

Severance FAQs

Overview

Severance plans are generally designed to provide financial support to employees who lose their jobs through no fault of their own. Benefits offered through a plan can help the employee weather the period of unemployment following a termination or layoff, and to some extent compensate the employee for the loss of seniority and other privileges or rights the employee may have enjoyed in his or her position.

Should You Adopt a Formal Severance Plan or Policy?

There is no requirement to offer severance pay under federal law. The reasons an employer might choose to offer severance vary, and an employer may design one or more plans to meet specific needs.

An employer may wish to provide severance to a specific group of employees (such as executives) who will be displaced because of some anticipated event, such as an upcoming merger or acquisition. That plan may simply be a contractual agreement individualized for each employee, or it could be structured more formally.

An employer who is implementing an extensive reduction in force (RIF) may wish to adopt a plan specifically geared to address the persons losing their jobs as a result of the RIF, though there is no obligation to do so.

Sometimes an employer will offer severance pay in exchange for the departing employee's signing a release and waiver of liability releasing the employer from claims of discrimination, breach of contract, wrongful discharge or the like, in connection with a termination or reduction in force. (Note that a severance agreement for any employee over the age of 40 must comply with the Older Workers Benefits Protection Act, which requires a number of specific provisions in the agreement and sets forth specific standards that must be met in any release in order to be effective as to age discrimination claims.)

Still other employers develop a company-wide severance plan to provide a sense of security for both prospective and current employees in the event of unexpected job loss.

Before you implement any type of severance plan, you need to give careful thought to its structure. You should also be aware that your plan may be covered by the Employee Retirement Income Security Act (ERISA), in which case you will be obligated to provide summary plan descriptions to employees and may have some reporting obligations to the U.S. Department of Labor. If you already have benefits such as a 401(k) plan in place, you may be familiar with some of these requirements.

What Should You Consider When Adopting a Severance Plan?

Who will be covered?

An employer may choose to provide severance benefits for all employees, from hourly paid workers to executives. Alternatively, severance benefits may be offered only to certain groups of employees, such as managers and executives. Severance benefits need not be the same among all groups of employees, for example, granting them to exempt employees and not to non-exempt, so long as the plan does not discriminate against any employee or group of employees based upon race, sex, age, color, national origin, or any other legally protected class.

What benefits will you offer?

Severance plans vary widely, but employers commonly pay severance based on an equation which considers the employee's compensation at the time of termination and the length of the employee's service with the employer—for example, one to two weeks' pay for each year of service (with predetermined minimums and maximums). Other companies multiply an employee's monthly pay times a certain number of months, typically one to three months. Severance



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payments may be made in one lump sum, or gradually with regular payroll periods.

Other factors considered by employers in determining the benefits of a plan include seniority, compensation level and coordination with other benefits.

In plans considering seniority, a typical formula multiplies the employee's pay by a number of weeks, months or pay periods covered by the policy times a seniority factor. For example, an employer might give everyone one month of severance, but add on additional weeks for each six months or each year of service after the employee's first year of employment.

Employers may consider the compensation level of each employee in setting severance pay levels as well as other benefits such as unemployment compensation as a set off.

Be sure to consider that severance paid to involuntarily terminated employees is subject to federal income, Social Security and Medicare, and federal unemployment taxes. State taxes such as workers' compensation and other withholding requirements may also apply.

What ERISA Requirements Do You Need to be Aware of?

Severance plans are generally considered employee welfare benefit plans under ERISA. Factors typically used in assessing whether a particular severance plan constitutes a welfare benefit plan under ERISA include whether the employer must exercise managerial discretion in its administration of the plan; whether a reasonable employee would conclude that the employer had an ongoing commitment to provide employee benefits; and whether the employer must analyze each employee termination individually in light of specific criteria.

Severance plans subject to ERISA must comply with a number of requirements, including the following:

- Provide employees a summary plan description (SPD), which summarizes the severance plan in clear, understandable language. The SPD must contain specific information as required by ERISA, including:
 - Eligibility requirements;
 - The basis for determining benefits;
 - Information regarding the plan sponsor, plan administrator, and the registered agent (for accepting service of legal process);
 - The procedures required to amend the plan;
 - The plan's I.D. number;

- The plan year; and
 - A statement regarding employee rights under ERISA, which must include the right to obtain plan documents and to examine them, and the right to file suit.
- Provide to all employees a written procedure which explains how an employee may file a claim and/or appeal the denial of a claim to the plan administrator.
 - This procedure must require the plan administrator to respond to an employee's claim for benefits within 90 days and to respond to an appeal generally within 60 days.
 - Employers with 100 or more employees and certain other employers may be required to submit an annual report (Form 5500) to the Internal Revenue Service.

The person administering the plan (usually the employer) is also subject to certain fiduciary obligations to employees under ERISA. For more on fiduciary obligations, [please click here](#).

An employer may amend the severance plan at any time, so long as it notifies employees of the amendments within the time required by law. It is important to note that failure to follow a written existing plan could expose the employer to liability under ERISA. Employers are strongly advised to consult experienced employment counsel in developing a severance plan, including to determine whether the arrangement is covered by ERISA.

Still have questions on severance plans?

Contact our specialists at **401.332.9325**.

