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 Texas Department of Insurance proposes 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. Proposed amended §§5.6403 and 5.6411 and new §5.6402 are necessary to clarify and implement 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 Department is proposing the remaining amended and new sections 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, or third party administrators (delegated entities). Additionally, the Department is simultaneously proposing the repeal of existing §§5.6401 (relating to Purpose and Scope), 5.6402 (relating to Definitions), 5.6404 (relating to Notification to Department), and 5.6409 (relating to Books and Records). The proposed repeal of these sections is also published in this issue of the *Texas Register*. This

proposal includes a proposed new section to replace each of the repealed sections.

The following paragraphs provide a general discussion of: 1) significant definitional changes to the Labor Code §407A.001 resulting from the enactment of HB 472 and resulting implementation matters; 2) the Department's proposed clarification of these definitional changes; 3) the significance and method of properly categorizing a delegated entity under the proposed sections; and 4) the significance of ensuring the financial solvency of groups; including a brief discussion of the proposed excess insurance, oversight, and contracting requirements. This general discussion will be followed by a detailed section-by-section overview of the proposal.

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(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 now 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(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 Department is proposing new §5.6402 and amended §§5.6403 and 5.6411 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(1) and (5-a), the amended definition of the term *service company* in the Labor Code §407A.001(8) only references the term *managing company*. The Labor Code §407A.001(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 proposed 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 may simply 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 functions 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(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 will be based upon how that entity categorizes itself--as an administrator or as a managing company.

Proposed Provisions to Clarify and Effectuate Legislative Intent. Proposed new §5.6402 and amended §§5.6403 and 5.6411 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, proposed 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, proposed 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, proposed new §5.6402 also prescribes a definition for the new term *third party administrator*. This proposed 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 proposed definition is used throughout this division to refer to a group's delegated entities that also perform regulated functions under the Insurance Code Chapter 4151.

Categorization of Delegated Entities Under Proposed New §5.6402. In general, the applicability of this division to a particular delegated entity depends entirely upon that entity's categorization under proposed new §5.6402. The categorization of an entity under proposed new §5.6402 is based upon the functions performed by the particular entity on behalf of a group. First, an administrator under proposed 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. Proposed 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, proposed new §5.6402(a)(2) does not, in any way,

prohibit an administrator from performing functions that are not specifically enumerated in proposed new §5.6402(a)(2). Second, proposed 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 proposed new §5.6402(a)(2), proposed new §5.6402(a)(12) also identifies several of the functions that may be performed by a service company on behalf of a group. Again, however, the enumerated functions are illustrative only and are not an exhaustive listing of the functions that a service company may perform on behalf of a group. In other words, proposed new §5.6402(a)(12) does not prohibit a service company from performing functions not specifically enumerated in proposed §5.6402(a)(12), provided that those functions are not already being performed by the group's administrator. Proposed new §5.6402(a)(12) makes clear that a service company may not perform a function on behalf of a group that is already being performed by an administrator for that same group. Lastly, proposed 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 proposed 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 functions on behalf of groups. Thus, the proposed 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 proposed 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 proposed §5.6402(a)(13).

Finally, it is important for a group to become familiar with the characterizations of its delegated entities under proposed new §5.6402 because a group's responsibilities under the amended and new sections will often depend upon the appropriate identification of its delegated entities. For example, proposed 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 proposed amended §5.6403(c)(6), (7), and (8), an applicant must properly categorize its delegated entities under proposed 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 proposed new §5.6402, a group cannot comply with the requirements of this division.

It is also significant to recognize that an entity may be categorized differently depending upon the functions that entity is performing and on whose behalf those functions are being performed. For example, proposed 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, 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 functions for more than one group or performs various functions for the same group, it is imperative for that entity and group to properly categorize the entity under proposed new §5.6402 in order to comply with the requirements of this division.

Examples of Categorizing Delegated Entities Under the Proposed 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) performs safety engineering services, compilation of statistics, and day-to-day management functions of a group (Group 1), Entity 1 is categorized as an administrator under proposed 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 proposed new §5.6402(a)(2). Proposed new §5.6402(a)(2) also clarifies that an administrator may perform a wide variety of services 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, Entity 1 is categorized as a service company for Group 2 under proposed new §5.6402(a)(12), but retains its categorization as an administrator under proposed 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. Because Entity 1 is not engaged by Group 2 to act as its administrator, Entity 1 is performing functions 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 proposed new §5.6402(a)(12) with respect to Group 2. However, because proposed 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 functions 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 proposed 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 comply with the requirements of this division, each delegated entity must be properly categorized under proposed new §5.6402 based upon the delegated functions the entity performs on behalf of each group.

Downstream Subcontractors. Lastly, the proposed amendments and new sections do not prohibit an administrator, service company, or third party administrator from further delegating the performance of a specific function 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 proposed new §5.6402, based upon the functions the downstream subcontractor is directly or indirectly performing on behalf of a particular group. Because proposed new §5.6402(b) makes clear that a group may engage only one administrator, any further delegation of a function of an

administrator, service company, or third party administrator to another administrator, service company, or third party administrator 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 proposed new §5.6402(a)(2) with regard to other delegated functions. For example, if the administrator (Administrator 1) of Group 1 further delegates functions 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 functions 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 functions to another entity, that entity is also categorized as a service company for Group 1.

Proposed Financial Solvency and Excess Insurance Requirements. Proposed amended §§5.6405 and 5.6411 and new §5.6412 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 proposing amended §§5.6405 and 5.6411 and new §5.6412.

Pursuant to the Labor Code §407A.054(b), proposed amended §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 insurer 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) currently requires 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 Association (Association) will be responsible for the additional funds necessary to cover the incurred liabilities of the insolvent group. If the Association 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 Association 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.

Proposed amended §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 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 proposed amended §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 proposed amendments 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 proposed §5.6405(a) amendments may not always be necessary. Thus, the proposed amendments to §5.6405(c) permit a group to petition the Department to obtain excess insurance in a different amount than the amount required by proposed amended §5.6405(a), subject to a minimum floor of $10 million per occurrence. Under the proposed §5.6405(c) amendments, 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 proposed §5.6405(c) amendments. However, proposed §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, proposed amended §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.

Proposed Oversight and Contracting Requirements. Proposed amended §5.6411 and 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, proposed amended §5.6411 and 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 function 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, proposed amended §5.6411 imposes minimal contracting requirements between: (i) a group and its delegated entities; and (ii) between a delegated entity and another administrator, service company, or third party administrator (downstream subcontractors) in certain circumstances. Proposed amended §5.6411 first requires a group to enter into a written agreement with its administrator, third party administrators, and 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. Additionally, proposed amended §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, proposed amended §5.6411(d) requires a group to describe the specific functions the delegated entity will be performing on its behalf, including any applicable instructions related to the performance of those functions. Proposed amended §5.6411(d) also requires each written agreement to contain a provision requiring each delegated entity to hold the appropriate license or authorization 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 functions, each group should be familiar with its delegated entities and the functions 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 functions those delegated entities will be performing; and (iii) what its expectations are with respect to the performance of those functions. 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 functions in accordance with the terms of the written agreement.

Proposed amended §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 can have disastrous and widespread results, especially with regard to the payment of workers’ compensation claims. A group cannot 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, proposed amended §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, proposed amended §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 proposed amendments to §5.6411(b) also requires a group's delegated entities to enter into a written agreement with their downstream subcontractors, but only if: (i) a delegated entity further delegates a portion of its management or discretionary decision making authority to a downstream subcontractor; and (ii) that delegated management or discretionary decision making authority relates to a function the group retains ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder. In those cases, the written agreement between the delegated entity and the 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 function is delegated from one entity to another, the greater the risk of non-performance or inadequate performance of that function becomes. A group retains ultimate responsibility and accountability for each function regulated under the Labor Code, the Insurance Code, or regulations adopted thereunder, regardless of the number of times the performance of that function 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 functions 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 functions 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.

Proposed Annual Operational Review Plan Requirements. To further emphasize the importance of a group's regular oversight over its delegated entities, proposed 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. Proposed 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 or solvency issues at a much earlier date, so that corrective action can be taken immediately. Further, proposed 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, proposed 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.

Proposed Clarification of Existing Rules. The remaining proposed amendments and new sections are a result of collaborative discussion with industry representatives and stakeholders regarding the clarification and reconsideration of the existing regulations. Proposed amended §5.6408 and new §§5.6404, 5.6409, and 5.6413 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.

Pursuant to the Labor Code §407A.455(3), the Department met with representatives of the Association in January and February, 2008, to discuss the Association's recommendations and concerns regarding the regulations applicable to groups. The Department also sought input from industry representatives and stakeholders and posted an informal working draft of the Department's proposed amendments to this division on the Department's website in November, 2007. The Department received several written comments regarding the informal working draft of the proposed amendments to this division. Further, the Department discussed the informal working draft of the proposed amendments to this division with representatives of the Association and industry in a small workgroup. The Department exchanged at least two separate informal

working drafts of the amendments to this division 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 to clarify definitions, to better define the roles and responsibilities of groups' delegated entities and their downstream subcontractors, to clarify the information that must be submitted to the Department upon application for a certificate of approval, to reduce unnecessary and duplicative administrative burdens related to bonds, biographical affidavits, and membership cancellation and termination notification, to clarify contracting requirements, and to 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.

Section-by-Section Overview. The following is a section by section overview of the proposal.

§5.6401. Purpose and Scope. Proposed new §5.6401 is necessary to better define and reflect 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 groups.

§5.6402. Definitions. Proposed new §5.6402 generally defines the terms that are used in this division and provides necessary clarification and guidance regarding the role and responsibility of each of a group's delegated entities. First, proposed new §5.6402(a) clarifies the meaning of the term

managing company in the Labor Code §407A.001(5-a), as added by HB 472, and as discussed previously in this proposal. Because the term *managing company* is defined identically in the Labor Code §407A.001(5-a) as the existing term *administrator* in the Labor Code §407A.001(1), proposed new §5.6402(a) clarifies that *managing company* has the same meaning as *administrator* and that any reference to the term *administrator* in this division, in all contexts, necessarily includes and references both *managing company* and *administrator*. Additionally, proposed new §5.6402(a) adds a definition for the new term *third party administrator,* which further clarifies the permitted roles and responsibilities of a group's delegated entities, with specific reference to the requirements of HB 472. Finally, proposed new §5.6402(a) provides a definition for the term *books and records*, provides additional clarity to the definition of *service company*, and more accurately incorporates the statutory requirements specified in the Labor Code §407A.002 for the formation of a group into the definition of *group*. Proposed new §5.6402(b) – (e) provides necessary clarification regarding the permitted roles of a group's administrator, service company, or third party administrator. Proposed §5.6402(b) provides that a group may only engage one administrator to implement the policies established by the board of trustees of the group and to provide day-to-day management of the group. However, this proposed section also makes clear that a group may engage more than one service company to provide services to the group. Proposed §5.6402(c) clarifies that an individual, partnership, or corporation may act as an administrator for more than one group. Proposed §5.6402(d) clarifies that an individual,

partnership, or corporation may act as an administrator for one group and as a service company for another group. Lastly, proposed §5.6402(e) provides that an individual, partnership, or corporation may not act 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 proposed 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 function it is responsible for performing to its administrator. Any function 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(8), which contemplates such an arrangement. Proposed §5.6402(e) does not, in any way, limit the functions that may be performed by either an administrator or a service company. Rather, this proposed subsection clearly delineates that an entity may not be categorized as an administrator and a service company for the same group at the same time.

§5.6403. Application for Initial Certificate of Approval. Proposed amended §5.6403 generally requires an unincorporated association or business

trust composed of five or more private employers that propose to organize as a workers' compensation self-insurance group to file an application for a certificate of approval with the Department. Additionally, proposed amended §5.6403 enumerates the items that must be included in an application for a certificate of approval. Proposed amended §5.6403(a) is necessary for consistency with proposed new §5.6402(a)(7), which more accurately incorporates the statutory requirements for the formation of a group into the definition of the term *group*. Proposed amended §5.6403(c)(6), (7), and (8) clarify the statutory requirements that administrators, service companies, and service companies providing claims services must obtain fidelity or performance bonds, as applicable. First, proposed amended §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 proposed amended §5.6408, 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 proposed amended §5.6403(c)(6) for each group for which the entity acts as an administrator. Proposed amended §5.6403(c)(7) requires each service company identified pursuant to proposed amended §5.6403(c)(12)(A) or (B), if there is one, to obtain a fidelity bond in the amount of $250,000. Proposed amended §5.6403(c)(7) also requires this fidelity bond to meet the requirements of proposed amended §5.6408. 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 proposed

amended §5.6403(c)(7) for each group for which the entity acts as a service company and is identified by that group under proposed amended §5.6403(c)(12)(A) or (B). Lastly, proposed amended §5.6403(c)(8) requires each service company identified pursuant to proposed amended §5.6403(c)(12)(A) 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. Proposed amended §5.6403(c)(8) makes clear that this performance bond is in addition to the fidelity bond required in proposed amended §5.6403(c)(7) for a service company identified pursuant to proposed amended §5.6403(c)(12)(A) or (B). Further, proposed amended §5.6403(c)(8) requires this performance bond to be in the form prescribed in proposed amended §5.6408. A service company qualifying under proposed new §5.6402(a)(13) 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 proposed amended §5.6403(c)(8) because a third party administrator providing services to or on behalf of a group must always be identified pursuant to proposed amended §5.6403(c)(12)(A). On the other hand, an administrator qualifying under proposed new §5.6402(a)(13) as a third party administrator is not subject to the additional performance bond requirement of proposed amended §5.6403(c)(8). 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 proposed amended §5.6403(c)(8) do not apply to administrators providing claims services. The requirements of proposed amended §5.6403(c)(7) and (8) do apply, however, to each entity that is categorized under proposed new §5.6402(a)(12) or (13) as a service company or as a service company that is also a third party administrator. For example, if an entity is categorized under proposed new §5.6402(a)(2) as an administrator (Administrator 1) for Group 1, but also performs delegated functions for another group (Group 2) that categorize Administrator 1 as a service company under proposed new §5.6402(a)(12) for Group 2, Administrator 1 is subject to the bond requirements of proposed amended §5.6403(c)(6) and (7). If Administrator 1 also performs delegated claims services for Group 2, Administrator 1 is also subject to the bond requirements of proposed amended §5.6403(c)(8) because Administrator 1 is categorized as a service company that is also a third party administrator under proposed new §5.6402(a)(13) 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 proposed amended §5.6403(c)(7) 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 proposed amended §5.6403(c)(8), as well. The bond requirements of proposed amended §5.6403(c)(7) and (8) also apply to a delegated entity's downstream subcontractors in the same manner. Proposed amended §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, proposed amended §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 proposed 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 proposed new §5.6402(a)(13) for that group. Proposed amended §5.6403(c)(12)(B) requires a group's business plan or plan of operation to provide the identity of any service company that has management or discretionary decision making authority relating to a function the group maintains ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder. This proposed subparagraph does not require a group's business plan or plan of operation to identify every service company that may perform functions on its behalf. Rather, proposed amended §5.6403(c)(12)(B) only applies to a service company that meets two specific requirements. First, the service company must have management or discretionary decision making authority. Second, that management or discretionary decision making authority must relate to a function the group maintains ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder. Proposed amended §5.6403(c)(12)(B) also applies to certain downstream subcontractors, as well. In total, proposed

amended §5.6403(c)(12)(B) applies to each 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, as well as any downstream subcontractor that is categorized as a service company under proposed new §5.6402(a)(12) and 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. Proposed amended §5.6403(c)(12)(C) requires a group's business plan or plan of operation to identify its accountant and actuary. Finally, proposed amended §5.6403(c)(12)(D) and (E) require a group's business plan or plan of operation to provide the identity of the affiliates of any person identified pursuant to proposed amended §5.6403(c)(12)(A) or (B), as well as a general description of the experience, qualifications, facilities, and personnel of any of those identified persons. This requirement will help identify any potential conflicts of interest among a group's delegated entities and downstream subcontractors. Proposed amended §5.6403(c)(13) and (14) require a group to submit a copy of each written agreement required under proposed amended §5.6411 of this division (relating to Contract Provisions) and a statement from the group that its third party administrators either hold the required authorization from the Department or have applied for the required authorization from the Department. In the event that a group's third party administrator has applied for the required authorization from the Department, proposed amended §5.6403(14) also requires a statement

from the group that it will verify that such authorization is granted by the Department before allowing the third party administrator to provide services to or on behalf of the group. Proposed amended §5.6403(e) requires a biographical affidavit to be submitted to the Department by 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 proposed amended §5.6403(12)(A) or (B). Additionally, under proposed amended §5.6403(e), a particular individual does not have to file a biographical affidavit with the Department if a biographical affidavit from the individual has been filed with the Department within the prior three years and contains substantially accurate information. Proposed amended §5.6403(e) further elaborates that a biographical affidavit contains substantially accurate information if the responses given by the individual in the affidavit on file with the Department continue to indicate sufficient experience, ability, standing, and good record to make success of a group probable. Proposed amended §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 proposed amended §5.6403(c)(12)(A) or (B) to comply with the requirements of Chapter 1 Subchapter D of this title (relating to Effect of Criminal Conduct). Proposed amended §5.6403(g) eliminates the dual bonding requirement applicable to those *administrators* and *service companies* under proposed new §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 proposed new §5.6402(a)(2) and as an administrator under the Insurance Code §4151.001(1), resulting in that entity being subject to the requirements of both proposed amended §5.6403(c)(6) and the Insurance Code §4151.055; or (ii) a service company under proposed new §5.6402(a)(12) and as an administrator under the Insurance Code §4151.001(1), resulting in that entity being subject to the requirements of proposed amended §5.6403(c)(7) 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 proposed amended §5.6403(6) and (7) and the Insurance Code §4151.055. Thus, the interest of the public is not negatively affected by the §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. Proposed amended §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 deemed necessary in determining whether to approve or disapprove an

application for a certificate of approval. The remaining proposed amendments to §5.6403 are necessary to correct grammatical errors and to re-designate the paragraphs accordingly.

§5.6404. Notification to the Department and Responsibility for Continued Compliance. Proposed new §5.6404 generally describes the circumstances under which a group is required to provide written notification to the Department and also clarifies the group's responsibilities for maintaining certain qualifications. First, proposed 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 proposed amended §5.6403 or the group's manner of compliance with the Labor Code §407A.051(c) or proposed amended §5.6403 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, proposed 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 proposed amended §5.6403(c)(12)(A). Proposed new §5.6404(b) clarifies that a group must meet the requirements of the Labor Code §407A.051(c) and proposed amended §5.6403, as those requirements apply to any change of information identified by a group under proposed new §5.6404(a). This proposed subsection makes clear that any change a group makes with regard to the information it files

with the Department pursuant to proposed amended §5.6403 or the Labor Code §407A.051(c) must still comply with the requirements of proposed amended §5.6403 and the Labor Code §407A.051(c). For example, if a group changes its administrator, the group must still meet the requirements of proposed amended §5.6403 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 proposed amended §5.6403(c)(6) and the Labor Code §407A.051(c), and the group must meet such requirement in its initial filing with the Department. Proposed 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. This proposed subsection 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. Proposed new §5.6404(d) requires a group to execute a written statement acknowledging its responsibilities under proposed new §5.6404. Lastly, proposed 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. Proposed 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.

§5.6405. Excess Insurance. Proposed amended §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. Proposed amended §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 proposed amended §5.6405(a). This proposed amended section 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, proposed amended §5.6405(c) prescribes that, in no event, may a group's excess insurance coverage be less than $10 million per occurrence. Proposed amended §5.6405(d) requires a group to submit to the Department 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 proposed amended §5.6405(c).

§5.6408. Fidelity and Performance Bonds. Proposed amended §5.6408 further defines the content, format, prohibitions, and requirements for a fidelity or performance bond required of an administrator or service company under proposed amended §5.6403(c)(6), (7), or (8). Specifically, proposed amended §5.6408(a) requires a fidelity bond required of an administrator under the Labor Code §407A.051(c)(12) and a service company under the Labor Code 407A.051(c)(13) to 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. This proposed amended section also requires a fidelity bond or performance bond to be payable to the group. Proposed amended §5.6408(b) requires a performance bond required under the Labor Code §407A.057 to be in the format prescribed in proposed amended §5.6408(c). Proposed amended §5.6408(c) provides the format and content for a performance bond required under the Labor Code §407A.057. Proposed amended §5.6408(d) prohibits an administrator or service company from

obtaining a fidelity bond or performance bond required under proposed amended §5.6403(c)(6), (7), or (8) 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, proposed amended §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 proposed amended §5.6403(c)(6), (7), or (8) 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, proposed amended §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. Proposed amended §5.6408(e) does not affect a group's responsibility to notify the Department of any change in the information filed by the group under the Labor Code §407A.051(c) and §5.6403 (relating to Application for Initial Certificate of Approval). Lastly, the remaining proposed amendments to §5.6408 re-designate the paragraphs accordingly.

§5.6409. Books and Records. Proposed new §5.6409(a) establishes the scope of the proposed new section, clarifying that the proposed 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. Proposed 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, a group must 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 paragraph (3) of proposed new §5.6409(b), if applicable. Proposed 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. Proposed 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 proposed new §5.6409(e), a group must ensure a weekly backup of its electronic books and records. Additionally, proposed 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. Proposed new §5.6409(g) and (h) provide that proposed 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 proposed 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, proposed new §5.6409(i) provides a 30-day grace period from the effective date of proposed 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 proposed new §5.6409.

§5.6411. Contract Provisions. Proposed amended §5.6411 prescribes the contracting requirements applicable to: (i) a group and its delegated entities and (ii) a delegated entity and its downstream subcontractors. First, proposed amended §5.6411(a) requires a group to execute a written agreement with any person identified pursuant to proposed amended §5.6403(c)(12)(A) or (B) that meets the requirements of proposed amended §5.6411. As discussed previously in this proposal, a person identified pursuant to proposed amended §5.6403(c)(12)(A) or (B) includes a group's administrator, third party administrators, and any service company that has management or discretionary decision making authority relating to a function the group maintains ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder. Proposed amended §5.6411(b) prescribes the contracting

requirements applicable to a group's delegated entities and their downstream subcontractors. Specifically, proposed amended §5.6411(b) applies only to a person identified pursuant to proposed amended §5.6403(c)(12)(A) or (B) who further delegates any of its management or discretionary decision making authority relating to a function a group retains ultimate responsibility for under the Labor Code, the Insurance Code, or regulations adopted thereunder to another administrator, service company, or third party administrator. If a person identified pursuant to proposed amended §5.6403(c)(12)(A) or (B) does delegate such authority to another administrator, service company, or third party administrator, then proposed amended §5.6411(b) requires that person to execute a written agreement with that downstream administrator, service company, or third party administrator that meets the requirements of proposed amended §5.6411. Proposed amended §5.6411(d) enumerates the minimal provisions that must be included in a written agreement under the proposed 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. Proposed amended §5.6411(e) also 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 that those books and records will be timely transferred to a group or its designee upon request of the group and at the termination or cancellation of the written agreement. Lastly, proposed amended §5.6411(f) provides that a written agreement required under subsection §5.6411 (a) or (b) must meet the requirements of §5.6411 no later than June 1, 2009. The remaining proposed amendments to §5.6411 are necessary to correct inconsistent references, to correct grammatical errors, to increase readability, and to re-number the paragraphs accordingly.

§5.6412. Operational Review Plan. Proposed new §5.6412(a) requires a group to annually adopt an operational review plan that provides for sufficient oversight of any person who has entered into a written agreement pursuant to §5.6411(a) or (b) (relating to Contract Provisions), which may be modified at any time to meet a group's needs. Proposed new §5.6412(b) prescribes the minimal requirements for a group's operational review plan. Specifically, proposed 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 proposed new §5.6412(b)(2)(A) – (C). Proposed new §5.6412(b)(2) requires a group's operational review plan to require any person who has entered into a written agreement pursuant to §5.6411(a) or (b) to submit quarterly reports to the group containing the information described in proposed new §5.6412(b)(2)(A) – (C), 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. Lastly, proposed 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 proposed new §5.6412. Proposed 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. Proposed 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, proposed new §5.6413(b) requires the group's notification under proposed new §5.6413(a) 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.

2. FISCAL NOTE. Danny Saenz, Senior Associate Commissioner for the Financial Program, has determined that for each year of the first five years the proposed amendments and new sections will be in effect, there may be an approximate $375 - $750 annual increase in revenue to state government as a result of the enforcement and administration of this proposal due to the estimated additional fingerprint submissions to the Texas Department of Public Safety (DPS). This amount is based on an estimated additional 25 - 50 annual submissions resulting from the proposed fingerprint requirement in proposed amended §5.6403(f) of the proposal and a statutorily authorized $15 fee for each submission collected by the DPS. The Government Code §411.088(a)(2)

authorizes the DPS to charge a $15 fee for each criminal history record information inquiry. It is the Department's understanding based on information provided by the DPS that this fee is for the costs of processing the fingerprints and maintaining the records and systems used by the DPS in processing fingerprint submissions. Therefore, additional fingerprint submissions may result in increased costs to the DPS, which may substantially offset or eliminate any additional revenue. It is anticipated that most individuals in the State of Texas will utilize the convenience and reliability offered by the authorized electronic fingerprint services and, as such, the Department estimates that there will be no measurable fiscal impact to local governments from the capture of fingerprints on paper cards by local law enforcement agencies as a result of the enforcement or administration of this proposal. There will be no anticipated effect on local employment or the local economy as a result of the proposal.

3. PUBLIC BENEFIT/COST NOTE. Mr. Saenz also has determined that for each year of the first five years the proposed amendments and new sections are in effect, there are several anticipated public benefits, and there will be potential costs for persons required to comply with the proposal.

Anticipated Public Benefits. The anticipated public benefits include: a more efficient and standardized process for regulating workers' compensation self-insurance groups (groups) and their delegated entities, resulting in ease of operations and processes for the industry and the Department; increased financial solvency and stability of groups; increased assurance of timely and

sufficient payment of workers' compensation benefits for injured Texas workers; increased oversight of a group's delegated entities, resulting in increased accountability for compliance with the Insurance Code, the Labor Code, and regulations adopted thereunder; reduced administrative burdens for groups and their delegated entities with regard to fidelity bond filings, biographical affidavits filings, membership cancellation or termination filings, and storage and maintenance of books and records requirements; protection of a group’s members from possible assessments; protection of the Texas Group Self-Insurance Guaranty Association (Association), which protects against the risk of insolvency of groups; protection of the industry against potential Association fund assessments; and more efficient regulation of the industry by ensuring that persons receiving authorizations from the Department are honest, trustworthy, reliable, and fit to hold those authorizations.

The proposed amended and new sections streamline the application process for applicants and clarify the requirements for groups and their delegated entities. It is anticipated that these necessary clarifications will result in more efficient regulation of the industry and increased compliance with Department regulations. Additionally, the proposed amended and new sections eliminate duplicative administrative requirements where possible, reducing unnecessary filing requirements for the industry. Although, under the proposal, the filing requirements for the industry have been reduced, the Department's ability to effectively regulate the industry will not be negatively affected by the reduction of these filings. To the contrary, the Department anticipates that a group’s required

filings, although reduced in number, will more accurately and timely identify potentially hazardous financial conditions. This is because the threshold requirements for filing certain notices with the Department have been amended to better correlate with hazardous financial condition indicators. As a result, the required filings should alert the Department of potentially hazardous financial conditions at an earlier point in time, so that appropriate corrective actions may be taken and financial complications may be avoided. Further, it is anticipated that the proposed amended and new sections will allow industry to realize cost savings resulting from reduced fidelity bond requirements and amended requirements related to the storage and maintenance of a group's books and records. Specifically, it is anticipated that groups will be able to take advantage of innovative and cost effective methods of storage and maintenance of their books and records that may be available outside of the State of Texas.

The proposed amended and new sections also require a higher amount of specific excess insurance for each group. It is anticipated that this requirement will enhance a group's solvency and financial stability by insulating the group from potentially devastating catastrophic claims payments. It is also anticipated that this requirement will protect a group’s members from possible assessments, the Association, and industry against potential Association fund assessments. Additionally, this requirement is anticipated to further ensure the timely and sufficient payment of compensable workers' compensation claims of injured Texas workers, even where the total cost over the life of the claims is significantly high.

Lastly, the proposed amended and new sections require increased oversight over a group's delegated entities and downstream subcontractors, which should result in increased accountability for compliance with the requirements of the Insurance Code, the Labor Code, and regulations adopted thereunder. Additionally, because the proposed amended and new sections also require certain individuals to submit biographical affidavits and complete sets of fingerprints to the Department upon application for a certificate of authority, it is anticipated that only those persons that are honest, trustworthy, reliable, and fit to hold a certificate of approval from the Department will be granted such authorization. This proposed requirement ensures the safety of the public and the integrity of the workers' compensation system.

Potential Costs for Persons Required to Comply with the Proposal.

Proposed Amended §§5.6403, 5.6405, 5.6408, and 5.6411 and Proposed New §§5.6404, 5.6409, 5.6412, and 5.6413 Requirements for Groups Currently Holding a Certificate of Approval

Under the Labor Code Chapter 407A and this division, unincorporated associations or business trusts composed of five or more private employers may establish a workers' compensation self-insurance group. The proposal prescribes the requirements for applicants applying for a certificate of approval under the Labor Code Chapter 407A and groups holding a certificate of approval under the Labor Code Chapter 407A. No person is required by law to establish a group. However, for those persons that choose to establish a group and who

currently hold a certificate of approval from the Department, there will be associated costs of compliance with proposed amended §§5.6405 and 5.6411, and proposed new §§5.6404, 5.6409, 5.6412, and 5.6413. There may be additional costs for these groups resulting from compliance with proposed amended §§5.6403 and 5.6408, depending upon whether a particular group changes: (i) any of the information filed in its original application for a certificate of approval under the Labor Code §407A.051(c) or proposed amended §5.6403; or (ii) its manner of compliance with the Labor Code §407A.051(c) or proposed amended §5.6403, such as obtaining new fidelity or performance bonds that meet required formatting requirements or amending a group's business plan to correctly identify a newly engaged service company. The Department anticipates that the costs of compliance with proposed amended §§5.6403 and 5.6408 will generally be of the same nature for groups holding a certificate of approval under the Labor Code Chapter 407A as for applicants for a certificate of approval under the Labor Code Chapter 407A. The specific anticipated costs associated with complying with proposed amended §§5.6403 and 5.6408 are described in the Department's cost analysis in the part of this Public Benefit/Cost note pertaining to potential costs to comply with proposed requirements for Applicants for a Certificate of Approval.

The probable costs associated with proposed amended §§5.6405 and 5.6411, and proposed new §§5.6404, 5.6409, 5.6412, and 5.6413 collectively result from notification requirements, maintenance of qualification requirements, contracting requirements, membership cancellation or termination reporting

requirements, and from obtaining and maintaining specific excess insurance, backing up, storing, and maintaining books and records, and implementing an operational review plan that provides for sufficient oversight of a group's delegated entities and downstream subcontractors.

Proposed new §5.6404 primarily prescribes notification requirements. Under proposed new §5.6404(a), a group is required to provide written notice to the Department identifying: (i) any change in the information filed by the group under the Labor Code §407A.051(c) and proposed amended §5.6403 (relating to Application for Initial Certificate of Approval); and (ii) any change in the group's manner of compliance with the Labor Code §407A.051(c) and proposed amended §5.6403. Proposed new §5.6404(b) requires a group to meet the requirements of the Labor Code §407A.051(c) and proposed amended §5.6403, as those requirements apply to any change of information identified by the group pursuant to proposed new §5.6404(a). Proposed new §5.6404(c) requires a group to provide written notice to the Department that any hazardous financial condition exists or is likely to occur. Additionally, proposed new §5.6404(d) requires a group to execute a statement acknowledging its responsibilities under proposed new §5.6404. Lastly, proposed 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. The total probable cost of preparing and submitting the information required under proposed new §5.6404(a), (c), or (d) should be less than $37. This is based upon a member of a group's administrative staff preparing the information necessary to comply with proposed

new §5.6404(a), (c), or (d) in less than one hour, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department estimates that a member of a group's management staff could review and approve the information prepared by a member of the group's administrative staff in less than thirty minutes, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. The total probable cost to comply with proposed new §5.6404(b) or (e) will vary substantially among groups based upon the business decisions made by individual groups, depending on how often a group chooses to change its manner of compliance with the requirements of the Labor Code Chapter 407A or this division. For example, if a group chooses to change the administrator named in the group's original application for a certificate of authority, the group may incur additional costs in order to meet the requirements of the Labor Code §407A.051(c) and proposed amended §5.6403 related to that specific change, such as the applicable bonding requirements under proposed amended §5.6403(c)(6). However, if a group chooses not to change its administrator, it will incur no such costs. Each group has the information necessary to estimate its own compliance costs. Any other costs for groups to comply with proposed new §5.6404 result from the legislative

enactment of the Labor Code Chapter 407A and are not a result of the adoption, enforcement, or administration of the proposal.

Under proposed amended §5.6405(a), a group must 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. The probable costs to comply with this proposed requirement will vary substantially between groups depending upon a group's size, volume, retention level, estimated payroll amount, number of member employers, payroll code classification, concentration of risk, market conditions, risk factors, and prior loss history. Based upon the information submitted to the Department, seven of the eight groups currently holding certificates of approval under the Labor Code Chapter 407A already maintain the level of specific excess insurance required by proposed amended §5.6405(a). Based upon those group's reported annual written premium and estimated excess insurance costs, the Department estimates that the probable cost to comply with proposed amended §5.6405(a) may range from 8.5 percent to 26 percent of a group's annual written premium. Additionally, proposed amended §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 under proposed amended §5.6405(a). No group, however, is required to petition the Department under proposed amended §5.6405(c). However, for those groups that choose to utilize the procedure provided by proposed amended §5.6405(c), there will also be associated costs of compliance with proposed amended §5.6405(c) and (d),

which collectively require a group to submit an analysis prepared by an actuary of the appropriate level of specific excess insurance for the group. The Department estimates that an actuary can develop an analysis of the appropriate level of specific excess insurance for a group in 12 to 14 hours, at the mean salary rate of $50.61 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, a member of a group's administrative staff could prepare the information necessary to comply with proposed amended §5.6405(c) in less than one hour, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department estimates that a member of a group's management staff could review the information prepared by the member of the group's administrative staff in less than one hour, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm.

Proposed new §5.6409(b) requires a group's books and records to be located within the United States, but allows a group's books and records to be located outside the State of Texas, provided certain requirements are met. All groups will generally be subject to the requirements of proposed new §5.6409(b), (c), (d), (e), and (f). For groups that choose to locate their books and records outside the State of Texas, there will be additional costs of compliance with

proposed new §5.6409(b)(1) – (4). The probable costs for complying with proposed new §5.6409(b), (c), (d), (e), and (f) will vary substantially among groups based upon individual business decisions made by individual groups, including choosing among various backup and storage methods for the group's electronic books and records, such as utilizing in-house storage and maintenance resources or employing an outside vendor to store and maintain the group's books and records. Because the Department considers the requirements in proposed new §5.6409(b), (c), (d), (e), and (f) to be consistent with prudent business practices, the Department does not anticipate that groups will need to make significant changes to their current storage and backup methods, systems, practices, and procedures. For example, certain groups may already have agreements with administrators or other independent vendors that address backup, maintenance, and storage of their books and records. Additionally, because proposed new §5.6409(b), (c), (d), (e), and (f) do not dictate the precise method or manner that must be utilized by a group, each group is free to choose the most economical means of complying with the requirements of proposed new §5.6409(b), (c), (d), (e), and (f). Further, each group has the information necessary to estimate its individual backup, storage, and maintenance needs associated with the requirements of proposed new §5.6409(b), (c), (d), (e), and (f). Lastly, no group is required to locate its books and records outside the State of Texas. However, for those groups that choose to utilize the procedure provided by proposed new §5.6409(b)(1) – (4) to locate their books and records outside of the State of Texas, there may be associated

costs of compliance. The Department estimates that a member of a group's administrative staff could prepare the information necessary to comply with proposed new §5.6409(b)(1) – (4) in less than one hour, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department estimates that a member of a group's management staff could review the information prepared by the member of the group's administrative staff in less than one hour, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. The Department also anticipates that any costs incurred as a result of complying with proposed new §5.6409 may be substantially reduced because a group may choose the most cost effective method for storing and maintaining its books and records, including utilizing vendors that are located outside the State of Texas. The Department anticipates that permitting groups to utilize vendors located outside the State of Texas will provide a group access to additional competitive markets, resulting in more choices and cost savings.

Proposed amended §5.6411(a) requires a group to execute a written agreement with its administrator, third party administrators, and service companies that have 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. Proposed

amended §5.6411(c), (d), and (e) prescribes the minimal provisions that must be included in these written agreements. The probable costs associated with these contracting requirements will vary substantially among groups depending upon the number of third party administrators and qualifying service companies a group utilizes; the types of services a group delegates to its administrator, third party administrators, and qualifying service companies; the complexity of a group's business plan or plan of operation; and the existence of any written agreements with a group's administrator, third party administrators, and qualifying service companies. The Department estimates that the total probable cost of complying with proposed amended §5.6411(a), (c), (d), and (e) should be less than $175 per written agreement. This estimate is based upon the following factors. First, existing §5.6411 requires a group to execute a contract with any person the group has engaged to perform a function regulated under the Insurance Code or the Labor Code. Thus, the Department anticipates that each group will already have a written agreement in place with its administrator and any service company or third party administrator that has been engaged by the group to perform a function regulated under the Insurance Code or the Labor Code. Second, proposed amended §5.6411(c), (d), and (e) requires that each written agreement contain only three additional provisions that are not already required under existing §5.6411. Thus, because groups should already have contracts in place with their delegated entities that already contain a portion of the required provisions of proposed amended §5.6411(c), (d), and (e), the Department anticipates that any changes to these existing written agreements

that are necessary for compliance with proposed amended §5.6411(c), (d), and (e) should be minimal. The Department anticipates that an attorney could review a group's existing contracts, draft new provisions that comply with proposed amended §5.6411(a), (c), (d), and (e), and finalize these contracts in less than three hours per written agreement, at the mean salary rate of $57.73 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Existing §5.6403(c)(11) requires a group to file a business plan with the Department identifying a group's administrator and service companies. Based upon the information included in the business plans of the groups currently holding certificates of approval under the Labor Code Chapter 407A, the Department does not anticipate that groups currently holding a certificate of approval will need to execute many new written agreements with their delegated entities in order to comply with proposed amended §5.6411(a), (c), (d), and (e). This estimate is based upon the fact that, in their business plan filed with the Department, most groups identified one administrator (per group) and a few service companies. However, for the groups that do need to execute new written agreements with their delegated entities in order to comply with proposed amended §5.6411(a), (c), (d), and (e), the Department anticipates that the costs of compliance for each new written agreement should be less than $230 per written agreement. The Department anticipates that an attorney could review a group's business plan, draft new written agreements that comply with proposed amended §5.6411(a), (c), (d), and

(e), and finalize these contracts in less than four hours per written agreement, at the mean salary rate of $57.73 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Any other costs associated with proposed amended §5.6411 result from the legislative enactment of the Labor Code Chapter 407A and are not a result of the adoption, enforcement, or administration of this proposal.

Proposed new §5.6412(a) requires a group to annually adopt an operational review plan that provides sufficient oversight of a group's delegated entities. Proposed new §5.6412(b) prescribes the elements that must be included in a group's operational review plan, such as a group's estimated projections for each quarter of the group's upcoming fund year and specific reports from a group's delegated entities. Lastly, proposed new §5.6412(c) requires the board of trustees of a group to consider the reports provided by the group's delegated entities and to provide for corrective action, as determined by the board of trustees of the group. The Department does not anticipate these reporting requirements to differ greatly from the reporting requirements already required under existing agreements between groups and administrators, third party administrators, and service companies. From information filed with the Department, agreements between groups and their delegated entities already specify to some degree that the delegated entities provide periodic, monthly, or as-needed reporting to the groups regarding the types of information contemplated under proposed new §5.6412(b)(1) and (2). Thus, the Department

anticipates that most groups should already receive the majority of the information required under proposed new §5.6412(b)(1) and (2) or at least have established the contractual right to do so. Overall, however, the probable costs to comply with proposed new §5.6412 will vary significantly among groups depending upon each group's business plan or plan of operation, the number of delegated entities the group has engaged, the amount of information each group is currently collecting from its delegated entities, and whether a group has already established the right to collect certain information from its delegated entities through a written agreement. Each group, however, has the information necessary to estimate its individual compliance needs associated with the requirements of proposed new §5.6412. Lastly, because proposed new §5.6412(c) requires a group to adopt an annual operational review plan, the Department estimates that a group may incur nominal, routine, administrative costs related to drafting and adopting the required annual operational review plan and considering and making recommendations based upon the required reports.

Proposed 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, proposed new §5.6413(b) requires the group's notification under proposed new §5.6413(a) 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. The probable costs of complying with proposed new §5.6413(a) and (b) should be less than $37. This is based upon a member of a group's administrative staff preparing the information necessary to comply with proposed new §5.6413(b) in less than one hour, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department estimates that a member of a group's management staff could review and approve the information prepared by the member of the group's administrative staff in less than thirty minutes, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Any other costs associated with proposed new §5.6413 result from the legislative enactment of the Labor Code Chapter 407A and are not a result of the adoption, enforcement, or administration of this proposal.

Proposed §§5.6403, 5.6405, 5.6408, and 5.6411 Requirements for Applicants for a Certificate of Approval

The proposal prescribes the requirements for applicants applying for a certificate of approval under the Labor Code Chapter 407A. For those persons applying for a certificate of approval under the Labor Code Chapter 407A and

this division, there will be associated costs of compliance with proposed amended §§5.6403, 5.6405, 5.6408, and 5.6411. The primary cost for applicants for a certificate of approval under the Labor Code Chapter 407A results from proposed amended §5.6403, which prescribes the requirements for an application for an initial certificate of approval. Proposed amended §5.6403 generally requires an applicant to provide proof of excess insurance and fidelity and performance bonds, as applicable, at the time of application, as well as copies of certain written agreements. Proposed amended §§5.6405, 5.6408, and 5.6411, which also apply to an applicant for a certificate of approval under the Labor Code Chapter 407A, further prescribe the specific requirements relating to such excess insurance, fidelity and performance bonds, and written agreements. The majority of the requirements of proposed amended §5.6403 are identification, notification, and documentation requirements, such as providing copies of bonds, biographical affidavits, written agreements, indemnity agreements, and acknowledgement forms, and identifying a group's business plan, its delegated entities, and its accountant and actuary. The probable costs for complying with the identification, notification, and documentation requirements of proposed amended §5.6403 should be less than $135. This estimate is based upon the following factors. First, the Department anticipates that a member of a group's administrative staff could prepare the information necessary to comply with the identification, notification, and documentation requirements of proposed amended §5.6403 in less than three hours, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State

Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department anticipates that a member of a group's management staff could review and approve the information prepared by the member of the group's administrative staff in less than two hours, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Proposed amended §5.6403(c)(12) specifically requires a group to also submit a business plan or plan of operation that describes the group's business activities, safety program, and organization. A group's business plan will vary substantially from group to group based upon the size of the group, the complexity of the group's business, the number and identity of the initial employer members, types and risks insured, and the number and type of the group's delegated entities. The probable costs associated with complying with proposed amended §5.6403(c)(12) are anticipated to be between $1,158 – $1,247. This is based on the Department's anticipation that a knowledgeable member of a group's management staff could properly prepare the portions of a group's business plan or plan of operation that relates to the identification and description of the group's organization, business activities, and safety program in 10-12 hours, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department

estimates that an actuary could prepare the appropriate financial statements related to the group's business plan in less than 14 hours, at the mean salary rate of $50.61 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Further, proposed amended §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 group's administrator, third party administrators, and qualifying service companies to comply with the requirements of Chapter 1, Subchapter D of this title (relating to Effect of Criminal Conduct), including submitting a complete set of fingerprints and certain identifying information to a person identified under §1.509 of this title (Relating to Fingerprint Format and Complete Application). The Department estimates that the probable costs of complying with proposed amended §5.6403(f) should be $45 - $55. The Department has been informed by the FBI and DPS that each individual who must provide fingerprints under §1.503(a)(2) of this title (relating to Application of Fingerprint Requirement) must pay a fingerprinting fee of $34.25. The $34.25 fingerprinting processing fee includes an FBI charge of $19.25 and a DPS charge of $15. Additionally, there is a $9.95 fingerprint collection fee charged by companies that take electronic fingerprints on behalf of the Department. While the Department anticipates that most individuals in the State of Texas will utilize the convenience and reliability offered by authorized electronic fingerprint services, an individual may choose to submit a paper fingerprint card instead of an electronic fingerprint

submission. In those cases, the individual must submit payment in the amount of $44.20 payable to the DPS, which includes the fingerprinting processing fee of $34.25 and the fingerprint collection fee of $9.95. Additionally, if an individual has his or her fingerprints captured on a paper fingerprint card by a criminal law enforcement agency, the Human Resources Code §80.001(b) authorizes a charge for such service in an amount not to exceed $10. Lastly, any additional information that must be supplied by an individual at the time of fingerprinting is minimal, and the Department does not anticipate an associated cost with providing such required information. Further, the Department anticipates that an individual or applicant should only have to submit a complete set of fingerprints under the proposed amendments one time, so long as the applicant maintains continuous licensure with the Department. An applicant for a certificate of approval under the Labor Code Chapter 407A must also comply with the requirements of proposed amended §§5.6405, 5.6408, and 5.6411, as those sections are incorporated into the requirements of proposed amended §5.6403. The specific costs associated with complying with proposed amended §§5.6405 and 5.6411 are described in the Department's cost analysis in the part of this Public Benefit/Cost Note pertaining to potential costs to comply with proposed requirements for Groups Currently Holding a Certificate of Approval. The probable costs associated with compliance with proposed amended §5.6408 will vary among groups based upon the total number of a group's delegated entities subject to proposed amended §5.6408 and upon the individual business decisions made by each group related to the payment of its delegated entities'

bonds. Although an applicant for a certificate of approval under the Labor Code Chapter 407A is required under proposed amended §5.6403(c)(6), (7), and (8) to submit a fidelity or performance bond on behalf of its administrator and service companies, including a service company performing claims services on behalf of the group, a group may choose to either pay for those bonds directly or to require its delegated entities to obtain and pay for those bonds. Based upon the information available to the Department, the Department estimates that the cost of a fidelity bond for an administrator or service company meeting the requirements of proposed amended §5.6408(a) and (d) should be between $150 - $550 per entity and that the cost of a performance bond for a service company performing claims services on behalf of a group meeting the requirements of proposed amended §5.6408(b), (c), and (d) should be between $150 - $300 per entity. Additionally, the Department estimates that the probable costs associated with compliance with proposed amended §5.6408(e) should be less than $37. This is based upon a member of a group's administrative staff preparing the information necessary to comply with proposed amended §5.6408(e) in less than one hour, at the mean salary rate of $14.13 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Additionally, the Department anticipates that a member of a group's management staff could review and approve the information prepared by the member of the group's administrative staff in less than thirty minutes, at the mean salary rate of $44.87 per hour, as set forth in the May 2007 State Occupational Employment

and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Any other costs associated with proposed amended §§5.6403 and 5.6408 result from the legislative enactment of the Labor Code Chapter 407A and are not a result of the adoption, enforcement, or administration of this proposal.

Once an application for a certificate of approval under the Labor Code Chapter 407A is approved by the Department, there will also be additional costs resulting from compliance with proposed amended §§5.6405 and 5.6411 and proposed new §§5.6404, 5.6409, 5.6412, and 5.6413. The Department anticipates that the costs of compliance with proposed amended §§5.6405 and 5.6411 and proposed new ,§§5.6404, 5.6409, 5.6412, and 5.6413 will be the same for applicants newly granted a certificate of approval under the Labor Code Chapter 407A as for groups holding a certificate of approval under the Labor Code Chapter 407A. The specific costs associated with complying with proposed amended §§5.6405 and 5.6411, and proposed new §§5.6404, 5.6409, 5.6412, and 5.6413 are described in the Department's cost analysis in the part of this Public Benefit/ Cost Note pertaining to potential costs to comply with proposed requirements for Groups Currently Holding a Certificate of Approval.

<u>Proposed Amended §§5.6403, 5.6408, and 5.6411, and Proposed New §5.6412 Requirements for Administrators, Qualifying Service Companies, Third Party Administrators, and Downstream Subcontractors</u>

A group's delegated entities and their downstream subcontractors may incur costs associated with compliance with proposed amended §§5.6403, 5.408, and 5.6411, and proposed new 5.6412. Proposed amended §5.6403(c)(6), (7), and (8), (e), and (f) collectively require a group's delegated entities and their downstream subcontractors to obtain fidelity or performance bonds, as applicable, and to submit biographical affidavits to the Department and a complete set of fingerprints to a person identified under §1.509 of this title. The Department anticipates that the costs of compliance with proposed amended §5.6403(c)(6), (7), and (8), (e), and (f) and §5.6408 will be the same for a group's delegated entities and downstream subcontractors as for applicants for a certificate of approval under the Labor Code Chapter 407A. The specific costs associated with complying with proposed amended §§5.6403 and 5.6408 are described in the Department's cost analysis in the part of this Public Benefit/ Cost Note pertaining to potential costs to comply with proposed requirements for Applicants for a Certificate of Approval. If a group's administrator, third party administrators, or qualifying service companies further delegate any of their 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 to another administrator, third party administrator, or qualifying service company, proposed amended §5.6411(b) requires a written agreement to be executed. Proposed amended §5.6411(c), (d), and (e) also prescribe the minimal provisions that must be included in such written agreements. The probable costs for complying with proposed amended

§5.6411(b), (c), (d), and (e) will vary substantially among delegated entities and downstream subcontractors, depending upon the number of times a particular function is delegated, who a particular function is delegated to, the complexity of a delegated entity's plan of operation; and whether a delegated entity already has existing written agreements with its downstream subcontractors. For those delegated entities that already have existing written agreements with their downstream subcontractors, the Department anticipates that an attorney could review those written agreements, draft new provisions that comply with proposed amended §5.6411(b), (c), (d), and (e), and finalize those contracts in less than three hours per written agreement, at the mean salary rate of $57.73 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. For those delegated entities who will need to execute a new written agreement with one of their delegated entities in order to comply with proposed amended §5.6411(b), (c), (d), and (e), the Department anticipates that the costs of preparing a new written agreement should be less than $230 per written agreement. The Department anticipates that an attorney could draft a new written agreement that complies with proposed amended §5.6411(b), (c), (d), and (e) and finalize each agreement in less than four hours, at the mean salary rate of $57.73 per hour, as set forth in the May 2007 State Occupational Employment and Wage Estimates for Texas published by the U.S. Department of Labor at http://www.bls.gov/oes/current/oes_tx.htm. Lastly, proposed new §5.6412(b) requires a group's operational review plan to

require the group's delegated entities and their downstream subcontractors to submit quarterly reports to the group regarding specified information. As discussed previously in this cost note, the Department does not anticipate the reporting requirements of proposed new §5.6412(b) to differ greatly from the reporting requirements already required under existing agreements between groups and their delegated entities and downstream subcontractors. Agreements between groups and their delegated entities already specify to some degree that the delegated entities provide periodic, monthly, or as-needed reporting to the groups regarding the types of information contemplated under proposed new §5.6412(b)(1) and (2). Thus, the Department anticipates that most delegated entities already provide groups with the majority of the information required under proposed new §5.6412(b)(1) and (2) or that they are at least contractually obligated to do so. Overall, however, the probable costs to comply with proposed new §5.6412 will vary significantly among each delegated entity and downstream subcontractor depending upon each entity's business plan or plan of operation, the number of groups each entity performs functions on behalf of, the types of functions each entity performs, the amount of information each entity is currently providing to each group it performs functions on behalf of, and whether a group has already established the right to collect certain information from that entity through a written agreement. Each entity, however, has the information necessary to estimate its individual compliance needs associated with the requirements of proposed new §5.6412(b). Additionally, the Department anticipates that a delegated entity or downstream subcontractor will

pass on any costs associated with the reporting requirements of proposed new §5.6412(b) to each group the entity performs functions on behalf of, thereby significantly decreasing that entity's compliance costs. Any other costs associated with proposed amended §§5.6403, 5.6408, and 5.6411 and proposed new §5.6412 result from the legislative enactment of the Labor Code Chapter 407A and are not a result of the adoption, enforcement, or administration of this proposal.

4. ECONOMIC IMPACT STATEMENT AND REGULATORY FLEXIBILITY ANALYSIS FOR SMALL AND MICRO BUSINESSES.

Workers' Compensation Self-Insurance Groups (Groups) Currently Holding a Certificate of Approval under the Labor Code Chapter 407A and Applicants for a Certificate of Approval under the Labor Code Chapter 407A

As required by the Government Code §2006.002(c), the Department has determined that the proposal will not have an adverse economic effect 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 will meet the definition of a small business under the Government Code §2006.001(2). 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. Each of these elements must be met in order for an entity to qualify as a small business under this section. However, neither a group nor an applicant will be able to 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. Eight groups currently hold certificates of approval under the Labor Code Chapter 407A, and there are no applications currently on file with the Department for a certificate of approval under the Labor Code Chapter 407A. Accordingly, the Department anticipates that no more than two applications for a certificate of approval under the Labor Code Chapter 407A will be submitted to the Department annually.

The Labor Code Chapter 407A permits an unincorporated association or business trust composed of five or more private employers to establish a workers' compensation self-insurance group. Under this arrangement, individual employers may enter into an agreement to pool their liabilities for workers' compensation benefits and employers' liability in this state. Pursuant to the Labor Code §407A.151, each group must be operated by a board of trustees composed of at least five persons whom the members of the group elect for stated terms of office. The trustees must be employees, officers, or directors of employers who are members of the group. Because a group may only act through its board of trustees, the Department has determined that a group is not independently owned and operated or self controlling because it is necessarily

subject to the control of other entities, namely its individual employer members. These individual employer members retain their individual status as individual entities. It is these individual entities that control the group. A group is not self controlling or subject to the independent control of only one employer member; rather, it is subject to the collective will of each of its individual employer members, who act through the elected board of trustees. As such, a group will always be subject to the collective control of its individual employer members. Because neither a group nor an applicant will meet the requirements of the Government Code §2006.001(2)(B), neither a group nor an applicant will be a small business under the Government Code §2006.001(2).

Administrators, Qualifying Service Companies, Third Party Administrators, and Downstream Subcontractors. As required by the Government Code §2006.002(c), the Department has determined that between 24 and 48 administrators, qualifying service companies, third party administrators, and downstream subcontractors will be subject to the proposal and may qualify as small or micro businesses under the Government Code §2006.001. No small or micro business is required by law to provide services to or on behalf of a group or to comply with the proposal. However, as required by the Government Code §2006.002(c), the Department has determined that the proposal may have an adverse economic effect on those small or micro businesses who choose to do so. Adverse economic impact may result from costs associated with fidelity or performance bond requirements, fingerprinting requirements, contracting requirements, and certain reporting requirements. The Department's cost

analysis and resulting estimated costs in the Public Benefit/Cost Note portion of this proposal pertaining to Potential Costs to Comply With Proposed Requirements for Administrators, Qualifying Service Companies, Third Party Administrators, and Downstream Subcontractors is equally applicable to these small or micro businesses.

In accordance with the Government Code §2006.002(c-1), the Department has determined that even though proposed amended §§5.6403, 5.6408, and 5.6411 and proposed new §5.6412 may have an adverse economic effect on small or micro businesses that are required to comply with these proposed requirements, the Department is not required to prepare a regulatory flexibility analysis as required in §2006.002(c)(2) of the Government Code. Section 2006.002(c)(2) requires a state agency, before adopting a rule that may have an adverse economic effect on small businesses, to prepare a regulatory flexibility analysis that includes the agency's consideration of alternative methods of achieving the purpose of the proposed rule. Section 2006.002(c-1) of the Government Code requires that the regulatory flexibility analysis "consider, if consistent with the health, safety, and environmental and economic welfare of the state, using regulatory methods that will accomplish the objectives of applicable rules while minimizing adverse impacts on small businesses." Therefore, an agency is not required to consider alternatives that, while possibly minimizing adverse impacts on small and micro businesses, would not be protective of the health, safety, and environmental and economic welfare of the state.

The general purpose of the Labor Code Chapter 407A is to allow employers, such as those in high risk industries, to form groups to pool their liabilities for workers' compensation benefits and employers' liability in this state. In permitting the formation of these groups, the Labor Code Chapter 407A also emphasizes the need for the groups to remain solvent and financially healthy and for workers' compensation benefits to be available on a timely basis. In order to accomplish these purposes, the Labor Code Chapter 407A prescribes specific financial, reporting, bonding, and licensing requirements applicable to groups and their delegated entities, such as administrators, service companies, and third party administrators. The Labor Code §407A.009 prescribes licensing requirements applicable to a group's administrator and service companies performing the acts of an administrator, as that term is defined in the Insurance Code Chapter 4151. The Labor Code §407A.051(e) directs the Commissioner to evaluate the financial information provided by a group with its application for a certificate of approval under the Labor Code Chapter 407A as necessary to ensure that the funding is sufficient to cover expected losses and expenses and the funds necessary to pay workers' compensation benefits will be available on a timely basis. Further, the Labor Code §407A.051(c)(12) and (13) and §407A.057 require a group's administrator and service companies to obtain fidelity and performance bonds. The common purpose of these requirements is to ensure a group's financial health, to ensure sufficient funding to cover expected losses and expenses, to ensure sufficient funding to pay workers' compensation benefits for

injured Texas workers, and to ensure proper accountability and regulation of a group's delegated entities.

The purpose of proposed amended §§5.6403, 5.6408, and 5.6411 and proposed new §5.6412 is to protect the health, safety, and economic welfare of injured Texas workers and the state of Texas generally by: (i) ensuring that persons performing delegated functions on behalf of groups are honest, trustworthy, and reliable and have sufficient experience, ability, standing, and good record to make success of the group probable; (ii) ensuring increased accountability and compliance with the requirements of the Insurance Code, the Labor Code, and regulations adopted thereunder; (iii) ensuring that workers' compensation benefits are available on a timely basis and in a sufficient amount; (iv) ensuring each group's general financial health; and (v) ensuring greater protection of a group's members from financial harm that may arise from assessments that an individual group may be required to levy on its own members to fulfill the group's obligations; and (vi) ensuring greater protection of all members of all groups from financial harm that may arise from the Texas Group Self-Insurance Guaranty Association (Association) assessments that may be required to be levied on all groups due to the insolvency of any one group.

The proposal requires the executive officers of a group's delegated entities to submit biographical affidavits to the Department and to submit complete sets of fingerprints. Because a group's delegated entities often have control over or access to a group's financial accounts, claims files, books and records, and premium and contribution collections, it is important that these

entities are honest, trustworthy, reliable, and have the necessary qualifications to make the success of the group probable. By requiring the key personnel of a group's delegated entities to submit their fingerprints and criminal history to the Department, the Department is better able to protect the interests of the public, the interests of injured Texas workers, and the integrity of the worker's compensation system. Further, the proposal implements the statutory bond requirements of the Labor Code Chapter 407A for a group's delegated entities. This added security provides groups with an additional safeguard in the event that one of their delegated entities does not properly execute its delegated functions. If needed, this added security should provide a group with the necessary tools to remedy the situation, especially where the payment of injured Texas workers' compensation benefits are involved. The proposal also requires a group to enter into written agreements with its delegated entities and, in certain circumstances, for those delegated entities to enter into written agreements with their downstream subcontractors. These proposed contracting requirements help ensure that all parties understand their responsibilities and obligations with respect to delegated functions and establish a group's expectations related to the performance of a delegated duty. It is especially important for groups to properly oversee their delegated entities because a group retains ultimate responsibility and accountability for all delegated functions under the Labor Code, the Insurance Code, or regulations adopted thereunder. The more times that a particular function is delegated from one entity to another, the greater the risk of non-performance or inadequate performance of that function becomes. The

proposed requirements are necessary to protect the interests of injured Texas workers by ensuring that workers' compensation claims are handled appropriately and paid timely, regardless of whether a group engages the services of a delegated entity or performs the required functions itself. Additionally, the proposal requires the ownership and possession of a group's books and records to be addressed in each written agreement. This is particularly important because a group's delegated entities will have access to or control of a group's books and records at various times. Because a group cannot comply with the requirements of the Insurance Code or the Labor Code with regard to the payment of workers' compensation benefits without knowing which of its claims has been paid or which of its claims remain outstanding, a group must have continuing access to its books and records, even if they are physically in the possession of one of its delegated entities. Additionally, a group may be placed in financial risk if it is unable to access its financial books and records as necessary. The proposed requirements are necessary to prevent situations where a group would be denied continuous access to its own books and records. Lastly, the proposal requires a group's delegated entities and their downstream subcontractors to submit various quarterly reports to the group. Requiring the submission of this information is paramount in enabling a group to better assess its ability to meet its obligations under the Labor Code, the Insurance Code, and regulations adopted thereunder on a regular basis. Additionally, a group's regular review of the required information will enable the group to foresee potential financial problems or solvency issues at a much earlier date, so that

corrective action can be taken immediately. 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 and a healthier workers' compensation system. The proposed requirements, both individually and collectively, will also provide greater protection of a group's members from financial harm that may arise from assessments that an individual group may be required to levy on its own members to fulfill the group's obligations. These proposed requirements will also provide greater protection of all members of all groups from financial harm that may arise from Association assessments that may be required to be levied on all groups due to the insolvency of any one group.

Therefore, the Department has determined, in accordance with §2006.002(c-1) of the Government Code, that because the purpose of proposed amended §§5.6403, 5.6408, and 5.6411, and proposed new §5.6412 and the authorizing statutes of the Labor Code and the Insurance Code is to protect the health, safety, and economic welfare of injured Texas workers and the state of Texas, there are no additional regulatory alternatives to the proposed requirements that will sufficiently protect the health, safety, and economic interests of injured Texas workers and the welfare of the state.

5. TAKINGS IMPACT ASSESSMENT. The Department has determined that no private real property interests are affected by this proposal and that this proposal

does not restrict or limit an owner's right to property that would otherwise exist in the absence of government action and, therefore, does not constitute a taking or require a takings impact assessment under the Government Code §2007.043.

6. REQUEST FOR PUBLIC COMMENT. To be considered, written comments on the proposal must be submitted no later than 5:00 p.m. on August 25, 2008, to Gene C. Jarmon, General Counsel and Chief Clerk, Mail Code 113-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. An additional copy of the comments must be simultaneously submitted to Danny Saenz, Senior Associate Commissioner for the Financial Program, Mail Code 305-2A, Texas Department of Insurance, P. O. Box 149104, Austin, Texas 78714-9104. Any request for a public hearing should be submitted separately to the Office of the Chief Clerk before the close of the public comment period. If a hearing is held, written and oral comments presented at the hearing will be considered.

7. STATUTORY AUTHORITY. The proposed amendments and new sections are proposed 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. 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.

8. CROSS REFERENCE TO STATUTE. The following statutes are affected by this proposal:

Rule	Statute
§§5.6401 – 5.6405, 5.6408, 5.6409, and 5.6411 – 5.6413	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, and 407A.455

9. 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 [~~of~~] 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) (No change.)

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

(1) – (5) (No change.)

(6) A fidelity [~~performance~~] bond for an [~~the~~] 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). [~~If the administrator serves as the service company, the bond shall be in the amount of $500,000. The bond shall be in the form prescribed in §5.6408 of this title (relating to Performance Bonds).~~]

(7) A fidelity [~~performance~~] bond for a [~~the~~] 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. [~~The bond shall be in the form prescribed in §5.6408 of this title.~~]

(8) A performance bond for a service company identified pursuant to paragraph (12)(A) of this paragraph 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)[~~(8)~~] An indemnity agreement executed by the members of the group binding [~~indemnifying~~] 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 [~~title~~] (relating to Indemnity Agreement).

(10)[~~(9)~~] An acknowledgement, in the form prescribed in §5.6407 of this division [~~title~~] (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 [~~as a result of executing the indemnity agreement in §5.6406 of this title~~].

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

(12)[~~(11)~~] A business plan or plan of operation that describes the group's [~~general~~] 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; [~~service companies, risk manager, accountant and actuary~~]

(B) 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;

(C) the identity of the accountant and 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) (No change.)

(e) Each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the [~~chief~~] executive officers [~~officer, president, secretary, treasurer, chief financial officer and controller~~] of a person identified pursuant to subsection (c)(12) (A) or (B) of this section [~~the administrator and any service company~~] shall provide to the department a completed biographical affidavit [~~adopted by reference under §7.507(b) of this title (relating to Forms Incorporated by Reference)~~]. 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 contains substantially accurate information if the responses given by the individual in the affidavit on file with the department continue to indicate sufficient experience, ability, standing, and good record to make success of a group probable. [~~when a person has one on file with the department~~]

(f) Each member of the initial board of trustees of a group, subsequent members of the board of trustees of a group, and the [~~chief~~] executive officers

[~~officer, president, secretary, treasurer, chief financial officer and controller~~] of a person identified pursuant to subsection (c)(12)(A) or (B) of this section [~~the administrator and any service company~~] 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 deemed necessary in determining 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 [~~The~~] 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 [~~acceptable to the Commissioner but in no event shall the excess insurance coverage be less than $5 million per occurrence~~].

(b) (No change).

(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 group's excess insurance~~], the commissioner [~~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 [~~factors~~]. In no event, however, shall a group's excess insurance coverage be less than $10 million per occurrence.

(d) To assist the commissioner [~~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 [~~Performance Bonds~~] required of an [~~the~~] administrator under the Labor Code §407A.051(c)(12) and a [~~the~~] service company under the Labor Code §407A.051(c)(13) 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 shall be made payable to the group.

(b) A performance bond required of a service company providing claims services to or on behalf of a group shall be in substantially the form set forth in subsection (c) [~~(b)~~] of this section.

(c)[~~(b)~~] A [~~The~~] performance bond required under the Labor Code §407A.057(a) shall contain the following text and shall be in the following format [~~is as follows~~]:

Figure: 28 TAC §5.6408(c) [~~§5.6408(b)~~]:

BOND OF [~~ADMINISTRATOR OR~~] SERVICE COMPANY FOR A WORKERS' COMPENSATION SELF-INSURED GROUP

Know all persons by these presents, that (name of [~~administrator or~~] 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) [~~Texas Department of Insurance~~] 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 [~~self-insurance~~] group) to perform duties and services for the group.

Now, therefore, if the principal shall perform its [~~his/her~~] 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)[~~Commissioner of the Texas Department of Insurance~~]; 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

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(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 [~~that engages any person to perform any function regulated under the Texas Insurance Code or Labor Code shall execute a contract with that person~~].

(b) If a person identified pursuant to §5.6403(c)(12)(A) or (B) of this division delegates any of its 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 to

another administrator, service company, or third party administrator, that person shall execute a written agreement with that administrator, service company, or third party administrator that meets the requirements of this section.

(c)[~~(b)~~] A group retains ultimate accountability and responsibility for compliance with all statutory and regulatory requirements, and no written agreement [~~contract, including a contract with the administrator or a service company,~~] may be construed to limit, in any way, the group's ultimate accountability and responsibility.

(d)[~~(c)~~] A written agreement [~~Any contract~~] entered into [~~between a group and~~] pursuant to subsection (a) or (b) of this section shall include [~~an administrator or a service company or any other person to perform functions regulated by the department must contain~~]:

[~~(1) a provision that the contract may not be construed to limit in any way the group's responsibility, including financial responsibility, to comply with all statutory and regulatory requirements~~];

(1) [~~(2)~~] a requirement that [~~requires~~] the administrator, service company, or third party administrator [~~subcontractors to~~] must comply with the applicable requirements of the [~~Texas~~] 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;

[~~(3) a provision that requires the subcontractor to be appropriately licensed to perform any function required by the Texas Insurance Code to be licensed; and~~]

(2) [~~(4)~~] a requirement that the administrator, service company, or third party administrator must permit [~~a provision that permits~~] the commissioner or the group [~~Commissioner~~] to examine at any time:

(A) its [~~the~~] financial solvency [~~of the person,~~]; and

(B) its [~~the~~] ability [~~of the person~~] to perform its responsibilities under the written agreement [~~contract.~~];

(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 upon:

(A) request of the group; and

(B) at the termination or cancellation of a written agreement entered into pursuant to subsection (a) or (b) of this section.

(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 has entered into a written agreement pursuant to §5.6411(a) or (b) (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 has entered 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.

10. CERTIFICATION. This agency hereby certifies that the proposed amendments and new sections have been reviewed by legal counsel and found to be within the agency's authority to adopt.

Issued at Austin, Texas, on _____, 2008.

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