

“Help! I Need Somebody To Tell Me What To Do With This 401(k) Plan!”

May 13, 2025

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In stock acquisitions and mergers, it is not uncommon for both the target company and the buyer to sponsor 401(k) plans, which requires the buyer to decide prior to closing whether to terminate the target’s plan, continue it, or merge it into the buyer’s plan. In this situation, to paraphrase the Beatles, buyers need somebody, and not just anybody to help with this decision process. While corporate counsel is always engaged to assist with corporate transactions, the parties may not initially think of getting benefits counsel involved. However, because the options of what to do with a target’s 401(k) plan are much more limited after the transaction closes, it is advisable to get benefits counsel involved early to help them navigate the following considerations:

- Even the most “plain vanilla” 401(k) plans can create liabilities for buyers, and while some issues can be identified through due diligence, it is often difficult, if not impossible, to discover and assess every existing plan operational failure through the due diligence process. For that reason, many buyers will require the target to terminate their 401(k) plans at least one business day prior to the closing date of the transaction, contingent on the closing actually occurring. Terminating a target’s 401(k) plan pre-closing is generally the best way to limit any liabilities arising from the target plan’s operations and documents and to ensure that any problems with the target’s plan does not “taint” the buyer’s plan.
- If a target’s 401(k) plan is terminated pre-closing, it will cause all the plan benefits to become fully-vested and entitle plan participants to receive a distribution of their accounts. After the target plan’s participants receive a distribution of their accounts, they can elect to roll the accounts over into the buyer’s 401(k) plan. Depending on the terms of both the buyer’s and target’s plans, the target plan’s participants may also be able to rollover any outstanding loan balances, but this generally takes some advance planning and coordination, which is another reason why getting benefits counsel involved early can be beneficial. A buyer may not want to accelerate vesting for participants or for participants to have an option to receive a distribution, which would weigh in favor of continuing the target’s plan post-closing.
- If a plan is not terminated pre-closing, the buyer will either have to maintain the target’s plan separately after closing or else merge the target’s plan with the buyer’s plan after closing. Maintaining the target’s plan post-closing could eventually cause coverage and testing issues if the buyer maintains a separate plan. Merging the target’s plan requires a protected benefits analysis to ensure that any protected benefits under the target’s plan are maintained in the buyer’s plan. This could cause the buyer’s plan to be more complicated to administer and maintain. Furthermore, when plans are merged, the surviving plan sponsor becomes responsible for operational errors that occurred under the target’s plan even before it was merged into buyer’s plan; in other words, existing errors under the target’s plan could taint the buyer’s plan. Many buyers are not willing to accept this risk.

The foregoing are just a few of the many considerations that go into deciding what to do with a potential target’s retirement plan, and there may be circumstances in which terminating the target’s plan is not feasible or possible. In those circumstances, benefits counsel can help buyers understand what options are available and the implications of the various options. Benefits counsel

can also help limit exposure to the buyer and its plan and, to the extent possible, avoid gaps in 401(k) plan coverage for the acquired employees and other unintended consequences. Buyers will undoubtedly appreciate having benefits counsel 'round to help!