

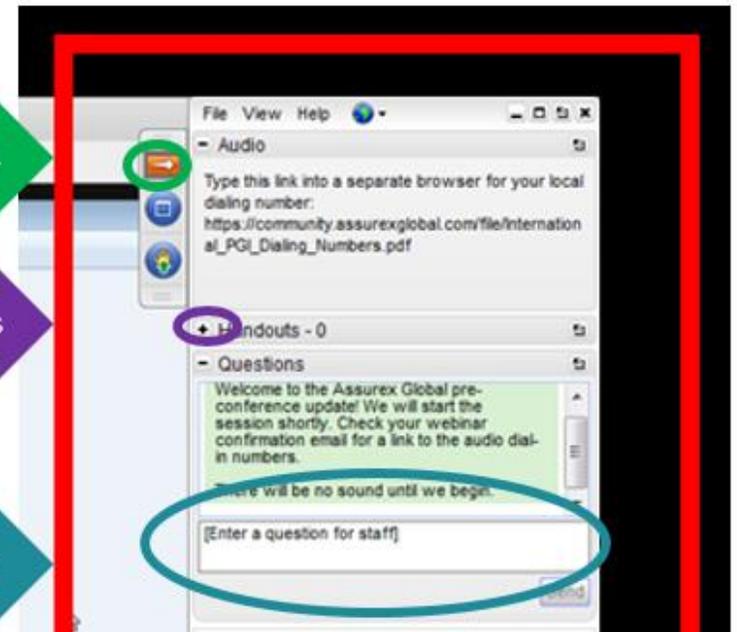
May 2019

Employee Benefits Issues During Mergers and Acquisitions

Benefit Comply, LLC

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- Welcome! We will begin at 3 p.m. Eastern
- There will be no sound until we begin the webinar. When we begin, you can listen to the audio portion through your computer speakers or by calling into the phone conference number provided in your confirmation email.
- You will be able to submit questions during the webinar by using the “Questions” or “Chat” box located on your webinar control panel.
- Slides can be printed from the webinar control panel – expand the “Handouts” section and click the file to download.



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Agenda

- M&A Overview
- Plan Transition Issues and Risks
- Controlled Group Review
- Specific Benefit Related Issues
 - ERISA
 - HIPAA
 - COBRA
 - Healthcare Reform
 - §125
 - Code Non-Discrimination Issues

M&A Overview

- Type of Transaction Matters
 - Asset Purchase
 - Buyer acquires some or all of seller's assets
 - Seller entity often continues to exist after sale
 - Seller typically terminates employees associated with the assets purchased – buyer may, or may not, hire some or all of these employees
 - Stock Purchase
 - Buyer acquires entire legal entity
 - Buyer takes responsibility for all assets and liabilities of seller, including responsibility for welfare plans
 - Seller organization may be part of a controlled group which complicates things!
 - Merger
 - A form of a stock purchase where two or more entities combine to form an entirely new entity

Plan Transition Issues to Consider

- Type of Transaction Matters (examples)
 - New Employees
 - Asset - Employees of selling entity hired by buyer are generally treated as “new hires” unless buyer is considered a “successor employer”, in which case it may be necessary to give credit for previous hours and wages
vs.
 - Stock – Employees are simply continuing employees and all prior work for company is considered
 - Existing Plans
 - Asset – Buyer has no automatic right or control over seller’s existing plans. New employees will generally be offered coverage in buyer’s plans
vs.
 - Stock – Buyer “takes over” sponsorship of seller’s plans (run both plans side by side? Or terminate seller’s plans and move employees to buyer’s plans?)

M&A Overview

- M&A Challenges Related to Health and Welfare Plans
 - Due diligence often focuses principally on benefits with financial assets (e.g. retirement plans, welfare plans with assets held in trust, etc.) and compensation issues related to key employees
 - Health and welfare plans (most don't hold assets in trust) are often not considered as carefully
 - Even if buyers looks into seller's benefits, they often don't fully consider the impact of the transaction on buyer's own benefit plans
 - Differences in employee demographics can impact costs
 - Integration issues (more later)
 - Details of pending transactions kept confidential
 - Important benefits-related employee communications are often not handled until the last minute
 - Administrative challenges (more later)
 - Plan years, plan documents, discrimination, etc.

Plan Transition Issues to Consider

- Potential Risks and Liabilities for Buyer to Consider
 - Unknown covered persons (severance agreements, COBRA QBs, etc)
 - Plan document and SPD problems
 - Failure to comply with requirements under COBRA, HIPAA, healthcare reform, and other group health plan mandates
 - Nondiscrimination requirements
 - Reporting Issues
 - ACA employer reporting
 - M-1 reporting for MEWAs
 - Missing, incomplete, or late Form 5500s

Plan Transition Issues to Consider

- Review Service Provider and Insurance Contracts
 - Service provider contract may allow for new terms, fee changes, etc.
 - Insurance contracts
 - Contracts could have underwriting or rating provisions related to significant change in membership
 - MEWA issues (more later)
 - Stop-loss contracts
 - Stop-loss contract may not automatically transfer to a buyer taking responsibility for a seller's self-funded plan

Controlled & Affiliated Service Groups

- Source of Controlled & Affiliated Service Group Rules
 - Internal Revenue Code §§414(b), (c), (m), (o) & (t)
- Terminology
 - Controlled group of organizations based on common ownership
 - Affiliated service group based primarily on management control and operational relationships (shared services)
- Why It Matters
 - MEWA status
 - Discrimination testing (§105(h), §125 cafeteria plan, etc.)
 - §4980H applicable large employer (ALE) status
 - Small employer underwriting and rating status

Controlled and Affiliated Service Groups

- **Controlled Groups**
 - Parent — Subsidiary
 - One individual or entity owns 80% or more of another entity (directly or indirectly) - sometimes referred to as “common ownership”
 - Brother — Sister
 - Same five or fewer owners own at least an 80% controlling interest in each of the entities; AND
 - Same five or fewer owners have an identical ownership in each entity totaling greater than 50%
- **Affiliated Service Groups**
 - Based on operational and management control
 - Principally effects service organizations
 - Focus is on operational relationships, not on ownership

ERISA Issues

- **Plan Documents & Notices**
 - May need to update plan documents
 - Plan sponsor changes if buyer takes over seller's plans
 - Plan eligibility rules changes to include additional entities and categories of employees
 - Plan year changes to allow for a short plan year and/or change in plan year to bring two plans with differing plan years into alignment
 - May need to distribute SMM or new SPDs
 - May need to distribute a Notice of Modification if plans are changed or terminated mid-plan year
- **Form 5500**
 - Who will take responsibility to file final Form 5500(s) for terminated plans?
 - Short plan years - Form 5500 must be filed 7 months after the end of the short plan year

Multiple Employer Welfare Arrangement (MEWA)

- Multiple Employer Welfare Arrangement (MEWA)
 - Inadvertent creation of a MEWA
 - Whenever two related organizations offer coverage under one health plan, controlled group status must be considered
 - Not all M&A stock transactions involve purchase of 100% of buyer stock
 - Covering “non-employees” under a plan (other than COBRA) can create a MEWA
 - Why does this matter?
 - MEWA must file a form M-1 with DOL
 - Fully-insured plans – carrier group contract may not permit MEWA coverage
 - Self-funded plans – Many states have very restrictive rules for self-funded MEWAs (e.g. limits on types of entities that may share plans as well as licensing, reporting and financing requirements)

HIPAA Issues

- HIPAA Privacy and Security
 - HIPAA privacy regulations allow a covered entity to disclose PHI in connection with the sale or merger with another covered entity – BUT – employers are not the covered entity, the health plan is the covered entity!
 - Sharing of PHI between employers involved in a transaction must be limited
 - Use de-identified information and share only the minimum necessary
 - Use employment-related enrollment information instead of health plan data
 - Never share identifiable claims data
 - Obtain authorizations from participants to share individually identifiable data

COBRA Issues

- IRS COBRA M&A Regulations
 - Definition of M&A qualified beneficiary (QB)
 - QBs already receiving COBRA coverage before the sale under seller's plan
 - QBs who experience their qualifying event (termination of employment) in connection with the transaction
 - Definition of successor employer on asset sale
 - Seller ceases to provide any group health plan “in connection with the sale” and buyer “continues the business operations associated with the assets purchased...without interruption or substantial change”

COBRA Issues

- COBRA Rules for M&A QBs
 - Asset sale
 - If seller maintains a group health plan after the sale, then a group health plan of seller must provide COBRA coverage to M&A QBs
 - If seller ceases to maintain any group health plan in connection with the sale, the group health plan of buyer must provide the COBRA coverage if:
 - (i) buyer maintains a group health plan; and
 - (ii) buyer is a successor employer
 - In an asset purchase, if buyer is a successor employer, employees continuing with buyer after the asset sale have no qualifying event (there has been no termination of employment)
 - The parties may contractually allocate the responsibility to make COBRA coverage available

COBRA Issues

- COBRA Rules for M&A QBs
 - Stock Sale
 - If seller is part of a controlled group according to Code §414 rules and the “seller group” maintains a group health plan – seller must offer COBRA to M&A QBs
 - Buyer is responsible for any M&A QBs if seller does not continue a plan or ceases to exist
 - In a stock sale, there is often not a qualifying event because a stock sale by itself does not cause a termination of employment
 - The parties may contractually allocate the responsibility to make COBRA coverage available

Healthcare Reform Issues

- **Grandfathered Status**
 - Changes to plan or membership could cause the loss of grandfathered status in buyer's existing plans
- **Small Group vs. Large Group Coverage**
 - ACA definition of small employer plan (50 in most states - 100 in a few) for underwriting and rating purposes is based on total employees in controlled group or affiliated service group
 - Carriers are not supposed to let a small employer who is part of a large controlled group purchase a small employer plan

Healthcare Reform Issues

- §4980H & Employer Reporting Issues
 - Unfortunately, there isn't much guidance in regard to M&A for purposes of §4980H or employer reporting
- ALE Status
 - In an asset purchase
 - If buyer was not already an ALE (50 or more FTEs) determine the average FTEs during the current year to determine whether compliance with §4980H and reporting would be required for next year
 - If buyer is already an ALE, the additional employees are simply added to the reporting requirements as of the date of the purchase
 - In a stock purchase
 - When each entity is a separate EIN but becomes part of a controlled group
 - If all entities were small enough not to be an ALE prior to transaction, not necessary to comply with §4980H or reporting for remainder year
 - If any of the entities were already an ALE - all entities would be considered ALE subject to §4980H and reporting as of the date of the acquisition

Healthcare Reform Issues

- §4980H Offer of Coverage
 - No clear transition relief available for newly acquired employees
 - Full-time employees and dependent children must be offered coverage immediately to avoid potential penalties
 - Who is considered a full-time employee?
 - Conservative approach is to give credit for previous hours of service, which may require coordinating measurement periods
 - Imposing a new waiting period or initial measurement period for acquired employees may put the employer at risk

Healthcare Reform Issues

- Employer Reporting

- Employer reporting is handled on a calendar year basis and there is no way to report for only a portion of the year
 - Seller entity terminates following the transaction –
 - Seller reports offers of coverage for the first part of the year and then indicates no full-time employees for months following the transaction
 - Buyer should include acquired employees in reporting for months following the transaction
 - Seller entity remains in place following the transaction –
 - If the entity was an ALE all year, report offer of coverage information as normal, but may need to indicate being part of an aggregated ALE group (controlled group or affiliated service group) for part of the year
 - If the entity was an ALE only following the transaction, it's unclear how to report for the first part of the year to avoid potential penalties
 - If coverage was offered, it would make sense to report accordingly

Healthcare Reform Issues

- Employer Reporting
 - Switch in Plan Funding Method – Coverage Reporting
 - If individuals are offered coverage under self-funded plan for only a portion of the year, 1095-C Part III (or Form 1095-B) coverage is reported only for such months
 - If individuals were covered a portion of the year under a fully-insured plan and a portion of the year under a self-funded plan, the individual will receive two forms:
 - (i) one from carrier showing months under the fully-insured plan
 - (ii) one from employer showing months under self-funded plan
 - If the individual is covered part of the year under two different employer self-funded plans, the individual will receive a Form 1095 from each employer

§125 Issues

- Election Changes
 - Assume buyer is taking over existing seller plans mid plan-year
 - What changes can employees make to existing elections?
 - §125 allows election changes where there is a change in cost or coverage imposed by employer
 - Insignificant change in cost – Employer can automatically change employee pre-tax payroll deduction
 - Significant change in cost – Employer can allow employees to make coverage changes
 - Significant improvement or curtailment in coverage – Employer can allow employees to make coverage changes
 - However, this would not trigger HIPAA special enrollment rights, so employer is not required to allow employees to make election changes

§125 Issues

- Health FSAs
 - IRS guidance permits two transition options so long as buyer and seller have the same plan year:
 - Employees may continue through the end of the plan year under seller's health FSA if buyer maintains the seller's health FSA
 - Employees' elections and balances (if any) may be transferred to buyer's health FSA
 - Employers may need to run a short plan year as part of the transition
 - Employees should be informed in advance of a short plan year to limit the risk of "over-elections" and forfeitures

Nondiscrimination Issues

- Nondiscrimination Rules

- Any time different benefits, costs, or eligibility are offered to different groups of employees in an organization, nondiscrimination rules must be considered
 - §125 nondiscrimination rules apply to all benefits offered through a §125 cafeteria plan
 - §105(h) nondiscrimination rules apply to self-funded health benefits
- IRS nondiscrimination rules apply across the entire controlled group or affiliated service group of companies!
 - Single companies within a controlled group often consider discrimination testing on only their own employees and fail to consider employees of the other companies in the controlled group
- IRS §105(h) “grace period” to bring discriminatory structure into compliance
 - §105(h) nondiscrimination rules for health plans borrow heavily from §410(b) nondiscrimination rules that apply to retirement plans
 - §410(b) specifically relieves plans that are part of a merger from nondiscrimination rules for at least the rest of the current plan year

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