SCHNEIDER DOWNS
Retirement Solutions

Employee Benefit Due Diligence in Mergers & Acquisitions

Five Common Misconceptions

Employee benefit plans are frequently overlooked as a source of potential liability in corporate mergers and acquisitions. Even though a target entity's retirement plans, health plans, and executive compensation agreements may seem ancillary to the business objectives underlying an acquisition, the fact remains that benefit-related liabilities can be substantial enough to make or break a potential deal. Getting employee benefit experts involved in the due diligence process can help alleviate any inherited liabilities and ensure a smooth transition for acquired employees post-transaction.

Here are five common misconceptions about employee benefit plans in corporate transactions:

Misconception #1

As long as the target entity's retirement plan has a favorable IRS determination letter, the acquiring entity need not worry about inheriting any qualification defects associated with the plan.

The Truth: In days of yore, the sponsor of a retirement plan would send a detailed application to the IRS every few years requesting a determination that the plan continued to satisfy the ever-changing set of rules and regulations applicable to qualified plans. Unfortunately, the IRS determination letter program has been gutted in recent years. While the IRS still issues determination letters in certain limited circumstances, such as plan termination, most plans are no longer covered by an up-to-date determination letter. Now more than ever, the due diligence process plays a key role in ferreting out any plan document shortcomings or other qualification defects that may be associated with a target company's retirement plans.

Misconception #2

Any benefit-related liabilities, if they exist, are likely to be so small as to be immaterial to the transaction.

The Truth: Benefit-related liabilities can become multi-million-dollar headaches if not avoided or appropriately remediated prior to the transaction. Some common benefit problems that can lead to hefty liability include defined benefit pension plan funding requirements (particularly in a down market), multiemployer plan withdrawal liability, retirement plan qualification defects, and employer shared responsibility penalties. Even seemingly minor issues, such as the plan sponsor's failure to meet reporting and disclosure deadlines, can lead to per-day penalties that can quickly grow substantial if not caught early. Investing sufficient time in the due diligence process can help catch these potential liabilities before the deal documents are signed, which is much better than inheriting them as an unpleasant surprise post-closing.

Misconception #3

The IRS allows an 18-month post-merger transition period to address any benefit issues arising from a merger or acquisition; therefore, it is not crucial that these issues be caught before the deal closes.

The Truth: While IRS regulations do provide for a post-merger transition period for compliance testing purposes, the scope of this relief is narrow. These transition rules allow the acquiring entity a period of time to treat any acquired benefit plans as separate from the acquiring entity's plans for certain compliance tests, such as coverage testing under section 410(b) of the Internal Revenue Code. In many cases, compliance testing is not a particular issue, so this post-merger transition relief is of limited benefit. When it comes to most benefit-related liabilities, such as plan qualification defects and funding obligations, the acquiring entity inherits 100% liability on the day the deal closes – unless appropriate protective steps have been incorporated into the deal documents, that is.

Misconception #4

Employee benefit issues are not relevant to the form or structure of a corporate transaction, and can instead be addressed at the tail end of the deal planning process.

The Truth: As any employee benefit advisor who works in the mergers and acquisitions arena can attest, benefit experts are frequently consulted only late in the planning process after major structural decisions have already been established: for instance, whether an acquisition will be structured as a stock or an asset deal. In some cases, these decisions can have a major impact on the scope of liability inherited from the target entity's retirement plans. Involving benefit experts early in the due diligence process helps to ensure that the deal is structured to mitigate any major benefit-related liabilities.

Misconception #5

If the target company offers generous benefits, it can simply move any acquired employees into its own plans without worrying about what benefits were offered by the predecessor employer.

The Truth: Transitioning employees from a target entity's benefit plans into a successor entity's plans is a complex process that requires substantial planning. In many cases, different employers' plans do not cover precisely the same classes of employees, meaning that a transition between entities could result in a loss of benefit eligibility for certain workers. In still other circumstances, plan features such as benefit distribution options and vesting schedules must be preserved by the successor employer, resulting in the need for potentially unpopular plan amendments. If involved early enough in the pre-deal planning process, employee benefit advisors can offer appropriate workarounds to ensure that the benefit transition works as smoothly as possible.

How Can Schneider Downs Help?

The Schneider Downs Retirement Solutions team has the expertise to assist companies that are considering mergers and acquisitions with important retirement plan related due diligence in order to mitigate potential liability. Our specialized team of advisors and consultants provide objective advice and expertise to help plan sponsors, govern their retirement plans appropriately, mitigate risk, improve participant outcomes, and support efficient and compliant plan operations. If you have questions related to our retirement services, please contact us at sdretirement@schneiderdowns.com or visit www.sdretirementsolutions.com.

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