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How a 401(k) Plan Can Affect a Merger or Acquisition

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A company preparing for a merger or acquisition runs due diligence on the target company's business fundamentals, client overlap, client retention capability, growth models, compensation structures, plants, property, and equipment. What else is there to cover?

The 401(k) plan. Although not as complex as many of the upfront due-diligence steps of a normal corporate action, handling a 401(k) plan properly takes some care and proper planning. This article outlines some of the care and planning necessary for a successful corporate action as it relates to a 401(k) plan.

To prepare for the successful business transaction, the 401(k) due diligence team must evaluate which type of acquisition is about to take place: stock or asset purchase. Once this acquisition structure has been identified, the due diligence team must understand its options as they relate to that particular type of transaction.

Stock Purchase

A stock purchase is the acquisition by an organization or individual of the stock of an organization in exchange for consideration such as cash or stock in the purchasing organization. The sellers in this case are the owners of the organization being purchased. They are selling their ownership interests in the form of shares of stock and receiving consideration in return.

A stock purchase typically requires that the buyer assume responsibility for any associated qualified plans, unless those plans are terminated prior to the close.

If the acquisition is the result of a stock sale, the buyer will assume the seller's retirement plan, unless the plan was terminated prior to close. If it is not terminated, the buyer may consider merging it with its own plan or maintaining it as a separate plan.

Asset Purchase

An asset purchase is the acquisition by an organization of certain business assets of another organization (for example, equipment, buildings, or accounts receivable) in exchange for consideration such as cash or stock of the purchasing entity. A transaction structured as an asset purchase may or may not require that the buyer assume responsibility for the acquired organization's retirement plan.

If the acquisition was the result of an asset sale, a merger of the buyer's and seller's plans may be feasible if:

- There is a mutual agreement
- The buy/sell agreement states that the buyer and seller will share in the decision making regarding the disposition of the seller's plan.

As a quick reference, the following are the four possible solutions a buying organization has with respect to the seller's 401(k) plan:

1. Merge the two plans into one new plan;
2. Maintain two plans separately and make continued contributions to both plans on an ongoing basis;
3. Freeze one of the plans and add the participants of the frozen plan to the other plan on a future basis; or
4. Terminate one of the plans and add the participants of that plan to the other plan on a future basis allowing the terminated plan's participants to roll over their terminated plan benefits to the ongoing plan.

Merging the Plans

Merging plans involves the consolidation of two or more plans into a single plan. Merging may be the best choice to try to reduce administrative costs, or if the buyer wants to create consistency, ease of administration, or simplify communications efforts.

Maintaining Separate Plans

In this option, the retirement plans of all affected organizations will be maintained separately. This might be the best choice:

- To provide different benefits to one group in order to attract or retain key employees or because the terms of a collective bargaining agreement;
- If the acquiring organization does not want to amend its current program to include the protected benefits from the other plan;
- If the acquiring organization does not want to amend the plan to offer more generous vesting; or
- If the acquired organization's plan has potential compliance issues that could "taint" the plan of the acquiring organization.

Freezing an Acquired Plan

Freezing a plan involves taking the steps to formally discontinue contributions or cease benefit accruals without distributing all of the plan's assets. This option may be attractive for buyers that are concerned with the compliance record of the acquired organization's plan. It may also be attractive for a buyer who wants to cover the acquired employees in the buyer's current retirement plan. A frozen plan must continue to be subject to governmental reporting and disclosure requirements. Frozen plans must also be amended to remain in compliance with changes in laws and regulations. Finally, all participants' vesting may need to be brought up to 100 percent.

Terminating the Plan

Under this option, the plan ceases to allow benefit accruals and contributions, and all of the plan's assets are distributed. Generally, all active participants and certain terminated participants become 100 percent vested. Typically, this option is chosen due to protected benefits concerns or compliance issues. Participants are allowed to roll over their account balances from the terminated plan into their new employer's plan.

Regardless of the buyer's choice in handling the seller's 401(k) plan, communication efforts during the pre-close, the at-close, and the post-close periods are critical. Pre-close communication is important so the best interests of all affected entities and timeliness of decisions are taken into account. If a buyer desires to terminate a plan under a stock purchase, the plan must be terminated prior to the close. Communication at the point of close is important to relieve participant anxiety. Finally, post-close communication with the current provider and the previous provider is important. Closing out a retirement plan properly alleviates potential issues years later with the Internal Revenue Service and the Department of Labor. A final 5500 is required when merging one retirement plan into another.

Conclusion

In closing, handling the retirement benefits package during a corporate action is not the most complicated due diligence matter, however, documenting the process and communicating it effectively can be critical to a successful integration of an acquired organization. ✪

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