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Employee Benefits Update

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Will a merger or acquisition upend your 401(k) plan?

Beware of ERISA entanglements and higher costs

Is your company contemplating buying another company, or a division of one? If so, be sure to assess and plan for the impact on your 401(k) plan, and that of the company you're acquiring, before pulling the trigger. The same applies if you're on the receiving end of an acquisition (though you might not be able to do as much if you're the acquisition target). In either case, allow yourself plenty of time to work through a series of important decisions.

Asset vs. stock sale

Two major challenges that often arise in merger and acquisition (M&A) transactions are ERISA compliance issues and unanticipated costs. But these challenges generally come into play only if the acquisition is through a stock purchase, vs. an asset sale.

In an asset sale, what's being acquired isn't the legal entity of the business itself — which continues to live on independently after the sale — but merely the company's assets. That means that the company that has sold its assets remains a going concern and the sponsor of its 401(k) plan.

Under an asset sale, the company that sold its assets typically will terminate its 401(k), and its participants will be able to roll their account balances into IRAs. Or, if your company hires the acquired company's employees, they might also be able to roll them into your plan.

Stock purchase options

Where things get more complicated is when your company buys another in a stock purchase. The result is that the acquired company's 401(k) plan lives on under your watchful eye. When an M&A transaction occurs via a stock purchase, you have three options:

1. Terminate the 401(k) plan.
2. Keep it running separately from your existing plan.
3. Merge it with your existing plan.

Why might you choose the first option? If you determine during due diligence before the acquisition that the 401(k) plan you have acquired has compliance issues, you would inherit those problems and need to address them. Merging a 401(k) that's violating ERISA in some way could taint your original plan. And you'd still have to fix the noncompliant plan — even if you just kept it operating independently of your existing plan.

There can be downsides to a termination, however. One is that, under the "successor plan rule," the former

2 common ways to merge plans

So let's say you've just acquired another company in a stock purchase transaction and now need to merge its 401(k) plan with yours. Generally, there are two ways of doing so:

1. Fund mapping. Under this approach, you move participants' assets from their original plan into funds in your plan that most closely resemble what they had in terms of investment objective and risk profile. (This can get tricky for you and the participants if there aren't any comparable funds.) You also need to give participants notice about your intentions so they have an opportunity to invest their funds differently if they so choose.

2. Re-enrollment. In contrast, this approach involves putting the burden on participants to liquidate their holdings in their old plan and re-invest that cash into the investment options in your plan. Participants who elect not to make those decisions can be defaulted into qualified default investment alternatives.

participants of that plan generally will have to wait a year before joining a new plan (such as your existing plan). You must distribute assets the participants had in the terminated plan to them. Many may succumb to the temptation to spend some of that money immediately, instead of rolling it into an IRA. Note that the successor rules don't apply if the seller's plan is terminated before the actual acquisition.

Suppose instead that the to-be-acquired company's 401(k) plan is fully ERISA-compliant. Why not just let it continue as-is after the acquisition? You could for a while, but you might eventually run into problems with ERISA discrimination tests if one plan is more generous than the other. Plus, you'd probably pay more to administer two plans than one combined plan. In addition, the controlled group rules may require you to merge the plans once the transition period is over.

(For more on the third option, merging an acquired plan with yours, see "2 common ways to merge plans" above.)

Added costs to consider

Even if merging the acquired company's 401(k) with yours is the best way to go, it won't be a cakewalk. It will run more smoothly, though, if you've studied the acquired company's operational process and plan design to ensure that both are aligned, and you've determined how you want to harmonize the two.

Before migrating the acquired plan to your existing recordkeeping platform, review your vendor agreements to see how much warning you need to give them before making a change. Another key consideration is the Internal Revenue Code's "anticutback" and protected benefit rules. It prevents plan sponsors from reducing the value of "protected benefits." That might require you to raise the generosity of one plan to balance it with the more generous one. Protected benefits include:

- Accrued benefits, such as the vested status of benefits and the value of such benefits before and after the merger,
- Optional forms of benefits such as payment schedules, timing and medium of distribution,
- Early retirement benefits, and
- In-service withdrawal options.

The most common plan provisions not subject to the anticutback rule include the right to make elective deferrals, loans, hardship withdrawals and after-tax contributions.

Also, certain plan investment options, such as guaranteed investment contracts (GICs) and stable value funds (SVFs), have liquidity restrictions that can keep funds tied up for as long as a year to avoid penalties. Although GICs and SVFs can be tricky to deal with when merging plans, it's also a big job to consolidate other plan investment options into your plan or replace them. Acquiring companies generally choose not to sweep the specific investment options of the acquired company's 401(k) into their own.

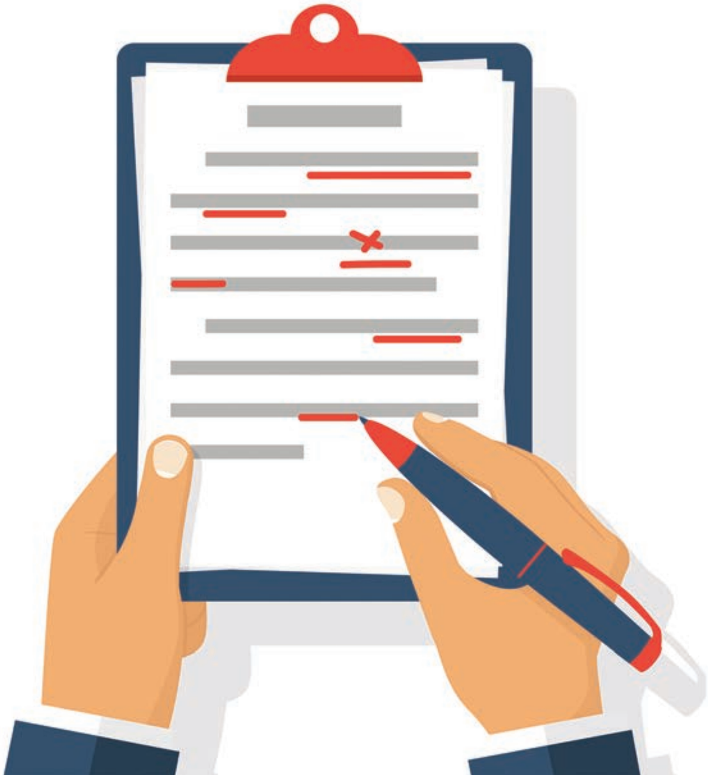
Doing the homework

These are just a few highlights of what may be involved in managing retirement plans during an M&A transaction, but enough to get you started down the path of planning your strategy. Also remember that terminating or merging plans will require you to file a final Form 5500, along with a final audit, if required. M&A involves many complex questions; be sure not to ignore your 401(k) plan. □

IRS liberalizes availability of self-correction program for plan "failures"

If your plan offers participants a plan loan option and you're not infallible, here's some good news: A recent IRS Revenue Procedure allows plan sponsors to jump through fewer hoops to fix several so-called "plan failures" relating to plan loans.

Specifically, plan sponsors can now fix more categories of loan glitches using the streamlined Self-Correction Program (SCP) under the IRS's umbrella Employee Plans Compliance Resolution System, instead of the more burdensome Voluntary Correction Program (VCP).



SCP and VCP fixes

Under the SCP, you can fix certain plan failures on your own without having to deal with the IRS or pay any fees. The program is intended to correct "operational errors," meaning you didn't follow the terms of your plan.

Rev. Proc. 2019-19 spells out the specific steps you need to take to fix the problems to be eligible for the SCP approach.

The VCP program, in contrast, involves sending the IRS an explanation of the error you'll be correcting along with a fee in the $1,500 to $3,500 range, depending on the size of your plan. You'll also need to explain how you intend to correct the error. You then must wait until the IRS accepts your proposed fix before you're back in its good graces.

"Insignificant" errors

The SCP is an option for errors that the IRS considers "insignificant." However, it also includes errors considered significant if you correct them by the end of the second year following the plan year in which the error occurred.

One category of error that is automatically classified as "significant" involves plan document failures, meaning noncompliant provisions within your plan document.

In contrast, IRS Revenue Procedure 2019-19 covers administrative errors, such as plan loan mistakes. For example, using the SCP, instead of the previously required more time-consuming and costly VCP method, plan sponsors can now self-correct mistakes involving:

1. Loans exceeding the $50,000 ceiling,
2. Loans with payment schedules beyond the five-year maximum payback period (longer periods are possible if the loan is used to buy a primary residence), and
3. Failure to properly address plan loan defaults.

In all three scenarios, unless you're able to make the necessary correction in time, you must report that the plan participant has received a "deemed distribution." The amount of money involved then becomes taxable.

Steps to correction

Rev. Proc. 2019-19 spells out the specific steps you need to take to fix the problems to be eligible for the SCP approach. For example, fixing a loan exceeding the $50,000 cap can be addressed if the excess amount is promptly repaid. That's simple enough, but the revenue procedure spells out three ways that loan payments — made before your realizing the amount borrowed exceeded the limit — are applied to reducing the excess principal.

When the loan period exceeds the five-year limit, fixing it in a way that lets you use the SCP involves re-amortizing the loan "over the remaining period of the proper payment period measured from the original date of the loan," according to the IRS. Thus, for example, if you discovered that a loan was set up with a six-year amortization schedule instead of the maximum of five years, and you make that discovery two years after the loan was made, you'd need to re-amortize the loan so that it's paid off in three years (bringing the total to five) instead of four.

Make the fix

Using the SCP to fix plan errors is better than addressing them after they're detected by the IRS in an audit. The agency prefers that you identify your own mistakes and come clean. Check with your plan administrator to ensure that new procedures are put in place to allow you to take advantage of the more liberal self-correction procedures. As with all ERISA rules, the devil is in the details. □

Compliance Alert

Upcoming compliance deadlines:

10/1 First day to distribute qualified default investment alternative (QDIA), safe harbor and automatic contribution arrangement annual notices to plan participants (no earlier than today)

10/1 Deadline for establishing a new safe harbor 401(k) plan

10/1 Deadline for setting up a SIMPLE for 2019

10/15 Extended deadline for filing 2018 Form 5500

10/15 Deadline for funding employer profit sharing contributions and employer matching contributions

10/15 Extended deadline for filing 2018 Form 8955-SSA

10/15 Extended deadline for filing 2018 individual tax returns

10/15 PBGC Comprehensive Premium filing and payment deadline

11/1 2019 SIMPLE notice due to current participants

11/15 Deadline for distributing summary annual report *if* the IRS Form 5500 filing extension was due to the plan sponsor's tax return extension

Warn participants of the risks of front-loaded deferrals

Some 401(k) plan participants have been known to shoot themselves in the foot when taking aim at higher investment returns. Some of these individuals may not be open to advice but, as plan sponsor, you can still provide information about the dangers of firing blindly and expecting to hit a target. Case in point: front-loading deferrals in hopes of boosting returns over the course of the year.

Theory behind front-loading

While front-loading deferrals could theoretically pay off, success depends on two factors:

1. A steady increase in the value of the securities or funds invested in by the participant, and
2. A minimal or nonexistent employer matching contribution.

Generally, making a large up-front investment isn't considered as wise as taking a dollar-cost averaging approach. The latter strings out an investment in installments to blunt the impact of a sudden drop in value. Many participants may understand this concept but still choose to roll the dice and invest as much as possible as soon as possible.

Role of matching formula

Understanding the impact of a 401(k) plan matching formula on a front-loading strategy is trickier for many participants. Here's an illustration based on a pay-period matching basis:

Suppose your plan, like many, provides a 50% match on up to 6% of compensation. An employee earning an annual salary of $120,000 bites the bullet and defers 25% of pay to reach the $19,000 maximum deferral amount as soon as possible.

Assuming a biweekly gross paycheck of $4,615, the employee defers $1,154 per pay period and hits the 2019 deferral ceiling of $19,000 after around 16 pay periods. Because the participant's deferral exceeds the 6% ceiling on matching contributions, the participant is eligible for the maximum match (50% of 6% is 3%) for each pay period deferrals were made. That amounts to $138.45 for about 16 pay periods, or $2,215.

But what if, instead of front-loading contributions, the participant had set deferrals to hit the $19,000 limit by year end? Doing so would have meant deferring around $731 per pay period instead of $1,154. That $731 deferral per pay period would still entitle the participant to the same matching contribution ($138.45) as under the first scenario, because $731 is about 16% of the participant's pay — well above the 6% ceiling for the matching contribution. As a result, the participant would get $138.45 matching contributions for every pay period of the year, totaling $3,600, or about 63% more than the contributions received under the front-loading scenario.

A sure thing

Although the difference between the two scenarios is only about $1,400, it's a sure thing under the dollar-cost averaging approach — unlike the investment returns using front-loaded deferrals. Be prepared to explain this to your participants who have "itchy trigger fingers" when it comes to their 401(k) plan deferrals. □

New exempt status income threshold could impact 401(k) plan costs

If your 401(k) plan employer contribution formula for hourly employees includes overtime pay, your plan costs may increase next year — along with your overtime pay outlays. That's because of the Department of Labor's revised rule increasing the income threshold for overtime pay eligibility that was published in September and that goes into effect January 1, 2020.

What's the rule?

A quick refresher: The $455 weekly pay threshold for exempt status will rise to $684 on January 1, 2020. This change is projected to make a million more workers eligible for overtime pay.

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The change left the "duties test" intact. For workers to be classified as exempt (and, thus, ineligible for overtime pay), their jobs' "primary duty" must still satisfy the executive, administrative or professional exemptions. So, a worker earning more than the new $684 weekly ($35,568 annualized) pay threshold would still be eligible for overtime pay for hours worked exceeding 40 in a week — if the job doesn't fall into those exemption categories.

What will it cost?

What will this change cost you? First, let's say you include overtime pay in compensation eligible for an employer 401(k) contribution, and that every 401(k) plan participant gets a 3%-of-pay nonelective employer contribution to their plan account. (That's the minimum percentage for safe harbor status and, therefore, a common practice.)

Suppose you have 500 employees and 200 of them will be newly eligible for overtime pay. And assume that their average pay is $655 per week, and that the average worker newly eligible for overtime puts in four hours of overtime per week.

Those additional 800 hours of weekly overtime, based on 1½ times base pay, adds up to about a $30,000 annual increase in nonelective plan contributions. To put things in perspective, that's only 3% of the extra wages you'd be paying these workers if they previously were ineligible for overtime pay.

The full picture

Even with an anticipated jump in payroll costs, it's important to get the full picture. You could amend your plan to make overtime pay no longer eligible for the 3% nonelective contribution. Or you might concentrate on keeping the workweeks of those employees newly eligible for overtime pay to 40 hours. Either approach will likely yield bigger savings while also minimizing incremental 401(k) costs. But discuss all options with your benefits advisor. □

The solution for skyrocketing audit fees

Finding ways to cut costs while maintaining quality seems to be at the top of every executives to do list. As the person responsible for your organization's employee benefit plan audit, we can help you not only reduce your audit costs but also provide a higher level of service.

Pension auditors must sift through enormous amounts of financial data in accordance with the requirements of numerous laws, regulations and professional standards. If they don't know what they're doing, they can easily get lost in the numbers, run up large fees and fail to provide an accurate assessment of a plan's financial status.

Pension audit specialists

Insero & Co. specializes in pension plan audits. Our professionals have extensive experience in this area and to ensure that our audits meet the highest standards of quality, our firm is a member of the American Institute of Certified Public Accountants (AICPA) Employee Benefit Plan Audit Quality Center and is registered with the Public Company Accounting Oversight Board (PCAOB).

Insero & Co. is the independent registered public accounting firm for many companies that file a form 11-K with the Securities and Exchange Commission. We currently perform audits for more than 150 plans ranging in size from 100 to 60,000 participants, and from $1 million to more than $10 billion in assets.

Big firm capabilities, small firm attentiveness

As our many satisfied clients will testify, we offer the comprehensive benefit services of a large national firm, but at less cost and with a higher level of service. With more than 125 accountants, professional consultants and support staff, our firm is large enough to bring robust resources to bear on almost every client need, yet small enough to provide the personal attention and relationship-based service that is important to our clients.

The culture of Insero & Co. is hands-on and proactive, shaped by the old-fashioned notion of doing what is in the best interest of the client. In addition to pension and corporate audits, we provide a full range of tax, accounting and consulting services, including internal audit/Sarbanes-Oxley services, outsourced accounting and wealth management.

Go with the experts

We would welcome the opportunity to discuss your audit or other needs and put our expertise to work for you. Please contact Vince Leo at 585-697-9683 or Mike Giess at 585-697-9639 and let us know how we can be of service.

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