What managers should ask their Professional Employer Organization (PEO)

The Business Consulting Group speaks with Lou D'Agostino, Principal at Iron Cove Insurance / FinCare, LLC (a firm that specializes in PEO brokerage), to hear his opinions on where he is seeing managers gain efficiencies in their human resources management.

One of the resources PEOs provide is health insurance. This is offered either as a pass-through model or as a self-insured model. What is the difference between the two models?

The pass-through model is when the PEO functions as the intermediary between a health insurance company and your firm and the insurance company takes your premium to cover employees for medical expenses. The PEO passes through the cost and risk of health insurance.

On the other hand, if a PEO collects your premium and keeps it until they have to pay your medical expenses, that's a self-insured model. In this setup, the PEO utilizes the medical network of a major health insurer (e.g. Aetna, United, Oxford) in order to provide a vast network of doctors. However, the true insurance risk still falls on the PEO.

The danger of working with a self-insured PEO comes when occasional cycles of extraordinary claims occur. This phenomenon not only depletes the cash reserves (aka float), but also puts the balance sheet of the PEO at risk – this in turn degrades the PEO's financial health. In order for the PEO to recover (and meet Wall Street expectations), it will need to increase its revenue drastically.

In a pass-through model, the PEO's financial health is immune from an extraordinary year of bad claims.

In a manager's analysis, they should consider the fact that a self-insured PEO may sustain much more financial impact in a bad claims year than a pass through model.

What are some of the large service charges a manager should pay attention to in terms of pricing efficiency from their PEO?

The three major areas are 1) health insurance, 2) worker's compensation insurance, and 3) monthly administrative fees.

With regards to healthcare, what is the average increase a manager should expect?

Nationwide, we typically see an average of 3% increase annually in health insurance costs. The NY Metro area averages 6-8%. If a manager observes increases above 10%, they should thoroughly investigate the increase; although do not expect to receive much loss related data or supporting information from the PEO provider.

If a manager determines they are being charged disproportionate healthcare increases how can they conclude if the increase is attributable to medical plans or administration of the plan?

Disproportionate increases are commonly a result of two reasons: 1) your employees have higher than average medical expenses, or 2) the PEO is charging you higher than normal rates. Insurance brokers should be tracking market price movements and thus be able to decipher why healthcare costs are abnormally increasing.

If a manager feels they may be receiving higher-than-average healthcare increases, do they have negotiating power? What can a manager do to mitigate these situations?

Managers always have negotiating power. If their employees exhibit higher than average medical expenses, they could: have the PEO position them in a different tiered plan, consider another insurance carrier, consider multi-year averages versus just one year's claims, or convert an after-tax payment to a pre-tax payment. There are ways for the manager to pay a lower premium, while paying their employee's higher deductibles, and still realize cost savings.

If employees exhibit below average medical claims, and the manager sees 10%+ increases in premium, there is a chance they are being over charged. Their broker can help confront the issue, as well as shop for another PEO. Insurance pricing is an algorithmic process and a broker should be able to tell if you are being unfairly charged.

Workers compensation insurance is another large expense for managers. This fee is often hard to discover due to bundling. What questions should a manager ask to uncover this charge and get a clear view into the fees they are being assessed?

Managers can quickly find this information from their payroll reports under names such as "Payroll Register" or "Detailed Payroll Invoice." Some PEOs bundle bill, hence combining charges and leaving you to determine the various monthly costs. Managers can run an off-cycle bonus payment and attempt to reverse engineer worker's compensation charges. In some cases, PEOs just refuse to be transparent and as a result, leave the manager with little information.

What are standard industry charges for workers compensation and how high have you seen charges reach? Are there specific terms managers should ask for to gain efficiencies in workers compensation pricing?

Worker's Compensation insurance is charged as a percentage (bps) of each dollar that is run through W2 payroll. There are ranges of acceptable rates on a per state basis based on classification of employees (e.g. Clerical Employee = 8810). As an example, in NYS, the rate per $100 of payroll that flows through the W-2 for the 8810 Class Code ranges from .17 to .18 cents per $100 of payroll. If you include related taxes and surcharges it may increase to .22 - .23 cents. For example, $20,000,000 in payroll for all 8810 employees in NYS should be calculated as follows:

$20,000,000/$100 = $200,000 x .18 = $36,000 in annual premium or 18 bps

In our opinion, anything over 30 bps begins to be too high. We quite often see 50 bps being charged, but the manager doesn't know that is too high. In rare cases, I've even seen 70 to 90 bps in states like CA.

Please remember that worker's compensation insurance is for the rare occasions where employees have work-site accidents. Since the financial services industry is a white-collar environment, loss ratios are historically extremely low (<4% annually) and to the extent that the PEO has self-insured this risk, this becomes a major PEO profit center.

There are generally two types of billing methods: Fixed Fee and Percentage Fee. Where do you see advantages in one billing method over the other? Are there key provisions managers should either ask for or be wary of?

Since most hedge fund employees receive bonuses in excess of base salary, the preference would be to have a fixed fee over a percentage of total payroll. Otherwise when employees receive a bonus the PEO does as well.

When a manager is reviewing their service charges they should pay attention to the monthly administration fee they are charged, but often this fee is hard to determine. How can a manager determine their administration fee and what are general industry ranges they should expect?

If a PEO doesn't bundle their pricing, a manager can find these administrative charges in the payroll reports. That being said, some PEOs simply refuse to offer transparency. We often see a rate of $250 per employee per month. In our experience, a reasonable administrative charge should be in the range of $78-$95 per employee per month.

Managers have the right to negotiate this fee down toward industry norms and their broker should be able to help them approach the PEO, and/or shop for another PEO.

Hedge fund management companies usually operate as a partnership or an LLC. This structure can create a scenario where working partners/members are not eligible for benefits coverage (as they are not technically "employees"). What service arrangements do you recommend working partners/members utilize to avoid unnecessary worker's compensation and unemployment tax charges?

There are PEOs who accommodate K1 partners and integrate benefits coverages seamlessly. For the PEOs that are more difficult, some managers pay the partners the amount equivalent to minimum wage via W2, so that they can be "included" for benefit purposes. With respect to Workers Compensation, each state has different requirements as to allowing exemptions or compensation caps for owners, partners and executives. In most states, owner/partners can be exempt from Workers Compensation by simply executing a waiver. As for executives, attestation forms can be signed to ensure that their salaries are capped for the purposes of determining workers compensation premium.

Is there a best time of year for a manager to change their PEO?

Year-end is always the best time to change PEOs. Changing PEOs mid-year may force resets on payroll taxes, medical deductibles and flex spending accounts. While there are mechanisms to ensure that a firm receives adequate credits, it creates some additional administration and possible disruption that needs to be managed. From a state and federal tax perspective, certain PEOs have a special IRS certification that enables them to credit payroll tax resets. Managers should consider, and ask for, a PEO that is IRS certified.

Communication Matters

By: Andrew Bergin, Managing Partner, Speaking Virtually

Launching a new hedge fund is like being the 700th coffee shop in a neighborhood full of Starbucks. How do you carve out a differentiated space for your fund and attract capital that has a multitude of global deployment options? After coaching at 22 hedge funds and 80 other firms from the CEO level down, I can suggest 3 simple methods to try as individuals and teams to communicate more effectively with investors.

- **Revisit the core stories of your fund.** Give yourself 350-500 words at your desktop and try re-crafting 2-minute versions of every business story. Once you type it out – then edit it down by shortening sentences, eliminating filler words and making it more conversational. Then verbalize these stories, with the material and without. Practice aloud for a loved one, colleague, friend or smartphone camera. Practice while jogging or walking the dog or in the car in traffic. The goal is to internalize the messages so you can tell them to strangers in any venue at any moment with no notes. It's going back to school on your business. Sounds like a pain in the neck – it is. Once done though, it's done for good, or until the story changes. Then, when you improvise in front of investors, you're not improvising off bullets in a pitch book. You're riffing off a solid story – your own – because you wrote it. In 38 years on the Street including 15 as a coach, I've observed that the best communicators are not creative – they're repetitive. Create a language for your fund and a vault of well-worn messaging for every PM, quant, researcher, analyst, manager in the firm to use. They'll speak in their own style but investors will get consistent, repeatable messages. They'll see you as a seamless team.
- **Before you hit the prospecting road, spar as a team**. Most teams don't have time for full blown dress rehearsals, even for a finals pitch. Sparring doesn't take that long. You take the team into a conference room for 30-60 minutes. You lay out the investor situation and then half the team does the pitch while the other half role-plays as the investors. They pepper the pitchers with questions and challenge their experience, track record, fee structure, team talent, numbers, etc. After 15 minutes of sparring, the team recaps what happened and discusses options. They may suggest that the pitchers reorder slides in the book, emphasize key points harder or change some verbal or nonverbal mechanics. In my experience, it's the best team practice you can do. Like any athlete in any sport, you get your game on before you perform. Too many teams in our business depend on their prior experience or serendipity to prep for investor meetings that could mean multiples of millions in new assets under management. Why go before prospective