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Benefits + Compensation

Employee Benefit Considerations When Making Workforce Modifications

The Bottom Line

- Employers should work closely with ERISA counsel to ensure that employee benefit plans (*e.g.*, non-qualified deferred compensation plans, health and welfare plans, and 401(k) plans) are being administered correctly as they make changes to their workforce.
- Employers should work with employment counsel to review separation agreements and analyze potential discrimination issues.

As economic conditions remain uncertain, many employers are taking a look at reducing costs and potentially making changes to their workforce. Apart from a myriad of concerns relating to employment laws, workforce modifications will also trigger certain Internal Revenue Code (Code) and Employee Retirement Income Security Act (ERISA) considerations affecting employee benefit plans and programs. Because these rules are so complex and highly dependent on the facts and circumstances relating to workforce changes, employers should work with ERISA counsel in advance of making any workforce changes to better prepare for how such decisions impact employee benefit plans rules and regulations. Below are some high-level issues to consider.

Internal Revenue Code Section 409A

Bonus, severance and non-qualified deferred compensation plans may be subject to the provisions of Code Section 409A, which governs the payment of certain forms of compensation. Any workforce modification, including termination, changes from full to part time, or movements from employee to independent contractor status, can trigger the payment of compensation amounts, but only if permitted by Code Section 409A. ERISA counsel can advise on the hidden risks and pitfalls of Code Section 409A when making workforce changes.

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Health and Welfare Plans

Employers should review their group health and welfare plan documents to understand when their employees will lose coverage and, where applicable, become eligible for coverage under the Consolidated Omnibus Budget Reconciliation Act (COBRA) or similar state law. Generally, coverage under an employer's group health and welfare plans will continue in accordance with the plan's terms (*e.g.*, to the end of the month in which the participant was terminated, but some plans cut off coverage sooner), although employers may be tempted to extend a coverage date for one reason or another. Plan documents will need to be modified to support exceptions and the date of loss of coverage is important in determining the deadlines for COBRA elections and notices, among other things. Additional COBRA considerations include:

- **Tolling Period** – When offering COBRA coverage, employers should note that the federal government has not issued an end to the COVID-19 national emergency. Therefore, the federal guidance extending certain COBRA deadlines, including COBRA election and premium payment dates, still applies (see here for our earlier Alert for more information on this guidance).

- **Subsidies / Affordable Care Act** – Some employers may consider offering COBRA subsidies to their terminating employees to help with COBRA coverage costs. Before doing so, employers should consult with ERISA counsel to discuss the legal ramifications of providing subsidies. For example, if not structured properly, the subsidies may run afoul of applicable nondiscrimination rules. Additionally, employers should be aware that employees may not be able to access coverage from the Health Insurance Marketplace (Exchange) once their subsidies run out, unless they experience another qualifying event.

401(k) Plans

Plan sponsors should review their 401(k) plan documents with ERISA counsel to consider the impact of any employment and benefit changes, including the following:

- **Loans** – Many 401(k) plans require loans to be repaid in full upon termination of employment; however, some plans provide for post-termination repayment. Loans that are not timely repaid will default and be treated as a taxable distribution to the participant. Plan sponsors, therefore, may wish to consider post-termination repayments or other strategies to help participants avoid negative tax consequences.

- **Final Employer Contributions** – Plan sponsors should review the allocation requirements under their 401(k) plans to understand if terminating employees are entitled to certain employer contributions (*e.g.*, matching and profit sharing contributions). Generally, participants need to satisfy certain requirements to be eligible for employer contributions.

Two common requirements include hours of service and being employed on the last day of the plan year. Based on these requirements, employees who terminate midyear may not be eligible to receive any employer contributions for the year in which they terminate. If a plan sponsor wants to make an exception for these employees, then a plan amendment may be necessary.

- **Participant Contact Information** – Missing participants have become an area of focus for the DOL during routine plan audits, so plan sponsors should review participant contact information for accuracy as they prepare for layoffs. Plan sponsors should work with ERISA counsel to develop and implement procedures to identify and find missing participants.
- **Vesting** – Generally, participants vest in employer contributions over time and would forfeit the unvested portion of their employer contributions upon termination of employment. However, if an employer terminates a significant number of employees (*e.g.*, 20% of its workforce), it may constitute a partial plan termination, which requires affected employees to be become fully vested regardless of their years of service. An employer may also adopt, at its discretion, an amendment that partially or fully vests terminating participants, provided applicable nondiscrimination requirements are satisfied.

For More Information

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