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Proper Documentation of Mergers: There's More to Mergers Than Just the Assets

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Mergers and Acquisitions are more than just combining the assets of the companies involved. Included in the merger would be any retirement plan that the acquired company might have.

In the past few years, an alarming pattern has been emerging in the retirement plan marketplace. It appears that many entities have been instructing plan sponsors to merely sign a letter of directive and maybe a form to coordinate the merger of plans and their assets when a company merger/acquisition has occurred. There are several documents that need to be prepared and steps that need to be taken prior to the merger of the assets (which is the "sexy" part of the process). In fact, there are even attorneys who have written entire books on the subject of mergers and acquisitions in employee benefit plans. So, clearly, there is more to the merger process than just the joining of the assets.

Let's start at the beginning: Company A decides to purchase Company B. It's a stock sale. Of course, Company A neglects to tell its third-party administrator (TPA) in advance that this transaction is about to take place. The TPA learns about the transaction when Company A is getting ready to submit its

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annual census data for testing and casually asks how they should reflect the data for Company B. Here's the mnemonic to remember—when you have a stock sale, you've bought the other company "lock, stock, and barrel." That includes any retirement plan that Company B might have. (And as a reminder, Internal Revenue Code (Code) Section 401(k)(10)(A) prohibits the distribution of the elective deferral portion of the participant's account if the employer maintains an alternative plan.) That puts Company A in a position where it must merge Company B's 401(k) plan into its own 401(k) plan or retain it as an ongoing or frozen plan, at least to the extent of any 401(k)-type funds.

Time to Hunt and Gather

The merger process begins with the hunt and gather phase. The TPA should have its client's, Company A, documents. So, at least that's half the battle won. The TPA needs to quickly have Company A work with Company B to gather all of Company B's 401(k) plan documents. The information that should be requested includes:

- Current Plan documents (most recent restatement)
- All amendments since that restatement
- Current procedures (for example, loans, qualified domestic relation orders (QDRO), etc.)
- Most recent valuation and non-discrimination testing.

Company A (or you) can pull down the Forms 5500 for the past three years from eFAST.

An initial, comprehensive review should be done to ensure that all the documents are properly signed and dated, that the testing was done appropriately, and that all Forms 5500 have been timely filed. Any obvious deficiencies will need to be addressed immediately and legal counsel may need to be engaged to assist with bringing the Company B plan into compliance. As part of the initial review, the Company B plan also should be reviewed to confirm any mandatory contributions or potentially tricky provisions, such as safe harbor or Qualified Automatic Contribution Arrangement (QACA).

Understand Your Transition Period under Code Section 410(b)(6)(C)

One of the best friends that you can have within a plan document is the election to apply the Transition Period to all acquisitions (found under Code Section 410(b)(6)(C)). This election must be found in both Company A and Company B's plan document. If properly elected, this allows the plans to exclude employees who become part of their entity or their controlled group, permitting the plan to stay separate and yet still not fail coverage rules during the Transition Period. The Transition Period is the period "(i) beginning on the date of the change in members of a group and (ii) ending on the last day of the 1st plan year beginning after the date of such change."

If you have this golden ticket, you need to make sure that neither plan is amended during the Transition Period other than in relation to insubstantial changes, such as a change of trustee. Changes that impact the coverage test for either plan will invalidate the Transition Period and then the companies may be stuck without their preferred options.

Performance of the Code Section 411(d)(6) Review

"I haven't heard of the 411(d)(6) test," said the Service Provider. Let's start with understanding Code Section 411(d)(6). If you haven't read it, it's the section of the Code that outlines the provisions that are considered protected benefits and cannot be taken away from participants. For example, if a participant is subject to a three-year graded vesting schedule and is already 50 percent vested in the matching contributions offered in the plan, the plan sponsor can't change this to a six-year graded vesting schedule and suddenly move a participant from 50 percent to 40 percent vested.

When someone performs a 411(d)(6) review (aka a protected benefits review), it is important to lay out a side-by-side comparison of all plan provisions from each plan to determine where things don't align. Special care should be taken if one or both of the plans provide for safe harbor or QACA provisions, and they don't match each other. Although there are some options under Notice 2016-16 that would permit mid-year amendments to a safe harbor plan, a mid-year merger of a safe harbor match plan into a non-safe harbor plan may create legal and operational challenges. Even when there is a merger situation and a mid-year revocation of the safe harbor becomes necessary, if such a change is permitted under Treas. Reg. Section 1.401(k)-3(e)(4)(ii), there is still a 30-day notice requirement. If the transaction is going to be occurring on Friday, and the TPA isn't notified until the Monday prior, the notice requirement can't be met. Sadly, this happens all too often.

Even if neither of the plans has any safe harbor or QACA provisions, there can still be plenty of problems addressing the other protected benefits. For example, suppose that the Company A plan provides for a Normal Retirement Age of age 65, but the Company B plan provides for a Normal Retirement Age of age 62. A plan sponsor and/or recordkeeper may have substantial challenges tracking participants that are subject to the age 62 provision. In fact, the recordkeeper may not be able to track the separate Normal Retirement Age provisions at all and the likelihood that a plan sponsor can is slim to none.

So, what's Company A to do? Welcome to the art of compromise. In many instances, Company A and Company B are going to have to agree to accept the protected benefit with the lowest common denominator. In the prior example, Normal Retirement Age may need to be amended to reduce the age to 62 for everyone. A common misconception is that eligibility provisions are a protected benefit. That's simply untrue. If Company B has a three months of service eligibility provision, and Company A has a one year of service eligibility provision, Company A can require that any Company B employee meet the one year of service requirement before participating in its plan. In many instances, Company A may choose to amend its plan to provide for immediate entry for Company B's employees and, generally, this is considered nondiscriminatory. However, this is not a legal requirement.

The Importance of the Merger Amendment

At the very least, once the 411(d)(6) review is completed, the document provider needs to prepare a merger amendment. This amendment is to the Company A document and it outlines not only the merger of Company B's plan into Company A's plan, but it should also outline all necessary protected benefits that are being preserved, or those provisions in Company A's plan that are being amended to harmonize the two plans, such as the allowance of the immediate entry for Company B employees.

For historical purposes, it's important that this merger history isn't lost in future restatements. Many document providers have addenda that allow for the documentation of protected benefits and all historical mergers that have occurred. If there is concern that such an addendum will turn the pre-approved plan into an individually designed document, have no fear. There is no indication from the Internal Revenue Service (IRS) that such changes would transform the plan.

What Is This Merger Agreement You Speak of?

The purpose of a merger agreement is to immortalize the agreement between Company A and Company B to merge the plans. Both parties will sign the agreement, as opposed to the merger amendment, which is signed only by Company A. A merger agreement should document the terms of the merger, including:

- Confirmation of what the surviving plan actually will be and what its name will be (sometimes the name changes with the merger);
- Any protected benefits that have been identified under Code Section 411(d)(6);
- Which accounts will be merged in (money types) and how they will be mapped over;
- Identification of when the employees will become eligible for the survivor plan;
- Who is authorized to take what actions; and
- Where the assets will be held.

Of course, other important details besides the items noted above also can be contained in the merger agreement if they help to document the terms. The process of documenting the merger conditions from an operational standpoint can really help both parties fully flesh out the decisions that need to be made and how the plan operations will look in the survivor plan.

Handling Those Special Situations

Many times, Company B doesn't have its own plan. Instead, Company B may be part of a Professional Employment Organization (PEO) and its Multiple Employer Plan (MEP). Dealing with a spin-off from an MEP may be a more difficult process than dealing with two single employer plans. The adopting employer may not have access to the full MEP documents that are needed for the protected benefits review and will need to negotiate back and forth with the PEO. Time should be allowed for this process. It also makes things more difficult, since Company B won't have its own Form 5500, so it will be less apparent whether there are any issues regarding the filing requirements.

When reviewing an MEP document for potential protected benefits, most often there will need to be three document pieces located: (1) the Participating Employer's Joinder Agreement (or Participation

Agreement), (2) the MEP Adoption Agreement, and (3) the MEP Base Plan Document. You should try to get the opinion letter to go with any MEP pre-approved document, as it is important to have a full set of prior plan documents for Company B. Remember that, if the Department of Labor (DOL) or IRS were to look at Company A's plan post-merger, the assigned agent will likely want to look at Company B's documents, as well.

Conversely, if the surviving plan is going to be the MEP, and the adopting employer is restricted in the number of plan provisions that it may customize within the MEP, negotiating for a reduced Normal Retirement Age, for example, may be increasingly difficult, as the provision may be elected at the MEP level and not at the participating employer level. As a result, the coordination of the merged provisions may require the PEO to become involved in the negotiations.

Coordination of New Enrollees

In the months leading up to the actual merger, coordination needs to happen between Company A and Company B to make sure that the proper documentation gets distributed to Company B's employees. Assuming that Company A's plan is going to be the survivor in our equation, all of Company B's eligible employees will need to be properly enrolled into the Company A Plan. Generally, that means new enrollment forms will need to be completed. (Note that the magical merger agreement we just discussed could provide that deferral elections from the merged-in plan will apply to the surviving plan.) New investment elections will need to be made. (Again, the merger agreement could provide for some mapping, which can save lots of time and aggravation. See how valuable it's starting to look?) Notices, Summary Plan Descriptions, disclosures, etc. will need to be handed out in a timely manner. All of this is enough to make the Human Resources Director crazy. And, absent proper timing, can trigger potential penalties from the DOL and/or IRS if not handled properly.

Therefore, it is important to make sure that this train is moving down the tracks at the same time as the merger process is inching towards its destination. Don't necessarily think of this part of the process as linear with the merger amendment/agreement. It should be coordinated in advance of the estimated merger date and not left until the last minute.

Participant communications shouldn't be overlooked in this process. As soon as the merger is announced, Human Resources already should be prepared with notices and memos outlining what employees should expect from the merger process. Employees become anxious enough with any merger situation. They don't need to worry about the retirement plan in addition to everything else. All potential communications should be prepared in advance and ready to send out when the appropriate time comes.

The Merger of the Assets

A good merger agreement and amendment have a date for the legal merger, but allows for administrative room to actually move the assets of the plans together. The best laid plans can often go astray and drafting your documents to only allow for a specific date for the physical combining of the assets to occur would be a terrible mistake.

The financial advisor to Company A should be amply involved and talking with his or her client to determine what type of asset merger will occur—cash or mapping. The recordkeeper/custodian may have specific forms or directives that are needed to assist with the coordination of the merger of the physical assets. It is important to determine what paperwork will be needed so that an actual target date for the liquidation and transfer of assets can be set. The blackout notice (aka Sarbanes-Oxley or SOX notice) needs to be distributed at least 30 days prior to any blackout period. [ERISA § 101(i); Labor Reg. § 2520.101-3] If mapping is happening, a mapping notice is required if the sponsor/plan administrator wishes to preserve its fiduciary liability protections under ERISA Section 404(c) and, if there is a change in the default investment alternative, a notice about that is also needed. [ERISA § 404(c)(5); Labor Reg. § 2550.404c-5]

Care also should be taken for any participant loans that may be outstanding with Company B's plan. Will Company A's plan even take the loans? What date will loan repayments be directed to Company A's plan? Are all loans in Company B's plan up to date (that is, no loans in default that shouldn't transfer)? Much of this should be resolved in the merger agreement drafting process and it shouldn't come as an 11th hour surprise. Participants should be kept informed along the way as to what they should expect with respect to their loan repayments.

Am I in This Alone?

No, certainly not. Company A and Company B should have legal counsel that has been advising it in regard to the merger. Therefore, look to them to provide information and appropriate guidance on the merger process with respect to the retirement plan. If that guidance doesn't seem to materialize, and you are the TPA or recordkeeper, propose that additional legal counsel be brought in. Don't put yourself out on a limb and offer legal advice on a matter when you are neither comfortable nor qualified to do so. Mergers and Acquisitions are not for the faint of heart. As noted earlier, entire books are written on the subject. Know, however, that just combining the assets is never the right answer. ■