The Nuts and Bolts of Merging Health Plans

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Overview

1. Impetus to merge
2. Fiduciary issues
3. Prohibited transactions
4. Feasibility studies
5. Due diligence
6. Notice requirements
7. Merger agreement
8. Transition issues
Mergers

Two or more multiemployer plans join to create one single ongoing plan

- Often in a similar industry or geographic region
- Often with employers that contribute to both merging plans
Merger Considerations

- Positives and negatives
- Actuarial considerations
- Fiduciary concerns
- Plan provisions
- Decision-making control post-merger
Impetus to Merge

• Political considerations
  – Supporting a plan that may be at risk on its own
  – Mergers of local unions

• Financial reasons
  – Administrative expenses
  – Investment diversification opportunities
  – Contribution base diversification
Merger Pitfalls

• Potentially less local control
  – Trustees may have less influence over future direction of plan
    • Choice of professionals
    • Funding and benefits
• Exposure to risk from the other plan(s)
• One plan subsidizing the other
Fiduciary Concerns

- Settlor vs. fiduciary function
  - Payment of merger expenses
  - Fiduciary liability
- Authority to merge plans
- Potential exposure if acting as fiduciary
Settlor v. Fiduciary Function

• Lack of guidance in health plan mergers
  – Numerous rules and regulations that apply to mergers of multiemployer pension plans
  – PBGC preapproval process for pension plan mergers which insulates trustees

• Mergers between multiemployer health plans are not subject to any federal regulations other than ERI SA’s fiduciary rules
Settlor v. Fiduciary

- **ERISA Sec. 3(21)(A)**
  - A person is a fiduciary only “to the extent” the person is performing a fiduciary function

- **Curtis-Wright Corp. v. Schoonejargon, 514 U.S. 73 (1995)**
  - A plan sponsor, even though it may act as a fiduciary when it is administering its welfare benefit plan, is not engaged in plan administration and, thus, is not acting in a fiduciary capacity when it decides to create, amend, or terminate such a plan

- **Beck v. Pace, 127 S. Ct. 2310 (2007)**
  - Employer’s refusal to merge was a settlor function, immune from fiduciary considerations of ERISA
The most common settlor functions are “design” decisions regarding:

- The establishment of a plan
- Which employees are covered
- The benefits to be provided
- Plan amendment, mergers or termination
What Is the Significance of Being a Fiduciary?

- *Donovan v. Bierwirth*, 680 F.2d 263 (2nd Cir. 1982)
  - The fiduciary’s duties imposed under ERISA are the **highest known to law**
- Three different, yet overlapping, standards:
  - Act solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them (the “Duty of Loyalty”)
  - Carry out duties in a prudent manner (the “Duty to Act Prudently”)
  - Follow the plan documents (unless inconsistent with ERISA)
Relevance of Status

- Plan assets may not be used to facilitate settlor functions
- Participants have no standing to sue plan sponsor for settlor decisions
- Insurance considerations
Merger as Both a Settlor and Fiduciary Function

- Two stages to merger
  1. Initial decision to merge the funds
  2. Process of implementing that decision
- Decision to merge is commonly made by bargaining parties and reflected in CBA
  - Typically a settlor function
  - Amendment of trust agreement to grant trustees the authority to merge plans
- Implementation of merger is fiduciary function
  - Must comply with duties to act prudently, for the exclusive benefit of participants and in accordance with plan documents
Fiduciary Considerations

• Is the merger in the best interest of both plans?
• How will the merger affect participants?
• Will one plan’s participants be subsidizing the benefits of another group?
• What is “fair” for plans with different contributions or benefits?
• What is the potential for a negative outcome?
Close Scrutiny

- When the same party is both a settlor and a fiduciary, courts will closely scrutinize the action being taken.

- Trustees must be prepared to:
  - Defend the rationale for the merger (as benefiting participants over time), and
  - Show that proper due diligence was conducted, supporting the “economics” of the transaction (that no material funding problem will result).
Prohibited Transactions

• ERISA prohibits any transaction
  – Between a plan and a party in interest, or
  – If the plans have common trustees
• Difficult to determine if a plan is a party in interest to another plan
  – Common trustees, same administrator, same sponsoring employers or unions, same industry
  – One fund provides services to the other (i.e., administrative services, leasing office space, etc.)
  – Relationship should be reviewed by plan counsel
• Self-dealing rules create an issue where there are common trustees
  – No exception for health plan mergers
  – Strategies for dealing with this issue
Creating Checklist and Timeline

- Trustees must have realistic expectations regarding timeline for merger
- Disclosure of PHI between plans pre-merger
- Attorney-client privilege issues
- Checklist
  - Feasibility study
  - Due diligence
  - Merger agreement
  - Plan documents for merged plan
  - Notices
  - Transition Issues
Feasibility Studies

- Looks at all points of consideration to evaluate what the impact of a merger will be
- How do the plans compare on the basis of similar actuarial assumptions
- Red flags with either plan
- Potential expense savings
- Post-merger control issues
Due Diligence

• Trustees should verify completion of all recommended due diligence items and status of outstanding items prior to the closing date
• Trustees should ensure that due diligence process is properly documented
• Due diligence should be completed consistent with the general fiduciary requirements of prudence, exclusive benefit and adherence to the plan documents
• Should involve all key plan professionals including administrative staff, attorneys, consultants and accountants
Due Diligence Review

• Documents to be reviewed include:
  – Copies of the most recent plan document/summary plan description and all amendments/summaries of material modifications (including effective dates)
  – Copy of agreement and declaration of trust and all amendments
  – Copies of the minutes of the meetings of the board of trustees, committees and subcommittees (held within the past three years)

• Should review plan documents/minutes for:
  – reservation of the right to terminate or amend the plan
  – Compliance with applicable laws (i.e., ERISA, ACA, COBRA, HIPAA, etc.)
Due Diligence
Documents to be Reviewed
(continued)

• Administrative/governance policies
  – Trustee expense reimbursement policies, employer contribution, audit, delinquency and collection policies, investment policy, record retention policy, arbitration policies, QDRO and QMCSO policies and HIPAA policies

• Participant forms and communications
  – All participant/beneficiary forms and notices, explanations of benefits, benefit/claim applications, enrollment, special enrollment rights, HIPAA, COBRA, and ACA notices (including but not limited to all ACA-required Summaries of Benefits and Coverage)
Due Diligence
Documents to be Reviewed
(continued)

• Insurance contracts and/or policies, including fiduciary liability insurance, fidelity bonds, EPLI, and D&O insurance
• A list of all accounts payable to the plans
• A list of all vendor contracts and BAAs
Due Diligence
Documents to be Reviewed
(continued)

- Form 5500 and audited financial statements
- All IRS or tax exemption letters
- Any tax opinion letters or governmental opinions or determinations
- IRS Forms 990
- All other material government filings
Due Diligence
Documents to be Reviewed

(continued)

• Any current agreement, policy or procedures describing the allocation of the costs of plan administration between the merging health plans and a pension plan or any other entity
• Reciprocity agreements
• Copy of any lease or rental agreements
• Employee handbook/manual or personnel policies
• Copy of any employment contracts or collective bargaining agreement with any employee or employees of the plans
Due Diligence
Documents to be Reviewed

(continued)

• Most recent HIPAA Privacy and Security Risk Assessments
• HIPAA Privacy and Security Policies and Procedures Manuals
• List of entities, business associates, institutions and/or insurance carriers with which the plan is trading critical plan information which includes ePHI
• A description of how ePHI is traded with each entity
• List and description of any HIPAA HITECH breaches for which notification to individuals or the government was required within the last five (5) years
Due Diligence
Documents to be Reviewed
(continued)

• Investment policy
• Actuarial reports
• Investment consultant reports
• Most recent net cash flow projections
• List of banks and accounts
Due Diligence Items
Potential Red Flags

- Governmental audits or investigations that are pending or were resolved within the last five (5) years
- A summary of all current and resolved litigation, arbitrations, lawsuits, actions, proceedings or claims that have been initiated by or against the plans and/or its trustees within the last five (5) years and information regarding any threatened litigation
- A description of any claims to fiduciary liability insurance, cyber insurance carrier or fidelity bond carriers
Sources of Liability

It is important to look out for major sources of liability that may effect the merged plan, such as:

• Inaccurate/untimely filed Form 5500
• Outstanding lawsuits
• Regulatory examinations or audits
• Excessive outstanding claims
Notice Requirements

• No statutory requirement to provide advance notice of merger

• Nevertheless, certain notices should be provided
  – Advance Notice to Affected Parties
  – Summary of Material Modifications
  – Notice to Affected Vendors
  – Notice to Insurers
Advance Notice to Affected Participants

• Notice should be provided to participants, beneficiaries, contributing employers, and any affected unions

• Notices should contain:
  ✓ Description of the benefit changes
  ✓ Closing date of the merger
  ✓ Enrollment deadlines for participants and beneficiaries
  ✓ Any changes regarding plan contributions to contributing employers

• Timing of notices
Summary of Benefits and Coverage

• Summary of Benefits and Coverage (SBC) Rule
  – Trustees must notify plan participants if there is a material modification to their benefits during the plan year

• Material modification defined as:
  – An enhancement of covered benefits, services or other, more general, plan or policy terms
  – A “material reduction in covered services or benefits,” including:
    • Changes or modifications that reduce or eliminate benefits
    • Increases in cost-sharing
Summary of Benefits and Coverage (continued)

- **Timing**
  - At least 60 days prior to the effective date of the change
  - If the change will be effective at the beginning of the following year the notice can be included as part of the regular SBC filing 30 days prior to the beginning of the plan year

- **Penalty**
  - Plan issuers or sponsors that intentionally fail to provide the notice are subject to a fine of up to $1,000 for each failure
  - Each covered individual equates to a separate offense
Notice to Vendors

- Review all vendor contracts to determine:
  - Method of terminating or transferring contract
  - Penalties for early termination
  - Notice requirements

- Plan vendors should be notified of the merger and informed as to whether they will continue providing services to the merged plan as soon as possible following decision to merge
Merger Agreement

- Integral to the establishment of the merged fund
- Serves as an amendment to the plans to satisfy the requirement that the fiduciaries follow the terms of the plan document
- Should be reviewed by trustees, attorneys and consultants to ensure that all issues are accurately and adequately addressed in the agreement
Contents of a Merger Agreement

The merger agreement should include all of the material terms of the merger including:

- The effective date
- The closing date
- The amount of assets to be transferred
- Any representations and warranties made between the funds
- A summary of the new benefit structure
Contents of Merger Agreement (continued)

• Procedure for appointing trustees to the merged fund
• Indemnification provisions for the trustees of the non-surviving fund(s)
• Description of fiduciary liability insurance for trustees of the merged fund and the non-surviving fund(s)
Contents of Merger Agreement

(continued)

• Administrative and transition issues
• Triggers for benefit modifications (if any)
• Any conditions such as:
  – Approval of trust agreement and/or SPD
  – Completion of due diligence
  – Agreement on consultants, executive staff, location of merged plan offices, etc.
Transition Issues

The following administrative and operational issues need to be addressed:

• Who will handle day to day administration and claims administration for the merged plan?
• What will happen to the staff of the non-surviving fund?
• If one or both funds use a TPA, which TPA will administer the merged fund, or does self-administration make sense?
• How will documents and records be transferred, and where will they be stored?
• How will claims run-out be handled?
  – High-dollar claims, out-of-network claims
• How will operations be effectively merged?
  – Property
  – People
  – Process
  – Technology/software
Transition Issues (continued)

- How will employer contributions be transitioned from the funds to the merged fund?
- Will the merger impact current methods for allocating contributions between related funds (pension plans, annuity plans etc.)?
- Insurance considerations
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- Potential advantages of merger
  - Administrative cost savings
  - Diversification of contribution base
  - Merged plan may offer more robust benefits
- Potential disadvantages of merger
  - Potential lawsuits/fiduciary liability
  - Trustees have less control
  - Exposure to risk from other plan
- Fiduciary v. settlor functions
- Importance of feasibility study
- Importance of due diligence
- Properly document all of the terms of the merger within the merger agreement
- Don’t forget to consider the numerous transitional issues involved in a merger and that a merger takes time (don’t rush it)!
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