Fidelity Benefits Consulting

Mergers & Acquisitions:

Compliance Considerations When Acquiring Plans

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Large corporate transactions often make the headlines with articles discussing "synergy," "market share" and other impressive business terms. This is exciting stuff!

There are new opportunities created and change is in the air. But someone needs to mind the store back in the benefits office. Along with market share, intellectual capital, buildings, etc., you have also acquired new employees and an array of benefits programs that need your attention.

In an earlier article, we discussed some high-level strategies for benefits integration and harmonization. This article will focus on the compliance challenges relative to your defined contribution plans these transactions present.

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Compliance status of acquired plans

As of the close date, the buyer assumes the compliance responsibilities of any plans associated with the deal. Acquiring companies should consider a review of these plans to identify areas that may warrant further action– from simple administrative issues to compliance failures requiring corrective action. This review should take into account all plan documents, participant communications, administrative procedures and testing results, and can include interviews of key administrative personnel, including, if appropriate, the plans' financial statement auditors.

The importance of this type of review increases significantly if a decision is made to merge a plan into one of the buyer's plans, which is common in M&A transactions. A compliance review prior to any such merger will prevent the buyer's plan from being tainted by any defects in the acquired plan.

Different Levels Review

The level of due diligence may vary, depending on the time available, the size of the target entity, the number of participants, the assets in the target plans, and the complexity of the plans being acquired. The level of due diligence is often dictated by past experience and the sophistication of the target entity.

Cursory

A cursory level of review will involve a review of the plan documents, governmental filings, sample forms and statutory testing results.

Medium

A medium level of review will additionally include a detailed walkthrough of the plan's operations with the individuals responsible for plan administration at the acquired company as well as sample calculations and an in-depth review of the testing results.

Comprehensive

A comprehensive review will include a large sampling of participants to validate any issues raised in the walkthrough of the plan's operations. A comprehensive review is especially appropriate when collective bargaining agreements are in place.

Review of Non-Qualified Plans

The operations of a non-qualified plan are often overlooked in a corporate transaction, but with the onerous penalties of Section 409A and the potential for additional taxation, it is critical that non-qualified plans are reviewed in depth. In addition to reviewing the plan documents and operations, the timing of withholding and remittance of FICA taxes should be reviewed. Given the complexities of the rules surrounding non-qualified plans, a medium-level or comprehensive review is recommended.

Timing

Timing can be critical for these reviews. Sooner is always better than later; especially if reviews can be completed before the close date. This timing would allow for some discussion with the seller regarding remediation and indemnification for any problems that are uncovered during the review.

Compliance status of the new controlled group

Mergers and acquisitions alter the fundamental makeup of companies by creating a new legal entity with a range of possible ownership structures. The concept of a "Controlled Group" has been developed by the IRS to address how plan compliance is impacted by various ownership structures. Ownership structures can be very complex as can these rules, but generally, companies that are at least 80% owned by the same parent are considered part of the same controlled group. Let's assume a merger results in a new company and a controlled group consisting of all employees and plans of the two parties to the deal. The resulting compliance challenges tend to be either operational in nature or related to nondiscrimination requirements.

Operational Considerations

One of the first tasks to be pursued as part of a merger or acquisition is to identify employees who have employment relationships with more than one company. Most commonly, you will find employees active with one company, but at the same time, are also terminated with a vested 401(k) account balance in the other company. Also common, especially in the healthcare industry, are employees currently working at two companies and participating in multiple plans.

These employment relationship changes require that employers monitor plan activity to avoid prohibited transactions (e.g., in-service withdrawals), 401(k) plan loan and hardship withdrawal problems, and deferral limit excesses. Significant coordination is needed in order to deal with the multiple payroll providers and record-keepers in the mix.

Non-discrimination testing

Retirement programs are subject to fairly complex rules regarding non-discrimination, ensuring benefits provided to Highly Compensated Employees ($120,000 annual pay) are not overly generous relative to benefits provided to Non-Highly Compensated Employees. 401(k) plans are subject to what is generally called ADP/ACP testing of employee deferrals and company match. Additional coverage testing under IRC section 410(b) is also required, which looks at plan eligibility for HCEs and NHCEs.

Merger and acquisition activity can have a significant impact on these test results. With a new set of plans within the controlled group, coverage testing can be a challenge. ADP/ACP tests tend to be more stable but if the acquisition involves a partial spin off from the seller's plan, results for the new smaller plan might be significantly different than for the full plan. Relief is available to plan sponsors that can provide a one-year grace period for some of these tests, but plan sponsors should review their specific situation to determine how the grace period applies.

Mergers and acquisitions are complicated, sometimes risky endeavors—bringing together two organizations effectively to create more value in the marketplace is hard work. A new harmonized benefits strategy will be needed to support the broader goals of the new organization. Ensuring ongoing compliance during this transition will enable your organization to avoid costly mistakes that distract from the company vision you are pursuing. This work might not make headlines, but when it comes to compliance, that's usually the goal!

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