Rhodes-Joseph & Tobiason Advisors, LLC

Leaving the Mothership

Employee Benefits for Spin-Offs

When acquiring a spin-off from a corporate parent, benefits are key to post closing success and minimizing employee disruption. Employee benefits represent significant costs for middle market companies but are critical to attracting and retaining a talented and productive workforce.

Both strategic and financial buyers need to distinguish corporate "Mothership" spin-offs from purchase of a stand-alone company. Successful transition of employee benefits in spin-offs presents unique challenges. In a spin-off, you're buying a business unit or subsidiary which was part of a larger group and the new entity either will now be standing on its own or integrated into other businesses of the acquirer.

This Briefing Paper focuses on the benefits issues confronted when the target spin-off leaves a large corporate parent to become a stand-alone company owned by a financial buyer. Strategic buyers will face many of these same concerns if the target is not immediately integrated into a broad based corporate benefits program.

Employee Benefits in a Spin-off: Don't Underestimate the Complexity and Opportunity

Before the acquisition, your new company was likely well supported as part of a much bigger organization. Frequently the target has limited expertise in employee benefits design, vendor management and cost control. The spun-off business looked to its parent company for plan design, for support from financial and IT systems, for benefits finance, accounting and audit, for vendor contracting, for employee communications, for compliance resources and for processes to satisfy fiduciary and governance rules.

Most often the benefit plans that the parent offered prior to the spin-off are not stand alone plans, but rather part of a comprehensive corporate program. These are typically corporate designed and administered and the necessary expertise resides at the headquarters level.

When a company or business unit is spun-off, the new company is left without the support of a Mothership. Going forward, the spin-off will have to create its own benefits expertise and develop functionality in design, financing, contracting, administration and governance to provide benefits plans for its employees.

Employees Watch Anxiously as the Mothership Departs

In any transaction employees have major questions about their jobs and their benefits. They want to know if they will still have work and paychecks. They want to be sure they and their families will be able to get healthcare and prescription drugs on Day One. They want to know that retirement benefits earned before the spin-off are secure.

What Should You Do If the New Company's Benefits Will Stand Alone?

Act quickly, leveraging your comprehensive employee benefits due diligence. It's critical to identify capabilities, ongoing requirements and needed expertise early on. The new company will need to put in place benefits expertise, through a combined internal and external team, to tactically and strategically manage its own program to ensure that the new benefits program supports the spin-off's business goals. This is true both for transition arrangements and for strategic program design and management going forward.

Continue the Existing Plans for a Transition Period?

One option is to continue existing plans through "shared services" for a short period following the transaction. For some benefits plans, there may be an opportunity to work with the Seller to utilize shared services for a transition period so that there is no interruption in benefits coverage. New benefits plans can be established during this transition period giving the spin-off time to design and implement its new program. Post transaction administration disruption is minimal for employees.

For the transition and going forward, focus on these key areas

- Developing short term and long term benefits strategies
- Plan design and financing
  - Cloning benefits or establishing new plans
  - Rate setting and funding arrangements for new workforce demographics
- Building a benefits team
- Choosing and managing vendors and advisors
- Administration, including government required filings
  - Payroll interfaces
- Employee and management communication
- Special transition needs
  - 401(k) plan account transfers/rollovers
  - Defined Benefit (DB) pension plan status and administration
- Governance
  - Plan committees

Shared service arrangements can help with transition for many health and welfare plans. For insured plans, the broker and the insurance company may be able to duplicate the plans and employees can stay on the current plan without interrupting coverage. For self-insured health plans (which are common in larger organizations), the Seller will want the new owners to be responsible for the actual claims and expenses for the transferred employees. A word of caution: When making these decisions for your new entity, recognize that local claims experience data is often unavailable and, therefore, self insured costs can be an unknown exposure.

Some types of employee benefits programs do not cover the spin-off's employees during a transition. Retirement programs risk becoming "multiple employer" plans if they cover employees who are no longer part of the controlled group. New retirement plans will need to be adopted to be effective on Day One, or there may have to be a "gap" period after the closing without retirement plan coverage.

Even though shared services arrangements can provide a transition period for some plans, it's very important to get all the new plans in place as soon as possible. Extended transition periods leave employees still looking to the former parent company for key benefits at a time when their focus should be on their new, stand-alone company identity.

Your New Benefits Program

While it's important to take into account the benefits program in place prior to the acquisition, you have a unique opportunity to, in effect, start over.

The benefits program in place prior to your acquisition may not be appropriate for the new company. Plans that served the Seller well may or may not be suitable for the spin-off for a variety of reasons, including industry type, cost structure, geographic location, size of company and competitive comparisons. Funding arrangements designed for large companies may not be right for the new entity.

Your new company's profile impacts the program you will offer to employees, your plan designs and funding arrangements and your choice of supporting vendors and services.

So start with a blank sheet. Don't miss out on this opportunity to create an updated, more cost-effective program that's better suited to the company and its employees.

You will want to look at more streamlined and cost effective programs and processes. For example, the Seller may have been able to offer a higher level of company financial support for benefits plans than is feasible for your new stand-alone company. This could be a good time to introduce a full suite of voluntary benefits which help attract and retain employees without direct cost to the employer.

Vendors and advisors that were appropriate to the Seller's program may or may not be a "fit" for the new company. Larger companies often deal directly with product and service providers and can leverage economic advantages due to the size of their workforce. Smaller companies usually don't deal directly with major product and service providers; they use the services of brokers and financial advisors to help them create and manage their benefits programs.

Your Action Plan

Vendor management is critical. Building on diligence data, develop a comprehensive list of all plans and product and service providers. Contact the product and service providers and brokers where applicable.

- ✓ The Seller will be able to put you in contact with the company's current product and service providers and brokers, often early in the discussions on a confidential basis.

Identify funding and financing arrangements for each of the plans, including transition arrangements.

- ✓ You'll need to have new contracts, agreements and funding arrangements in place as soon as possible.
- ✓ Identify new vendors that may be needed to support stand-alone benefits plans.

Establish the benefits function for the new company. You'll want to form your new benefits management team, identifying or recruiting internal expertise and installing administrative support systems needed after the acquisition.

- ✓ Develop a timeline for implementing your new benefits program. Starting Day One, you need to be ready to offer a benefits program to all your employees – both those who transitioned and new hires.

At the same time, you'll be transitioning, and then designing and implementing, your compensation, other HR programs and payroll and administrative systems. It's vital to coordinate the resources, goals and communications for all these critical areas.

- ✓ Your HRIS/payroll interface must be in place for benefits deductions, eligibility and bill processing.

Design your strategic plan for the new benefits program – Be sure that the benefits are the right ones to support your business goals.

- ✓ A strategic plan is critical to set out future milestones, helping you chart your new program.

Communicate often – Frequent and clear communication throughout the process will ease employee concerns and allow them to focus on the business.

- ✓ Keep employees informed of the process you're following; your goals and what remains the same and what's changing. Make sure the employees have timely information so that they can effectively make decisions as they enroll in new programs.

Conclusion

There's a great deal of uncertainty for employees in any transaction. They're focused on future job opportunities and the new ownership and management are unknown. And they're very concerned about their benefits.

And in a spin-off, employees are leaving the Seller's benefits program; there are heightened concerns and unique challenges in addressing those concerns.

Benefits should not become the source of anxiety for employees. Instead, benefits can be a key unifying employee relations tool during a time of very significant corporate change.

Don't miss this unique opportunity to communicate the value of your benefits program so that it's not taken for granted – you're not just continuing what was in place before. Benefits meet important life needs of employees. Effectively communicating a well designed and well administered program can transform this time of uncertainty and stress for the workforce into an opportunity to affirm the employee focus of your new company as it bids farewell to the Mothership.

First Year Timetable to Develop The Spin-Off's Own Benefits Program

Pre-Closing – Transition Planning

- Develop benefits inventory and phone/email contact with product and service providers
    - Put in place transition arrangements for the short term
    - Continue plans with current parent company where feasible
    - Work with 401(K) providers and other vendors where new plans are required; mirror the parent company's plans or develop new designs
    - Determine future of any Defined Benefit (DB) pension plans
- Communicate

Day One – Easing Employee Concerns

- Medical and Rx plans in place – Employees can obtain medical services and prescription drugs
- Communicate

First months – Managing the Program Strategically

- Face to face meetings with product and service providers
- Form internal team
- Start Strategic Plan process
- Review governance processes and procedures
- Communicate

One Year from Closing Date – Implement Strategic Plan for Employee Benefits

- Transition Complete
    - First annual enrollment completed for new benefits program
    - Update Strategic Plan and schedule next implementation actions
- Communicate

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Quick Reference Guide - A Managing Benefits Checklist™

	If you're buying a stand alone company	If you're carving out a corporate spin-off
Design	Current design can remain in place until strategic review completed and map for the future developed	New plans must be implemented quickly, with limited time for strategic analysis and forward planning
Administration	Administrative processes are in place and can continue	New interfaces and other administrative processes must be established; shared services can provide short term transition support
Internal Team	An internal team has been designing and administering the benefits program and remains in place	A new benefits team has to be established which recognizes that many different functions impact employee benefits – HR, Finance, Legal, Tax, Payroll and Public Relations
Funding	Current funding and financing for each plan should be reviewed for consolidation opportunities	New funding and financing arrangements must be established for each plan including special transition arrangements
External Product and Service Providers	Current product and service providers and agreements can remain in place	Existing vendors may agree to work with the new entity, and vendor agreements can be duplicated. However, larger corporations often deal directly with product and service providers within a "national accounts" structure. The new, smaller entity may need to bring in other product and service providers and negotiate new agreements
Governance	New owners should commence review of current processes and practices to ensure effective governance is in place; changes can be implemented incrementally	New local processes and practices must be developed, introduced and implemented to ensure all legal requirements are being met

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