Transamerica Retirement Solutions

MERGERS AND ACQUISITIONS:

Key considerations for retirement plan conversion

A White Paper Prepared by Transamerica Retirement Solutions

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Ms. Laura Gaynor is a vice president at Transamerica Retirement Solutions. She specializes in mergers and acquisitions and has over 24 years of pension experience in technical compliance and administration. Ms. Gaynor currently works on business development and client integration while continuing to support both Transamerica's technical and merger and acquisitions services teams. She is a frequent speaker at various industry conferences, including Mid-Sized Retirement & Pension Plan Management, American Society of Pension Professionals & Actuaries, and Center for Due Diligence.

Best practices for a seamless retirement plan transition

While economic recovery has been slow overall, the recent increase in merger and acquisition ("M&A") activity stands in sharp contrast. Global M&A activity increased by 9% in 2011 over the previous year, according to Bloomberg News. Substantial cash reserves and improved financing options have given corporate buyers the confidence to forge synergies with new partners and capitalize on the competitive advantage that M&A transactions can provide.

For a merger or acquisition 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, an activity that can present a significant challenge unless a sound strategic approach 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 any retirement plan conversion requires attention to a number of details, additional special considerations exist in an M&A scenario. For an organization undergoing a merger or acquisition, an overarching concern should be to 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 that is 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 is 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, then 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 company'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 often determines what options in implementing a retirement plan strategy are available to the plan sponsor. The issues involved with the transaction itself and the impact on retirement plans can be quite complex. Thus, it is best to enlist the help of experts. For any organization acquiring or merging with another, a good first step is to engage its legal advisors, plan advisors, and plan provider early in the process to determine how best to accomplish the overall objectives. These resources should be able to offer valuable insights, recommend alternatives, and help avoid pitfalls.

An important issue to consider is whether 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 this expertise. The plan advisor can help identify key considerations, evaluate prospective plan providers, and ensure that 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 over 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 in order 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. In either case, the decision can be made with analysis, since in order to either maintain separate plans or maintain separate carve-outs within a plan, the plans must pass certain nondiscrimination testing.

Therefore, before the merger or acquisition actually takes place, it is imperative to consider the retirement plans and the benefits provided by those plans, 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 to identify areas of difference (see Exhibit 1 on pages 12 and 13), and a compliance review should be completed on both plans.

Conduct a compliance review

Qualified retirement plans cannot retain their qualified status if they are not compliant 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 decided upon.

Consider alternatives

It is 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 is important to be aware that having different benefits for different groups of employees can add to plan administrative complexity and cost, and will require additional nondiscrimination testing. Therefore, it is important to identify potential compliance issues prior to making a decision. (See *Considerations when a controlled group exists* on page 5.)

2. **Both 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, of necessity, be greater. A cost benefit analysis will facilitate the decision on whether to maintain separate or merge plans. Coverage testing will be conducted to ensure plans can stand alone or the plans will be required to be aggregated together. If there are different benefits provided under each of the plans, additional nondiscrimination testing may need to be performed to ensure that a plan does not disproportionately favor highly compensated employees.

3. **Both the acquiring and acquired organizations have retirement plans in place, and the acquiring entity is not required to take ownership of the existing plan.** Two options exist under this scenario:

a. As part of a negotiation process, the acquiring organization can agree to not take ownership of the acquired entity's plan. In general, this action would lead to the plan being terminated, and the termination of the plan would be the previous sponsor's responsibility. In this scenario, employees can be brought into the acquiring organization's plan after decisions are made concerning crediting prior service and benefit structures for this group of employees. 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. As part of the negotiation process, the acquiring organization decides to take ownership of the acquired entity's plan and then either maintains two separate plans or merges the plans together. Maintaining two 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 together requires careful analysis of plan design to evaluate protected benefits. Separate benefit structures will trigger the need for 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 the monies over into another retirement plan—this is sometimes referred to as "leakage." This means they will forfeit a portion of their retirement savings to taxes. Those employers more 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 is important for plan sponsors to establish intentions in writing by completing and signing 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 acquired 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, these 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 in order to not be discriminatory. If either of the existing retirement plans (or both) do not pass minimum coverage testing as "disaggregated" (or tested separately), two options exist:

1. Expand the coverage under the plan that failed the testing—a potentially costly approach; or
2. Aggregate the plans, creating a single new plan. As this is extremely complicated, it is 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 both 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 is likely to want to maintain the plan with which they are most familiar—their existing plan. There are key steps an employer can follow to ensure a successful transition.

First, the potential for conversion itself offers the opportunity to reevaluate features and benefits of an existing plan. It also affords the opportunity to identify areas of satisfaction and those that might warrant improvement. Obtaining information on similar plans offered by other competitors 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. Before bringing more employees into a plan, current plan participants could be surveyed about satisfaction, and data could be examined for any troubling trends with respect to, for example, use of the available investments and the level of participation.

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 in order to familiarize them with the status of the plan's testing and financials.

An overall plan assessment also allows for the consideration of any additional opportunities the plan's conversion process may present—for example, if the sponsor handles the majority of retirement plan services internally, the addition of new plan participants as a result of the merger or acquisition may create a great deal more work that internal resources might not be in a position to handle. Outsourcing some or all administrative services to a provider or third party may provide additional benefits. The plan advisor should assist in evaluating the necessity of outsourcing solutions.

Plan provider requirements

In order for the plan provider to determine how best 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 to be 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.
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Reaffirm or reevaluate the investment menu

Before moving forward with any plan conversion, sponsors should take the opportunity to examine the investment options offered to participants. An appropriate range of investment 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 those of employees within the acquiring entity, and 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 in order to gain a complete understanding of the advantages that 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?** Might they benefit from having more "prepackaged" or "managed" solutions such as target date funds, managed accounts, or other solutions that assist participants with portfolio building?

If it is determined that any funds in the acquired company's plan should remain on the menu, sponsors should investigate whether 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 their platform to help avoid liquidation of plan assets as part of the transition process. Both solutions avoid the need for participants to take any action unless they do not want to keep their portfolios "as is," instead opting for new selections. If a provider can map the investments to 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 elect to 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 bulked together and assets moved in bulk. This strategy may also include a mapping strategy, as previously discussed. Handling conversions as such makes the rollover process much easier from a participant perspective, and leads to a lesser amount of retirement plan leakage.

Key considerations when converting a 403(b) plan:

Organizations must be classified as nonprofit under 501(c)(3) in order 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 assist with evaluating these costs and deciding how they are to be handled, if applicable.

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

Selecting the right provider

As you may have realized by now, much of the efficiency of the conversion process rests with the ability of your plan provider to handle the process. The only way to ensure that a plan provider is equipped to offer all the advantages necessary is to be clearly focused on the plan needs and the solutions that best meet those needs for plan design, investment options, plan administration, ongoing compliance, monitoring, and plan participant support services.

Not all plan providers are knowledgeable about and equally experienced in plan conversion. Although it may at first seem burdensome to change providers to fully take advantage of the M&A scenario, to do so may ultimately be a better solution if sponsors are able to engage a provider with the necessary expertise to ensure a smooth conversion and an open architecture that will allow for the desired investment menu to be maintained or created.

Determining provider capabilities

While fairly straightforward, the conversion process involves a number of complicated steps. Sponsors should assess the experience their current provider has with plan conversions and as the conversion process as well as the provider's capabilities 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 process from beginning to end?** If the provider has not done this in the past, it may be an indication that experience is lacking.
- **How long does the provider expect the entire conversion process to take?** Some providers may try to give the most optimistic estimate. Typically and realistically, however, unless unique complexities in a retirement plan exist, the conversion process should take approximately 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.
- **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 closely will the conversion team work with the sponsor's service teams once the conversion is completed?** The provider should be able to describe in detail exactly how the conversion process is coordinated with subsequent ongoing service efforts to facilitate administration, participant communications and other aspects of the plan.
- **How will the provider work with other vendors to transfer data and plan assets?** Providers should report specifically on what other companies they have worked with in the past and insights about their previous experiences. Sponsors should find out what went right and what went wrong, as this kind of knowledge can be invaluable in gaining perspective about what to expect, what to avoid and how to take control of the situation.

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

Sponsors should evaluate which of the various channels to reach out to employees will be most effective so that they can tailor communications to their needs as much as possible. 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 process is underway, sponsors will rely heavily on their provider's transition team to help with employee communications. Since the corporate culture of the acquiring organization may be distinctly different from that of the acquired entity, the communication strategy will need to be especially attuned to different needs. The steps on the following page can help in the development of a communication strategy.

1. **Make an assessment of the new total workforce to determine best ways to reach them.** Consider mobility, work hours, and worksite locations. Remember that employees within the acquired organization may have different expectations and experiences in terms of communications channels. Plan providers can make recommendations that should encompass more than one method of communication to ensure that any message is on target and broadly distributed.

2. **Ensure that communications don't occur during periods of the year that represent peak production times for various employees groups.** At peak production times, employees may have too much on their plates to properly focus the needed time and attention to 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 either be on vacation or inattentive because they are covering for other coworkers. This is especially important if the conversion will involve "blackout periods" during which employees will not have access to their accounts.

4. **Evaluate whether it will be more effective to send important information to employees' homes or to their work locations.** Cost is also a factor as it is less expensive to utilize an internal mailing distribution system than the post office. On the other hand, employees may be able to give more time and attention to materials they receive and can review at home.

5. **Assess whether it will be more effective to hold employer-sponsored group meetings, use email, or create bulletin boards to promote interest and enthusiasm around changes in the retirement plan.** Depending on the workforce, sponsors may want to utilize web solutions such as webcasts with flexible meeting times to accommodate employees who may not be able to assemble in a centralized location.

6. **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.** Endorsements from a trusted source may be extremely helpful in an M&A situation in order 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 that they remain informed and comfortable about their benefits can go a long way towards reducing employee stress triggered during the M&A process. A seamless plan conversion can ease anxieties and keep employees focused and productive. Hence, it is worth taking the time to analyze the retirement plan situation as an overall component of an M&A strategy.

Exhibit 1: Plan comparison checklist for merger of ABC Plan into 123 Plan

	ABC Plan merging plan	123 Plan surviving plan	Surviving plan provisions
Plan name			
Employer			
Participating employers			
Plan year			
Contribution types *(source)* provided for under the plan			
Eligibility *(by source)*			
Entry date *(by source)*			
Pretax deferral formula			
Roth contribution			
Auto enrollment			
Employer matching contribution formula			
Non-elective contribution formula			
Additional contributions			
Early retirement age **protected benefit*			
Normal retirement age **protected benefit*			
Loans *List all loans provided*			

	ABC Plan merging plan	123 Plan surviving plan	Surviving plan provisions
Vesting *(list by source)* **protected benefit*			
Forfeitures *(list by source)*			
Compensation definition *(list by source)*			
Compensation period *(list by source)*			
Compensation exclusions *(list by source)*			
Normal form of benefit **protected benefit*			
Optional forms of benefits			
In-service distributions *(list available sources)* **protected benefit*			
Hardship distributions *(indicate Safe Harbor or not and sources available)*			
Cash out			
Rollovers			
Investment elections			
Testing method			
HCE determination			

About Transamerica Retirement Solutions

Transamerica Retirement Solutions (Transamerica) is a leading provider of customized retirement plan solutions for organizations of every size.

Transamerica partners with financial advisors, third party administrators, and consultants to cover the entire spectrum of defined benefit and defined contribution plans, including: 401(k) and 403(b) (Traditional and Roth); 457; profit sharing; money purchase; cash balance; Taft-Hartley; multiple employer plans; nonqualified deferred compensation; and rollover and Roth IRA.

Transamerica helps more than three million retirement plan participants save and invest wisely to secure their retirement dreams. For more information about Transamerica Retirement Solutions Corporation, please visit **www.trsretire.com**.

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This paper is general in nature and not intended as tax or legal advice. Because each employer is unique, an employer should consider its individual circumstances when evaluating a defined benefit plan administrative solution and should consult their retirement plan and/or legal advisor.

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