

ERISA COMPLIANCE FOR SEVERANCE PAY ARRANGEMENTS?

A private employer planning on downsizing or implementing a reduction in force ("RIF") has many items on its checklist to consider. The employer that intends to offer severance pay benefits must understand how Employee Retirement Income Security Act of 1974 ("ERISA") may impact the RIF. Severance pay arrangements fall into one of three classifications under ERISA and the Department of Labor regulations implementing the law: qualified defined benefit plans, welfare plans and pay practices.

Defined benefit pension plans may be used to provide severance benefits. This approach is particularly attractive if the sponsoring employer has an overfunded defined benefit plan because the excess assets in the plan may be used to fund severance payments. Funding severance benefits through a defined benefit plan may have the additional advantage of spreading the cost over a number of years in accordance with the plan's actuarial assumptions. However, defined benefit pension plans are subject to many complicated Internal Revenue Code and ERISA requirements. Chief among these requirements is that benefits may not discriminate in favor of highly compensated employees. They are also expensive severance vehicles for those who do not sponsor an existing plan.

A severance pay arrangement may avoid the complications of being a defined benefit pension plan if the arrangement meets the requirements of Department of Labor regulations. A severance pay arrangement will not be considered a defined benefit pension plan, but will be considered a welfare plan, if:

- payments are not directly or indirectly contingent upon the participant retiring;
- total payments do not exceed twice the participant's annual compensation during the year preceding termination; and
- all payments to a participant are completed within 24 months of termination.

The prohibition against retirement will not be met if the arrangement limits eligibility to those employees who are the same age or older than the earliest retirement age under the employer's retirement plan. If the sponsoring employer wishes to avoid the pension plan requirements, the employer may not require employees to take severance pay benefits at the same time they take pension benefits. Employees may not be required to waive their right to future employment, as well.

Severance pay plans that are welfare plans do not escape ERISA. They are subject to ERISA's disclosure, reporting, fiduciary and claims procedures requirements. The plan must be in writing, and the employer must provide a summary plan description to participants. These severance pay plans and their summary plan descriptions are not voluminous documents, however. As for the annual report requirement, small welfare plans avoid this requirement if severance benefits are paid from the general assets of the employer and the plan has fewer than 100 employees eligible to participate.

Only pay practices escape ERISA's reach. If the employer's severance program requires employer administration and the program has an identifiable, intended group of beneficiaries, it will be either a welfare benefit plan or a pension plan. If former employees continue to receive periodic compensation after severance, then the employer administration required to continue those payments makes the pay practice exception unavailable. In order to avoid both the defined benefit and the welfare plan requirements, an employer arguably may do nothing more than write a check to departing employees at termination.

If you have any questions, please contact William D. Roberts at ebplans@hallrender.com or 502.560.9364 or your regular Hall Render attorney.