Evaluating PEOs: Potential Problems Your Clients Need to Know

Professional Employer Organizations (PEOs) promote savings on health insurance premiums, but at what cost?

Although PEOs offer a seemingly attractive HR outsourcing solution for small/mid-size businesses, there are many drawbacks that companies must consider before making the switch. NOTE: Due to the vast differences between PEO companies, how they operate, and the states they operate in, the content below cannot be applied against all PEOs. Use for informational purposes only.

	Potential Problem	Potential Result
Administrative Fees	Many PEOs base their fees on a percentage of payroll; therefore you give the PEO a raise every time you give a raise to the employee. Administration fees are very high ($175++ PEPM), and do not include workers compensation or health insurance. PEO's have adopted an "a la carte" model, but didn't drop administration fees	Your will incur higher out of pocket expenses for the same level of service.
Taxes and Wage Base Limits	Some PEOs keep charging on FICA ($110,100 Wage Base), FUTA ($7,000 Wage Base) and SUTA after the wage base limits have been reached. The extra withholding is pure profit to the PEO. Some PEOs utilize a blended tax, for example 11% for all wages as opposed to 17% on the first $7,000 in wages and 8% after.	Huge overpayment of taxes
Section 125 Plans	PEOs do not reimburse you for FICA savings realized through Section 125 Plans such as FSAs and POPs.	Overpayment of taxes
Workers' Compensation	PEOs charge workers' compensation premiums on overtime wages at the higher overtime pay rate. Depending on the PEO, many companies are excluded from the model because of prohibited industries in the master Workers Compensation plan. Some PEOs also do not allow new ownership employees to be excluded from WC insurance. The owners are the highest earners generally and sometimes work in multiple areas of the company so are classified in the highest rated area. Resulting in losing favorable Experience Modification for good loss history.	Overpayment of workers' compensation premium
Payroll	Payroll costs are charged as a percentage of payroll rather than a per employee per month fee (PEPM).	Out of pocket fees increases as your wages increase
Control – Plan Selection	You are limited to the insurance companies and plans offered under the PEO. You have no control if they decide to change carriers or benefit plans.	Lack of flexibility / disruption of benefit
Control – Employment	The PEO is now the employer of your employees - not you. Paychecks, W-2s, etc., will come from the PEO from now on.	Employee confusion
Large Group Mandates	Now that you and your employees are part of a PEO, you may be treated as a large employer group	Unneeded additional expense
SUTA/SUI	The SUI rate under a PEO is based on the PEO's experience, not your business's experience. You could pay higher SUI rates due to higher turnover the PEO experiences as a large group. Filed under the PEO's tax number. Clients who had favorable rates due to low turnover are now paying the highest rate, or paying thousands in unnecessary taxes	Overpayment in SUI premium

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Source: Mutual of Omaha, "Dismantling the PEO"

Evaluating PEOs Continued...

	Co-Employer Arrangement—PEO Cons
FMLA Regulations	Subject to FMLA regulations even if the group is under 50 employees
Shared Risk	Shared risk between PEO and client, however Service Agreements contain exculpatory language that protects the party with the "deeper pockets"—the PEO
Bundled Pricing	Bundled pricing makes it difficult for a client to determine what they are actually paying
Upfront Fees	There can be large upfront fees associated with PEOS, especially with enrollment fees which are due upon signing the Service Agreement
"Sick Pool"	Client/worksite employees are theoretically 'pooled' for better insurance rates. If many companies went to PEO for that reason, it could be that they couldn't be insured elsewhere, thereby creating a 'sick pool'. In actuality, companies are looked at—and rated—separately
FICA	If a business owner switches over to a PEO in the middle of the year, the "FICA Ticker" kicks in. The difference is that because the employer of record has changed (and taxes filed are with the PEO's FEIN), the employer starts paying FICA all over again as does the employee. The employee will get their taxes back at the time they file their returns, but the employer does not

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