THE K CORPORATION
a financial strategies firm

Mergers & Acquisitions

Impact of business transitions on retirement plans

Important Information for Mergers & Acquisitions

Many plan sponsors may not realize the impact of a business transition on a retirement plan. And when they do…it may be too late to get the desired outcome. The attached information is designed to facilitate meaningful discussions when faced with an M&A situation, change of company ownership or similar event. It may benefit plan sponsors to "get out in front" of these situations in terms of impact on the retirement plan(s). The objective relative to the qualified plan(s) under these circumstances is generally to balance the desire to treat employees fairly, and facilitating a smooth transition with keeping associated costs to a reasonable level. Therefore it is critical that available options are understood.

To assist in discussion around this topic, this Merger & Acquisition guide includes:

- M&A Frequently Asked Questions to provide a summary of some of the basic concepts.
- M&A Questionnaire that may be used as a tool for collecting pertinent information to assist with the analysis.
- Due Diligence Document Checklist.
- General Company Information Factsheet

M&A Frequently Asked Questions

While **K Financial Services, Inc. dba The K Corporation** or its representatives is prohibited from providing legal or tax advice, we can provide general information to assist plan sponsors in framing issues for discussion with their legal counsel regarding potential options for treatment or retirement plans that are impacted by a Merger & Acquisition (M&A) or similar transaction. Our goal is to collaborate with you on sorting our the plan related issues and facilitate what can be a fairly complex process. The following Frequently Asked Questions (FAQs) are intended to provide general information regarding the possible M&A transaction scenarios, the options for disposition of the plan in each scenario and related issues that may affect how the plans are treated. Following the FAQs is a questionnaire that may be used as a tool to gather information regarding the upcoming transaction.

Q.1 What company level transactions can impact a qualified plan?

The type of transaction will impact the options available for treatment of the impacted company's plans. For example it is important to confirm which of the following transactions has occurred:

- Sale of company;
- Acquisition of all or part of another company; or
- Merger of companies.

Q.2 Why is it important for the plan sponsor's attorney to consider how the qualified plan will be treated in connection with the transaction?

It is very important that the plan sponsor's attorney be involved. Often these scenarios are fairy complex. It is critical that actions regarding the plan are handled properly to preserve the plan's tax qualified status.

Q.3 Should the disposition of the plan be addressed in the transaction paperwork?

It is very important that the disposition of any qualified plan(s) of the companies involved in the transaction be documented early in the process. Sometimes the plan sponsor's options can be limited after the company level transaction has been closed.

Q.4 Why is the effective date of the corporate transaction a critical detail to confirm (e.g., date of sale, company merger, etc.)?

The effective date of the transaction should be confirmed with the plan sponsor as early as possible. There are several reasons for this. First, as stated above, the disposition of the plan(s) should be addressed in pre-transaction discussions/negotiations. The plan sponsor's options may be limited after the transaction has been completed. In addition the effective date of change in ownership may have a direct impact on compliance testing and reporting during the transaction year.

Q.5 What is a stock sale (purchase of ownership interest)?

In a stock sale the owners of the company sell their ownership interest (stock, partnership interest, etc.) in exchange for cash or other consideration. For example, stock certificates are re-issued in the names of the buyers who now own the business entity. Generally the buyer assumes all liabilities. Since the entire company is being sold (not just the assets or a division/location) the purchasing company is usually also taking over the plan of the selling company unless the plan is terminated.

Where there is a partial stock sale (e.g., one location or division) there may be other considerations regarding which party is responsible for the plan.

Q. 6 What is an asset sale?

An asset sale is the purchase of the business assets of another company. The seller is the company receiving cash or other consideration; the shareholders retain their shares in the company.

Q. 7 When does a severance from employment for qualified plan purposes (i.e., a distributable event) occur in a sale transaction?

This answer generally depends on whether an asset sale or stock sale has occurred, and on whether the buyer assumes responsibility for the plan.

Stock sale– Normally, in a stock sale, employees continue working for the same company, but there are different shareholders. The business entity continues. Generally a severance from employment has not occurred as employees are still working for the same company. However, an exception applies for the sale of a wholly owned subsidiary to an unrelated entity, where the subsidiary's plan is no longer maintained by the subsidiary and there are no assets transferred from the seller's plan to a plan of the acquired subsidiary. Here a "severance from employment" may have occurred for plan purposes.

Asset Sale– In an asset sale an employee who works for the new employer has incurred a "severance from employment" unless the buyer assumes responsibility for the seller's plan or accepts a transfer of plan assets to the buyer's plan (i.e., plan merger).

Q.8 What if the purchasing company acquires some (but not all) of the selling company's assets (e.g., one division or location)?

In this scenario participants associated with the sale may become employees of the purchasing company. This may result in a partial plan termination for the selling company and require that the affected participants be made 100% vested. (See Q.9 below.)

Q.9 Is there a potential for a partial plan termination?

A partial plan termination is most frequently a concern when there is a partial asset sale. It is important to determine if a partial plan termination has occurred.

- As a rule of thumb, if at least 20% of employees are no longer eligible for the plan as a result of the company transaction, a partial termination may have occurred.
- Whether a partial termination has occurred is a "facts and circumstances" determination that must be made by the plan fiduciary. A plan sponsor can file for IRS determination on this point, however.
- 100% vesting is required for affected employees if partial termination has occurred.
- Partial plan termination does not occur if there is a plan merger or transfer of plan assets for acquired employees, since this would be considered a continuation of the plan for the affected participants.

Q.10 Why is it important to know if any of the plan sponsors involved are part of a controlled group of corporations, or have other qualified plans?

If a controlled group scenario exists, or there are other plans, this could impact the options available for the disposition of the impacted plans. For example, can the plan sponsor merge plans to reduce costs? How will coverage rules be impacted?

Q.11 Are there considerations around plan documents?

It is critical to make sure that any plans involved in a plan merger have been updated for the latest regulatory changes (the Pension Protection Act for example) and are in good order. Note that merging a plan that is out of compliance with an updated and approved prototype does not, by itself, correct the prior plan defects. There may need to be a discussion with the plan sponsor around remedial corrective action.

Q.12 What special challenges exist where participant loans are involved?

Loans can be tricky in an M&A situation where a recordkeeping service provider change is made, or a plan with outstanding loans is merged into another plan. This is a primary concern due to the level amortization and default rules, where there is a blackout period in which processing is suspended for a period of time. Careful consideration must be given to outstanding loans in many scenarios to prevent loans from going into default status as a result of the change.

Q. 13 Why do safe harbor plans need special attention?

Traditional safe harbors or Qualified Automatic Contribution Arrangements (QACA) merit special attention in M&A situations due to the restrictions on mid-year plan amendments. IRS did provide some guidance on mid-year amendments to safe harbor plans in Notice 2016-16. The conservative approach is to make the plan merger, if applicable, effective as of the first day of the next plan year to avoid this issue. It is also important to make sure that required notices are sent on a timely basis while working through the logistics of the transaction.

Q. 14 Why do automatic enrollment plans require special attention?

Automatic enrollment plans also may require special consideration because of the unique coverage rules around these arrangements. For example, an Eligible Automatic Contribution Arrangement (EACA) amendment can generally only be effective mid-year if only newly eligible employees are covered (some exceptions apply). It is also important to make sure that the employee notice requirements are met with regard to the year of the change.

Q.15 Why do we need to know if there is employer stock involved as an available investment?

The existence of employer stock impacts installation and ongoing recordkeeping and necessitates discussions around share versus unit based accounting, valuation, etc. There may be certain recordkeeping limitations to consider in this regard.

Q.16 Why is it important to know if there are any known qualification defects, operational errors, VCP filings, etc. and if so, how they are being addressed?

If there are any existing issues this could impact the decision as to whether to merge the plans, etc. This could include such things as late deposits of 401(k) deductions, compliance testing issues, missed 5500 filings, unaccounted for unallocated amounts, etc. Note that merging a plan with operational defects into an approved prototype plan does not, by itself, cure existing defects. Plan sponsors should be encouraged to seek legal guidance around necessary corrective action.

Q.17 What options are available for the disposition of the plan(s) of the selling company in a Merger or Acquisition scenario?

Distributions to impacted participants

- Must be a distributable event, e.g., severance from employment. See definition of "severance from employment" under stock vs. asset sale in Q7.
- May be permitted under an asset sale where employees terminate employment with the seller and go to work for the buyer; but only if the buyer does not assume the plan or accept a direct transfer of plan assets.
- Rare in a stock sale unless a subsidiary is sold and certain conditions apply (see Q.7).
- See Plan Termination below. This would be a distributable event.

Merge the Plans– Merge the plan of the selling company into the plan of the purchasing company. This is considered by the IRS to be a continuation of the selling company's plan.

- Plan provisions must be compatible; decisions may be necessary with regard to the surviving merged plan.
- Purchasing company takes on fiduciary responsibility for the selling company's plan from the date that plan was originally established.
- Service with the selling company must be counted toward eligibility and vesting under the purchasing company's plan.
- There is no distributable event for the participants in the selling company's plan because a merger is considered to be a continuation of the seller's plan.

Purchasing Company Maintains Both Plans– The purchasing company can take responsibility for the selling company's plan and continue to maintain it separately along their own plan.

- The purchasing company takes fiduciary responsibility for the selling company's plan from the date it was originally established.
- Service with the selling company continues to be counted toward eligibility and vesting.
- There is no distributable event for the participants in the selling company's plan because the selling company's plan is being continued (no severance from employment for plan purposes).
- Each plan would have to meet the coverage rules separately unless plans may be aggregated for testing purposes. Certain coverage transition rules exist however.
- Administration costs increase because two plans are maintained.

Selling Company Terminates their Plan– The selling company could agree to terminate the plan before the sale is finalized.*

- Participants in the selling company's plan become 100% vested.
- Plan termination is a distributable event for the participants of the selling company and they must have the option to take a cash distribution or rollover their account balance to another qualified plan (e.g., the purchasing company's plan or an IRA).
- Purchasing company is not required to count years of service with the selling company toward eligibility and vesting in their own plan.

Q.18 Is a government filing necessary as a result of a merger or transfer of plan assets?

IRS form 5310A is filed to report mergers, spin-offs and transfers 30 days before the transaction occurs, however, there is an exception to this filing under which many defined contribution plans fall. In a defined contribution plan if the following requirements are met the 5310A does not have to be filed:

- The aggregate of the participant account balances in each plan equals the fair market value of the total plan assets (i.e., there are no unallocated suspense accounts);
- the assets of the plans must be aggregated to form the merged plan, and;
- immediately after the merger, each participant's account in the merged plan is equal to the sum of their accounts if the plans existing prior to the merger.

There is an exception allowing certain suspense accounts to be maintained (e.g., a forfeiture account or 415 excess amount) under certain circumstances. **Plan Sponsors should discuss this matter with the plan's attorney to determine if a filing is necessary.**

** Timing of the plan termination is very important. If the selling company's plan is terminated after the sale, the successor plan rule may apply which prohibits the distribution of the 401(k) elective deferrals solely by reason of plan termination. Some exceptions apply.*

What do I need to ask?

This questionnaire is designed as a tool to collect relevant information about the M&A transaction to facilitate plan sponsor decisions around the disposition of qualified plans and impact on participants.

1. In general terms, what is happening?

- ☐ Sale of company
- ☐ Acquisition of all or part of another company
- ☐ Companies are merging

2. Is the plan sponsor's attorney involved with the transaction?

- ☐ Yes
- ☐ No

3. Will the disposition of the plan be addressed in the transaction paperwork?

- ☐ Yes
- ☐ No

4. What is the effective date of the corporate transaction, e.g., date of sale, company merger, etc.?

_____ MM/DD/YYYY

5. Is this a stock sale or an asset sale?

Describe general circumstances

- ☐ Stock Sale
- ☐ Asset Sale

6. What is the plan sponsor's intent or preference?

- ☐ Plan merger
- ☐ Spin off
- ☐ Plan termination
- ☐ Freeze plan
- ☐ Maintain buyer and seller's plan separately
- ☐ If permissible, allow distributions e.g. treat as severance from employment
- ☐ Undecided and is asking for consulting on options subject to their attorney's approval

7. Is there a potential for a partial plan termination?

- ☐ Yes, 20% or more of participants are impacted or other facts & circumstances apply
- ☐ No, less than 20% of participants are impacted and no other facts or circumstances

8. Is this a controlled group of corporations?

- ☐ Yes
- ☐ No

If yes, please explain: _____

_____
_____
_____
_____
_____

9. Do the employers involved (buyer of seller) have other qualified plans?

- ☐ Yes
- ☐ No

If yes, what is the name and type of each plan?

_____
_____
_____
_____
_____

10. Who are the service providers for each plan?

Current document provider_____

_____

Type of plan document (e.g., prototype, volume submitter or custom/individually designed)?

_____
_____

Current record keeper _____

_____

TPA service provider _____

_____

11. Have all plan documents been updated for the latest regulatory requirements (e.g., Pension Protection Act, etc.)?

☐ Yes

☐ No

12. Are there participant loans involved?

☐ Yes

☐ No

13. Are any of the plans involved traditional safe harbor plans or Qualified Automatic Contribution Arrangements?

☐ Yes

☐ No

If yes, describe the safe harbor provision for each plan:

_____
_____
_____
_____
_____

14. Are there automatic enrollment plans involved in the transaction? (i.e., EACA, QACA, ACA)?

☐ Yes

☐ No

If yes, describe the automatic enrollment provision for each plan:

_____
_____
_____
_____
_____

15. Is there employer stock involved as an available investment?

☐ Yes

☐ No

16. Are there any known qualification defects, operational errors, VCP filings, etc.?

☐ Yes

☐ No

If yes, describe the problem and how the plan sponsor is addressing it:

_____
_____
_____
_____
_____

17. Is there any other pertinent information relative to the transaction?

_____
_____
_____
_____
_____

Due Diligence Document Checklist

When conducting a mergers and acquisitions (M&A) corporate transaction, it's critical to review specific 401(k) plan documents to ensure compliance, identify liabilities, and assess the potential impact on the transaction. Here's a list of key 401(k) plan documents that should be reviewed by the Plan Sponsor:

Plan Documents & Governance

- ☐ Adoption Agreement
- ☐ Amendments
- ☐ Basic Plan Document
- ☐ Fidelity Bond
- ☐ Fund Policies
- ☐ Mergers & Acquisition Documents (if applicable)
- ☐ Meeting Minutes
- ☐ Notices & Disclosures
    - ☐ 404(a)(5) Participant Fee Disclosure
    - ☐ 408(b)(2) Plan Sponsor Fee Disclosure
- ☐ Plan Termination Documents (if applicable)
- ☐ Retirement Committee Charter (if applicable)
- ☐ Summary Plan Description (SPD)
- ☐ Summaries of Material Modification(s) (SMMs)
- ☐ Trust Agreements
- ☐ Loan Policies

Plan Compliance

- ☐ Corrective Actions & Government Filings
- ☐ IRS Determination Letters
- ☐ IRS Form 5500 filings: past 3 years including all schedules
- ☐ Plan Audits
- ☐ Non-discrimination Testing Results
    - ☐ ADP/ACP Test Results for the past 3 years
    - ☐ Top-Heavy & Coverage Tests

Investments & Service Providers

- ☐ Investment Policy Statement (IPS)
- ☐ Investment Fund Participation Agreement(s)
- ☐ Provider Service Agreements, Contracts, and Fee Schedules/Invoices
    - ☐ Financial Advisor
    - ☐ Recordkeeper
    - ☐ Third-Party Administrator (TPA) (if applicable)
    - ☐ 3(16) Fiduciary Service Provider (if applicable)
    - ☐ 3(38) Investment Manager Agreements (if applicable)

Plan Data, Participation and Contribution

- ☐ Collective Bargaining and Labor Agreements
- ☐ Employee Census Data
- ☐ Participant Loan Records
- ☐ Annual Contribution Records: Employer & Employee

General Company Information Factsheet

COMPANY INFORMATION	Buyer	Seller
Legal Name of Company		
Tax Identification Number		
Legal name of all other companies owned (partially or fully), by any person who owns (some or all of) the Plan Sponsor, and, % ownership for each company		
Has the company name ever been changed? What was the prior name(s)?		
Type of Business Entity:		
Has the company ever changed the type of business (corp to partnership, partnership to an LLC, etc.)? If so, when?		
Payroll Vendor		

CONTACT INFORMATION	Buyer	Seller
Plan Trustee(s) (name, title, direct phone number, and e-mail address)		
Main Contact for day-to-day plan management (name, title, direct phone number, and e-mail address)		
Authorized Signer(s) (name, title, direct phone number and e-mail)		
Recordkeeper Contact (name, title, direct phone number and e-mail)		
Third Party Administrator Contact (name, title, direct phone number and e-mail)		
Payroll Vendor Contact (name, title, direct phone number and e-mail)		

PLAN INFORMATION	Buyer	Seller
Name of plan		
Recordkeeper		
Recordkeeper Plan ID		
Third Party Administrator (if applicable)		
Number of participants		
Number of eligible employees		
Current plan assets (include a current asset allocation and current expense ratios)		
Plan Document (standard prototype, non-standard prototype, custom, or volume submitter)		

Planning & Execution Overview of Retirement Plan Transition

Leading up to the corporate action (planning)

Employers' responsibilities

• Notify plan recordkeepers and other providers of the pending action

• Describe the nature and objectives of the planned merger, acquisition, or divestiture and how the retirement plan transition supports this action

• If the seller will be terminating its plan prior to the transaction date, create a termination timeline and include final compliance tasks and distribution options for participants

• If the buyer will assume plan sponsorship of the seller's plan either by merger or a stand-alone plan, make plan design, coverage, and investment decisions

• Gather the seller's plan documents and other relevant information and make it available as required

How plan consultants and recordkeepers can help

• Analyze the key considerations for the retirement plan transition

• Suggest an optimal plan approach and benefit design

• Review the seller's plan(s) to determine compliance status

• Provide a comparison of all plans involved in the transition

• Provide investment consulting services

• Determine the effect of the corporate action on the funded status of defined benefit plans and outline various options

• Coordinate the revision of plan documents

• Support the development of initial employee communication and any required notices

After the plan transition is complete (execution)

Employers' responsibilities

• Communicate plan changes to employees

• Determine payroll strategy

• Ensure all necessary plan amendments and plan material updates are completed within IRS deadlines and/or reasonable time periods

• Complete any final compliance tasks (e.g., Form 5500) associated with the seller's plan

How plan consultants and recordkeepers can help

• Provide guidance with the employee communications strategy

• Create communication materials and conduct meetings with employees (if appropriate)

• If it's a plan merger, determine if the seller's plan has any protected benefits that must be preserved in the buyer's plan

• Determine the impact of the retirement plan transition on compliance testing

• Determine the transition's impact on

employer contribution costs

• Help with the transfer of assets

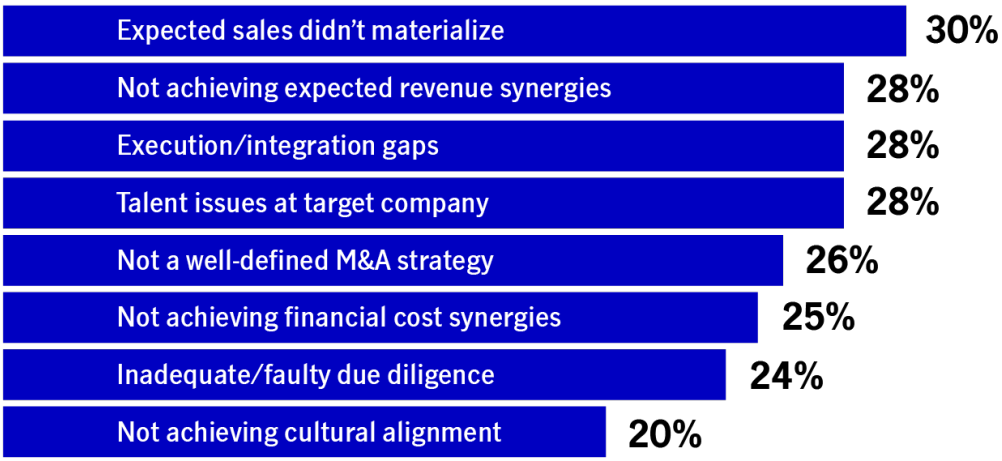
• Reconcile data/update files

• Assist with payroll integration

• Activate the participant website for transitioning employees

Top internal reasons why M&A transactions haven't generated expected value

Each number indicates the percentage of surveyed CEOs selecting each response



Source: "The state of the deal: M&A trends 2020," Deloitte, 2019. A survey of 750 executives at U.S.-headquartered corporations and 250 at domestic-based private equity firms.