COMPLIANCE Spotlight

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Reduction in Hours, Furloughs, and Layoffs and the Impact on Employee Benefits

The financial ebb and flow of the different sectors of the economy are not always in alignment. For example, where the transportation sector may benefit from low fuel costs, the energy sector may suffer. As such, at any given point in time, when one industry is performing well, there is another sector of the economy that may be experiencing economic turmoil and facing the difficult decision of reducing employee hours, introducing furloughs, or laying off employees to reduce payroll expenses. Employers have a number of issues to consider when deciding to reduce the size of their workforce, such as application of the WARN Act or the size of severance packages to offer. Also important to understand and consider is the impact that these decisions will have on health and welfare benefits. Employers must exercise caution so that the tough decision to reduce the size of their workforce does not lead to unintentional errors with significant employee benefits implications. This article from Gallagher discusses some of the issues associated with staffing reductions and spotlights the most significant employee benefit considerations faced by employers and their employees.

Reduction in Hours, Furloughs, and Layoffs: A Menu of Terms

Although each employer in a given industry may want to achieve the same goal – a reduction in payroll costs – the path chosen in furtherance of that goal may differ based on the individual employer. Employers have a number of options available to them when it comes to reducing payroll costs. An employer can downsize its workforce by laying off employees, resulting in a permanent reduction in its workforce through terminations. Employers looking for a solution that does not permanently terminate employment relationships can turn to furloughs, which allow employees to return after a temporary unpaid leave generally lasting a few weeks to a few months. Alternatively, employers who do not want any pause in employment relationships, but want to reduce employment-related costs, may decide to reduce the number of hours some of their employees work.

Employers who decide to Reduce Employee Hours must proceed with Caution

Since the Patient Protection and Affordable Care Act (the ACA) was signed into law, employers have struggled to contain the costs associated with the law's Employer Mandate. Many employers turned to a strategy of capping employees' hours of service below the ACA full-time threshold of 130 hours per month in order to reduce the number of employees considered to be full-time under the ACA, and thus those to whom coverage should be offered to avoid Employer Shared Responsibility penalties.

Section 510 of ERISA provides that an employer may not "discharge, fine, suspend, expel, discipline, or discriminate against a participant or beneficiary for exercising any right to which he is entitled under the provisions of an employee benefit plan […] or for the purpose of interfering with the attainment of any right to which such participant may become entitled under the plan…." Employees have argued that a reduction in hours constitutes discrimination and interferes with their attainment of health coverage. Some cases have primarily centered on evidence tying the reduction in hours to an employer's desire to reduce health care costs, which may be sufficient to show an intent to interfere with an employee's benefits.

Counting Hours for Furloughed Employees

Employers that are considering a reduction in payroll expenses will certainly look towards reducing any associated benefits expenses as well. Already well known to employers, the Employer Mandate requires employers of a certain size to offer affordable coverage that provides minimum value to their full-time employees in order to avoid Employer Shared Responsibility penalties. It would seem almost automatic that an employee whose hours are reduced such that he or she is no longer considered to be a full-time employee would not be offered health coverage any longer. As discussed above, a full-time employee generally works at least 130 hours per month (or at least 30 hours per week). However, an employer must be cautious when seeking to cease offering coverage to an employee who has dropped below full-time status (whether through a reduction in hours or as a result of a furlough) because an employee's full-time status may be protected depending on the method used to determine full-time status (monthly measurement method or look-back method).

The monthly measurement method is the more straightforward of the two measurement methods used to determine an employee's full-time status. An employee's hours of service are calculated for a given month and an offer of coverage must be made for any month in which the employee has at least 130 hours of service in order to avoid a penalty associated with that employee. For example, an employee has at least at least 130 hours of service from January through June, but is furloughed for two weeks during July, and then resumes normal working hours for August through December. The employer must offer coverage for January through June and August through December, but does not have to offer coverage for July in order to avoid a penalty.

An employer using the look-back measurement method, however, may find an employee's full-time status protected. An employee's full-time status is determined during a *measurement period* (between three and twelve months) and will remain as such during the corresponding *stability period* (which follows the measurement period *plus* any administrative period). Therefore, when an employee has been determined to be a full-time employee during the measurement period, his or her full-time status during the corresponding stability period is protected. This means an employee who originally met the full-time employee threshold under the look-back measurement period will continue to be considered a full-time employee for the corresponding stability period even if his or her hours are reduced or he or she is furloughed and no longer meets the full-time hours of service threshold. As such, employers utilizing the look-back measurement method should not assume that all employees who no longer meet the requirements of a full-time employee should no longer be offered health coverage. Before removing any employees from coverage, employers should first determine whether an employee's full-time status is protected under a stability period.

Furloughs do not Necessarily Mean that the 'Status Quo' is Maintained

When an individual is furloughed, he or she still remains an employee of the employer; the employment relationship is not terminated. As such, some employers who decide to furlough employees assume that because the employment relationship continues, the employee automatically continues to be eligible for coverage under the employer's group insurance policies. However, group insurance policies (including stop loss policies purchased by self-insured group health plans) include specific language to define which employees are eligible for coverage under a given policy. For example, many group insurance policies define an eligible employee as a full-time employee who has satisfied any applicable service requirement. Full-time may be defined in the policy as a specified number of hours (30 hours per week is

common), or some policies may include a definition based on the look-back method of counting hours. Regardless of how any given policy defines a full-time employee, under these policies an employee who no longer satisfies the definition of full-time employee ceases to be eligible for coverage under the relevant policy when he or she drops below the threshold definition. In that instance, coverage would cease and the employee must to be offered COBRA coverage, assuming the plan is subject to COBRA. If an employer continues coverage for any employees that fall below the eligibility requirement, without first obtaining insurer (or stop loss carrier) agreement, the employer may find itself unintentionally self-insuring the coverage for all affected employees (and covered family members). As such, if an employer is considering instituting a furlough, then the employer should reach out to the insurer or stop loss carrier to obtain their agreement to continue coverage for affected employees.

Insurers are often willing to continue health coverage for employees on a furlough, particularly if the furlough will only be for a few months. However, the insurance policy should include the appropriate provision. Some group insurance policies may already contain a provision permitting an employer to continue coverage for a specified time frame. The time frame may be until the end of the month in which the furlough begins, or it may be for a longer period, such as one to three months. An employer considering a furlough will need to review their insurance policies to evaluate provisions already contained in the policies, what provisions are desired, and what the insurer is willing to underwrite.

As part of the process employers will also want to review insurance policies for benefits other than health insurance – such as life and disability insurance – to determine what options may be available since there are other, similar issues under those plans. If an employee loses eligibility when a furlough begins, coverage will end and any conversion privilege should be offered (virtually all life insurance policies have a conversion provision, conversion is less common for disability). Under COBRA, qualified beneficiaries have 60 days from the date the plan sends the COBRA election notice to elect to continue group health coverage. Unfortunately, the same is not true for other types of insurance policies. A typical group term life insurance policy will give the employee 30 or 31 days after the date that coverage terminates to convert. Conversion privileges are included in the documents describing the plan, but there is no standard notice required. In addition, although some employers proactively advise employees of their conversion right, there is no standard notice or time frame for doing so. If coverage will be ending during a furlough, employers may want to provide a separate notice to affected employees when the furlough begins.

If the employer decides not to amend a policy to cover furloughed employees, then coverage generally may be reinstated when the employee returns from the furlough. Reinstating health insurance may be fairly straightforward since the ACA prohibits requirements such as “actively at work,” and prohibits the use of pre-existing condition exclusions. However, life and disability insurance policies virtually always contain “actively-at-work” provisions, and many disability policies include an exclusion for disabilities caused by pre-existing conditions. Moreover, the insurance policy may treat an employee returning from a furlough as a “new” employee subject to these requirements. Employees returning from a furlough to full-time hours should be able to satisfy the actively-at-work requirement, but the imposition of a new pre-existing condition provision may result in reduced disability coverage for some employees.

Applicable Large Employers Must Include Laid Off Employees in Their IRS Reporting

Section 6056 of the ACA requires every applicable large employer (ALE) to file a form (i.e., a Form 1095) with the IRS with information about its full-time employees and to furnish each full-time employee with a statement containing similar

information. These forms must be filed regardless of whether the ALE offers coverage, or the employee enrolls in any coverage offered.

In order to complete a Form 1095-C, an employer must indicate on Part II of the form whether it offered coverage for all days of the calendar month to a particular individual (and any dependents). However, if an employee terminates employment with the ALE before the last day of a month and the coverage (or offer of coverage) expires upon termination of employment, but the coverage would have otherwise continued until the end of the month, then the ALE should report that month as an offer of coverage using code 2B. If the coverage (or offer of coverage) would have continued had the employee not terminated employment during the month, then the ALE will be eligible for relief under the Employer Mandate for that employee's last month of employment.

COBRA Notices for Employees No Longer Covered

The requirements under COBRA are clear– continuation coverage must be offered when qualified beneficiaries (certain employees, terminated employees, retirees, spouses, former spouses, and dependent children) lose coverage due to a triggering event (called a "qualifying event"), such as a termination of employment or a reduction in hours worked. Plan sponsors and plan administrators are required to provide qualified beneficiaries with COBRA election notices upon the loss of coverage triggered by qualifying events. The election notice describes the ensuing COBRA rights and obligations to which a qualified beneficiary is entitled, as well as, the procedures necessary to make an election of COBRA coverage. COBRA coverage is not automatic; it must be affirmatively elected. Without a timely provided notice, the employer is exposed to lawsuits and fines. When instituting large scale layoffs or terminations, human resources departments may be increasingly prone to costly failures to timely provide the COBRA election notice.

The election notice must be furnished by the plan administrator to qualified beneficiaries within 14 days after the plan administrator receives the notice of a qualifying event (from either the employer or the qualified beneficiary). If the qualifying event is one where the employer has the obligation to notify the plan administrator of the event (such as a termination of employment or a reduction in hours) and the employer is the plan administrator, then the election notice must be provided to the qualified beneficiaries within 44 days from the date that the qualifying event occurs.

Organizations undergoing mass terminations, layoffs, or reductions in hours must ensure COBRA election notices are provided in a timely manner. Although compliance may be difficult for employers with employees spread across multiple locations, the alternative may prove to be immensely costly. Employers that violate COBRA requirements could face penalties under the Internal Revenue Code and ERISA. Further, employers are at risk of lawsuits filed by the Department of Labor and/or qualified beneficiaries. The compounding effect of COBRA penalties creates an environment that strongly encourages compliance.

Generally, the IRS penalty is a non-deductible excise tax of up to $100 per day per violation during the non-compliance period. This period begins on the date of the COBRA violation begins and ends on the date that it is corrected. The final penalty will ultimately depend on factors such as whether the IRS finds the violation to be inadvertent, more than de minimis, due to reasonable cause, or if the violation is corrected within 30 days.

Under ERISA, a participant or qualified beneficiary may bring a civil action against the employer. The employer may be liable to the individual who failed to receive notice, for up to $110 per day from the date of failure to comply. ERISA allows a qualified beneficiary to file suit against an employer for failure to provide COBRA coverage. If the qualified beneficiary prevails, the employer could be required to pay the qualified beneficiary's claims that were incurred during the non-compliance period. Employers should bear in mind that in addition to the qualified beneficiary's claim regarding liability in an ERISA lawsuit, they may also be required to pay the qualified beneficiary's attorneys' fees.

Action Steps

- Carefully communicate the reasons behind any reduction in hours.
- Do not automatically rescind offers of coverage to furloughed employees if you are using the look-back method to determine full-time status and the furloughed employees are in a stability period.
- Carefully review the eligibility and actively-at-work provisions of all the benefits.
- Ensure laid off employees are correctly accounted for on all Forms 1095-C and corresponding employee statements.
- Ensure that all COBRA qualified beneficiaries receive a timely election notice once coverage is lost as a result of a termination of employment or a reduction in hours.
- Stay tuned for more.

Employers should carefully evaluate their health and welfare plans to determine if they are in compliance with both federal and state law. If you have any questions about information contained in this Spotlight or would like additional information, please contact your Gallagher Consultant or account team member.

The intent of this analysis is to provide general information regarding the provisions of current federal laws and regulation. It does not necessarily fully address all your organization's specific issues. It should not be construed as, nor is it intended to provide, legal advice. Your organization's general counsel or an attorney who specializes in this practice area should address questions regarding specific issues.

