



Your Workforce Management Professionals



Professional Employer Organizations An Overview

PEO's were created to provide medical and work comp insurance for businesses not large enough to afford lower cost group plans, lest costly than individual employee plans. Through a section of the IRS code it was discovered that if an employer "fired" its employees, had the employees rehired by a PEO, and then "leased" the employees back from the PEO, the original employer could then participate in the PEO's group benefit plans, which were normally of lower cost. This lower cost was due to the larger number of "employees" the PEO could offer an insurance carrier and the spreading of medical and injury losses over a wider population. After much litigation by the government during the 1980's, the IRS, with certain conditions, accepted the PEO method of providing benefits, although recent IRS rulings regarding PEO 401(k) and other retirement plans are still being examined.

A PEO's profit margins were derived from the spread between their actual medical and work comp premiums and the premiums charged to clients, premiums that in most cases were below what the client could obtain. Over the last 4 years, many insurance carriers have gradually backed out of providing PEO's with insurance coverage because many PEO's had enrolled any company they could find that would participate, regardless of the company's health claims experience or injury rates. This resulted in a rapid increase in medical and injury payments by the insurance company, which caused carriers to drop coverage or increase the PEO's premiums. These increases began to erode the PEO's profit margins. Many PEO's then elected to go to partially or fully self-insured medical and work comp programs. However, re-insurance carriers for these plans also became very selective, with only 4 or 5 re-insurance carriers currently willing to offer re-insurance coverage to PEO's. Both cases have resulted in increased medical and work comp costs to the PEO, costs that are either passed on to the client or absorbed. You can guess which one is occurring. Today, in many cases, the cost of small company group plans and workers compensation, for generally healthy employers, varies very little in price of those offered by a PEO. In addition, once an employer reaches 100 or more employees, the benefits of a PEO rapidly disappear, both from a benefit and "administrative" standpoint.

This erosion of profit margins and increased insurance coverage costs has resulted in shrinkage of PEO's from a high of 900 + 3 years ago to just under 600 today. One of the largest PEO's in 2002, CNA, divested itself of its nationwide PEO business line, which they had established to sell more insurance lines through PEO clients. In other words, CNA could not make a profit either on their insurance lines or client administrative fees. CNA left thousands of businesses scrambling for coverage, with other PEO's being very selective on new clients. On top of this, in losing PEO membership, these companies could not obtain individual company medical and work comp claims experience incurred during their association with the PEO, resulting in the business being treated and rated as a "new company" by insurance carriers, regardless to how many years the business existed and/or how low medical and work comp claims experience may have been. In many cases, these businesses were required to pay higher than normal work comp and medical rates based on their industry standards rather than individually. Some could not find an insurance carrier willing to offer coverage or found the new premiums unaffordable due to the medical conditions of employees.

PEO's have become very selective regarding companies they will co-employ with, steering away from non-white collar companies and/or companies with medical problems, high accident rates,



high turnover, and blue-collar workforces. They also have a tendency to drop (non-renew) current clients that incur high costs in these areas or clients with an unskilled management staff that causes increased PEO staff involvement with day-to-day people issues. In regards to litigation, be it in employment, compliance, safety, or a host of other people related issues; the PEO must take an “arms length” position that does not involve them. In other words, if a client company gets into real people problems, and the problem originated with the company and its management, the PEO will not involve themselves in legal/compliance issues. Indeed, such language is incorporated into the PEO contract. Yet the nature of joining a PEO results in many employers having to comply with even more compliance and legal regulations than they would had they not joined.

The administrative systems provided are mainly to control costs in insurance and to convince a client that the PEO will effectively “manage” the employer’s workforce. Although they provide some direction, they are not in the business of managing the investment in people for the client or growing the client’s business through people. Some are willing to provide high-level personalized HR services, at a very significant increase in admin fees, as long as they are not labor intensive. Today, most PEO’s are making their profits from administrative fees. Therefore, the less quantity of “administrative” services they can provide, resulting in less staff needed to “administrate”, the more profit they can make. In most cases, the PEO representative a company turns to for assistance will have very little experience in actual management of people in a business. A typical PEO representative will be “in charge” of “assistance” to as many as 15 to 20 firms. They offer “advice on what to do”; none will actually perform what they may advise.

Choosing a PEO is a major commitment with significant potential downside. Make sure the costs you (or your employees) are paying for medical, dental, and other benefit packages, along with worker’s compensation premiums and payroll processing, cannot be obtained at the same price (or less) on a standalone basis. (Remember, these costs, with the exception of payroll, are in addition to PEO administrative fees).

Equally important, carefully compare administrative costs, which can range from 2% to 8% of payroll, to the actual services to be performed (you can ask some of the questions provided below). Ask the PEO to provide you with a specific list of services to be performed, in exchange for administration fees, in the following areas:

- Employment Administration
- Employee Training and Development
- Government Compliance (Harassment/EEOC Charges, OSHA Inspections)
- Safety Management
- On-Site Recruiting, Interviewing, Selection, Screening and Orientation Services
- On-Site Counseling and Employment Termination Services
- Unemployment, OSHA, Work Comp, EEOC Hearing Attendance and Response Preparation

Last, make sure to investigate multiple PEO firms, check references, compare plan costs, administrative fees and service levels. Then price these services on a standalone basis.

Some Questions to Ask

1. Will the PEO actually recruit, interview, reference check, background check, hire and orient new employees for you? Will they do the same if you have to counsel or terminate an employee? Will they write up counseling forms for you?



2. Will the PEO develop a policies and procedures manual covering all aspects of personnel management, including OSHA compliance, specific to your industry and company? If so will you have to modify them to fit your business needs or will they perform the service?
3. Do they do on-site training for employees and management staff in all aspects of the business or just their administrative systems?
4. Will they assist in establishing and maintaining the company's culture?
5. Since your employees are in a co-employment relationship, is the PEO more interested in protecting the interests of the PEO in regards to employment, benefits, counseling and termination, or your interests?
6. If the PEO provides forms, manuals, policies & procedures, will they take the time and effort to customize them for you based on your needs, or are the document boilerplates, one-size-fits-all, requiring you to write company specific policies?
7. If you wish benefits outside of the PEO's benefit package, will the PEO obtain them for you, administer the program and communicate effectively with employees to increase employee satisfaction and reduce turnover; are benefit costs the same or greater than you could obtain outside a PEO?
8. Does the PEO provide on-site personal assist in the administering these forms, manuals, policies and procedures and benefits? More importantly, will the PEO take the time to understand the your culture, management style and individual employees as part of applying these policies/procedures in everyday people management situations? Will you be dealing with experienced HR professionals that have managed people or administrative staff with 1 to 3 years experience?
9. Does the PEO have a high interest making the business as successful as the owner wishes it to be?
10. Will the PEO be available on a daily basis to assist the business owner in building his/her business through the business's employees?
11. If the business is faced with federal compliance issues such as an OSHA, EEO or Wage and Hour spot audit, will the PEO provide on-site rather than telephone support?
12. Is there an extra charge for on-site visits? How far is the nearest PEO office with staff? At what level of experience is the office staffed? How many companies are assigned to each staff member?
13. When the business owner calls the PEO, will they be speaking with a degreed HR professional, experienced in day-to-day people management, familiar with the company and its people, or a representative/technician with 1 – 3 years experience that will determine if the problem needs to be "bumped up" to a higher level?
14. Will they take an active role in reducing accidents and injury claims with daily return to work management of injured employees?
15. Does the PEO reimburse or indemnify your company for legal fees and damages arising from any claim filed by a worker?
16. How will future claims in the PEO's workers compensation, medical and unemployment program affect the your business? Will the PEO pass on increases in these programs to you, as a result of the PEO taking large losses incurred by other PEO clients? More importantly, should you elect to leave the PEO, how will the your new workers compensation mod rate/premiums, medical premiums and unemployment taxes be affected?
17. During the time you employ under 50 employees, are you prepared to offer employees guaranteed return-to-work leaves under the Family Medical Leave Act (FMLA) for personal medical, family medical and adoption/child care for 60 work days and/or intermittent leave as low as 1 hour a week for a total of 480 hours a year? Does the PEO use a calendar year or rolling 12-month period to determine how much time has been



- used? Most importantly, will the PEO physically handle all the paperwork, communicate effectively with the employee and coordinate such leave with workers compensation statutes, the American's with Disabilities Act (ADA) and any paid/unpaid leave programs you have in place, such as vacation, personal and sick time?
18. If you have a workforce of 10 and 4 are out on FMLA leave, will the PEO physically recruit, interview, background check and hire temporary replacements to fill the production void? Is this service free, at an additional charge, or not available?
 19. Will the PEO set up a compensation system for you specific to your business? Job descriptions? Performance evaluations? Will they train your managers to give effective evaluations? Will they monitor and manage pay increases in light of overall costs?
 20. How is the PEO handling the recent IRS ruling regarding multi-employer PEO 401(k) plans changing to a single employer plan? How will your firm's leaving the PEO affect the current PEO provided retirement plan and the establishment of a new plan in the event you leave the PEO?
 21. Does the PEO reserve the right to hire and fire? Will they physically appear to coach management on an actual counseling or termination session and/or actually do the counseling/termination? Do they have training programs in these and many other people management areas? Will they present these programs and other needed employee and management training on-site?
 22. Will they administer any in-house grievance system and help resolve employee disputes on-site on a daily basis?
 23. If the PEO is charging you on a per employee per month basis or as a percentage of payroll, what portion of the fees are for what services? What does the admin charge truly provide you?

Contrary to the tone of the above, none of the above is meant to dissuade a business from entering a contractual relationship with a PEO. PEO's have been, and can be, a viable business alternative to obtaining benefits, including retirement plans that would otherwise be too costly or un-obtainable. They can also be beneficial if a company insists that PEO staff not replace their in-house HR support and that the PEO work through this staff, providing a "check and balance" resulting in increased day-to-day effectiveness. Unfortunately, most businesses under 200 employees that are interested in joining a PEO are doing so solely to obtain benefits cost reduction and minimum administrative systems such as payroll. Many are surprised, after joining, that the PEO does not provide the kind of HR support needed (or was assumed to provide) to manage and grow a business; and that the business now must comply with many laws it was not formerly required to comply with (see question #17 above).

Among HR Consult's many services is providing assistance in analyzing whether joining a PEO will be a good fit for an organization. We also perform a detailed analysis of a company's strategic and financial goals as well as the company's culture and provide an unbiased opinion regarding entering a co-employment relationship with a PEO. If a PEO is a fit, HR Consult works closely with the client to ensure the PEO contract is structured correctly and that the client is fully aware of the positives and negatives of entering such a contract. In the event, the PEO is not a fit, HR Consult, in many cases, can provide services far exceeding those of a PEO, at a lower cost and higher quality service level.