Why PEOs and Staffing Companies Don’t Mix
When It Comes To Workers’ Compensation

By Steve Odell

It was 3:00 in the morning about three years ago when I woke up in a cold sweat from a nightmare I was having.

The workers’ compensation market for my PEO and staffing clients was beginning to harden dramatically. Many of the fringe players who had gotten into the business a year or two before were non-renewing their entire books or running into financial problems. Even my pedigree carriers were struggling to keep pace with my needs as a preferred broker.

My nightmare continued because I had two renewals coming up, one a PEO and the other a temporary staffing company. The PEO bragged about how it was the “branch office” of its insurance provider, yet wrote bad business and arbitraged its rates. That obviously didn’t hold much water when its premium was $1,000,000 and its losses already exceeded $1 million. The PEO understood neither underwriting nor how reserves trend and develop. Insurance company underwriters get fired and PEOs get non-renewed when that happens.

As this bad night’s sleep continued, the temporary staffing account obviously had been having claims activity too. This company decided not to implement a light duty program because it was too much effort to bring employees into their offices or even consider light duty job description for their client locations. Reserves continued to escalate and their insurance carrier decided the only option was to non-renew.

It came down to a morning appointment with the PEO and afternoon appointment with the staffing agency. Both had policies expiring at 12:01 a.m. the next morning. We were rushing to complete the state fund and assigned risk applications because that became our only option. We had hoped to have other quotes with options for each client. The only options were large deductible plans with aggregates of $2 million and letters of credit fully guaranteeing the maximum because – you guessed it – the financials were weak. We should have completed those darn applications in advance, as a back up because now we realized coverage would not incept until the day after receipt. This would cause a one or two-day gap in coverage. Besides breaking the law, what was the company going to do? Take the risk or shut down their operation?

All this became my responsibility and the sole reason for both of these companies potentially being put out of business. But it wasn’t my fault, was it? I preached risk management, yet the marked had been soft and there were always options at a lower cost. Wow, this appeared to be a dot.com meltdown.

I sat up in bed, wide-awake, and ran into my office writing profusely so as not to lose my stream of consciousness. It was then I realized that not only was the insurance market not going to cooperate with us like it had before, but many companies within these two industries were going to be at risk of going out of business.

PEOs and staffing companies – businesses that are so very different and viewed so negatively by the insurance community – have been excommunicated by reinsurers and forced now to take whatever they can get. They are smothering the marketplace with submissions to any broker or carrier who will listen. They are digging their hole deeper because the only story they have to tell is that they now understand what to do and the 20 percent of clients who caused 80 percent of their losses had been or were being terminated.

Let’s try and dissect the core competencies that exist from a workers’ compensation perspective and why PEOs and staffing companies don’t mix.

First, the length of time in business is a critical factor in the carrier’s due diligence. Most PEOs have not been in business more than a few years, while firms in the staffing industry generally have longer histories. Carriers certainly look for longevity, management commitment to safety and loss control in the workplace, and a five-year history of losses that can give predictability and credibility.

**RISK MANAGEMENT**

Most PEOs and staffing companies I meet with claim they have a person with the title of risk manager. Normally, this is a person with either a claims or a loss control background, usually not both. That’s not a risk manager! These industries need risk management either in-house or outsourced. The carriers will have more interest with a true risk management program in place.

The five critical elements in the risk management process are: Identification analysis and measurement, risk control, risk financing, and risk administration.

How much due diligence do PEOs and staffing companies actually perform in these areas? Too often, it is minimal.

**LOSS CONTROL AND CLAIMS MANAGEMENT**

The big problem with PEOs and how carriers view them is that once you take over an entire employee base and worksite, you have just inherited all the pluses and minuses of that location and culture.

The temporary staffing company,
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on the other hand, does have more control of its own employees and can direct jobs they perform within a worksite. Many even have onsite supervisors who manage the job functions of their people at client locations. There is therefore less worksite exposure for a staffing company than for a PEO in the eyes of many carriers.

Worksite selection appears to be the major crime committed by both of these industries. However, the staffing industry has been much more proficient at it for a longer time. Carriers have been imposing class code restrictions, but both industries haven’t responded in the same fashions. Guess where most of the violations have come from?

Even when companies have the right codes, do the right due diligence at worksites, the loss control programs frequently fall short. Pre-loss initiatives by the PEOs to their client worksites are incomplete and lack follow through.

Managing the claim after it has occurred is critical. Staffing companies appear to have the ability to better control the management of a claim if they have implemented light duty programs and can bring an injured employee back to work as soon as possible.

PEOs, although claiming they have light duty programs, many times can control neither the worksite nor the client company. One of the major writers of workers’ compensation for both industries has this to say and it is a direct quote: “Over the last four to five years, PEO owners don’t have the same mentality they should have had when the market was soft. We clearly view them as solely in the business to make a quick buck. Because they suffer from lower margins, they have to generate a large volume of business to make money and therefore have very little focus on loss control and claims management.”

“Many of these owners come from outside the industry and are just looking at it as a mechanism to generate profit for the short term and are not in business for the long term.

This is why we underwrite the ownership of a company first. There are also tremendous amounts of violations regarding class code restrictions. They appear to have no sense of concern about the employees’ welfare at their clients’ worksites, verses the way a temporary staffing company views its employees. The bottom line to controlling claims is a long-term commitment, not a short-term fix, and we clearly view the staffing industry as much more committed to this than those in the PEO world.”

CONCLUSION

There are companies whose workers’ compensation programs have self-destructed and now can’t obtain coverage. Many PEOs are piggy backing their workers’ compensation with other PEOs. Temporary staffing companies are running their payrolls through PEOs. These relationships are being formed in tenuous times and for the wrong reasons! I believe this will lead to a further eroding of the reinsurance marketplace and carriers will not be in a position to offer coverage at any price. Don’t mix these apples and oranges. You’re not in the fruit business!

Although the marketplace is beginning to soften again, “buyer beware!” Temporary staffing companies survived state funds and assigned risk plans for years when there was no product available. PEOs can’t survive the “arbitrage bed” they made for themselves. A cleaning of both industries has occurred and only the “risk managed” ones will survive.

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