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PRACTICAL THOUGHTS ON MERGING AFTER AN ACQUISITION

Some organizations are committed to mergers and acquisitions despite the pandemic. Depending on how economic conditions evolve, mergers and acquisitions may pick up in 2021 and 2022.

Before a merger, human resource departments may be involved in activities such as due diligence investigations; after a merger, HR is quite involved as the two organizations attempt to meld benefits and culture.

This Advisor explains the following key actions HR frequently must take when two organizations merge:

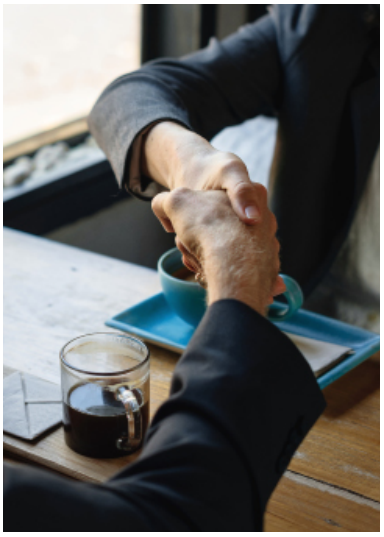
- Learn the difference between asset and stock sales
- Review benefit plans from both organizations and think through merging benefit approaches. Consider:
  - Employee optics
  - Different options and plan years – deductible and coinsurance credits-potential issues with HDHP deductibles accumulating more than 12 months
- Assess potential COBRA obligations
- Review Spending Accounts--how to manage these accounts especially with different plan years
- Identify any union obligations
- Plan for ACA Reporting
- Assess any missed PCORI fee
- Identify any new state mandates or state law requirements
- Think through ERISA implications
- Identify terminal stop loss liability with self-funded plans

Employers should consider creating a merger team with key HR representatives from both organizations. Working together may create a merger plan all employees in both organizations will accept more readily.

Know the difference between asset and stock sales

The type of transaction in an acquisition is important in many aspects of a merger.

Continued on Page 2



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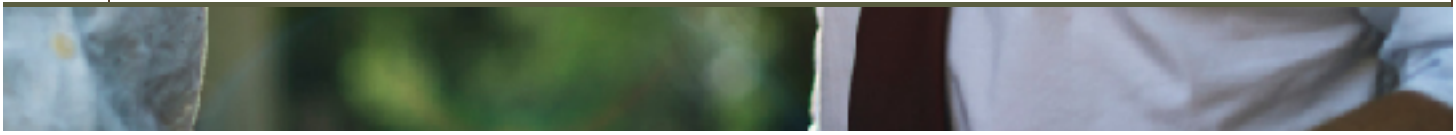

There are two types of transactions:

- Stock sale – a transfer of stock in a corporation that causes the corporation to become a different employer or a member of a different employer.
- Asset sale – a transfer of substantial assets such as a plan or division or substantially all the assets of a trade or business.

Human resources will often not have the details of the transaction, but knowing the type of transaction is important because it affects some merger activities.

Review benefit plans from both organizations and decide how to merge approaches

Merging benefits takes some thought. Does the organization want to consolidate benefit plans or maintain separate plans reflecting benefits in place at the point of the merger?

- If benefits are significantly different, conduct a cost/benefit analysis. Is the best plan to offer everyone the lower benefits levels, the higher levels or meet somewhere in the middle? This discussion should not be done in a vacuum. Wages and other benefits should be considered.
- Once you make benefit decisions, look at these issues:
  - How will you communicate changes to employees? After an acquisition, most employees are concerned about their jobs. Be sure your employees understand your commitment to them and why their benefits are changing.
  - Think about how you are going to structure the two separate benefit, HRIS and payroll systems. If you intend to have separate entities, it will take time to create these structures.
  - If a plan is self-funded and the decision is to maintain separate benefit structures, you should conduct Section 105(h) nondiscrimination tests to make sure the plan is not discriminating in favor of the highly compensated employees.
  - Consider how you will merge plans or participants, especially if the participants moving to your new plan are in the middle of a deductible/coinsurance accumulation period. Employees will want to know whether the new plan will credit any deductibles/coinsurance credits from their former plan. Most health plan vendors will agree to credit deductibles, less common are coinsurance credits. Because in many cases, these credits are handled manually, it can often be two or three months before they show on participant's accounts. It is important to explain the process to employees so they understand the delay in getting credits applied.
  - Think about the impact of certain benefits on plans that you offer. For example, assume one of the organizations has an onsite clinic and the second organization has a qualifying high deductible health plan (HDHP) with an HSA. The acquiring organization decides to offer the onsite clinic and the HDHP as an option to all employees. The onsite clinic provides free primary care for all employees. This option would disqualify the HDHP because the onsite clinic provides primary care before employees meet the deductible. In this instance, you can keep both. However, the onsite clinic would need to charge the HDHP plan participants the fair market value of the services. Work with your health plan vendor to allow the onsite clinic to run these claims through your plan and apply the cost to the HDHP participant's deductible.
  - If any employees will have new networks for health or dental plans, you should do a disruption analysis. In addition, you should think about transitional care for any current critical care situation when an employee's health care provider is not in the network. This would include late-stage pregnancies or in-progress cancer treatment.
  - If the prescription drug vendor is changing, you should investigate how medications that require

Continued on Page 3

prior authorization or step therapy will be handled. Employees may have to go through prior authorization or step therapy protocols under the new pharmacy vendor.

– If both organizations offer employees HSAs with their HDHPs, are the vendors the same? If not, you may need to find out how to rollover HSA funds to the vendor who will be linked to the HDHP.

An important issue to consider is how to provide deductible credits under an HDHP if the two plans have different accumulation years for the deductible. For example, one deductible may accumulate on a calendar year and the other on a policy year. If you allow deductible credits on an HDHP for more than twelve months, you need to make sure the plan maintains qualifying HDHP status. This is best explained with an example.

> Company A bought Company B. Both offer HDHPs. Company A's HDHP deductible accumulates on the calendar year. Company B's HDHP deductible accumulates on the policy year (September 1 – August 31). Company A wants to incorporate Company B's employees into its HDHP on January 1, 2021. It also wants to provide deductible credits for Company B employees for any deductible expenses between September 1, 2020, and December 31, 2020. Is this permissible?
>
> If the carriers involved will allow it, it is permissible. However, Company A will need to make sure its HDHP deductible is high enough to allow Company B participants a 16-month accumulation period. To calculate this amount, take the minimum allowed HDHP deductibles and figure out what the minimum deductible is each month. For this example, we divide the $1,400 single minimum deductible for 2021 by 12. The result is $116.67. We multiply that by 16 (the number of months in the accumulation period) and the result is $1,866.72. This is the minimum permitted deductible for an HDHP with a 16-month accumulation period. Since Company A's HDHP single deductible is $2,000, the plan can allow the Company B participants to accumulate the deductible credits over 16 months.

While medical benefits may be the most difficult to work through in a merger, don't forget other benefits:

- Dental: If you are merging dental benefits, think about missing tooth exclusions and think through how any dental work in progress will be handled.
- Disability: How will you handle any pre-existing condition limitations?
- Voluntary benefit offerings: If you are going to integrate the acquired company into your voluntary life plan, will your carrier allow you to take over current elections without subjecting the acquired employees to new evidence of insurability requirements?

Also review contracts to determine whether the change in headcounts might affect current rates. Many insurance contracts allow the insurance carrier to revisit the rates if the employee headcount changes by a specific percentage midyear. For example, if an employer has a 10 percent change in employee count, the insurance carrier can change rates midyear. Reductions in the workforce usually trigger midyear rate changes. In some cases, you may be able to push back against a rate change, especially if your demographics do not change meaningfully with the added lives.

From an administrative standpoint, you need to make plans regarding eligibility. If you are merging plans, will employees of the acquired group need to meet new hire waiting periods? In many cases, employers want to waive the new hire waiting periods for these employees so they have continuous health coverage. You need to verify with carriers that waiving new hire waiting periods is acceptable. Also decide how you are going to add their employees to eligibility files for your carriers.

If your organization plans to terminate contracts of the acquired organization, make sure you read the termination provisions in their contracts to understand your termination obligations.

In addition to benefits decisions, employers need to think through all human resource policies, such as pay scales, vacation time and other paid time off, dress codes, and so on.

The decision on how to handle benefits involves discussions of plan differences, budget targets and the role the benefit plans will play in the new corporate culture. The process for executing the plan will be much more detailed and require thought on administrative structure and practical issues such as deductible credits.

Continued on Page 4

Assess any potential COBRA obligations

COBRA obligations depend on the type of transaction.

- Stock sale – a transfer of stock in a corporation that causes that corporation to become a different employer or a member of a different employer
- Asset sale – a transfer of substantial assets such as a plant or a division or substantially all the assets of a trade or a business.

Two entities define COBRA obligations: the selling group and the buying group. They are defined in the table to the right for each type of transaction.

	Stock Sale	Asset Sale
Selling Group	The controlled group of corporations or group of trades or businesses under common control of which a corporation ceases to be a member, as a result of the stock sale.	The controlled group of corporations or group of trades or business under common control that includes the corporation or other trade or business that is selling the assets.
Buying Group	The controlled group of corporations or group of trades or businesses under common control of which the acquired organization becomes a member as a result of the stock sale.	The controlled group of corporations or group of trades or businesses under common control that includes the corporation or other trade or business that is buying the assets.

Your organization should identify "M & A qualified beneficiaries." An M & A qualified beneficiary is one whose qualified event occurred before or in connection with the sale. This includes qualified beneficiaries COBRA already covers under the sellers' plan and whose employment was associated with the assets or entity being sold. These M & A qualified beneficiaries also include qualified beneficiaries who experienced a qualifying event as result of the sale.

Stock Sale

If employees continue employment with the acquired corporation after a stock sale, they have not experienced a qualifying event since their employment has not been terminated. This logic applies even if the buying organization does not offer health plan coverage.

If a selling group maintains a group health plan after the sale, then that plan must offer COBRA to M & A beneficiaries.

If the selling group does not offer group health plan coverage after the sale, the COBRA obligation transfers to the buying group for M & A qualified beneficiaries.

Asset Sale

Asset sales are a little different. In general, an asset sale is a qualifying event for covered employees whose employment was part of the purchased assets regardless of whether the buying group employs them after the sale. However, a qualified beneficiary must actually lose coverage under the group health plan of the selling group to have experienced a qualifying event and be considered an M & A qualified beneficiary.

An exception may apply if the buying group keeps the employees associated with the assets and is considered a successor employer. There is no qualifying event in this case. A buying group is considered a successor employer when:

1. The selling group no longer provides group health plan coverage in connection with the sale.
2. The buying group continues business operations associated with the assets purchased without substantial interruption or substantial change.

The group health plan of the buying group must make COBRA coverage available to M & A qualified beneficiaries if:

- The seller stops providing any group health plan to any employee.
- Coverage stops because of the sale.
- The buying group continues business operations associated with the assets purchased without interruption or substantial change.

COBRA obligations can get quite complicated in mergers and acquisitions. The liability does not always fall to the seller. The liability can transfer to the buyer if the seller stops offering a health plan at the point of sale or even later if the seller stops health plan coverage within qualified beneficiaries' maximum coverage period.

Buying and selling groups can always negotiate COBRA liability as part of the sales agreement. However, if one group fails to meet its COBRA obligations, the other group needs to make sure qualified beneficiaries have access to coverage.

Continued on Page 5

Review Spending Accounts - how to manage these accounts especially with different plan years

It is typical for organizations to offer medical flexible spending accounts (FSAs) and/or dependent care FSAs. Consolidating the plans is often difficult. As with COBRA, the action steps depend on the type of sale.

Asset Sale

In an asset sale, the buyer purchases the assets of a business. In this sale, the seller's employees are terminated and the buyer potentially rehires them.

The IRS officially regulates health FSAs in IRS Revenue Ruling 2002-32. In asset sales, employees generally lose employment with the seller and may gain employment with the buyer. This means the employees would be terminated under the seller's FSA and may experience a forfeiture or may need to be offered COBRA for underspent accounts if the seller maintains their plan. The IRS Notice details how buyers and sellers can navigate the spending accounts in a merger. The two choices are:

- **Option 1: Coverage Continues Under Seller's Health FSA With Salary Reductions Under Buyer's Plan.** For this option to apply, the seller needs to continue its business operations after the asset sale and continue to maintain its health FSA. The buyer either has or will create a cafeteria plan that offers health FSA coverage through pre-tax salary reductions. The seller and buyer agree to have the transferred employees continue to participate in the seller's health FSA for an agreed-upon period (for example, through the end of the plan year). The seller and buyer also agree on the extent to which the original salary reduction elections made under the seller's plan will continue as if made under the buyer's plan.
- **Option 2: Coverage and Salary Reductions Under Buyer's Plan.** This approach is more common. The buyer agrees to cover the transferred employees under its health FSA for the remainder of the plan year. The employees' account balances (whether underspent or overspent) under the seller's health FSA are rolled over to the buyer's health FSA. The seller continues its business operations after the asset sale and continues to maintain its health FSA. However, all claims for reimbursement after the asset sale are submitted to the buyer's health FSA (even claims incurred before the asset sale but not yet reimbursed). The transferred employees' salary reductions continue for the remainder of the plan year under the buyer's plan.

The ruling notes that in each option, no midyear election change is permitted because the transferred employees do not lose eligibility for health FSA coverage as a result of the asset sale. They retain eligibility either under the seller's health FSA or the buyer's health FSA.

Stock Sale

In stock purchases, much depends on the status of the acquired organization's plan.

If the acquired business maintains its own cafeteria plan and the plan is continued following the transaction, employees' health FSA elections would continue uninterrupted.

If employees participated in an affiliate's cafeteria plan, the plan could be considered terminated after the purchase. This termination could result in forfeitures under the affiliate's plan. IRS officials have informally indicated that the second option of IRS Revenue Ruling 2002-32 can be applied. This would allow employees of the acquired business to be brought into the buyer's cafeteria plan midyear at the point of sale with the same level of FSA coverage and the same salary reduction elections as they had under the affiliate's cafeteria plan at the time of the sale.

Another option would be for the buyer to arrange with the affiliate to offer COBRA-like coverage to transferred employees in order to avoid the use it-or-lose it rule. Remember, COBRA is not technically required to be offered in a stock sale if employment continues. Those not electing the COBRA-like coverage could still submit claims for expenses incurred before the transaction during a run-out period.

Identify any union obligations

If the company you want to purchase has a union agreement, it is important to understand your obligations. Again, the type of sale is important; whether it is a stock or asset sale matters.

In a stock sale, the buying organization must recognize the provisions in the current union contract. In an asset sale, if the buying organization is considered a successor employer, then it must also recognize the current union contract provisions.

There is some latitude that may allow a buyer to renegotiate a union

Continued on Page 6

contract. This is a highly technical issue that should be discussed at length with a labor attorney.

From a technical standpoint, you need to make sure you can provide the union negotiated benefits (if the union does not provide them directly). If your current vendors can't provide the benefits as required, consider working with the selling organization's vendor directly.

If you are the buying organization, you need to understand that you must honor all the provisions in a union agreement. The agreement dictates hiring, terminations, benefits, sick time and many other employment benefits and provisions. You certainly have less flexibility in handling everyday issues when you are subject to a collective bargaining agreement. You may want to consult with a labor attorney to better understand how to work with the union, honor the agreement, and conduct future negotiations.

Plan for ACA Reporting

The IRS has not provided much guidance on handling confusion arising from ACA reporting.

If both employers are considered Applicable Large Employers, then the responsibility will usually fall to the organization that issues the W-2. Assume Company A buys Company B as of September 1, 2020. Company B will issue W-2s for its employees through August 31, 2020. As of September 1, 2020, Company A paid the Company B employees it hired after the sale. It will issue W-2s for these employees from September on.

In this situation, technically, Company B is responsible for 1095 C forms up to August 31, 2020. Company A is responsible for 1095 C forms for September 1, 2020, going forward.

Organizations can negotiate different responsibilities as part of the sales agreement. For example, if Company B is shutting down a business, it may want to negotiate with Company A to take responsibility for issuing the 1095 C Forms back to January 1, 2020. This can be done, but Company A should be cautious, since Company B needs to provide all the necessary information to complete and submit these forms.

In addition, in a stock purchase or a transaction where you are assuming the liabilities of an acquired organization, you should request all materials on complying with the ACA employer mandate. This means records of the 1094 and 1095 C Forms, documentation on how it determined full-time status, and so on. There is a lag between when a penalty is assessed and when employers submit 1094 C and 1095 C forms. The lag can be from three to four years. Make sure as part of the transaction, you obtain the historical records in case you need to appeal a penalty for the acquired organization.

Assess any missed PCORI fee

If your organization takes on the acquired organization's liabilities, you might also need to verify that the organization has paid the PCORI fee. If the health plan is fully insured, the insured carrier pays the PCORI fee.

If the plan is self-funded or part of the health plan is self-funded, for example, by offering a health reimbursement arrangement (HRA), the acquired company should provide the historical Forms 720 to prove it paid the PCORI fee.

Identify any new state mandates or state law requirements

If the acquired organization has employees in states that you have historically not operated in, then you need to review state laws. These state laws may require your organization to modify its processes for:

- State-mandated disability laws
- Paid Family Leave laws
- State FMLA laws
- State COBRA law
- State health insurance mandate laws

Employers need to comply with laws in states where they have employees. These laws can be complex. You need to understand what your obligations are when you acquire employees from a state you did not previously operate in.

Think through ERISA implications

It is likely the acquired organization had its own ERISA plan. You may have acquired an organization that was part of an IRS control group and covered under that ERISA plan. Your organization needs to determine how it wants to handle the ERISA obligations of the acquired organization.

Employers can have more than one ERISA plan. They may amend their current ERISA plans to incorporate the acquired organization or they could have separate ERISA plans for the acquired organization. Remember, plans with more than 100 participants as of the beginning of the plan year must file a Form 5500. The more ERISA plans an employer sets up, the more Form 5500s the employer might have to submit.

Be careful when you include more than one employer under an ERISA plan. When all the employers under an ERISA plan are part of the same IRS control group, there is no issue.

Continued on Page 7

However, if shared ownership does not rise to the level of an IRS control group, including those two employers under the same ERISA plan could create a Multiple Employer Welfare Arrangement (MEWA). MEWAs may require additional reporting at a minimum. If a MEWA is self-funded, states may require significant additional requirements.

In addition, if you assume the liabilities of an acquired organization, you need to make sure to file a final Form 5500 for the acquired organization's last plan year if it becomes part of your ERISA plan.

Identify terminal stop loss liability with self-funded plans

If the organization you acquire had a self-funded plan, you need to determine how the stop loss contract will cover claims incurred but not paid when the contract is terminated. Claim lag is the time between incurring a claim and submitting it for payment. Nowadays since most of the claim process is entirely automated, typical claim lag can be several months. Also, keep in mind that facilities may not bill until a claimant is discharged and these charges tend to be significant. Claims presented after the stop loss contract is terminated are called run-out claims.

Purchase agreements rarely stipulate which organization owns the run-out risk. However, the purchase agreement may stipulate the organization responsible for the run-out claim risk, so it is important to read the agreement carefully.

Stop loss coverage on run-out claims must be examined on a situation-by-situation basis. Some stop loss contracts may provide for run out claims while others may not. Also, if you terminate a stop loss contract mid-year, that may negate any provisions in the contract for run out claims. Be sure to obtain the stop loss contract for the acquired organization and understand its provisions. It is also important to understand how the change in ownership might affect coverage.

You may need to approach the stop loss vendor to negotiate a terminal liability option to cover the acquired organization's run-out claims. If covering the run-out claims under the acquired organization's stop loss coverage is not possible, you can approach your stop loss carrier to negotiate covering "run-in" claims under your contract. Run-in claims would occur within a time period before the stop loss coverage effective date but not covered by the acquired organization's stop loss contract.

CONCLUDING THOUGHTS

This Benefit Advisor highlights benefit issues when organizations merge. Employers need to pay close attention to details in order to make sure the blending of the two organization goes as well as it can.

As you can see, mergers are complicated with many details to consider. Take the time to think through all the issues. Also, make sure to communicate with all employees. Mergers create uncertainty. Most employees will be concerned with job security; a lack of communication will amplify those concerns.

If your organization grows through mergers and acquisitions, it may make sense to create a detailed checklist and a work plan to handle them.

If you have any questions, please contact your Marsh & McLennan Agency | Michigan team. MMA

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