Pensions Management Institute

International 2
Managing International Employee Benefits

Assignment 4 Notes

(Part 7 – Mergers and acquisitions)
(Part 8 – Future employee benefit trends)

Recommended Time: 3 hours

1. Explain how a company might place a value on a transferring defined benefit pension scheme.

10 marks

A company might adopt the following approach:

- Split the liabilities of the defined benefit plan between those that have accumulated for service prior to
- closing ("past service liabilities") and those which will accrue after closing
- For the past service liabilities, determine an actuarial value for the liabilities. IFRS or US GAAP is a likely measure for how these liabilities will be valued
- Compare the actuarial value of the liabilities with the market value of assets that will transfer as part of the transaction
- If there is any shortfall, this is a "debt"
- Assess any deferred tax credit that might apply to this debt (such a tax credit will exist if the company can receive a tax deduction for contributions required to finance the identified debt)
- The net debt (i.e. debt less tax credit) would be taken off the purchase price for the business

2. Identify the key stages of the merger and acquisition process.

10 marks

Answer should include:

a) An initial courting phase after which the buyer and seller decide whether to proceed with more detailed discussions. A heads of terms sheet, or similar document, setting out the key areas of understanding between the parties is often agreed at this stage.
b) Due diligence. During this phase, a potential buyer can review the seller's business and to form an opinion of the expected income from the business as well as the associated costs and risks.
c) Contract negotiations and signing of the sale and purchase agreement, and any other related agreements (e.g. transitional services agreements).
d) Closing the transaction (i.e. the time of the actual transfer of the business from seller to buyer). This generally occurs within several months after signing, but can be delayed further if, for example, the competent competition authorities require time to assess whether the transaction can go ahead in its envisaged form.

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3. **Explain what is meant by due diligence.**

5 marks

Due diligence is the process of investigating the target company's business to gain a full understanding of the operation of the business, the revenue and costs associated with the business and the risks being borne by the business. The scope of due diligence of employee benefits needs to be well defined. Often "pensions" due diligence is understood to encompass all long-term employee benefits including not just pension plans but also long service awards (e.g., 'jubilee payments), retiree medical plans, termination indemnities, early retirement plans, death and disability plans.

4. **Explain the difference between a representation, a warranty and an indemnity.**

10 marks

Answer should include:

- A representation is a statement presented as fact by the buyer or seller.
- A warranty is a statement under which the buyer or seller promises that a statement is true or that a specific action will be made.
- An indemnity provides specific protection to the buyer or seller in respect of a specific action or risk
- Minimum and maximum claim amounts under the warranty and indemnity clauses may be defined.

Generally, an indemnity provides a greater level of protection than a warranty.

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5. Explain how an employee benefits professional can contribute to a due diligence process.

15 marks

Answer should include:

- A benefits professional can contribute to the due diligence process by using his/her expertise to:
- Review plan documents in the data room (note some may be in foreign language and therefore outside consultancy support might be required) to understand what benefit programs are currently offered
- Understand the implications of the transaction on the benefit programs (ie will target employees be able to continue to participate or will alternative arrangements be required) and any additional potential liabilities that might arise
- When reviewing documentation ensure that, as far as has been disclosed, that the plans are compliant with local legal and regulatory requirements
- Identify any pending disputes
- Compare the benefit programs operated by the target with those offered by the Purchaser and identify potential integration issues
- Identify the accumulated liabilities (and any assets) associated with benefit plans operated by the target and make recommendations on how the Purchaser might be compensated for any shortfall
- Identify the future accounting costs of the benefit programs and ensure adequate allowance is made for these within the profit and loss accounts of the target company
- Identify future cash requirements associated with the benefit programs
- Identify risks associated with benefit programs operated by the target
- Identify the impact of the Purchaser's accounting treatment on the target's plans
- Identify if ongoing support from the Seller will be required

6. Describe some of the actions that a Purchaser must take after a merger and acquisition deal to acquire a target company has been signed.

20 marks

Answer should include:

There are two important periods to consider:

- The period between signing and completion
- The period after completion

The period between signing and completion can often be an extended one particularly if competition authorities are required to study the transaction prior to granting clearance. It should be noted that during this period, the Buyer may have limited access to the Seller and the potential transferring employees. This can hamper some of the required activities and will necessitate careful planning with the Seller to ensure that all the required steps have been completed prior to completion. Some of the activities that companies should undertake are:

1. Prepare for the transfer of employees – this might happen automatically if there is a share deal or for example in Europe, if their work is exclusively related to the business being sold. However, in many cases the employee's agreement will be required to transfer. Any change will require careful planning and delicate communication with the affected employees
2. Prepare for plan carve outs. If employees will need to be transferred out of a benefit plan because of a transaction, then the buyer will need to decide whether they can be included in an existing buyer plan or will need to have a new replacement plan. This will require careful communication with the affected employees.
3. Establishment of new plans. In the case that the transferring employees cannot participate in their existing plans post completion, it will be necessary to establish new plans for the transferring employees or agree which Purchaser plans they will participate in.
4. Establishing continuation of insurance cover. Insurance cover may be provided under an insurance policy that includes more than the transferring population. It will be important for the Purchaser to ensure that adequate cover is established and is effective from the day of completion so that there are no gaps in insurance cover
5. Communication. Some communication with the transferring employees will be possible (even if this is to be led by the Seller). However, an important activity in the period prior to completion will be to plan for the communications that will take place immediately after completion – when the Purchaser will be able to take full responsibility for dealing with its employees.

The activities taking place after completion will depend on the type of transaction and the level of integration that will normally occur. However, some of the activities will include:

1. Enrolment of employees in replacement plans
2. Harmonisation of employee benefit plans, post-acquisition. This will entail comparing target company plans with those offered by the purchaser and looking to harmonise programmes to obtain the maximum efficiency possible. It will be important that any comparison will be done by reference to total compensation and not simply isolating benefits alone.

7. **List some of the current "hot topics" that are influencing the employee benefit arena and explain how the economic shift to Asia might impact on a multinational company's approach towards managing employee benefits in the region.**

20 marks

Answer should include:

- People living longer
- The desire to reduce defined benefit pension risk
- The changing nature of State pension provision
- Expansion into new territories
- Increased mobility
- Global financial crisis
- Changes in Accounting Standards
- EU Pensions Directive
- US legislation in healthcare

The increasing economic strength of China and India and the emergence of several Asian economies means many companies are turning their attention to these rapidly expanding markets. This means companies are:

- Establishing operations in some of these markets
- Creating regional headquarters to oversee their operations in the region

This shift might impact a multinational company's view on employee benefit policy as follows:

a. A need to be more diversified in the policy to cover different practices specific to the Asian region
b. Employee benefits may be less important in some of these markets and consequently the employee benefit policy needs to reflect this (and needs to reflect the increasing importance of other elements of the package)
c. Whether the company should establish a regional policy instead of a global policy?
d. A need to ensure that the basic governance requirements are still undertaken. It will be important for the company to establish how this can be done given the more limited resources available in these emerging markets

8. **Describe what best practice towards defined contribution schemes might include.**

10 marks

Answer should include:

Best practice would consist of developing a yearly calendar of activities and some of these might include:

- Supporting the investment monitoring of investment providers to ensure the fund choice available remains appropriate
- Monitoring investment choices made by employees to ensure that broadly appropriate decisions are being taken
- Maintaining regular and informative communications with participants
- Ensuring the providers supporting the scheme continue to meet their obligations.
- Ensuring the governance committee of the plan undertakes its role appropriately