Retirement Plans Impact on M&A

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Overview of Transaction Types

Stock Purchase / Sale

In a stock transaction, a buyer (a company, individual or group of individuals) acquires a business through the purchase of the stock of another company. While its underlying ownership has changed, the company that is purchased often continues with business as usual.

Employees are not terminated as a result of the transaction.

There is normally the option to terminate the prior plan (as long as it is done prior to the sale), merge to two plans, or provide two separate plans.

Asset Purchase / Sale

With an asset purchase, as the term suggests, the buyer purchases the assets of a company. Assets might include buildings, inventory, the customer list and even employees.

Sometimes the seller no longer exists as a business entity. The employees may be effectively terminated from the seller and become new employees of the buyer, typically performing the same jobs as before.

If there is a full purchase of the organization, then the seller is required to terminate the plan.

Merger

Somewhere in between, there might be a pure *merger* of companies, which is treated like a stock sale. Even in a *merger of equals* there is typically a surviving company.

Plan Termination

Pros/Cons of Terminating the Seller's Plan

PROS

Reduced Liability

The buyer is not required to protect any of the provisions under the seller's plan, nor are they liable for any potential issues.

Simplified Transition

The buyer maintains their current plan and, in an asset purchase where the newly acquired employees are treated as new hires, the transition and ongoing communications may be simpler.

Participants Can Roll Their Assets

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CONS

Loss of Forfeitures

Because all affected employees must be 100% vested under a plan termination, the employer will lose the use of any potential forfeiture dollars generated by participant terminations.

Additional Compliance / Legal Work

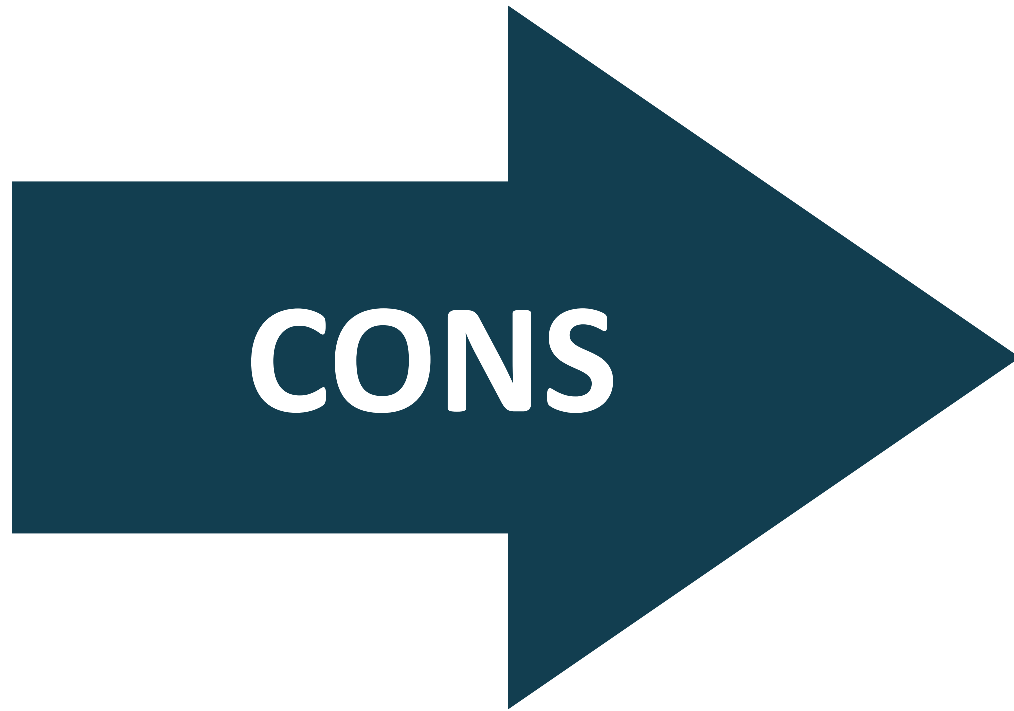
At a high level, plan documents must be brought up to date with all required discretionary amendments, and receiving an IRS determination letter for the termination is a best practice.

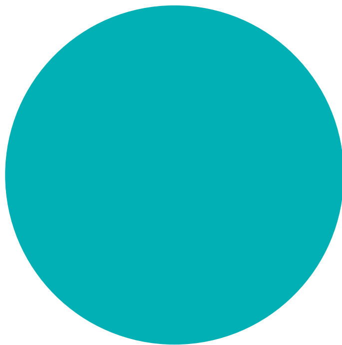
Loans Become Taxable

Any outstanding loans held by participants in the seller's plan will become immediately taxable and may be subject to an additional 10% excise tax (unless such loans are rolled over to the buyer's plan).

Continue The Seller's Plan As A Stand-Alone Plan

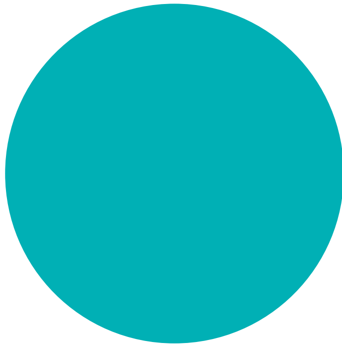
Pros/Cons of Continuing the Seller's Plan





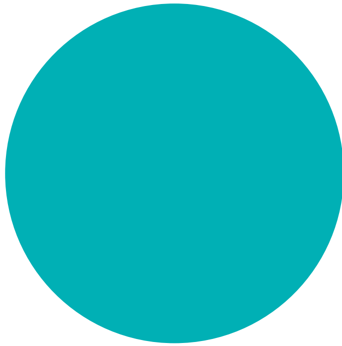
Simplified Communication

Generally, there are no special operations or communications issues when the plans are kept separate.



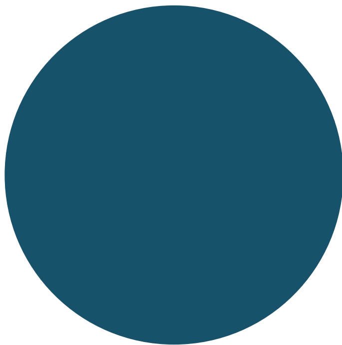
Separate Plan Design

The plan design may be significantly different than the buyer's plan. Additionally, if there is not funding or desire to bring the benefits up to the buyer plan it allows



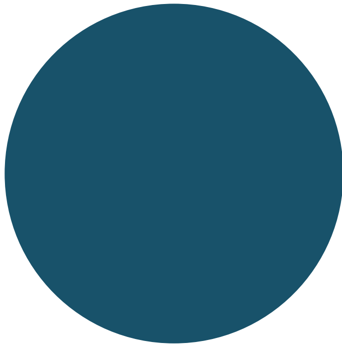
Helps Manage Plan Defects

Where there is a plan defect, it also may make sense to keep the plans separate. Once the defect is corrected, ideally through a filing under VCP and receipt of a compliance statement from the IRS, the plans could be merged.



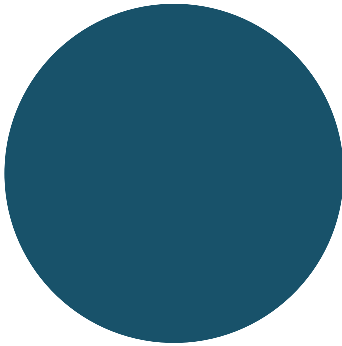
Increased Cost

Many of the disadvantages fall into the additional cost category: plan setup, ongoing maintenance, multiple payrolls, communications, plan documents, audits, testing, Form 5500 filing and perhaps even less favorable pricing on investments.



Must Pass Testing On Their Own Merit

Plans need to be able to pass coverage and actual deferral percentage (ADP)/actual contribution percentage (ACP) nondiscrimination testing on their own. If they cannot, additional testing issues come into play.



Employee Relations Issues

It may hinder the assimilation of acquired employees into the buyer's structure, and there may be the perception of unfair treatment if one plan appears to be more generous than the other.

Plan Merger

Pros/Cons of Merging the Plans

Reduced Cost/Administration Workload

From the employer's perspective, there can be a significant reduction in cost and administrative effort. One plan document reduce, one audit, one Form 5500 and one set of nondiscrimination tests can reduce fees further.

Streamlined Participant Experience

From the employee's perspective, they can see their combined retirement plan account in one place. Most commonly all employees are on the same benefit structure, although they may have some protected benefits that are different from the current plan.

Reduced Participant Costs

As assets grow it provides economies of scale for recordkeeping, administration, and investments. These costs are normally paid at the participant level.

Compromised Plan Qualification

If there is a possibility of plan defects that are not properly corrected prior to the merger, the qualification of the acquiring plan may be tainted or compromised. There may be a cost liability to the buyer to rectify the issues.

Can Complicate Administration

If there are protected benefits, or perhaps a different match for different groups, the administration becomes a little more complex. This could require additional testing that could be costly.

Strategic Considerations

There are many factors to consider when a qualified plan is part of an acquisition. It is critical to review the qualified plan as early as possible in the overall process.

Overall goals and objectives of the buyer

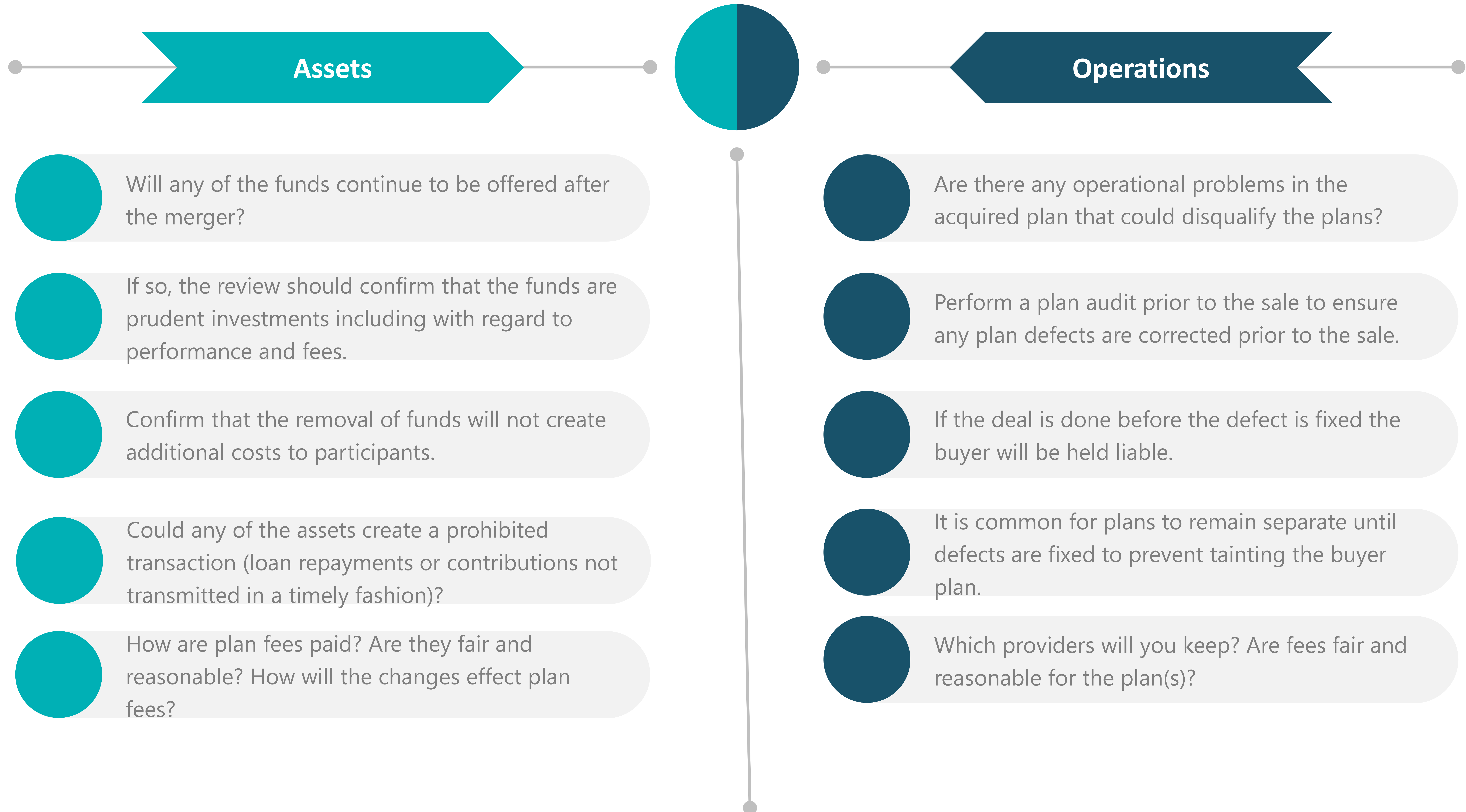
- What benefit plans are currently offered by the buyer?
- What benefit plans are in place at the acquired company?
- What can the purchaser afford?
- Should the seller's plan be terminated or merged with the buyer's plan?
- Do the answers to these questions affect employee relations?

Legal/regulatory/technical rules to consider

- Depending on the transaction will you terminate the plan, merge, or keep the plans separate?
- How will these changes drive compliance testing?
- Are their protected benefits?
- How will these changes effect payroll? Will you combine or keep payroll separate?
- How will you communicate the changes? What education and enrollment meetings are expected?

Fiduciary Considerations

At a broader level, the fiduciaries of the plan must put on their ERISA hats to help ensure there are no problems in the acquired plan that could negatively impact the qualification of the receiving plan.



Benefits Considerations

A side-by-side comparison of plan provisions should be performed to determine any differences between the plans and how those differences will be resolved.

Crediting Service

- If there is not severance from employment, prior service must be credited
- If there is a severance from employments, the buyer may credit prior service
- If there is a stock sale of a subsidiary to an unrelated company, prior service may ne counted
- If the plans merge or the prior plan is maintained prior service must be counted towards vesting

Vesting

- Participants are 100% vested if a plan termination occurs
- Compare and contrast vesting schedules and ensure vesting is correct
- If the new plan has an inferior vesting schedule, prior accrued benefits should keep prior vesting schedule

Benefits that are protected

- Allocation conditions may not be changed during the plan year if the old conditions have been met
- Withdrawal rights associated various contribution sources
- In-service withdrawals
- Withdrawal rights at a certain age for prior contributions
- Normal and early retirement age
- True-up contributions if accrued

Benefits that are not protected

- Right to make pretax or after-tax contributions
- Availability of loans
- Right to a certain investment
- Hardship withdrawals
- Rollovers into the plan

What happened when due diligence isn’t performed?

Best Practices

This will provide proper time to help review the plan and allow the experts to consult with your firm on how the transaction will affect your organization, and the type of transaction that best fits your preferred outcomes.

This will include a review of investments, providers, plan design, payroll, if plan procedures are being followed, and uncovering any unexpected errors or costs that may come along with the transaction.

This will allow you to see what type of benefits you may owe, the type of benefits you must protect, and at times may provide valuable insights into additional benefits you may want to offer.

This is normally only needed if a plan termination is occurring. Though by engaging experts early if errors are found, it also allows you to be able to get DOL blessing on any corrections made prior to the transaction.

Thank You!

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