MANAGING THE COMPLEX

Navigating the Merger & Acquisition Landscape

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BEST PRACTICES FOR A SEAMLESS RETIREMENT PLAN TRANSITION

In the business world, change is a way of life. There were more than 18,000 mergers and acquisitions in the United States in 2022 — instances in which two organizations merged into one entity or one organization purchased another outright.[1] Many times, the buyer and seller offer retirement plans, leaving an important decision about one of the most valuable benefits an organization can offer.

For a merger and acquisition (M&A) to be successful, a symbiotic relationship between the organizations involved must be developed. Part of the integration process — and an essential, often overlooked, aspect — involves consolidating employee retirement plans. A merger or acquisition generally involves a retirement plan conversion, which can present significant challenges unless a sound strategy is in place.

This article examines the special considerations of retirement plan conversion due to M&A activity and offers best practices for achieving a seamless transition.

WHAT IS SPECIAL ABOUT THE M&A SCENARIO?

While all retirement plan conversions require attention to detail, additional considerations exist in an M&A scenario. Organizations undergoing a merger or acquisition should ensure that any action taken does not compromise the qualified status of any existing or newly created retirement plan. The ultimate goal is to achieve a happy "marriage," with consideration given to both the objectives of the organization and the well-being of the employees involved (i.e., plan participants).

DEVELOPING AN M&A STRATEGY

Any organization considering, or in the process of, acquiring or merging with another institution has already identified key financial and business objectives. All too often, however, firms do not consider the implications of employee benefits until the transaction is well under way — or even finalized. As a result, there may be unanticipated costs or administrative complexities that could have been avoided with a bit of careful foresight and advance planning.

Before deciding on how to address retirement plan issues, it's important to identify the primary goals, objectives, and philosophy that underlie the M&A strategy. Generally, organizations have one of two overarching concerns with respect to the retirement plan: minimize plan costs or minimize plan disruption.

MINIMIZE PLAN COSTS

If this is a primary objective, the resulting steps might focus on how obligations can be addressed in the most cost-efficient manner. One solution may be to merge the acquired organization's plan into the surviving plan with no significant plan changes (other than those that are legally required, such as protecting certain benefits for the acquired employees). This will minimize costs by avoiding those associated with maintaining multiple retirement plans (e.g., plan audit costs, plan filing costs, etc.). Another option may be to terminate the plan. This may not be the most appropriate option, however, due to leakage concerns.

MINIMIZE PLAN DISRUPTION

Strategies with this primary objective may emphasize how to accommodate the needs of different groups of employees. One possible solution is to maintain separate plans.

Whatever the objectives, the degree to which a plan conversion will succeed often relies on the amount of preparation done beforehand and the ability of a plan provider to efficiently manage the process. Whether maintaining separate plans, merging the plans into one, or terminating a plan, various legal and compliance implications exist. Plan sponsors will want to ensure that any changes are handled efficiently — especially if a plan conversion is necessary. A poorly executed conversion can severely undermine positive reception to any changes — certainly an undesirable outcome in an M&A atmosphere in which employees may already be feeling uncertain about their future.

GETTING STARTED

The very nature of a specific M&A situation and complexity of the transaction often determines what options are available to the plan sponsor when creating and implementing a retirement plan strategy. For any organization acquiring or merging with another, it's important to enlist legal advisors, plan advisors, and plan providers early in the process to determine how to accomplish the overall objectives. These resources should offer valuable insights, recommend alternatives, and help avoid pitfalls.

It's important to consider if the current provider is up to the task. If the incumbent plan provider lacks significant experience with plan conversions, it would be worthwhile to consider other providers that do have the required knowledge. The plan advisor can help identify key considerations, evaluate prospective plan providers, and ensure the chosen solution will meet all rules and regulations necessary to maintain compliance.

Sponsors may want to consider additional opportunities that the conversion process presents, such as changing plan providers, revising the investment menu, or outsourcing certain administrative tasks. If considering moving to a new provider, sponsors should:

- Request a contractual discontinuation quote from the providers of both the acquiring and acquired organizations. The plan advisor can be instrumental in negotiating this quote.
- Collect current plan documents, 5500 forms, and nondiscrimination test results, as these materials will help familiarize any prospective providers with the status of the plan's testing and financials.
- Consult with the plan advisor and legal counsel to assess any contractual obligations to a current provider and obtain terms for disengagement in writing. The advisor should be the buffer in working with the current provider to determine how to best transition the plan to a new provider.

BEFORE INITIATING A PLAN CONVERSION:

- Locate and review plan documents, including any amendments
- Determine warranted revisions to existing plan documents
- Review service agreements and contracts to identify any discontinuation periods, contract terms, or surrender penalties that may apply if a provider or investments are removed from the plan
- Identify any notifications that must be communicated in writing to providers that are no longer going to be part of the plan, and determine deadlines for delivering these notices

TAKE STOCK OF THE SITUATION

Sponsors must first identify the requirements that impact their specific situations and their resulting responsibilities. When one organization acquires or merges with another, the options available may be dictated by the type of transaction. For example, a stock acquisition requires that the acquiring entity must automatically assume ownership of the acquired entity's retirement plan. In an asset acquisition situation, however, plan acquisition is open to negotiation. Agreements reached through collective bargaining with unions may also impact decisions about plan features, benefits, and employee eligibility.

Additionally, the acquired organization's plan may include "protected benefits" that cannot be taken away from participants — such as vesting schedules, withdrawal provisions, and the definition of normal retirement age. If these protected benefits are more generous than those of the existing plan at the acquiring organization, further analysis is necessary to determine if it makes sense to merge the plans and create carve-outs for groups of employees. If the carve-outs are too extensive, keeping separate plans may be more judicious due to the complexities involved in the administration of a plan with multiple carve-outs. Once an informed decision is made to maintain separate plans or create carve-outs in a merged plan, nondiscrimination testing is required.

Therefore, before the merger or acquisition takes place, it's imperative to consider the retirement plans and their respective benefits, as options may be limited after the transaction is completed. A checklist of key features of the plans can be used to do side-by-side comparisons, and a compliance review should be completed on both plans.

CONDUCT A COMPLIANCE REVIEW

Qualified retirement plans cannot retain their qualified status if they don't comply with various laws and regulations. There can also be significant financial implications for plan participants if a plan becomes non-compliant. Compliance reviews should be conducted on existing plans of both the acquirer and the acquired. The review will allow for comparison of the plan designs, provisions, objectives, investments, administration, communication, education, and contribution amounts. It will also identify potential obstacles to compliance before a course of action is determined.

CONSIDER ALTERNATIVES

It's likely that one of three scenarios will come into play for the acquiring organization.

1. **The acquiring organization has a retirement plan in place while the acquired firm does not.** In this situation, new employees can be absorbed into the existing plan after several decisions have been made. For example, will prior service of new employees be counted toward eligibility and vesting requirements? Will benefits for this group be the same as for all other employees? It's important to consider that having different benefits for different groups of employees can add complexity and cost, and will require additional nondiscrimination testing. Therefore, it's important to identify potential compliance issues before making a decision. (See **Considerations when a controlled group exists** on page 7.)
2. **The acquiring and acquired organizations have retirement plans in place, and the acquiring entity is obliged to take sponsorship of the acquired entity's plan.** In this situation, the acquirer must decide between maintaining separate plans and consolidating into one plan. Maintaining separate retirement plans for employees can be the costliest option, as the administrative burden will be greater. A cost benefit analysis can help determine whether to maintain separate plans or merge plans. Conduct coverage testing to determine if the plans can stand alone or if they will need to be aggregated.If there are different benefits provided under each of the plans, additional nondiscrimination testing may be required to ensure a plan does not disproportionately favor highly compensated employees.
3. **The acquiring and acquired organizations have retirement plans in place, and the acquiring entity is not required to take ownership of the existing plan. There are two options under this scenario:**

    a. The acquiring organization can negotiate to not take ownership of the acquired entity's plan. In general, this would lead to the plan being terminated, with the termination being the previous sponsor's responsibility. In this scenario, employees can be brought into the acquiring organization's plan after decisions about crediting prior service and benefit structures. In addition, employees may be able to roll over their accounts from the terminating plan, but a due diligence process should be performed on the terminating plan to ensure there are no compliance issues.

    b. Through negotiation, the acquiring organization decides to take ownership of the acquired entity's plan and either maintains two separate plans or merges the plans. Maintaining separate plans (after ensuring certain nondiscrimination tests are passed — this will need to be continually monitored) generally, is not the most cost-efficient solution. Merging the plans requires careful analysis of plan design to evaluate protected benefits. Separate benefit structures will trigger certain nondiscrimination testing.

If a plan is terminated, all participants become immediately vested regardless of vesting criteria. Employees often choose to take plan distributions from a terminated plan as a lump sum rather than rolling their assets into another retirement plan. This is known as "leakage" and means the employees will forfeit a portion of their retirement savings to taxes. Employers who are actively involved in helping employees save for retirement will want to avoid this scenario, as it may not be in the best interest of the employees.

Once a decision has been made and a strategy is in place, it's important for plan sponsors to complete and sign the appropriate plan documents, corporate resolutions, and administrative and investment agreements.

CONSIDERATIONS WHEN A CONTROLLED GROUP EXISTS

The nondiscrimination testing requirement is primarily an issue when the acquired organization is considered part of the acquiring organization's "controlled group." A controlled group exists if there is a certain amount of "controlling interest" among the acquiring and the acquired organizations. The amount of controlling interest needed to determine if a controlled group exists varies based on the relationship between the organizations. If a controlled group structure does not exist, nondiscrimination testing issues generally do not come into play.

If a controlled group relationship exists, both plans must be reviewed together to determine whether highly compensated employees are treated more favorably. Testing may indicate that similar plan provisions may need to apply to all employees to not be discriminatory. If either of the existing retirement plans does not pass minimum coverage testing as "disaggregated" (or tested separately), there are two options:

1. Expand the coverage under the plan that failed the testing — a potentially costly approach
2. Aggregate the plans, creating a new single plan. This is extremely complicated, so it's important to consult with the plan advisor and provider to weigh options, analyze costs, and determine a strategy that will make the most sense for the plan sponsor and the employees.

PRE-CONVERSION PLAN ASSESSMENT

If the sponsor decides to merge the plans, a plan conversion is required. More often than not, the acquiring organization will likely want to maintain its existing plan due to familiarity. There are key steps an employer can follow to ensure a successful transition.

First, the conversion offers an opportunity to reevaluate features and benefits of an existing plan. It's also an opportunity to identify areas that need improvement. Obtaining information on similar plans offered by other providers could provide perspective on whether the existing plan and its features are competitive. The plan advisor should be able to assist the sponsor by obtaining competitive information for comparison purposes — or benchmarking. Before bringing more employees into a plan, it's valuable to survey current plan participants and examine data to identify troubling trends with respect to investment options, participation rates, and deferral rates, among other things.

In addition, the following steps should be part of an efficient plan assessment:

- Locate and review plan documents and amendments
- Determine if revisions to the plan documents are warranted
- Review service agreements and contracts to identify discontinuation periods, contract terms, or surrender penalties that may apply
- Examine service agreements for notifications that must be communicated in writing to any providers that may be eliminated from the plan; determine deadlines for delivering these notices
- Collect current 5500 forms and results of nondiscrimination tests, if applicable, to offer to prospective plan providers to familiarize them with the status of the plan's testing and financials

An overall plan assessment can also unearth additional opportunities presented by the conversion process. For example, if the sponsor handles the majority of retirement plan services internally, additional plan participants as a result of the merger or acquisition may create more work than internal resources are capable of handling. Outsourcing some or all administrative services to a provider or third party may provide additional benefits. The plan advisor should assist in evaluating the need for outsourcing.

PLAN PROVIDER REQUIREMENTS

For the plan provider to determine the best way to implement the conversion, sponsors will need to provide details about the plan they will be offering and about those that will be terminated or frozen, including:

- Contracts and service agreements that apply to the plan(s)
- A list of all available investment options with corresponding ticker/CUSIPs
- A written description of any liquidity restrictions that may apply to a specific fund
- A written estimate of fees, market value adjustment options, surrender penalties, short-term trading fees, or other applicable contract termination charges
- Confirmation of notification lead times that may apply if assets are transferred to another vendor
- Contract expiration dates (if applicable)
- For 403(b) plans, confirmation of assets that are available to transfer based on plan sponsor direction versus individual participant direction

REAFFIRM OR REEVALUATE THE INVESTMENT MENU

Before moving forward with any plan conversion, sponsors should examine the investment options offered to participants. An appropriate range of options is critical to the ability to build a diversified portfolio. Employees of the acquired organization may have a different risk tolerance and therefore different investment needs than employees of the acquiring entity. Those different needs must be addressed as part of a fiduciary's responsibility. In a sensitive situation such as a merger or acquisition, participants may feel as if they are forced to give up investments with which they have been satisfied, or they may be confused about what to do with their current and future investments. Avoiding such sentiment may be especially important if a plan for a new group of employees is to be terminated. Thus, sponsors may wish to ensure that appropriate substitutes are offered within the existing plan to replace the options new employees are losing.

As part of an investment review, sponsors should compare the investment options available to participants in both organizations (the acquirer and the acquired) and identify the asset classes and types of options that will be available to all participants. Sponsors should leverage their plan advisors to discuss current and prospective investment options to fully understanding the advantages each option may represent. In evaluating the plan's investment needs, the following questions should be answered:

- Is the investment lineup sufficient for all plan participants? Are there important differences in the types of investments being used by employees in the acquired group that need to be accommodated in the new plan?
- What share classes are used in the plans? Are lower-cost alternatives warranted?
- Will any investments impose a withdrawal charge if transferred? If so, how will the situation be handled and who will bear the cost?
- Are participants getting enough guidance and advice to make informed decisions? Could they benefit from having more "prepackaged" or "managed" solutions such as target date funds, managed accounts, or other solutions that help them build their investment portfolio?

If any funds in the acquired organization's plan are scheduled to remain on the menu, sponsors need to know if their current provider can maintain those funds on its platform. Additionally, the plan advisor and provider can assist in developing a strategy to map current holdings to similar investments under the new plan.

Mapping existing assets into similar investment options within the retirement plan platform can often simplify the conversion process. The plan provider should propose an appropriate mapping strategy, or alternatively, be able to transfer investment options "in kind" to its platform to help avoid liquidation of plan assets during the transition. Both solutions don't require participants to take any action unless they want to make new investment selections. If a provider can map the investments to the plan sponsor's satisfaction and offers an appropriate range of solutions for handling investments, the transition will be smoother and communications to plan participants will be simpler.

HANDLING EXISTING PLAN ASSETS IN A TERMINATED PLAN

If a plan is to be terminated, employees' assets may move from one provider to another during the conversion process. In this scenario, employees are generally given the option to roll over their assets to the new provider (and choose from the available options under the new plan) or withdraw their assets subject to applicable tax requirements.

In certain situations, it may be beneficial to work with the current and new providers to develop a rollover strategy that will allow for "bulk" rollovers, where all rollover requests are combined and the assets are moved in bulk. This strategy may also include a mapping strategy, as previously discussed. Handling conversions in this manner makes the rollover process much easier for participants and can help reduce retirement plan leakage.

KEY CONSIDERATIONS WHEN CONVERTING A 403(B) PLAN:

Organizations must be classified as nonprofit under 501(c)(3) to be eligible to offer a 403(b) plan. A 501(c)(3) letter must be obtained from the IRS.

Investigate whether the plan investments include institutionally or individually owned assets. Institutional ownership of assets empowers the employer to initiate the transfer of plan assets from one provider to another on behalf of plan participants. If investments are individually owned (as are some annuity contracts), participants will be individually responsible for deciding whether to transfer to a new provider or maintain their assets with the former provider. Fees may be associated with moving assets from the former provider. A new provider can help evaluate these costs and decide how they should be handled, if applicable.

Transferring participant account information and assets from one provider to another requires the former and new provider to share information. Sponsors will need to assess how best to facilitate this step and establish monitoring guidelines.

DETERMINING PROVIDER CAPABILITIES

While fairly straightforward, the conversion process involves several complicated steps. Sponsors should assess their current provider's experience with plan conversions and its ability to determine if it may be advantageous to move to another provider. With any provider, an in-depth analysis should determine the following:

Will the provider assign a dedicated conversion project manager and team to facilitate the conversion from beginning to end?

If the provider has not done this in the past, it may be an indication that experience is lacking.

Will the provider furnish a comprehensive "specimen project plan" that outlines timelines and processes for completing a plan conversion?

Sponsors should have their plan advisors review this document to confirm that all necessary steps have been identified and addressed, and that the timeline is realistic.

How will the provider work with other vendors to transfer data and plan assets?

Providers should specifically reference other companies they've worked with in the past and share insights about their experiences. Sponsors should find out what went right and what went wrong, as this knowledge can be invaluable in gaining perspective about what to expect, what to avoid, and how to take control of the situation.

How long does the provider expect the conversion to take?

Some providers may try to give the most optimistic estimate. Unless there are unique circumstances, the conversion should realistically take about three months to complete. If a provider estimates a shorter time frame, that provider may not be able to deliver on promises or satisfy expectations.

How closely will the conversion team work with the sponsor's service teams once the conversion is completed?

The provider should be able to describe exactly how the conversion is coordinated with subsequent ongoing service efforts to facilitate administration, participant communications, and other aspects of the plan.

DEVELOP COMMUNICATION STRATEGIES IN ADVANCE

Even during the smoothest of plan conversions, participants will be impacted when the changes occur — especially if a previous plan is terminated and/or a provider that represented a long-standing relationship to the plan is being replaced.

Preparing affected participants in advance by explaining the reasons for action, providing details of any changes, and detailing the benefits of the plan is a critical communications message that should be delivered sooner rather than later.

Sponsors should evaluate the most effective way to connect with employees so they can tailor the communications to fit their needs. The plan provider should have the ability to support this effort with recommendations for a comprehensive communications program. The plan advisor should review the proposed communication strategy.

Once the plan conversion is underway, sponsors will rely heavily on their provider's transition team to help with employee communications. Since the culture of the acquiring organization may be distinctly different from that of the acquired entity, the communication strategy will need to be attuned to different needs. The steps on the following page can help you develop a communication strategy.

SIX STEPS TO CREATING AN EFFECTIVE COMMUNICATION STRATEGY

1. Assess the new total workforce to determine best ways to reach them. Consider mobility, work hours, and worksite locations. Remember that employees of the acquired organization may have different expectations and experiences in terms of communication channels. Plan providers can make recommendations that should encompass more than one method of communication to ensure all messages are on target and broadly distributed.
2. Ensure that communications don't occur during peak production periods for various employees groups. At peak production times, employees may have too much on their plates to properly focus on retirement program changes. Again, this may require being sensitive to the needs of the acquired organization and its high-volume business patterns.
3. Avoid communicating plan changes during holiday periods. During these periods, employees may be on vacation or inattentive because they are covering for other coworkers. This is especially important if the conversion will involve "blackout periods" when employees will not have access to their accounts.
4. Evaluate how to distribute important information to employees. Email and internal distribution are more efficient and cost-effective than traditional mail, but employees may be able to give more time and attention to materials they receive and can review at home. In addition, consider using employer-sponsored group meetings, emails, or bulletin boards to promote interest and enthusiasm around changes to the retirement plan. Depending on the workforce, sponsors may want to use digital solutions such as webinars with flexible meeting times to accommodate employees who may not be able to assemble in a central location.
5. Determine whether it will be effective to engage key employee segments, such as department managers, to serve as advocates for explaining the plan changes to their staff.
6. Endorsements from a trusted source may be extremely helpful in an M&A situation to reassure and engage employees in the process.

CONCLUSION

Building a cohesive organization after a merger or acquisition takes time. Communicating with employees to ensure they remain informed and comfortable about their benefits can go a long way toward reducing employee stress during the M&A process. A seamless plan conversion can ease anxieties and keep employees focused and productive, which should be reason enough to analyze the retirement plan as an overall component of an M&A strategy.

ABOUT TRANSAMERICA

Transamerica has been helping people save and invest through their employer-sponsored retirement plans for more than 80 years. Transamerica works with financial professionals, third party administrators, and consultants to cover the spectrum of defined benefit and defined contribution plans, including 401(k), 403(b), 457, and multiple employer plans. For more information, please visit transamerica.com.

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[1] "FactSet: Number of Merger and Acquisition Transactions in the United States in 2020 and 2022, by Deal Value," Statista, January 19, 2023.

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