

2014 - 01: Severance Agreements & Unintended Consequences

Overview

Employers sometimes wish to ease the financial impact of an employee layoff, retirement, termination, or extended disability. Two methods often used to meet these objectives are 1) the offering of a severance benefit that pays all or a portion of the premium for Federal COBRA (or State) continuation coverage or 2) a delay in the loss of employer sponsored health insurance coverage until a date beyond the actual end of employment date. While these practices are intended to assist employees during their transition, they sometimes have unintended consequences for both the employee and the employer. These issues vary based upon the person's eligibility for other insurance such as from a spouse's plan, another employer, the Health Care Reform Exchange/Marketplace, Medicare, or other statutory benefits.

Unintended Consequences

Consider the following example:

- A married employee enrolled in single coverage that costs \$400 per month
- The employee is laid off
- The employer wishes to "help" by providing health insurance for 3 months

Employer agrees to pay COBRA premium of \$400 (plus the 2% administration fee) for 3 months. At the end of 3 months, employee attempts to join spouse's plan where the premium share is \$100. Coverage is denied because under HIPAA Special Enrollment Rights, the right to join a spouse's plan at other than open enrollment would require application within 30 days of loss of other coverage or expiration of COBRA rights. Since the employee elected COBRA upon loss of coverage and not the spouse's plan, the next qualifying event is either the spouse's next open enrollment or the expiration of COBRA. Depending upon when open enrollment is, the employee could incur up to 11 months of additional COBRA premiums at \$408 per month before becoming eligible for the \$100 per month plan, ultimately costing the employee an additional \$3,388.

Age-Based Rating Complications

Health Care Reform has established age based rates for plans offered by companies with fewer than 50 full time employees, or plans purchased through the Marketplace. Marketplace based plans require no medical proof of insurability but must be purchased during open enrollment periods or following a qualifying event, such as loss of coverage at termination of employment. Many people, especially those under the age of 45, may find Marketplace policies less expensive than premiums for plans from a company using a composite rating system (one average premium for all ages). Paying for COBRA premiums or delaying loss of coverage may disqualify an employee's right to buy coverage at the Marketplace in much the same way as through a spouse's plan in the example mentioned above.

Other Situations to Watch

- **Delayed Loss of Coverage** - Some employers may choose to terminate an employee's employment but leave the employee active on their insurance plan for a period of time before offering COBRA. This practice can cause problems for the employer in the event of an insurance company audit or the annual plan renewal. Individuals who are active on the plan but not "actively at work" and not listed as a COBRA participant may have claims denied and the employer could be required to fully fund the cost of care. Most carriers will limit a delayed loss of coverage to 90 days. In addition, having individuals enrolled on the plan who are not actively at work can hinder the ability to make an insurance carrier change at renewal.
- **Disabilities** – Employees who suffer a long term disability may also want to join a spouse's plan similar to the example described above. An employer who covers COBRA following a disability can create the same

denial of coverage problems. Likewise, keeping the employee on the company plan by delaying loss of coverage can create the problems described under the “Delayed Loss of Coverage” section. An added potential problem with disabilities is that delaying loss of coverage can complicate the documentation of the beginning date of their disability which is needed to qualify for additional statutory benefits available after a disability, such as Social Security Disability benefits. If the employer attempts to correct the records retroactively, they may inadvertently disclose that the disabled person was not eligible for benefits for some portion of the time period covered.

- **Medicare Eligibility** - An employee who retires beyond normal retirement age may enroll in Medicare during a Special Enrollment Period of 8 months following the end of employment. An employer who pays for COBRA and delays Medicare enrollment more than 8 months may cause the individual to forfeit their Special Enrollment Rights and pay a higher premium (penalty) for Medicare.
- **Marketplace Eligibility** – Individuals may purchase Marketplace policies during annual open enrollment or following a qualifying event such as termination of employment. An employer who pays for COBRA for several months as part of a severance agreement may effectively disqualify the person from Marketplace eligibility until the next open enrollment since loss of coverage is a qualifying event but expiration of a severance benefit is not.

Solutions

To avoid the unintended consequences described above, an employer may want to consider giving lump sum cash as a severance payment. The health insurance coverage would end at the normal coverage end date and the employee would be offered COBRA. The severance payment in the form of a lump sum cash payment gives the person the opportunity to determine how to best spend the severance payment toward health care coverage. They may elect COBRA coverage, use the funds to help offset the cost of being added to a spouse’s plan, purchase Marketplace coverage, or enroll in Medicare. The result is the ex-employee makes the best decision for their circumstances without any unintended negative consequences, and the employer should not be held liable for the ex-employee’s decisions.

Employers may also want to establish a specific Return To Work Policy that communicates termination of employment and loss of coverage after a specific period of time following a Leave of Absence or disability. 90 days is a common time period and is consistent with the Family Medical Leave Act requirements for companies with 50 or more full or part-time employees.

To protect your company from problems created by another employer offering an ill-advised severance package, such as paying COBRA, we strongly urge clients to obtain signed HIPAA Special Enrollment Rights Notices from each new hire that is eligible for benefits and at each open enrollment period from all benefit eligible employees. These notices outline the employee’s rights and responsibilities including qualifying events and time periods allowed to enroll or add dependents. Should an employee make a bad decision in selecting another source of coverage, the HIPAA Special Enrollment Rights Notice confirms in writing the employee’s understanding and acceptance of the potential consequences of a waiver of employer provided benefits, the circumstances under which they may be allowed to enroll, and when those rights may be exercised.

If you have any questions about this update or The Conestoga Group’s COBRA Service, please contact Fredonna Smith of The Conestoga Group at 610-889-9500, ext. 103 or fredonna.smith@conestoga.biz.

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