PEO: The Devil is in the Details

Ryan Insurance Services, LLC

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Abstract

PEO: Is it right for you?

For small to mid-sized companies – especially those going through a phase of rapid growth - professional employer organizations (PEOs) can seem like a quick, easy solution to a wide range of complex problems. For busy leaders, the picture painted by PEOs is enticing. They promise to remove the hassle of payroll, benefits, HR, tax administration, and regulatory compliance so leaders can focus on growing their business.

In order to outsource these employee management tasks to a PEO, the PEO will need to hire their client's employees and become their employer of record for tax and insurance purposes. The client's employees are now employed by the PEO, creating what is commonly referred to as a co-employment relationship.

But here's the rub: co-employment relationships are notoriously complex and litigious. Simple misunderstandings can quickly escalate into costly lawsuits and your only protection is a contract written and executed by the PEO. The nature of these agreements can potentially put business owners – and their future - in a tenuous financial and legal position. At worst, they can lull you into a false sense of security that can result in lawsuits, fines, and fees.

Better pricing and plans are also touted as a big benefit, but do the positives outweigh the negatives? It seems great to have someone dealing with HR headaches, but what does that really mean for your employees? No doubt, a PEO can seem like the answer to all your problems, but is it? The reality of this arrangement may be far more costly – in both hard and soft costs – than it appears.

Given what's at stake, the decision to engage a PEO warrants careful consideration before signing on the dotted line. In this white paper we will shine a spotlight on three common misconceptions about PEOs and provide alternatives so you can make a smart decision about your business and your bottom line.

Detail #1: Indemnification and Legal Protection

One of the most attractive benefits of a PEO is the promise of indemnification and legal protection in employment matters. Unfortunately, the nuances of employment law mean that you might not have the protection you think you do. Given the substantial financial risks involved, you owe it to your employees and your business to read the fine print BEFORE you sign on the dotted line.

Far and away, your biggest financial and legal exposure when engaging a PEO is federal and state taxes and overtime. Unpaid federal and state taxes, plus the resulting penalties and interest, can be as high as 40 percent of the workers' income over the course of three years. At first glance, your PEO contract may appear to indemnify you from these risks, but the reality is far from straight forward. The very nature of the co-employment relationship creates a gray area which means you could be bearing more of the risk than you realize.

Defining this grey area is the job of the Fair Labor Standards Act (FLSA) and the "economic realities test." This test uses a series of questions to determine whether a worker is a contractor or an employee. Unfortunately, the interpretation of these answers is subjective and varies wildly from state to state and jurisdiction to jurisdiction. If a worker is determined to be an employee under this test, then the federal minimum wage and overtime rules (subject to any exemptions) and the Family and Medical Leave Act (FMLA) apply.[1] As the employer, you could be jointly liable for any alleged violations... regardless of the protections outlined in your PEO contract.[2]

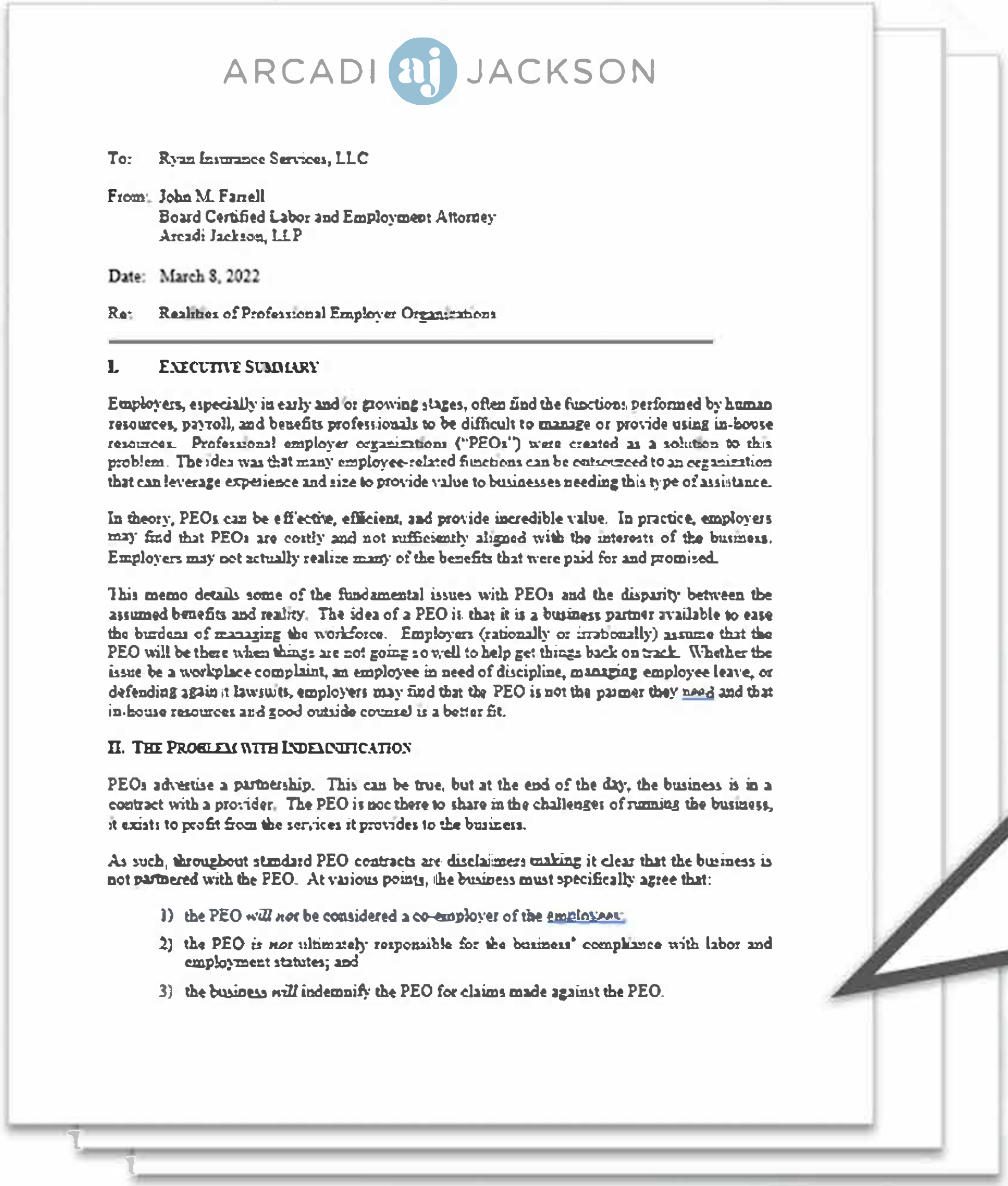
Equally concerning is the fact that these risks are often non-insurable. Insurance companies may agree to pay some portion of attorney fees (following a sizable deductible) for a class action wage claim, but the funds to settle claims of unpaid taxes and unpaid overtime will almost always be completely paid by the employer: you. Likewise, failure to confirm that your PEO is properly maintaining employee records could create additional problems and liabilities.[3]

Bottom Line: If it walks like an employer and talks like an employer, the government could call it an employer and responsibility will follow. Your PEO cannot protect you from these obligations, regardless of what your contract might say.

Solution: No one takes care of you like you take care of you. The risk related to utilizing employees is a reality that cannot be safely outsourced to a third-party without your strict oversight; you cannot afford to take your hands off the wheel.

Liability in the real world.

An employee files a claim based on the questionable behavior of another employee. The lawsuit names your business and the PEO as joint defendants. The PEO's employment practices liability (EPL) insurance policy is triggered, but the carrier appoints just one lawyer for the defense. If you and your PEO have different priorities, this can easily create conflicts related to strategies and settlement terms. At the end of the day, it is your reputation and finances on the line and having a PEO has only taken you out of the driver's seat, not off the hook



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To: Ryan Insurance Services, LLC

From: John M. Farrell
Board Certified Labor and Employment Attorney
Arcadi Jackson, LLP

Date: March 8, 2022

Re: Realities of Professional Employer Organizations

I. EXECUTIVE SUMMARY

Employers, especially in early and/or growing stages, often find the functions performed by human resources, payroll, and benefits professionals to be difficult to manage or provide using in-house resources. Professional employer organizations ("PEOs") were created as a solution to this problem. The idea was that many employee-related functions can be outsourced to an organization that can leverage experience and size to provide value to businesses needing this type of assistance.

In theory, PEOs can be effective, efficient, and provide incredible value. In practice, employers may find that PEOs are costly and not sufficiently aligned with the interests of the business. Employers may not actually realize many of the benefits that were paid for and promised.

This memo details some of the fundamental issues with PEOs and the disparity between the assumed benefits and reality. The idea of a PEO is that it is a business partner available to ease the burdens of managing the workforce. Employers (rationally or irrationally) assume that the PEO will be there when things are not going so well to help get things back on track. Whether the issue be a workplace complaint, an employee in need of discipline, managing employee leave, or defending against lawsuits, employers may find that the PEO is not the partner they need and that in-house resources and good outside counsel is a better fit.

II. THE PROBLEM WITH INDEMNIFICATION

PEOs advertise a partnership. This can be true, but at the end of the day, the business is in a contract with a provider. The PEO is not there to share in the challenges of running the business, it exists to profit from the services it provides to the business.

As such, throughout standard PEO contracts are disclaimers making it clear that the business is not partnered with the PEO. At various points, the business must specifically agree that:

1) the PEO *will not* be considered a co-employer of the employees;
2) the PEO *is not* ultimately responsible for the business' compliance with labor and employment statutes; and
3) the business *will* indemnify the PEO for claims made against the PEO.

Excerpts from this legal memo available at peoescape.com

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Detail #2: Volume Buying and Cost Savings

Capital is the lifeblood of a growing enterprise. So, when a PEO tells you that they can save you tons of money on HR, compensation, payroll, benefits, and workers' compensation, it gets your attention. But how are all those savings realized?

This shift in employment status, the story goes, will allow the PEO to pool your employees with employees from their other clients. Now, they have a bigger group of employees and therefore, more buying power. More buying power – in theory – translates into better products at a lower cost. What makes it all work, is the idea that the reduced costs gained from being part of a larger group will cover the administrative fees. Fat chance.

This gross oversimplification of the complexities related to employing workers glosses over the many determining factors that affect your costs in the real world. What state or states do you operate in? What's your industry? What types of workers do you employ? How many employees to do you have? What is your ownership structure? The answers to these - and many other questions – are just part of what determines whether or not a PEO is the best financial decision for your business. Turns out, maximizing your employment dollars is far more complex than saving money by buying toilet paper in bulk.

The painful reality is that there are no shortcuts when it comes to your most valuable asset: your employees. To ensure the best outcomes - legally and financially - there is no substitute for fully understanding your company, the law, and the marketplace. Only then will you have the information you need to make a fact-based decision.

Bottom Line: Having employees is inherently complex and expensive. Blindly handing those costs off to a third-party is less than ideal.

Solution: Find an expert you trust and dig into your unique business realities. After all, the only decision-maker you can really trust is the one that has gotten you to where you are today: you.

Beware of Hidden Costs

PEOs, as of this printing, are not required to cap FUTA, SUTA, or Social Security. They can continue to charge you for these line items, even after you have reached the earnings cap. This is typically outlined in the contractual language of your PEO -- making it 100% legal. These hidden fees can average out to be more than 5 percent of payroll, which could have a significant impact on your overall costs.[4]

Case Studies: A Real-World Comparison

Where the Rubber Meets the Road

If moving to an unbundled model is right for you, the savings can be significant. Here are two examples of companies that took the time to see if a PEO made sense for their business, in the real world.

Company A

Small brokerage firm
Six employees
No internal HR/Finance staff
Currently outsourcing some payroll/HR functions

When the owners of Company A decided they wanted to offer benefits to their employees, they sat down and ran the numbers. Given their small size and the age of their staff, health plans were limited to those with age-banded rates that were not only expensive but varied wildly from person to person. By joining the PEO's larger group, the company was able to save $150 per month/employee on health insurance which offset the PEO's administrative fees of $170 per month/employee. In addition, Company A was able to consolidate their current payroll/HR expenses under the PEO, thereby saving additional expenses. A thorough analysis of their unique circumstances supported the benefits of joining a PEO.

PEO Makes Sense ✓

Company B

Medium-sized financial advisory and investment firm
Rapid growth
60 employees
Controller managing HR issues, as needed
Currently engaged in a PEO

When the leadership of Company B engaged their PEO four years ago, outsourcing their basic HR functions was a good solution for managing their employment-related needs. Four years – and 40 employees – later, the company was no longer sure their PEO made logistical or financial sense. During that same time, their PEO expenses had risen dramatically (from $150 per month/employee to $200 per month/employee), and leadership was looking for ways to reduce costs while improving the benefits and services for their employees. With even more growth on the horizon, Company B conducted an exhaustive audit of their benefits, HR, and payroll and discovered they could save over $100K per year by unbundling from their PEO. By unbundling, Company B not only regained the power to choose the exact payroll and benefits that worked best for them, but they were also able to use those savings to engage an experienced HR professional which improved internal morale and their ability to attract top talent.

Unbundling Makes Sense ✓

Detail #3: Better Products and Streamlined Service

For a growing business, attracting – and retaining - the very best talent can be the difference between success and failure. This means that offering competitive compensation packages, including benefits, are more than the right thing to do, they make good business sense. The tricky part is balancing the need for competitive benefits with the cost of finding and administrating them. So, when a PEO offers to not only give you access to better benefits, but administer them as well, it's easy to see why they are so popular.

If only this worked in the real world as well as it does on paper! The oversimplification here comes down to the fact that "one-size-fits-all" never fits as well as something custom made, and that bulk buying often means ending up with a whole lot of something you may not need or want. The reality is that when a PEO goes to the marketplace they are choosing products and services that will meet the needs of a large, diverse group of employees… not finding the perfect fit for your specific group. This means your employees could end up with a higher cost benefit program, than they would if you were negotiating on their behalf.

The promise of services and support around payroll, benefits, and HR is another area where the PEO may seem like a better arrangement than it actually turns out to be. One of the perceived benefits of a PEO is that you don't have to manage these administrative tasks internally but be wary of what outsourcing this important part of the employee experience means for your organization. When it comes to sensitive personal information, employees often feel more comfortable talking to someone they know, rather than a stranger from outside the business.

This kind of personal relationship with your employees is essential when you are looking to attract and retain the best talent. It speaks to your priorities and the strength of your business. If your benefits are weak or poorly administrated, you could be creating more problems than you solve. According to a 2019 survey of CEOs, presidents, and executive leadership, four of the top five biggest challenges they faced were directly related to talent management, with finding top talent listed as their number one challenge.[5] Given how critical talent is to the health of your business, it is important to ask yourself how outsourcing the employment experience could impact your employees, now and in the future.

Table, CEO Benchmarking Report, 2019, Predictive Index

In the end, customized benefit plans, personalized HR support, and a strong employment brand might not be on the top of your radar when considering a PEO, but they should be. It is important that these personal, intangible costs are part of the equation when weighing the pros and cons of engaging a PEO. After all, it is still your name on the sign out front and employees want to know that you will be there for them when it counts.

Bottom Line: When it comes to supporting your team, one degree of separation can be one too many. Outsourcing critical HR functions can affect more than your bottom line, it can create a wedge between you and your team.

Solution: Staying involved in your employees' health and well-being is critically important, whoever administers them. It is your responsibility, and in your best interest, to stay informed, involved, and engaged.

The Power of Unbundling

For small to mid-sized growing businesses, what's the alternative? You need to maximize capital, provide attractive benefits, and make sure your employees are happy and healthy... all while continuing to run your business. How do you balance all these imperatives in a way that makes financial and logistic success?

Moving to an unbundled model is a way to streamline your employment needs without losing your autonomy. This means choosing vendors, products, and services that are the right fit for your unique business and then making sure they deliver on what they've promised. This doesn't mean you have to go it alone; it just means you are back in the driver's seat instead of relying on a third-party intermediary.

The first step to successfully unbundling is finding the right providers, someone with the expertise to ask the right questions and provide you with the resources you need to make informed decisions. An insurance broker that has experience working with HR, payrolling, and related software providers is an ideal choice. In addition to experience, it is important that you, and your leadership team, feel comfortable with their expertise and advice. Chemistry is intangible but critical, so trust your gut when it comes to how you feel, but make sure to fact-check your feelings with referrals and testimonials.

The next step is understanding your unique business realities. Only after you have conducted a thorough review - with a vendor you trust – will have the information you need to decide if a PEO – or some alternative – is right for you. Some of the items you will need to review are:

- Census (list of employees/headcount/location/job function)
- Current payroll
- PEO statement

Once you break it all down, your options will suddenly be clear. For some companies, a PEO might be the best choice, for others, an unbundled model might have more of what you need and less of what you don't. Either way, now you know. From here, you can take the next step toward building the support system you need to responsibly manage your employment needs.

If you are already engaged with a PEO and want to make the move to unbundling, it starts with connecting key members of your team with your providers to make sure everyone is on the same page. When it comes to implementation, your providers can replace the products and services formerly provided by your PEO. From there it's just a matter of moving through the following steps:

1. Complete the necessary forms.
2. Find life/health benefits, payroll, HRIS, and TPA services that meet your unique needs.
3. Review your options including cost estimates and timelines.
4. Make fact-based choices regarding your benefits, HR, and payroll.
5. Inform your PEO of business relationship termination date (30 days in advance).

Providers You Can Trust

Looking for a partner to start the process? The team assembled at RIS has the expertise to conduct a thorough analysis of your current business realities and provide you with the facts you need to make the right choices for your business.

About RIS Insurance Agency, Inc.

RIS Insurance Agency, Inc. (RIS) provides HR options for companies already engaged with a professional employer organization (PEO) for their HR needs. The highly-competitive unbundled payroll, insurance, and benefits model coordinated by RIS gives their clients a way to take control of their business and their bottom-line.

Citations

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3. All the Reasons You Shouldn't Work With a PEO, By John Farnsworth, November 29, 2017

4. Myths vs Truths – What PEOs Don't Want You to Know, Brown and Brown Insurance, https://www.bbsocal.com/peo-options/exiting-a-peo/peo-myths-vs-truths/

5. CEO Benchmarking Report, 2019, Predictive Index, https://resources.predictiveindex.com/ebook/ceo-benchmarking-report-2019/