rules, as those requirements relate to service companies. Pursuant to the Labor Code §407A.009, a person acting as an administrator as defined in the Insurance Code Chapter 4151 is subject to the requirements of the Insurance Code Chapter 4151 and Department rules, as those requirements relate to Chapter 4151 administrators. Therefore, one person may be simultaneously subject to the requirements of several provisions of the Insurance Code, the Labor Code, or rules adopted thereunder if the functions or services performed or offered by that person require such regulation. In the event that a person performs or offers several functions or services on behalf of a group that require regulation under different provisions of the Insurance Code, Labor Code, or rules adopted thereunder, that person will be required to hold all appropriate authorizations and comply with all applicable statutes and rules in order to perform or offer the regulated functions and services. This is because a single authorization issued pursuant to the Insurance Code or the Labor Code does not authorize a person to perform or offer any additional regulated functions or services than those specified by the authorization. Each authorization relates to specific functions or services

regulated under specific Insurance Code or Labor Code provisions. Therefore, a person must hold the applicable authorizations in order to perform or offer the corresponding regulated functions or services.

Comment: One commenter requests that the proposed rules be clarified to specifically exempt from regulation 19 persons and entities specified in the Insurance Code §4151.002 that are exempted by the Insurance Code §4151.002 from the provisions of Chapter 4151. The commenter states that the Commissioner does not have the statutory authority to adopt rules that would result in the dual regulation of these persons. The commenter also requests that the Department acknowledge in either the adopted rules or the adoption preamble that these persons are not third party administrators or service companies and are not subject to the requirement set forth in the proposed rules to obtain a certificate of authority or report any data other than that required under other provisions of the Insurance Code and associated rules and the Labor Code and associated rules. The commenter states the following to support the commenter's requests: (i) the Insurance Code §4151.002 identifies persons and entities that are exempted from the provisions of Chapter 4151; (ii) there are 19 examples of various persons with whom groups or third-party administrators contract for services; (iii) none of the 19 persons collect premiums or contributions from or adjust or settle claims on behalf of a group; (iv) each of the 19 persons provide services to a group or third-party administrator that are advisory or technical in nature and do not constitute the adjusting or settling of a

claim; (v) the group or third-party administrator retains decision-making for resolving disputed claims issues in benefit disputes, determining whether or not a medical bill is to be paid or denied, and determining whether or not health care presented for pre-authorization is approved; (vi) the Labor Code and associated rules regulate these activities and provide for enforcement of the associated rules; (vii) the insurer or group is responsible for any violation of Division of Workers' Compensation rules as they relate to the payment of benefits; (viii) these 19 persons are directly regulated by either the Department or the Division of Workers' Compensation under another section of the Insurance Code and related rules or the Labor Code and related rules; and (ix) the Division of Workers' Compensation's enforcement authority and authority to impose a financial penalty on an insurer, group, third party administrator, or attorney representing an insurer or group adequately provides for the regulation of such persons.

Agency Response: The Department disagrees that the proposed rules need to be clarified to specifically exempt from regulation the persons and entities exempted from regulation under the Insurance Code Chapter 4151 as provided in §4151.002. The adopted rules do not address the applicability of the exemptions contained in the Insurance Code Chapter 4151, nor do they interpret the requirements of that chapter. This is not necessary or appropriate for these adopted rules. The purpose of the adopted rules is to regulate groups and their relationships with third-party administrators and other entities or individuals who

provide specific services to a group or a group's third-party administrator in accordance with the Labor Code Chapter 407A and the Insurance Code Chapter 4151. These adopted rules do not address the applicability of the Insurance Code Chapter 4151. The applicability of the Insurance Code Chapter 4151 is addressed in the rules that implement Chapter 4151, which are in Chapter 7, Subchapter P of Title 28 of the Texas Administrative Code. The rules in this adoption define a “service company” under the Labor Code Chapter 407A as “a person that directly or indirectly provides services to or on behalf of a group, other than the services provided by an administrator, including, but not limited to: (i) claims adjustment; (ii) safety engineering; (iii) compilation of statistics and the preparation of premium, loss, and tax reports; (iv) preparation of other required self-insurance reports; (v) development of members’ assessments and fees; and (vi) administration of a claim fund. However, in response to other comments, the Department has revised §5.6403(c)(12)(B) as proposed with respect to a group’s service companies. Adopted §5.6403(c)(12)(B), in conjunction with adopted §5.6403(c)(7), (8), (12)(A), and (13), §5.6404, §5.6408. §5.6411, and §5.6412, provide that the notification, bonding, contracting, and reporting requirements only apply to a group’s service companies that are third-party administrators or that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational

documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder.

Comment: Three commenters assert that the Legislature never intended for the rules adopted to implement the provisions of the Insurance Code Chapter 4151 to include an attorney or law firm as a party regulated as a third-party administrator or service company. All three commenters assert that lawyers and their law firms are regulated by the Supreme Court of Texas and the State Bar of Texas. Therefore, law firms should not be subject to the proposed rules. Two of the commenters assert that the regulation of lawyers under the proposed rules would violate the Texas Constitution, Section I, Article II. According to one commenter, any attempt by the Department to impose a licensure obligation on law firms would impinge upon the authority of the Texas Supreme Court and the State Bar of Texas to regulate the practice of law. According to two commenters, the Insurance Code Chapter 4151 was the Legislature's action to give the Department the authority to regulate third-party administrators who were not subject to regulation by any other agency. One commenter states that the background and purpose of the bill, as described in the bill analysis in CSHB 472, makes this point clear. The commenter states that a common thread running throughout the Insurance Code Chapter 4151 is the Legislature's attempt to enlarge the Department's regulatory authority without impinging upon other

regulatory schemes. Two commenters cite the example that the statute provides an exemption for licensed adjusters but not for their adjusting companies. One commenter states that at first glance, there appears to be parallel regulatory intent with regard to attorneys. The commenter states that the statute contains an express exemption for licensed attorneys, but not for law firms comprised of licensed attorneys. The commenter asserts that any attempt to include law firms in the group of organizations requiring licensure under Chapter 4151 carries separation of powers concerns and would be unconstitutional under the Texas Constitution, Section I, Article II. According to this commenter, there is a 1999 Texas Supreme Court case to support the principle that regulation of attorneys and the firms in which they organize is the responsibility of the Supreme Court of Texas and the State Bar of Texas. The commenter expresses doubt regarding whether an express legislative grant of licensure authority to an administrative agency with regard to licensure of law firms would be constitutional. The commenter further states that the Legislature has not expressly delegated such licensure authority to the Department. The commenter also states that semi-annual audits and on-site examinations by the Commissioner would be administratively difficult, if not impossible, to implement and might run afoul of the attorney-client privilege.

Agency Response: The proposal does not address the regulation of law firms under the Insurance Code Chapter 4151.

Comment: A commenter states that some of the proposed language is vague and may lessen or even eliminate any benefit of efficiency and compliance. The commenter states that some of the new language can be interpreted to increase potential filings, unnecessarily burdening both the groups and the Department, and result in arguments over compliance in an examination. The commenter states that while it agrees that timely and sufficient payment of benefits to injured workers is of paramount importance, the commenter does not believe this is directly affected by the rules (e.g., increased excess insurance ensures that the group will not have to pick up the catastrophic costs but will not change the timeliness or accuracy of benefit payments that must be made by the group and reimbursed by the excess carrier). The commenter agrees that the prevention of insolvency will lessen any interruption or problems in payment of benefits. The commenter states that the timeliness and accuracy of benefit payments on a regular basis is not directly affected by these rules and that appropriate benefit payments are in the regulatory authority of the Division of Workers' Compensation, which has an extensive enforcement mechanism.

Agency Response: While the commenter does not specify which of the proposed language is vague and may lessen or eliminate any benefit of efficiency and compliance or which language can be interpreted to increase potential filings, the Department has identified and revised several of the proposed amendments and new sections as adopted to: (i) clarify which of a group’s service companies must be identified in a group’s business plan

(§5.6403(c)(12)(B)); (ii) clarify which persons are subject to the contracting and operational review plan requirements (§5.6403(c)(12)(B) and §5.6411(a) and (b)); (iii) clarify the bonding requirements for administrators and service companies (§5.6408); and (iv) clarify the information that must be submitted to the Department upon application for a certificate of approval (§5.6403(c)(12)(B) and (C)). The Department disagrees that the timeliness and accuracy of benefit payments are not directly affected by these rules. One purpose of the adopted amendment to §5.6405(a) is to enhance the protection of a group's financial condition and health by increasing the minimum excess insurance requirements for each group. By protecting groups against the financial impact of catastrophic claims, the adopted amendment to §5.6405(a) provides additional assurance that groups have sufficient financial ability to pay workers' compensation benefits in a timely and accurate manner, as contemplated by the Labor Code §407A.051(e). If a group has insufficient specific excess insurance to cover the catastrophic losses, the group is obligated to pick up the portion of catastrophic losses not covered by the excess insurance. This additional liability can cause a group to have significant financial problems, and even result in financial insolvency, which can lead to workers' compensation benefits being paid untimely or inaccurately. Also, one purpose of adopted new §5.6412 is to require that a group monitor the actions of certain contractors and sub-contractors and to ensure that the actions, or inactions, of these contractors and sub-contractors do not result in a hazardous financial condition for the group and negatively effect the group's

ability to make timely and accurate benefit payments on a regular basis to injured workers.

Public Benefit/Cost Note

Comment: A commenter states that the estimated costs for certain proposed requirements are most likely too low. For example, the commenter states that, although the cost of an actuary could be $50.61 per hour if the actuary is on staff, most groups do not have actuaries on staff and the hourly rate would be much higher. The commenter agrees that there will be benefits and costs associated with the proposed rules and appreciates the Department's consideration of some of the problems that arose with earlier rules. The commenter states that cost alone should not prevent adoption of necessary regulations, but the commenter wants to ensure that any additional cost is to address a specific problem and is addressed in the most effective way in terms of both cost and impact on the problem. The commenter states that the actual cost will be directly affected by whether the language in proposed §5.6403 is clarified and narrowed as the commenter recommends. The commenter objects to proposed §5.6403(c)(12)(B) that requires a business plan or plan of operation that describes the group's business activities, safety program, and organization to include the identity of any service company that has management or discretionary decision making authority relating to a function the group retains ultimate responsibility for under the Labor Code, the Insurance Code, or

regulations adopted thereunder. According to the commenter, the qualifier "any service company that has management or discretionary decision making authority" does not clearly delineate which service companies must be included in the plan of operation. The commenter states that this provision will also affect what notifications of changes in the information must be provided to the Department over time. The commenter states that many people who provide services to a group have some discretion and that discretion may affect the adjustment of claims, but they do not have the ultimate authority over payment of the claim**.**

Agency Response: The Department disagrees that the estimated costs for certain requirements are too low, including the commenter's example of the estimated hourly cost of an actuary being too low. The Department's Public Benefit/Cost Note published in the July 25, 2008 *Texas Register* identified the costs associated with each of the proposed requirements. In some cases, the Department determined that a cost for a specific requirement could vary between groups or delegated entities. In those cases, the Department specifically identified the factors that could affect the actual cost incurred by a particular group or delegated entity when complying with a specific requirement. Further, some costs could be affected by individual business decisions made by a particular group or delegated entity. The Department identified the specific situations where a particular cost could be affected by such individual business decisions. The Department also identified the potential cost savings that could

be realized by groups and delegated entities as a result of certain sections of the proposed rules. Those sections as proposed provided for a reduction in the amount of required administrative filings and new innovative and cost saving storage and maintenance options. The Department also identified the benefits associated with the proposed rules in the published Public Benefit/Cost Note.

Only one specific example was provided by the commenter to support the commenter's assertion that the costs are most likely too low, which relates to the cost of an actuary's services for determining the appropriate level of a group's excess insurance. The requirement to obtain an actuarial analysis of the appropriate level of specific excess insurance for the group is not a new requirement, but one already mandated in existing §5.6405. Further, the actuarial analysis required by §5.6405(c) as adopted is not a mandatory requirement. Rather, it is an optional provision that groups, at their discretion, may elect to pursue. Specifically, §5.6405(c) as adopted provides an option that groups may elect to pursue in order to obtain a waiver from the requirements of §5.6405(a) as adopted. Section 5.6405(a) as adopted requires that a group obtain excess insurance for losses that exceed the group's retention in an amount that will pay all benefits required under the Labor Code and rules adopted thereunder for a compensable claim. Section 5.6405(c) as adopted provides a group the option to petition the Department from relief from §5.6405(a) as adopted in order to purchase a lesser amount of excess insurance. However, the Department is concerned with avoiding a potentially

hazardous financial condition or insolvency that may result in unpaid claims owed to injured Texas workers. Therefore, §5.6405(d) as adopted provides that, in order to assist the Commissioner in reviewing a petition filed under §5.6405(c) as adopted, the group shall submit an analysis prepared by an actuary of the appropriateness of the specific excess insurance for the group. In the cost note for this optional provision, the Department clearly noted that the services of an actuary would be required and provided an indication of the costs of an actuary using independent third party data provided by the U.S. Department of Labor. Further, the Department notes that §5.6405(d) codifies a process followed by the Department in the past for a group to submit an actuarial analysis of the appropriateness of the specific excess insurance for a group. The Department fully anticipates that any group that elects to pursue this option and receives the Department's approval to obtain a lesser amount of excess insurance will experience an overall cost savings that substantially exceeds the costs anticipated to be incurred for compliance under §5.6405(d). This is because the costs to purchase a lesser amount of excess insurance will be significantly cheaper, and the cost savings will exceed any additional actuarial costs incurred under §5.6405(d) as adopted.

Additionally, the commenter states that the actual cost will be directly affected by whether the language in proposed §5.6403 is clarified and narrowed as the commenter recommends. In response to the comments from this commenter and other commenters, the Department has revised and narrowed

§5.6403(c)(12)(B) as adopted. Under adopted §5.6403(c)(12)(B), the notification, bonding, contracting, and reporting requirements of the adopted rules apply only to a group's service companies that perform one or more of the following services: (i) provide cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts; (ii) maintain the group's accounting records or organizational documents; (iii) store or maintain the group's electronic books and records, including a person identified by a group under §5.6409(b)(3); or (iv) provide management of a function for which the group retains ultimate responsibility for under the Insurance Code, the Labor Code, or rules adopted thereunder. Section 5.6403(c)(12)(A) as adopted further provides that the notification, bonding, contracting, and reporting requirements of the adopted rules apply to a group's service companies that are third party administrators. The Department appreciates the commenter's acknowledgement that the Department considered concerns that arose with the earlier rules. The Department also appreciates that the commenter's statement that cost alone should not prevent the adoption of necessary rules.

Economic Impact Statement

Comment: A commenter disagrees that there is no adverse effect on a group simply because a group does not meet the definition of a small business. The commenter states that groups will have some additional costs and since groups

are non-profit and for the benefit of its members, it is even more important that any increased costs are tied to reasonable and narrowly drawn rules to address specific real problems. The commenter states that the need and extent of additional regulation must be balanced against the legislative desire for an additional affordable and available source of workers' compensation coverage for Texas small and mid-size employers and the continued health of existing self-insurance groups, which will protect injured workers, employer members of the group, and the Texas Self Insurance Group Guaranty Fund. The commenter opines that there may be some minimal changes to the proposed rules that will both protect the health, safety, and economic interests of injured Texas workers and the welfare of the state in a less burdensome and clearer way.

Agency Response: Because the commenter does not provide any suggested minimal changes to the proposed rules, the Department is unable to comment on such changes. The Department understands the commenter’s disagreement and concern that because a group does not meet the definition of a small business that there is no adverse effect on a group. The Department, however, followed the requirements of the Government Code §2006.002(c) in determining whether there would be an adverse effect on a group and therefore, whether the Department was required to prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Pursuant to the Government Code §2006.002(c), the Department is required to provide an economic impact statement and a regulatory flexibility

analysis that projects the economic impact of a rule on a small or micro-business *only* if the Department's proposal would have an adverse economic affect on a small business or micro-business. The Government Code §2006.001(2) defines a small business as a legal entity, including a corporation, partnership, or sole proprietorship, that: (i) is formed for the purpose of making a profit; (ii) is independently owned and operated; and (iii) has fewer than 100 employees or less than $6 million in annual gross receipts. The Government Code §2006.001(1) defines a micro business as a legal entity, including a corporation, partnership, or sole proprietorship, that: (i) is formed for the purpose of making a profit; (ii) is independently owned and operated; and (iii) has not more than 20 employees. As required by the Government Code §2006.002(c), the Department determined that the proposed rules would not have an adverse economic impact on any workers' compensation self-insurance group currently holding a certificate of approval under the Labor Code Chapter 407A or any applicant for a certificate of approval under the Labor Code Chapter 407A because neither a group nor any applicant met the definition of a small or micro business under the Government Code §2006.001(1) and (2). Each of these elements must be met in order for an entity to qualify as a small or micro business. Neither a group nor an applicant meet the second requirement because neither a group nor an applicant can be independently owned and operated. Generally, independently owned and operated businesses are self-controlling entities that are not subsidiaries of other entities, are not otherwise subject to control by other entities, and are not publicly

traded. Additionally, if, as the commenter states, groups are non-profit, they do not meet the for-profit requirement of the small business and micro business definitions. Because the Department determined that neither a group nor an applicant can meet the requirements to qualify as a small business under the Government Code §2006.001(2)(B), the law does not require the Department to prepare a regulatory flexibility analysis that considers alternative methods of achieving the purpose of the proposed rule.

5. NAMES OF THOSE COMMENTING FOR AND AGAINST THE SECTIONS.

For, with changes: The Surety & Fidelity Association of America; Texas Self-Insurance Group Guaranty Fund; Texas Group Insurance Association; Texas Cotton Ginner's Trust.

Against: None.

Neither for nor against, with recommended changes: Pringle & Gallagher, LLP; Parker & Associates, LLC; Insurance Council of Texas; Flahive, Ogden, and Latson; Texas Construction Trust; Texas Alliance of Energy Producers.

6. STATUTORY AUTHORITY. The amendments and new sections are adopted under the Labor Code §§407A.001, 407A.002, 407A.005, 407A.008, 407A.009, 407A.051, 407A.052, 407A.054, 407A.056, 407A.057, 407A.201, 407A.252, 407A.355, 407A.455, and the Insurance Code §36.001. The Labor Code §407A.001 defines *administrator*, *Commissioner*, *Department*, *group*, *managing*

company, *modified schedule rating premium*, *same or similar*, and *service company*. The Labor Code §407A.002 provides that an unincorporated association or business trust composed of five or more private employers may establish a workers' compensation self-insurance group under the Labor Code Chapter 407A, provided certain stated conditions are met. The Labor Code §407A.005 requires an association of employers to hold a certificate of approval issued under the Labor Code Chapter 407A in order to act as a workers' compensation self-insurance group. The Labor Code §407A.008 provides that the Commissioner shall adopt rules as necessary to implement the Labor Code Chapter 407A. The Labor Code §407A.009 requires an administrator or service company under the Labor Code Chapter 407A that performs the acts of an administrator as defined in the Insurance Code Chapter 4151 to hold a certificate of authority under the Insurance Code Chapter 4151. The Labor Code §407A.051(a) requires an association of employers that proposes to organize as a workers' compensation self-insurance group to file an application for a certificate of approval with the Department. Additionally, the Labor Code §407A.051(b) and (c) enumerates the particular items that must be included in an applicant's application for a certificate of approval. The Labor Code §407A.051(d) requires a group to notify the Commissioner of any change in the information required to be filed under the Labor Code §407A.051(c) or the manner of a group's compliance with the Labor Code §407A.051(c). Finally, the Labor Code §407A.051(e) specifically requires the Commissioner to evaluate the

financial information provided with the application as necessary to ensure that the funding is sufficient to cover expected losses and expenses and that the funds necessary to pay workers' compensation benefits will be available on a timely basis. The Labor Code §407A.052 requires the Commissioner to issue a certificate of approval to a proposed group on finding that the group has met the requirements of the Labor Code Chapter 407A Subchapter B. The Labor Code §407A.054 requires a group to obtain specific excess insurance for losses that exceed the group's retention in a form prescribed by the Commissioner. Additionally, the Labor Code §407A.054 provides that the Commissioner may establish minimum requirements for the amount of specific excess insurance based on differences among groups in size, types of employment, years in existence, and other relevant factors. The Labor Code §407A.056 requires an indemnity agreement filed by a group pursuant to the Labor Code §407A.051 to jointly and severally bind the group and each employer who is a member of the group to meet the workers' compensation obligations of each member. Additionally, the indemnity agreement must be in the form prescribed by the Commissioner and must include minimum uniform substantive provisions as prescribed by the Commissioner. Subject to the Commissioner's approval, a group may add other provisions necessary because of that group's particular circumstances. The Labor Code §407A.057 provides that, in addition to the requirements under the Labor Code §407A.051, the Commissioner may require a service company providing claim services to furnish a performance bond of

$250,000 in the form prescribed by the Commissioner. The Labor Code §407A.201(c) requires the group to notify the Commissioner and the Commissioner of Workers' Compensation of the cancellation of termination of a membership not later than the 10th day after the date on which the cancellation or termination takes effect. The Labor Code §407A.252 provides that the Commissioner shall examine the financial condition of each group to determine the group's ability to meet the group's obligations under the Labor Code Title 5 Subtitle A. Additionally, the Labor Code §407A.252 provides that the Commissioner shall have full access to the records, officers, agents, and employees of a group as necessary to complete an examination under the Labor Code §407A.252. The Labor Code §407A.355 defines "insolvent." Additionally, this section also provides that if the Commissioner determines that the group is in a hazardous financial condition, the Commissioner may take action as provided by the Insurance Code Article 21.28-A (enacted without substantive change by the Texas Legislature as the Insurance Code Chapter 443). The Labor Code §407A.455 provides that the Texas Self-Insurance Group Guaranty Fund shall provide recommendations to the Commissioner regarding rules or guidelines applicable to groups. The Insurance Code §36.001 provides that the Commissioner of Insurance may adopt any rules necessary and appropriate to implement the powers and duties of the Texas Department of Insurance under the Insurance Code and other laws of this state.

7. TEXT.

§5.6401. Purpose and Scope. This division establishes the licensing, contracting, reporting, and financial requirements, procedures, responsibilities, and obligations applicable to applicants and workers' compensation self-insurance groups holding a certificate of approval issued under the Labor Code Chapter 407A.

§5.6402. Definitions.

(a) The following words and terms, when used in this division, shall have the following meanings, unless the context clearly indicates otherwise.

(1) Actuary--A member in good standing of the Casualty Actuarial Society or a member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserves opinions by the Casualty Practice Council of the American Academy of Actuaries.

(2) Administrator--An individual, partnership, or corporation engaged by the board of trustees of a group to implement the policies established by the board of trustees and to provide day-to-day management of the group, as defined in the Labor Code §407A.001(a)(1). Day-to-day management may include, but is not limited to, claims adjustment; safety engineering; compilation of statistics and the preparation of premium, loss, and tax reports; preparation of other required self-insurance reports; development of members' assessments and fees; and administration of a claim fund. For

purposes of this division, *administrator* includes and has the same meaning as *managing company*, as that term is defined in the Labor Code §407A.001(a)(5-a). Any reference to the term *administrator* in this division in all contexts necessarily includes and references both *administrator* and *managing company*.

(3) Books and Records--All books, accounts, records, documents, written agreements, contracts, papers, correspondence, claims files, receipts, bills, notes, pleadings, investigatory files, or any other written or electronic material relating to the business of a group.

(4) Certified Public Accountant--An accountant or firm in good standing with the American Institute of Certified Public Accountants and the Texas State Board of Public Accountancy and who conforms to the Code of Professional Ethics of the American Institute of Certified Public Accountants.

(5) Commissioner--The Commissioner of Insurance.

(6) Department--The Texas Department of Insurance.

(7) Group--An unincorporated association or business trust composed of five or more private employers that meet all of the requirements of the Labor Code Chapter 407A and this division.

(8) Managing company--As defined in paragraph (2) of this subsection.

(9) Modified schedule rating premium--As defined in the Labor Code §407A.001(a)(6).

(10) Person--An individual, partnership, corporation, organization, government or governmental subdivision or agency, business trust, estate trust, association, or any other legal entity.

(11) Same or similar--As set forth in the Labor Code §407A.001(a)(7).

(12) Service company--A person that directly or indirectly provides services to or on behalf of a group, other than the services provided by an administrator, including, but not limited to:

(A) claims adjustment;

(B) safety engineering;

(C) compilation of statistics and the preparation of premium, loss, and tax reports;

(D) preparation of other required self-insurance reports;

(E) development of members' assessments and fees; and

(F) administration of a claim fund.

(13) Third party administrator--An administrator or service company, as those terms are defined under this division, that holds itself out or acts as an administrator, as that term is defined in the Insurance Code §4151.001(1).

(b) A group shall engage only one administrator to implement the policies established by the board of trustees and to provide day-to-day management of

the group. A group may engage more than one service company to provide services to the group.

(c) An individual, partnership, or corporation may act as an administrator for more than one group.

(d) An individual, partnership, or corporation may act as an administrator for one group and as a service company for another group.

(e) An individual, partnership, or corporation may not act as both an administrator and a service company for the same group at the same time.

§5.6403. Application for Initial Certificate of Approval.

(a) An unincorporated association or business trust composed of five or more private employers that proposes to organize as a workers' compensation self-insurance group shall file with the department an application for a certificate of approval.

(b) Contents of the application must include the information required by Labor Code §407A.051.

(c) In addition to the information required under subsection (b) of this section, an applicant shall also provide the following:

(1) A statement that demonstrates that the members of the group are in the same or similar type of business as required by Labor Code §407A.002(a)(1).

(A) The statement should demonstrate that the members of the group have the same governing classification.

(B) If the members of the proposed group have different governing classifications, the statement should demonstrate how the business pursuits of the members of the group are similar enough in operation in the Commissioner of Insurance's discretion to be grouped together.

(2) To aid the department in making the determination that the trade or professional association meets the requirements of Labor Code §407A.002(a)(2) that the trade of professional association has been in existence in this state for purposes other than insurance for five years before the establishment of the group, provide copies of documents relating to the organization, governance and operation of the association and a narrative describing the activities of the association. Annual reports, conventions, seminars, dues requirements, newsletters and other evidence acceptable to the Commissioner of Insurance may be submitted to aid the department in making its determination.

(3) In addition to the copy of the bylaws of the group required by Labor Code §407A.051(c)(6), submit copies of documents relating to the organization, governance and operation of the group.

(4) Projected financial statements for the 24 month period from the group's start of operations using quarterly balance sheet projections based on the group's fiscal year, quarterly cash flow schedules reflecting expenditures by

category, quarterly revenue and expense projections and an actuarial projection of the group's total projected incurred liabilities for workers' compensation which demonstrate compliance with Labor Code §407A.051(c)(10) which requires the group to show its financial ability to pay the workers' compensation obligations of the employers who are members of the group and Labor Code §407A.053(c) which requires the group to post security equal to the greater of $300,000 or 25% of the group's total incurred liabilities for workers' compensation. The projections shall include an estimate of the employees to be covered on which the projections and actuarial assumptions are based. The projections must reflect the identity, qualifications and credentials of the persons making the projections.

(5) A written commitment, binder, or policy or contract of excess insurance that meets the requirements of §5.6405 of this division
(relating to Excess Insurance).

(6) A fidelity bond for an administrator in the amount of $250,000. The fidelity bond must meet the requirements of §5.6408 of this division (relating to Fidelity and Performance Bonds).

(7) A fidelity bond for a service company identified pursuant to paragraph (12)(A) or (B) of this subsection, if there is one, in the amount of $250,000. The fidelity bond must meet the requirements of §5.6408 of this division.

(8) A performance bond for a service company identified pursuant to paragraph (12)(A) of this subsection that provides claims service to or on

behalf of a group, if there is one, in the amount of $250,000. This performance bond is in addition to the fidelity bond required in paragraph (7) of this subsection for a service company. The performance bond shall be in the form prescribed in §5.6408 of this division.

(9) An indemnity agreement executed by the members of the group binding the members, jointly and severally, for the obligations of the group. At a minimum, the agreement shall include the provisions described in §5.6406 of this division (relating to Indemnity Agreement).

(10) An acknowledgement, in the form prescribed in §5.6407 of this division (relating to Acknowledgement of Indemnity Agreement), executed by each member of the group that it is aware that it can be called upon to pay the workers' compensation claims of another member of the group pursuant to the Labor Code Chapter 407A.

(11) The statement required by §5.6404 of this division (relating to Notification to the Department and Responsibility for Continued Compliance).

(12) A business plan or plan of operation that describes the group’s business activities, safety program, and organization. The plan must also include:

(A) the identity of the administrator of the group and any third party administrator that provides services to or on behalf of the group;

(B) excluding any person identified pursuant to subparagraph (C) of this paragraph, the identity of any service company that performs one or more of the following services:

(i) provides cash and asset management services to a group, including any person that has access to or disbursement authority over any of the group's assets and accounts;

(ii) maintains the group's accounting records or organizational documents;

(iii) stores or maintains the group’s electronic books and records, including a person identified by a group under §5.6409(b)(3) of this division (relating to Books and Records); or

(iv) provides management of a function for which the group retains ultimate responsibility under the Insurance Code, the Labor Code, or rules adopted thereunder;

(C) the identity of:

(i) the accountant of the group; and

(ii) the actuary of the group.

(D) a general description of the experience, qualifications, facilities, and personnel of a person identified pursuant to subparagraph (A) or (B) of this paragraph; and

(E) the identity of the affiliates of a person identified pursuant to subparagraph (A) or (B) of this paragraph. A group may identify such affiliates in an organizational chart.

(13) A copy of each written agreement required under §5.6411 of this division (relating to Contract Provisions).

(14) A statement that a third party administrator identified pursuant to paragraph (12)(A) of this subsection either holds the required authorization from the department or has applied for the required authorization from the department and that the group will verify that such authorization has been granted by the department before the group allows the third party administrator to provide services to or on behalf of the group.

(d) The group must also submit the following:

(1) proof that it has received payment or a promise to pay from each member of 25% of its first year estimated modified schedule rating premium. If the group approves a member's submission of a promise to pay the 25% of premium, the employer must submit payment of the amount promised no later than 10 days after the effective date of the member's coverage with the group, or

(2) a certification by a certified public accountant and an actuary that assets and reserves of the trust satisfy the requirement of the Labor Code §407A.051(c)(11)(B).

(e) Each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the executive officers of a person identified pursuant to subsection (c)(12)(A) or (B) of this section shall provide to the department a completed biographical affidavit in accordance with §7.1604(b)(1)(C) of this title (relating to Application Denial, Suspension, Cancellation, or Revocation). A biographical affidavit is not required if a biographical affidavit from the individual has been filed with the department within the prior three years and contains substantially accurate information. A biographical affidavit must demonstrate that the affiant has sufficient experience, ability, standing, and good record to make success of a group probable.

(f) Each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the executive officers of a person identified pursuant to subsection (c)(12)(A) or (B) of this section shall comply with the requirements of Chapter 1 Subchapter D of this title (relating to Effect of Criminal Conduct).

(g) A person subject to this division and to the requirements of the Insurance Code §4151.055 may satisfy the requirements of §4151.055 by obtaining a fidelity bond that meets the requirements of subsection (c)(6) or (7) of this section, as applicable.

(h) Pursuant to the Labor Code §407A.051(b)(7), the commissioner may require the submission of any other relevant information reasonably required to

determine whether to approve or disapprove an application for a certificate of approval.

§5.6404. Notification to the Department and Responsibility for Continued Compliance.

(a) No later than 30 days after the effective date of the change, a group shall provide written notice to the department identifying:

(1) any change in the information filed by the group under the Labor Code §407A.051(c) and §5.6403 of this division (relating to Application for Initial Certificate of Approval); and

(2) any change in the group's manner of compliance with the Labor Code §407A.051(c) and §5.6403 of this division.

(b) A group must meet the requirements of the Labor Code §407A.051(c) and §5.6403 of this division as those requirements apply to any change of information identified by a group pursuant to subsection (a) of this section.

(c) A group shall provide written notice to the department no later than 10 days of first becoming aware that any hazardous financial condition exists, or that, in the opinion of its administrator, any hazardous financial condition is likely to occur. For purposes of this subsection only, hazardous financial conditions include the conditions described in the Labor Code §407A.355(a) and (b) and any event, series of events, or negative trend that may affect the group's ability to continue as a viable group.

(d) A group shall acknowledge its responsibilities under this section by executing a statement that it will meet the notification requirements of subsections (a) and (c) of this section and filing it with the department.

(e) A group is required to maintain the qualifications necessary to obtain a certificate of approval issued under the Labor Code Chapter 407A at all times.

§5.6405. Excess Insurance.

(a) Unless otherwise approved by the commissioner, a group shall obtain excess insurance for losses that exceed a group's retention in an amount that will pay all benefits required under the Labor Code and rules adopted thereunder for a compensable claim.

(b) The group shall obtain and maintain excess insurance coverage from an insurer that has a certificate of authority from the Texas Department of Insurance or from an eligible surplus lines insurer in compliance with Chapter 981 of the Texas Insurance Code and related provisions of the Texas Administrative Code, provided that:

(1) the surplus lines insurer is also certified as a trusteed reinsurer by the Texas Department of Insurance, in accordance with Insurance Code, Article 5.75-1(b)(3) (effective April 1, 2007, Article 5.75-1(b)(3) is repealed and re-adopted as Insurance Code §§493.102, 493.152 - 493.155, and 495 157);

(2) the surplus lines insurer maintains a financial strength rating of "A-" or better, as determined by A.M. Best Company;

(3) the surplus lines insurer provides a clean, irrevocable, and unconditional letter of credit in favor of the group as beneficiary and held by the group, subject to withdrawal solely by and under the exclusive control of the group, to secure the payment of losses, including losses, loss adjustment expenses, incurred but not reported losses, and any other obligation of the surplus lines insurer under the terms and conditions of the excess insurance policy, whether paid or unpaid by the group:

(A) in no less than the greater of:

(i) the amount of actuarially projected losses to ultimate; or

(ii) the amount of actual losses to ultimate;

(B) issued by a qualified United States financial institution as defined in Insurance Code, Article 5.75-1(e) (effective April 1, 2007, Article 5.75-1(e) is repealed and re-adopted as Insurance Code §§493.002, 493.102, and 493.104); and

(C) provided the letter of credit is in a form acceptable to the Texas Department of Insurance and meets the requirements in 28 TAC §7.610, except for those requirements that apply solely to reinsurance agreements;

(4) the group timely collects recoverables and receivables from the surplus lines insurer, but in no event, later than 90 days, including, if needed, drawing down on the letter of credit;

(5) the group submits the surplus lines policy forms, renewal forms, certificates, endorsements and amendments applicable thereto, and any agreements between the surplus lines insurer and the group to the Texas Department of Insurance for review prior to use and the group may not accept or enter into any agreement or arrangement with the surplus lines insurer that has not been reviewed by the Texas Department of Insurance;

(6) the group demonstrates to the satisfaction of the Texas Department of Insurance that the group meets the requirements of subsection (b) of this section before obtaining and in order to maintain excess insurance coverage from an eligible surplus lines insurer; and

(7) the group notifies the Commissioner in writing no less than five calendar days after receiving notice of cancellation or nonrenewal of the excess insurance policy and no less than 30 calendar days prior to the effective date of any proposed change in the excess insurance policy, by endorsement or otherwise.

(c) A group may petition the department to obtain excess insurance in an amount that is different than the amount required by subsection (a) of this section. In determining whether to grant a group’s petition, the commissioner shall consider the current market conditions; a group's size, types of employment, years in existence, and risk exposure; other forms, if any, of additional financial security available to the group; and any other relevant factor.

In no event, however, shall a group's excess insurance coverage be less than $10 million per occurrence.

(d) To assist the commissioner in making the determination under subsection (c) of this section, the group shall, at a minimum, submit an analysis prepared by an actuary of the appropriate level of specific excess insurance for the group.

§5.6408. Fidelity and Performance Bonds.

(a) Fidelity bonds required of an administrator under the Labor Code §407A.051(c)(12) and §5.6403(c)(6) of this division (relating to Application for Initial Certificate of Approval) and a service company under the Labor Code §407A.051(c)(13) and §5.6403(c)(7) of this division must protect against loss caused directly by an act of fraud or dishonesty by the employees of the administrator or service company and such fidelity bond shall include the group as a loss payee.

(b) A performance bond required under the Labor Code §407A.057(a) and §5.6403(c)(8) of this division for a service company providing claims services to or on behalf of a group shall be in substantially the form set forth in subsection (c) of this section.

(c) A performance bond required under the Labor Code §407A.057(a) and §5.6403(c)(8) of this division shall contain the following text and shall be in the following format:

Figure: 28 TAC §5.6408(c):

BOND OF SERVICE COMPANY FOR A WORKERS' COMPENSATION SELF-INSURED GROUP

Know all persons by these presents, that (name of service company), as principal, and (name of surety), as surety, being a surety company duly authorized to do business in the State of Texas, are held and firmly bound unto the (name of group or in the event of a receivership, the receiver) for the obligations and liabilities of the principal, arising from or related to providing claims services, in the sum of $_____, lawful money of the United States, for the payment of which sum we bind ourselves, our successors and assigns, jointly and severally.

The conditions of the above obligations are:

Whereas, the above named principal has entered into an agreement dated _____ with (name of group) to perform duties and services for the group.

Now, therefore, if the principal shall perform its duties and obligations under the agreement dated _____, then this obligation shall be void; otherwise, this obligation will remain in full force and effect.

PROVIDED, this bond may be canceled as a future liability by the surety upon sixty days written notice to the principal and the (name of group or in the event of a receivership, the receiver); however, such cancellation shall not discharge the surety's liability accrued during the term of this bond or which shall accrue in said sixty day period.

In witness whereof said principal and surety have executed this bond the _____ day of _____, 20__, to be effective the ___day of _____, 20__.

_____
Principal

_____
Surety

Form Number FIN 464

(d) Administrators and service companies may only obtain a fidelity or performance bond from a surety company authorized to engage in business in this state as a surety or an eligible surplus lines insurer in compliance with the Insurance Code Chapter 981 and regulations adopted thereunder.

(e) An administrator or service company that has a fidelity or performance bond cancelled or terminated and not replaced with new coverage that meets the requirements of the Labor Code Chapter 407A and this division and that is effective concurrently upon the date of the cancellation or termination shall:

(1) immediately inform the commissioner in writing, which in no event shall be later than five business days from the date the administrator or service company first becomes aware of the cancellation or termination; and

(2) immediately inform the group in writing, which in no event shall be later than five business days from the date the administrator or service company first becomes aware of the cancellation or termination.

§5.6409. Books and Records.

(a) Except as otherwise provided in this division, this section applies to all books and records of a group, regardless of whether the books and records are located in the State of Texas or outside the State of Texas.

(b) A group’s books and records must be located within the United States of America and its territories at all times, but may be located outside the State of

Texas, provided that the group provides prior written notice to the department that:

(1) provides the specific address outside the State of Texas where the group’s books and records will be located;

(2) identifies the types of books and records that will be located outside the State of Texas, including those that will be maintained in an electronic format;

(3) if applicable, identifies the vendor of a leased or purchased software or electronic platform who will provide services to the group related to the maintenance of the group’s books and records; and

(4) if applicable, includes the group's continuity plan in the event of cancellation or termination of the arrangement with a vendor identified by the group pursuant to paragraph (3) of this subsection.

(c) All books and records of a group shall be:

(1) electronically or physically accessible to the department upon the department’s request; and

(2) maintained in a manner that provides an audit trail between the group's general ledger and the group's source documents.

(d) A group's electronic books and records must be maintained with reasonable controls to ensure the integrity, accuracy, and reliability of the electronic storage system and to prevent the deterioration of the electronic books and records.

(e) A group must ensure a weekly backup of its electronic books and records.

(f) A group must be able to access a complete and current set of its electronic books and records or a complete and current backup of its electronic books and records from a location in the State of Texas at all times.

(g) This section does not in any way limit the commissioner's authority under the Labor Code §407A.252 and §407A.355.

(h) To the extent of a conflict between this section and the Labor Code §407A.252 or §407A.355, the Labor Code §407A.252 or §407A.355 prevails.

(i) A group holding a certificate of approval issued prior to the effective date of this section shall comply with the provisions of this section no later than 30 days after the effective date of this section.

§5.6411. Contract Provisions.

(a) A group shall execute a written agreement with a person identified pursuant to §5.6403(c)(12)(A) or (B) of this division (relating to Application for Initial Certificate of Approval) that meets the requirements of this section.

(b) If a person identified pursuant to §5.6403(c)(12)(A) or (B) of this division delegates any of the services that it has agreed to provide on behalf of a group to another person, the delegating person shall execute a written agreement with the person to whom the services are delegated. The written agreement must meet the requirements of this section.

(c) A group retains ultimate accountability and responsibility for compliance with all statutory and regulatory requirements, and no written agreement may be construed to limit, in any way, the group's ultimate accountability and responsibility.

(d) A written agreement entered into pursuant to subsection (a) or (b) of this section shall include:

(1) a requirement that the administrator, service company, or third party administrator must comply with the applicable requirements of the Insurance Code and the Labor Code and rules adopted thereunder, including holding the appropriate licenses or certificates of authority under the Insurance Code or the Labor Code;

(2) a requirement that the administrator, service company, or third party administrator must permit the commissioner or the group to examine at any time:

(A) its financial solvency; and

(B) its ability to perform its responsibilities under the written agreement;

(3) a description of the duties or services that the administrator, service company, or third party administrator is expected to provide and any applicable instructions related to the performance of those services, including references to a group's claims handling practices or procedures; and

(4) a provision relating to continuity of services, including run off fee schedules and the transfer of the books and records of a group from one administrator, service company, or third party administrator to another administrator, service company, or third party administrator.

(e) A written agreement entered into pursuant to subsection (a) or (b) of this section shall also ensure that the books and records of the group:

(1) remain the property of the group at all times;

(2) are available to the group or its designee at any time while in the custody of an administrator, service company, or third party administrator; and

(3) will be timely transferred to the group or its designee:

(A) upon request of the group;

(B) at the termination or cancellation of a written agreement entered into by an administrator, service company, or third party administrator pursuant to subsection (a) or (b) of this section; and

(C) in compliance with all applicable statutory and rule requirements.

(f) A written agreement required under subsection (a) or (b) of this section must meet the requirements of this section no later than June 1, 2009.

§5.6412. Operational Review Plan.

(a) A group shall annually adopt an operational review plan that provides for sufficient oversight of any person who is required to enter into a written agreement pursuant to §5.6411(a) or (b) of this division (relating to Contract Provisions)**.** The group may modify the operational review plan at any time in order to meet the group's needs.

(b) The operational review plan shall, at a minimum:

(1) include the group's estimated projections for the information enumerated in paragraph (2) of this subsection for each quarter of the group's upcoming fund year;

(2) require any person that is required to enter into a written agreement pursuant to §5.6411(a) or (b) of this division to submit quarterly reports to the group containing the following information, as applicable:

(A) projected premium revenue for the current fund year and a comparison to premium revenue for the previous fund year;

(B) membership counts, including members lost and gained in the current fund year; and

(C) a summary of the performance of the group for each fund year in which the group has been in existence, including:

(i) number of claims reported;

(ii) incurred losses;

(iii) premium received;

(iv) loss ratio;

(v) expense ratio;

(vi) delineation of claims likely to exceed the specific retention; and

(vii) delineation of fund years likely to exceed any aggregate retention; and

(3) provide for corrective action, as determined by the board of trustees of the group, if the performance of the group does not meet its estimated projections required under this section.

(c) The board of trustees of a group shall consider the reports submitted pursuant to subsection (b) of this section. The reports, the board's consideration of the reports, and the board's recommendations for the group based upon the reports shall be noted in the minutes of the board of trustees of the group and shall be maintained in the books and records of the group.

§5.6413. Membership Cancellation or Termination.

(a) A group is required to notify the commissioner pursuant to the Labor Code §407A.201(c) only if the group experiences a reduction in membership, caused by either cancellation or termination, resulting in a cumulative reduction of 10 percent or more of its annual written premium, not later than the 10th day after the date on which the cumulative reduction in membership takes effect.

(b) The notification required by subsection (a) of this section must include:

(1) an explanation of the reason for the cancellation or termination of each member of the group; and

(2) a statement indicating how the group anticipates addressing the membership loss, including whether or not assessments of the remaining members of the group will be necessary.

CERTIFICATION. This agency hereby certifies that the adopted amendments and new sections have been reviewed by legal counsel and found to be a valid exercise of the agency's legal authority.

Issued at Austin, Texas, on January 23, 2009.

Gene C. Jarmon
General Counsel and Chief Clerk
Texas Department of Insurance

IT IS THEREFORE THE ORDER of the Commissioner of Insurance that amendments to §§5.6403, 5.6405, 5.6408, and 5.6411 and new §§5.6401, 5.6402, 5.6404, 5.6409, 5.6412, and 5.6413 specified herein, concerning workers' compensation group self-insurance coverage, are adopted.

AND IT IS SO ORDERED.

MIKE GEESLIN
COMMISSIONER OF INSURANCE

ATTEST:

Gene C. Jarmon
General Counsel and Chief Clerk

COMMISSIONER'S ORDER NO. 09-0049

JAN 23 2009