## The Pension Implications of Company Takeovers and Mergers

### Thursday 17th June (late morning)

### Chairman: Keith Whitehead (UK)
### Opener: David Solomon (Australia)
### Closer: Mary Hardiman Adams (USA)

## Papers for discussion:

**R. Chapman & R. Jagelman (UK):**
"Company acquisitions in the UK — how important are pensions?"

**A. F. M. Jungman (Netherlands):**
"The valuation of pension benefits in cases of mergers within and across borders."

**H. T. Mitchley (South Africa):**
"Pension Fund aspects of mergers and takeovers in South Africa."

## Summary of Discussion

Mr. David Solomon (Australia) opened the discussion by summarizing the highlights of the three papers submitted. He noted that all the papers stressed the need for early actuarial involvement in takeovers and mergers, and he compared the technical points made by each author.

The open discussion of this topic, in which a dozen attendees participated, essentially revolved about the role and the responsibilities of the actuary in a merger situation. The two main points brought forth, about which there was no disagreement were:

the greatest protection in a merger is to have a well funded plan

it is of greatest advantage to those who are contemplating a merger to have the actuary involved as early as possible in the negotiations . . . agreement with the papers' authors.

The dual obligation of the actuary to the employees and to the client who hires the actuary was discussed.

With respect to the obligation of the actuary to the employees, whether as in the UK where the actuary is advising the trustees whose duties are to the members and potential beneficiaries, or in the US where there is the actuary's obligation to the employees under ERISA, the concensus was that the actuary's own personal professional integrity would make him want to do the correct thing by providing fair allocations to employees in a takeover or merger situation.

As a technical matter, in looking at benefits to the employees, various methods of assigning benefits were noted. One method is to prepare an asset allocation, and vest the employees in his allocated share; alternatively the employee's accrued benefit, computed on an historical basis (i.e. using actual past salaries) or on a projected basis (salary scale used prospectively) could be used. With respect to vesting, and in response to concern about possible unscrupulous buyers, it was noted that some employers 100% vest all of the employees who are in a location being purchased. Then, in the event of a subsequent redundancy there is no question the employees benefits are at least what they had earned up to the date of acquisition. There is also the situation where the selling employer keeps the liability for past service benefits, with the purchaser simply providing future service benefits.

There were several areas noted where the actuary's duties to the employer — whether it be the buyer or the seller — are of an essential nature:

1. Numbers; their implication.
2. Legal requirements with respect to the benefits rights of the employees.
3. Advice as to good practice and usual practice.
4. Clear technical language.

Thus, it appears, one of the consulting actuary's best contributions, whether negotiating a purchase price, or allocating employee assets, is to make sure that the liability and benefit amounts involved, what the transaction is, are clearly stated. An objective is to ascertain that everyone is aware of what obligations fall on whose shoulders, and what the implications of these obligations are on the overall financial viability of the employer.

While the main discussion centered about funded pension plans, the question of the treatment of post retirement fringe benefit (life, medical insurance) plans in a merger or acquisition situation was brought up. In the US, these plans are generally not prefunded, and there is generally no legal documents promising lifetime post-retirement coverage, but the liability is there — the employees expect the benefits. The more sophisticated buyers and sellers are now looking at these . . . and now, in the US the accountants are looking into requiring certain levels of book reserves. Thus, while we can still expect not to have prefunding, the book reserves would exist. The question of unfunded pensions paid under a contract or other informal arrangement was also brought up, with the reserving situation not unlike that indicated above for fringe benefit plans.

As an overview, there were serious concerns expressed about the actuary doing the right thing, and about the actuary's reaction if he perceives a potentially unscrupulous situation in a purchase or merger (e.g. employees will become redundant immediately and be denied rights or the perception of poor advice). There was a suggestion for setting standards among the international community. But, the final thought was that we want ourselves to do the best possible for our clients and for their employees; and we expect this, also, of our fellow actuaries.

## Summary of Individuals' Comments

### (Canada)

noted the two different situations of acquisitions: The first is the purchase of stock; employees have not changed their employment. In the second, the company's assets are purchased; employees change employment. In Canada, it is now quite well recognized that in these takeovers, the new employer must recognize all service both for qualifications and for amounts of benefits. Plan termination is possible in lean situations, with some protections to the employees. The greatest protection is to have a well funded plan (including rapid liquidation of liabilities . . . past service, 15 years; deficits; 5 years).

### (US)

noted the balance sheet of the purchaser in the first situation above, must show any unfunded vested liability. He indicated, in a situation where assets do not cover liabilities, it may be advantageous to redo the *pro forma* financial statements to eliminate entries relating to amortizing pension past service. He noted the US pension termination insurance and the serious situation arising because, in certain instances, companies have shifted their pension obligation to the Pension Benefit Guaranty Corporation. He mentioned post retirement death and medical benefits and their reserving situation.

### (US)

noted that when an unfunded liability is put on a buyer's balance sheet, a goodwill item of equal amount is shown as an asset. The net bottom line effect is zero; but the amounts do have to be shown.

**(UK)**

brought up the situation of an unfunded pension which may or may not be contractual. He cautioned that in a merger or acquisition, this can be a matter that is not very obvious, and care should be taken not to overlook it.

**(UK)**

described two recent takeovers and the attitudes of the buyers and sellers along with the effect on attitude towards employees when the actuary was brought in at an early stage. He also pointed out that the UK actuary has two tasks; he is advising the client employer on a business deal and he is advising the trustees whose duties are to the employees.

**(UK)**

described a current situation where a purchasing company has no pension plan. Upon an acquisition, the acquired company's pension assets exceeded the value of vested benefits. The purchaser is considering discontinuing the plan and will reap the rewards of the excess past funding. (The vendor should have had advice on what would happen if the plan continues, and on making sure value is received for the assets transferred.)

**(US)**

commented on the valuation of pension schemes where regulated business such as an insurance carrier, bank or holding company is involved.

**(Canada)**

noted that mergers and acquisitions take place for business reasons, and the actuary should be objective in advising about the liabilities, risks and opportunities when dealing with the pension plan.

**(Australia)**

agreed with the previous speaker about objectivity, but indicated that it is important to have very clear, not misleading documentation. He felt that a standard or code of practice, to operate internationally, would be most useful and would serve to help eliminate confusion as to terms and general principles.

**(UK)**

first spoke of the role of the actuary in not only advising clients about rights and entitlements, but about good practice. This would include in the case of a vendor assurance that employees future benefits would not be diminished. He then discussed three recent cases where the final approach to settlement was different in each case. He indicated he would like to see as a standard that there is a fair share of the fund for all employees; plus a warranty from the vendor to make up any shortfall needed for a final salary basis.

**(UK)**

noted the moral dilemma of the situation when in a merger negotiation, the other side is not getting proper information or is not asking the right information.

**(UK)**

discussed the question of employees' redundancy as compared to winding up a fund, or disposition of a no longer viable facility. The whole comparison is then, as indicated earlier, the background for a business decision.

**(UK)**

further amplified the recognition of possible high expenses of redundancy payments as compared to assuring pension continuation and noted the moral obligation to the employees concerned.

**Mary Adams (US)**

closed the session by summarizing the highlights of the discussants comments.