



BENEFIT *Advisor*

In This Issue

In this third issue of the McGrawWentworth Benefit Advisor for 2009, we discuss issues that need to be addressed when reducing your workforce. The economy continues to weaken and many employers are reducing their workforce to continue operations in these lean times.

Employers need to make sure they provide proper notification and detailed communications when reducing their workforce.

We welcome your comments and suggestions regarding this issue of our technical bulletin. For more information on this Benefit Advisor, please contact your Account Manager or visit the McGrawWentworth web site at www.mcgrawwentworth.com.

“Reductions in Workforce”

Many employers in Michigan and across the country are letting employees go. Reducing the workforce is not an easy choice for employers. The current economic situation, however, is forcing employers to make these tough decisions.

Eliminating jobs is difficult emotionally not only for employees, but for human resource professionals as well. The process requires empathy. Equally critical is making sure your organization handles each situation properly and notifies all the necessary entities.

When employees lose their jobs, they also lose their employer-provided health insurance. Many employees may want to continue their coverage under COBRA, but that can be very expensive. Our next *Advisor* will be devoted to discussing health coverage options for former employees.

This *Advisor* explores the following key issues employers need to consider when they reduce their workforces:

- Severance Agreements
- Permanent Shutdowns
- Temporary Layoffs

- Rehire Provisions
- Trade Assistance Act

Reducing your workforce is never easy, it is important to manage the process properly.



Severance Agreements

Employers may offer severance agreements to employees when they are laid off. The benefits vary. Most agreements include provisions to continue salary and health benefits. They may also include job re-training, job search assistance, résumé development classes, interview skill classes and so on.

According to the American Society of Employers, 34% of Michigan organizations have a single severance plan that covers all employees, while 25% of Michigan employers do not offer a severance plan at all. In some cases employers arrange severance packages for certain employees or specific classes of employees. The most common severance plan design offers one week of severance benefits for each year of service.

Although it is in the organization's best interest to develop formal severance plans, many organizations do not establish them. In some cases, the company agrees to severance benefits with a handshake or outlines terms in an informal document. These arrangements are unwise because in a dispute, these employers have no proof to defend their positions. In addition, Human Resources needs to make sure the severance agreement does not violate federal law.

If your organization continues health benefits as part of a severance package, you should consider the following details:

- The former employee must understand health benefits under a severance agreement run concurrently with COBRA. If you fail to make this fact clear, you may run into problems with your health insurance carrier or stop-loss vendor. Your organization will still be obligated to offer COBRA when the severance period ends. The result will be the health plan carries the risk for a former employee longer than COBRA requires. Insurance carriers and stop-loss vendors are generally not obligated to accept this extended risk and if they do not agree to extend the COBRA coverage, this liability could end up as the employer's responsibility.



Your organization may wish to revisit paying for COBRA premium as part of severance in light of the recently passed American Recovery and Reinvestment Act of 2009 (ARRA). If an employer pays for part of the COBRA premium, the employer-paid amounts are not eligible for the government subsidy.

- If your organization requires former employees to pay part of the premium for health coverage, your organization

can allow the former employee to pay with pre-tax dollars. Your organization must be able to make a pre-tax deduction from the severance check. In addition, the

Section 125 plan's eligibility provision must extend to former employees covered by the employer's health plan. Be careful if your organization pays severance in a lump sum to employees. Your organization can only allow pre-tax contributions to pay benefits in a current Section 125 plan year. Your former employee cannot pay pre-tax premiums in advance across Section 125 plan years.

- Some employers continue health benefits but require the employee to pay the premium. The employer will then reimburse paid premiums after subtracting any required employee contribution. It seems as if this process would be an administrative hardship, but employers set up this process for a reason. If the

severance plan allows health benefits to continue at just the employee's contribution, very few former employees would discontinue the health benefits. Many employees may have other health plan coverage available through a spouse or a new employer. If they must actually pay COBRA premiums, employees covered through another source would be unlikely to continue coverage under the former employer's plan. Employers can reimburse former employees for health plan premiums on a tax-favored basis since they know they are reimbursing medical coverage premiums.

Consult a retirement expert before you agree to allow former employees to continue contributing to a retirement plan because these contributions are not usually permitted.

You will need to track all employees involved in severance arrangements. If your severance agreement allows life benefits to continue, make sure your life insurance carrier agrees to continue these benefits. Disability carriers are usually reluctant to continue coverage. If your organization runs severance and COBRA concurrently, you should notify the employee when severance ends. At this point the employee may be required to pay the full COBRA premium, unless the employee is eligible for government assistance through ARRA.

Permanent Shutdowns

In the case of a permanent shutdown, the employer needs to consider the following issues:

- **Will your organization need to notify workers as required by the Worker Adjustment and Retraining Notification Act (WARN)?** WARN is a federal law designed to protect workers, their families and communities when a plant is closed or an organization has a mass layoff. In general, WARN applies to employers with 100 or more full-time employees (excluding anyone who has worked less than 6 of the most recent 12 months). The WARN Act requires employers to give all employees 60 days' written notice of a plant closing or mass layoff. This notice must include specific details. Only business partners are not entitled to this notice. The DOL has produced a fact sheet to help your organization comply with the WARN Act requirements. The details can be found at <http://www.doleta.gov/programs/factsht/warn.htm>.
- **Will your organization establish a reserve fund to pay for all expenses related to the shutdown?** Publicly traded companies commonly have funds set aside in a reserve to pay all expenses related to a shutdown. If your organization is setting aside funds in a reserve, be sure to estimate the benefit cost accurately. Most organizations use their annual projections to estimate the amount to set aside for health plan expenses. If your benefits are self-funded, using active employee cost projections will probably lead you to underes-

NOTABLE THOUGHTS

REAL GENEROSITY IS DOING SOMETHING NICE FOR SOMEONE WHO WILL NEVER FIND IT OUT.

FRANK A. CLARK

estimate the true cost. Most organizations see an uptick in claims when employees have advance notice of a shutdown or layoff. It makes sense; employees will have non-critical elective procedures done before they lose their health plan coverage. Some of this increase will depend on your employee demographics. Younger employees tend to have fewer medical issues and fewer concerns about losing health plan coverage.

A good rule of thumb may be to assume that employees losing their jobs with advance notice will use the plan at roughly 150% of active employees. Spencer's Research annually reports on COBRA participants' plan use. The number each year falls between 145% and 150% of active use.

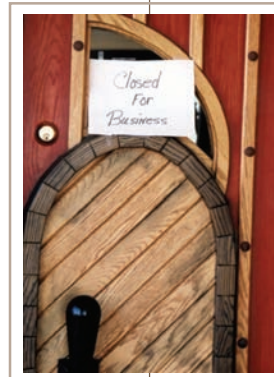
If your organization accounts separately for Incurred But Not Reported (IBNR) claims, you may need to adjust for increased claim utilization.

Your finance group should work closely with Human Resources to make sure you have adequately funded and budgeted for the costs that will be paid through the reserve.

- **What obligations occur as part of any severance agreement?** If you continue benefits in a severance agreement, make sure your employee knows COBRA runs concurrently. In addition, make sure your carrier agrees to cover any benefits you choose to offer during the severance period.
- **Will your organization have difficulty with health plan coverage because of the reduced headcount?**

Insurance carriers, stop-loss carriers, PPO networks and others involved in providing your benefits have rules governing your working arrangements. A common rule is that when eligibility fluctuates within a certain percentage, generally between 10% and 15%, carriers can

revisit rates mid-year. If your plan is self-funded and your workforce numbers fall drastically, it may be time to



consider a fully insured option. Be aware, however, if you have more people on COBRA than active employees, insurance carriers will be reluctant to cover your workforce. In difficult times, your organization should make sure all contract wording is clear and accessible and you should flag contract provisions that may be important as the number of people covered on your plan decreases.

With some organizations, permanent shutdowns will be part of Chapter 7 bankruptcy proceedings. In bankruptcy, fully insured health plan claims are treated differently from self-funded claims. When premiums are paid to an insurance carrier, the carrier pays claims incurred while the coverage is still in effect. If the claim is incurred while coverage is in effect but submitted after coverage ends, the insurance carrier will generally pay the claim, subject to its rules.

Self-funded plans are a different story. In general, if an organization declares bankruptcy and is unable to pay claims under a self-funded health plan, the employee is treated the same as any other debtor during the bankruptcy proceedings. In some cases, claims will not be paid. In addition, if your employees contribute funds for coverage, ERISA obligates you to use those contributions only to pay claims. Using those contributions to pay other business expenses violates ERISA provisions and in some cases, your company may be held criminally responsible.



Temporary Layoffs

Temporary layoffs create additional issues that employers need to keep in mind. If your organization is temporarily laying off employees or reducing work schedules, pay attention to the following issues:

- What are your layoff policies?** Typically, employers explain their layoff policies in employee handbooks and in summary plan descriptions. Unfortunately, in many cases, the layoff policies vary from document to document. The ideal approach would be to make all documents consistent. If your carrier cannot satisfy your layoff policy requests, you'll need to amend that section of your ERISA wrap document.
- Does your layoff policy make sense?** In many cases, layoff policies were determined at a time when the current employment situation would not even have been imaginable. Now that your organization may be facing temporary layoffs, should you amend your layoff policy? For example, let's say a company decided to adopt a schedule of two weeks on, two weeks laid off for the first quarter of the year. That same company's policy is to end benefits as of the last day worked. Think of the work this creates for the first quarter; every two weeks health benefits for everyone laid off will end and COBRA benefits may begin. Let's say the same company

allows benefits to be reinstated immediately when employees return from a layoff. When everyone returns for the next two weeks, coverage will need to be reinstated. Your organization will need to process multiple COBRA election periods every two weeks. This layoff provision is not practical given the current business plan and should be changed.

- Make sure to collect your employee contributions:** When benefits continue in a temporary layoff situation make sure your company policies allow you to collect employee contributions for health care coverage. Your organization does not need to collect the payments from employees after tax; instead employees can pay the contributions when they return to work through pre-tax deductions.
- Don't forget life and disability plans:** If temporary layoffs become permanent, employees can take certain benefits with them. They can continue their medical plan coverage, for example, through COBRA. Also, insurance carriers often allow them to continue life insurance coverage by converting the group life insurance to an individual policy. The rates will be different, but medical underwriting is typically not required. Read your contract carefully. If your organization is going out of business, conversion may not be available to employees in that situation.

Some employers are asking their life carriers to add portability to their basic employer-provided life insurance coverage. Portability allows the employee to continue group life coverage at the same rate after employment terminates. Some carriers have time limits on when the rate will expire, such as allowing the portability option to apply for only three years. Portability is not common on basic employer life coverage and it may increase the life rate anywhere from 4% to 8%. However, some employers are recognizing the value of allowing employees to continue life coverage at an affordable rate. It is **not** common for a disability plan to include conversion or portability. Since some older disability contracts may include a limited conversion option, you may want to review your contract to see whether it includes this provision.

If your organization offers voluntary benefits, you should review how these benefits are handled at employee termination.

- **Reduction of work hours:**

Some organizations are reducing work hours rather than laying off employees. This option may affect benefits. Let's say, for example, your plan states full-time employees working 40 hours a week are eligible for coverage. If you have moved to a four-day work

week, your employees would no longer be eligible for the health plan. If your organization did not intend to discontinue benefits, you will need to address this issue so that your employees do not lose their coverage. Your organization, however, does not necessarily need to modify eligibility in your contract, especially if you are only reducing work hours temporarily. Lowering the hour requirement may, in fact, open the plan eligibility to more workers. If you do not want to formally amend the eligibility, you should contact your health plan vendors and stop-loss carriers and tell them you wish to continue benefits only for normal full-time employees who cannot meet the hourly eligibility requirements because your company has temporarily reduced their work hours.

Temporary layoffs are difficult for human resources and employees. You need to be sure your employees understand whether or not their benefits will continue during these temporary

layoff situations. Organizations should define what is considered a temporary layoff and explain the impact on benefits during that period. Employees should receive a

communication package describing how benefits will continue and for how long. When you lay off an employee, make a note to remind yourself when employment and benefits will officially terminate. At that point, coverage ends and you need to issue COBRA notification.

Rehire Provisions

Hopefully, this difficult economy will turn around soon. When the economic situation improves, your organization may start rehiring. While this is great news, rehires also create a significant amount of work.

Generally if an employee is rehired within a certain period of time, benefits can be reinstated immediately. If the employee is not rehired within that time, the employee is considered a new hire and will need to meet any new hire waiting period requirements.

Multiple documents, including employee handbooks and summary plan descriptions, have rehire provisions. You must first determine whether your rehire provisions are consistent in all these documents. Just as they limit layoff provisions, carriers may also limit how the rehire provision can be described.

Clearly, a consistent provision in all documents would be the easiest to administer. If that is not possible, create a chart outlining the benefits available and the rehire provisions in each contract, so you know how to administer the plans.



**Trade Assistance Act
Applicability**

The original Trade Act of 1974 provided benefits to employees who lost their jobs because of increased imports or a production shift to a location outside the United States. In 2002, the Trade Assistance Act of 2002 (TAA) extended the Trade Act benefits.

In this weak economy many of those who have lost jobs could very well qualify for TAA benefits. The following benefits will be very helpful to your former employees if they are eligible:

- Job search assistance
- Relocation allowances
- Unemployment assistance
- Re-training assistance
- Supplemental income
- Additional benefits under COBRA

The additional COBRA benefits make COBRA more affordable. The act initially included the Health Coverage Tax Credit, a refundable tax credit for up to 65% of the premiums for COBRA or other qualifying coverage.



To be considered eligible, an employee:

- Must be eligible for TAA benefits.
- Must be paying premiums for qualifying coverage.
- Must not have any other group health plan coverage available to the individual taxpayer or his/her family members.
- Must not be in prison.

The American Recovery and Reinvestment Act of 2009 (ARRA) increased the tax credit to 80% of eligible health insurance premium. The 80% tax credit will be available to qualified family members who continue their COBRA coverage after the employee becomes eligible for Medicare or if family members experience a secondary qualifying event due to divorce or death. The 80% tax credit in these situations can be continued for up to 24 months. In addition, some TAA qualified beneficiaries may see an extension of their continuation period. Individuals receiving HCTC because of TAA eligibility may continue that benefit until the termination of their TAA eligibility or December 31, 2010.

The TAA affects COBRA administration in two different ways:

- **Tax credit for medical plan premiums:** Employees can receive the tax credit in two ways:
 1. Employees can take the credit when they file their annual tax returns. The employer will need to document for the employee how much money was spent on COBRA for the health plan during the year. The documentation should include funds paid for employee coverage and any dependent coverage, provided the dependent is considered eligible under Section 152 of the Internal Revenue Code.
 2. The government can immediately fund the 80% of the COBRA premium through an electronic funds transfer between the government and the health plan. Under this direct assistance option the employee pays 20% of the premium directly to the government and the government then forwards the full COBRA premium to the plan. This process is generally set up when the employer or insurance carrier has a number of former employees qualifying for TAA benefits. Your organization and your former employees both need to understand the specifics of this process.

NOTABLE THOUGHTS

WISDOM IS THE REWARD YOU GET FOR A LIFETIME OF LISTENING WHEN YOU'D HAVE PREFERRED TO TALK .

DOUG LARSON

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One interesting administrative note is that the government does not accept late payments for the COBRA premiums. If an employee pays the premium just one day late, the government will return the 20% of the premium and will not allow the 80% assistance for that month. If the payments are late twice, the employee will be disqualified for the direct assistance from the government. This law, however, does not change your *organization's* obligations under COBRA. Your plan must still provide the employee the grace period COBRA requires. The plan must accept payments during the grace period to maintain COBRA coverage.



- **Special second election period:** Once TAA benefits are approved, the employer must offer a second opportunity for TAA beneficiaries to elect COBRA. The thought being, some individuals will fail to elect COBRA when it is first offered because they can't afford the premiums. The second election period begins the first of the month in which the individual is approved to receive TAA benefits. The second election period lasts for 60 days. If an employee opts for COBRA during the

second election period, the employer must reinstate coverage as of the first day of the second election period. However, the maximum coverage period, typically 18 months, is measured from the original qualifying event date. Your organization must include a brief summary of the TAA requirements in the general notice, summary plan description and election notice.

How can an employer know whether an employee qualifies as a TAA recipient? Employers can apply for benefits on behalf of their employees if they feel the workforce reduction qualifies under TAA. Although they are not required to apply for benefits, employers can work with the Department of Labor (DOL) to determine whether their situation would qualify for these

additional benefits. A group of employees can also petition the DOL if they believe their job loss should qualify. If this is the case, the DOL will contact the employer for the specifics of the situation.

The DOL has a number of resources on the Trade Assistance Act on their website at http://www.doleta.gov/tradeact/2002act_index.cfm.

Concluding Thoughts

Workforce reductions are difficult for employees and employers alike. Determining severance agreements, working on permanent plant shutdowns or managing temporary layoffs is time-consuming. In addition, these situations require appropriate notifications. Federal and state laws often detail the process to follow.

In this economy it makes sense to prepare an action plan to deal with potential layoffs or shutdowns so that your organization does not miss crucial notifications or points to address. Your organization may even want to create a checklist to help ensure you've handled all these important issues correctly.

If your organization has questions regarding workforce reductions, please contact your McGraw Wentworth Account Director. **MW**

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