M&A Health and Welfare Plan Checklist

August 2109

Due diligence efforts prior to a merger or an acquisition often focus on benefits with significant financial assets (retirement plans or other funded benefits). Health and welfare plans are sometimes not considered as carefully. Even if buyers carefully review the seller's health and welfare benefits, often they do less analysis to understand the impact of the transaction on their own benefit plans.

Furthermore, employee communications are complicated by the fact that details of pending transactions must be kept confidential, so important benefits-related employee communications are often not transmitted until the last minute. This checklist is designed to help an employer think about health and welfare plan issues that need to be considered, preferably well in advance, when a merger or acquisition is likely to take place.

Plan Transition Issues to Consider

- Asset Purchase
  - Employees hired by the buyer are typically treated as "new hires" and are offered coverage in existing buyer plans; however,
    - The buyer may not want these employees to have to meet a new waiting period.
    - The buyer may want to create a plan that mirrors the seller's plan for those employees.
- Stock Purchase
  - The buyer must decide how to handle the seller's existing plans:
    - The buyer may "take over" and become the sponsor of the seller's existing plan alongside existing plans already sponsored by the buyer.
    - The buyer may want to terminate the seller's plans and transition employees to existing buyer plans.
- Service Provider and Insurance Contracts – Contracts may contain provisions that can be triggered by an M&A transaction. All contracts should be carefully reviewed so there will be no surprises.
  - Service provider contracts may allow for new terms, fee changes, etc. in the event of ownership change.
    - Insurance contracts could have underwriting or rating provisions related to significant change in membership.
    - Stop-loss contracts may not automatically transfer to a buyer taking responsibility for a seller's self-insured plan.
- Other Issues
  - Will employees experiencing a benefits change mid-plan year be given credit for deductibles and out-of-pocket expenses already met?
  - Will the buyer credit employees for length of service at seller when determining benefits eligibility?

HIPAA Privacy and Security

The HIPAA privacy and security regulations allow a covered entity to disclose private health information (PHI) in connection with the sale to or merger with another covered entity. However, employers are not typically considered the covered entity; the employer sponsored health plan is technically the covered entity. Consequently, sharing of PHI between employers involved in a transaction must be limited.

- Use de-identified information whenever possible and share only the minimum necessary.
- Try to use employment-related enrollment information instead of health plan data.
- Obtain authorizations from participants when possible.

COBRA

The IRS has issued detailed COBRA M&A regulations. The parties involved in the transaction may contractually allocate the responsibility to make COBRA coverage available. If responsibility is not negotiated, IRS rules apply.

- Definitions
  - M&A Qualified Beneficiary (QB)
    - QBs already receiving COBRA coverage before the sale under the seller's plan.
    - QBs who experience their qualifying event (i.e. termination of employment) in connection with the transaction.
  - Successor Employer in Asset Sale
    - *"Seller ceases to provide any group health plan to any employee in connection with the sale and if the buyer continues the business operations associated with those assets without substantial change or interruption"*
- Summary of IRS Rules
  - Asset Sale
    - If the seller maintains a group health plan after the sale, then a group health plan of the seller must provide COBRA coverage to M&A QBs.
    - If the seller ceases to maintain any group health plan in connection with the sale, the group health plan of the buying group must provide the COBRA coverage if:
      - (i) the buying group maintains a group health plan; and
      - (ii) the buyer is a successor employer.
  - Stock Sale
    - If the seller is part of a controlled or affiliated service group (according to Code §414) and the "seller group" maintains a health plan—the seller must offer COBRA to M&A QBs.
    - The buyer is responsible for any M&A QBs if the seller does not continue a plan or ceases to exist.

Health Reform Issues

- §4980H & Employer Reporting Issues
  - Guidance about M&A for purposes of §4980H or employer reporting is limited. Employers should consult with their advisors when determining how to handle employer reporting after a transaction.
  - Employers must consider changes to reporting requirements when employee coverage changes between fully insured and self-insured.
- Applicable Large Employer (ALE) Status
  - Are any of the entities involved in the transaction becoming an ALE for the first time?
- Definition of Full-time Employees
  - Do the companies involved in the transaction use different methods (e.g., look-back measurement or monthly) to define full-time employees?
- Other Health Reform Issues to Consider
  - Could the transaction cause a loss of grandfathered status?
  - Rules related to small group vs. large group coverage might need to be reviewed, depending on the size of the organizations involved in the transaction.
  - Buyer must be aware of potential liability for mistakes made by seller under the §4980H employer shared responsibility rules (the "employer mandate").

Section 125

- Assume buyer is taking over existing seller plans mid plan-year.
  - What changes can employees make to existing elections?
- Changing plan years considerations
  - Section 125 does not allow a plan year of more than 12 months, so the buyer may need to run a short plan year to bring two plan years into alignment.
  - Short plan year issues
    - FSA elections for short plan years can be complicated for employees to understand.
    - A form 5500 may need to be filed for a short plan year.

Nondiscrimination Rules

Nondiscrimination rules apply across the entire controlled group or affiliated service group of companies (as determined by Code §414 rules). Employers involved in an M&A transaction may need to consider the nondiscrimination testing across multiple corporate entities.

- §125 nondiscrimination rules apply to all benefits offered though a Section 125 cafeteria plan.
- §105(h) nondiscrimination rules apply to self-insured health benefits.
  - IRS §105(h) "grace period" to bring discriminatory structure into compliance

Multiple Employer Welfare Arrangements (MEWA)

Beware of the inadvertent creation of a MEWA. Whenever two organizations offer coverage under one health plan, Code §414 controlled group status must be considered.

- Do the combined entities constitute a controlled group? If not, a MEWA has been formed if employees are covered under a single health plan.
- Covering "non-employees" (e.g., directors, independent contractors, etc.) under a plan can create a MEWA.
- Why does this matter?
  - A MEWA must file a form M-1 with the DOL.
  - Fully insured plans – Carrier group contract may not permit MEWA coverage.
  - Self-insured plans – Many states prohibit, or have very restrictive rules related to, the offering of a self-insured MEWA.

Summary

Health and Welfare benefits are just one of many important matters employers must consider when involved in a Merger or Acquisition. Unfortunately, the financial advisors engaged by the employer to assist in the transaction are not always experts in health and welfare employee benefits. Employers should always turn to a qualified employee benefits specialist to help make sure these important issues are addressed correctly.