Market & Legal Update

MAY 2025

USI CONSULTING GROUP

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MARKET UPDATE | Markets Surge Despite Continued Uncertainty

As we have seen quite regularly in 2025, the markets seem to move, in large part, in line with tariff news. As such, it was no surprise that markets surged on May 12th after the United States and China announced a 90-day pause on most of the tariffs on either country. It was announced that the combined U.S. tariff rate on Chinese imports would be cut to 30% from 145%, while China's tariffs on U.S. imports would fall to 10% from 125%. The Dow jumped 1,161 points the day of the announcement.

Markets reacted similarly on May 27th as President Trump announced that he would pause the European Union (EU) tariff hikes after the EU agreed to fast-track trade talks with the U.S. The U.S. has reportedly been pressuring the EU, which has 27 member states, to cut tariffs on American goods. The EU is reportedly readying some $108B in retaliatory tariffs if talks fail. The 50% tariffs that were set to go into effect on June 1st would be delayed until July 9th. The Dow added over 740 points that day as well.

The Dow jumped **1,161 points** the day of the announcement

As such, despite the continued uncertainty regarding tariffs, markets posted positive returns for the month of May following the aforementioned tariff news. The Dow Jones Industrial Average (DJIA) added 4.2% while the S&P 500 Index gained 6.3%. The tech-heavy NASDAQ Composite surged 9.7% as technology stocks rebounded significantly. On the international front, the MSCI EAFE Index tacked on 4.7% while the MSCI Emerging Markets Index gained 4.3%. Fixed income, as measured by the Bloomberg US Aggregate Index, fell 0.7% as yields rose during the month.

Market Return Indexes	May 2025	YTD 2025	2024
Dow Jones Industrial Average	4.2%	0.1%	15.0%
S&P 500	6.3%	1.1%	25.0%
NASDAQ (price change)	9.7%	-0.7%	28.6%
MSCI Eur. Australasia Far East (EAFE)	4.7%	17.3%	3.8%
MSCI Emerging Markets	4.3%	8.9%	7.5%
Bloomberg High Yield	1.7%	2.7%	8.2%
Bloomberg U.S. Aggregate Bond	-0.7%	2.5%	1.3%
Yield Data (Month End)	**May 2025**	**April 2025**	**March 2025**
U.S. 10-Year Treasury Yield	4.41%	4.17%	4.23%

It's not only markets that react almost lockstep with tariff news. The consumer is also quite reactive. The Consumer Confidence reading, which had fallen for 5 straight months, began the year at 105.3 in January, but had dropped significantly to 85.7 in April. May's reading from the Conference Board was expected to come in at a slightly higher reading than in April, as economists expected a reading of 87.1. However, the actual data showed a reading of 98.0. The cutoff date for preliminary results was May 19th, meaning any opinions swayed by the US-China tariff delay were likely factored in. That's not to say the increase was wholly a result of the improved U.S.-China tariff situation, but it certainly was a factor.

While consumer confidence thankfully rebounded, there was some rather negative news released in May pertaining to defaulted federal student loans that could significantly hinder consumer spending and, as a result, impact the growth of the economy. Coming into the year, student loan delinquencies were rather subdued at just 0.9% in the fourth quarter of 2024. However, there was an expectation that student loan defaults would ultimately be much higher after reinstituting student loan payments following their pause from March 2020 to September 2023.

That expectation became a reality when, on May 5th, the U.S. Department of Education resumed collections for defaulted federal student loans which resulted in the student loan delinquency rate surging to 8.2% in the first quarter of 2025. Among 42.7M student loan borrowers, over 5M are currently in default. Further, another 4M are seriously delinquent, which, if moved to default, would mean that over 20% of the federal student loan portfolio would be in default.

Defaulting on student loans will not only lower the credit scores for the borrowers but would also likely preclude them from attaining loans without much higher borrowing rates. Add in the fact that wage garnishments will likely begin this summer, and the almost 10M defaulted borrowers will be severely constrained from a spending standpoint. Per J.P Morgan, assuming a wide range of interest rates and payment plans, monthly collections on student loans will reduce disposable income by $3.1B to $8.5B a month. With tariffs already expected to impact spending to some degree, this student loan news only exacerbates an already tenuous situation.

The uncertainty that comes along with tariffs has only been intensified by the administration's propensity to change the tariff plan rather quickly. Markets despise uncertainty, and we not only saw how that uncertainty negatively impacted domestic markets in the first quarter, but that same uncertainty has since given investors a rollercoaster ride here in the second quarter, despite a strong month of May. Add in the uncertainty regarding the impact of the student loan default issue and its potential impact on consumer spending and ultimately the growth of the economy, and investors certainly have a lot to digest going forward.

LEGAL UPDATE

Retirement Plan Issues in Mergers and Acquisitions

Business combinations involving mergers and acquisitions can significantly affect retirement plans. When acquiring another business, the buyer must decide how to address the target company's existing retirement plans. A decision to merge, to terminate or to maintain the target's retirement plans may affect the terms of the purchase agreement and the scope of due diligence required. For example, if the seller maintains a Nonqualified Deferred Compensation (NQDC) plan, a change in control might trigger vesting or distributions. And acquisitions involving a defined benefit pension plan demand particular caution, as the transaction itself may be subject to government reporting requirements.

Treatment of Target Retirement Plans

A company acquiring another business that sponsors one or more qualified retirement plans generally has three options.

1. **TERMINATE** the Target's Retirement Plan
2. **MERGE** the Target's Retirement Plan into the Buyer's Retirement Plan
3. **CONTINUE TO MAINTAIN** the Target's Retirement Plan as a Separate Plan

While terminating the target's retirement plan avoids causing qualification issues for the buyer's plan and entails the least amount of due diligence, plan termination fully vests all affected participants and often is itself a distributable event. Offering employees a distributable event ultimately may affect their retirement readiness. Merging or maintaining the target's retirement plan does require considerable due diligence. And maintaining the target's plan as a separate plan also may expose the buyer to the burdens and expenses of an additional plan, including separate notices and filing requirements and audit.

Retirement Plan Due Diligence

A company buying another company that intends to merge a target's retirement plan into its own or to maintain such plan on an ongoing basis should review the following as appropriate due diligence:

- Review a complete set of the governing plan documents (including all restatements and amendments since the last IRS determination letter). Reviewers should ensure that the plan has been kept up to date with all changes in law pursuant to IRS amendment timing requirements and that all documents properly are signed and dated.
- Review the IRS determination letter (or IRS opinion letter if the plan is maintained in an IRS pre-approved format). The reviewer should ensure that any amendments required by the letter were executed timely and should note any expiration date on such letter.
- Perform a protected benefits analysis by identifying any benefits, rights or features that the sponsor must preserve after a merger of plans.
- Review any governmental correspondence or filings related to the plan and confirm that no such plan is subject to any audit by the IRS, DOL or PBGC.
- Consider plan design implications for the plan as merged or as maintained separately.
- Understand steps and the timing required to merge, to freeze or to terminate the plan.
- To the extent that qualification failures or fiduciary issues *(e.g., late deposits)* are identified, determine which party will bear the burden and liabilities of correction, both in terms of legwork and financing.

Coverage Testing Requirement and Transition Relief

In general, mergers and acquisitions (M&As) are likely to create a controlled group or affiliated service organization where the entities are considered one employer for purposes of retirement plan coverage testing requirements. With respect to coverage testing, applicable law often affords the parties transition period relief from the controlled group testing requirements, under certain conditions, until the end of the plan year following the plan year in which a business transaction occurs. Plan sponsors contemplating a business combination are encouraged to engage consultants early in the process to begin assessing these critical issues.

Special Considerations for 401(k) Plans

Profit-sharing plans with a cash or deferred arrangement (401(k) plans) must comply with extra limitations on the timing of participant distributions. The termination of a 401(k) plan only constitutes a distributable event for participants if the plan sponsor (determined on a controlled group basis) does not maintain any other defined contribution plan within twelve (12) months of the termination. The practical effect of this rule is that, once a transaction closes, the target's 401(k) plan either must be merged into the buyer's plan or must be maintained separately on an ongoing basis. Once the transaction closes, the plan sponsor loses the ability to terminate the target's 401(k) plan – unless the plan sponsor terminates all of its own defined contribution plans as well.

Purchase Agreement Provisions Regarding Retirement Plans

If the buyer intends to merge or to maintain the target's retirement plan, the buyer should insist on the seller making the full list of standard representations and warranties concerning employee benefit plans. If the seller will be terminating its retirement plan prior to the transaction, then fewer representations regarding such plan may be appropriate. The buyer also might consider seeking indemnification pursuant to the agreement from the seller for breach of any of these representations concerning compliance issues arising prior to the transaction. Covenants should specify the disposition of the target's retirement plan. If the buyer prefers the seller to terminate a retirement plan prior to the transaction, then the covenants should enumerate any steps the buyer might require *(e.g., filing an IRS determination letter application on the terminating plan)*.

Nonqualified Deferred Compensation Plans

The parties should carefully review any NQDC plans, (including any individual employment contracts or agreements, which may provide for deferred compensation outside of the context of a formal plan). A "change of control" is a common trigger for the vesting or even payment of deferred compensation. The buyer and seller should understand any effect the transaction will have on the involved NQDC plan. Surprising key people in an organization concerning their compensation is rarely advisable.

Defined Benefit Pension Plans

If the target sponsors a defined benefit pension plan, due diligence will include understanding this plan's funded status. The parties should remember that a change in control is a reportable event to the Pension Benefit Guaranty Corporation (PBGC). Indeed, certain reportable events require reporting prior to the event. The plan sponsor should work with its actuaries and consultants to understand any PBGC reporting requirements. Defined benefit pension plans often require more notice and process to terminate than defined contribution plans.

Finally, if the target is signatory to a collective bargaining agreement requiring contributions to a multiemployer plan, the buyer should understand its potential exposure to any assessment of withdrawal liability. Even contributions due to such a plan for a handful of such employees could result in a significant assessment of such liability in the event of withdrawal. And buyers should be sensitive when sellers assert the existence of withdrawal liability exceptions *(e.g., the construction industry exception)*. While an exception might apply to some employee groups, it might not apply to all union employees, especially belonging to different unions.

USI Consulting Group's experienced M&A experts are available to guide your organization through the acquisition process, including the retirement plan due diligence process, helping you mitigate risk and negative financial effects. Through our parent company, USI Insurance Services, we have employee benefits and property & casualty experts to help with your holistic benefits offering.

Retirement Resources for You

USI Consulting Group's team of experts is happy to assist employers with all retirement plan compliance matters and changes in the market, including those discussed here, to help you mitigate risk and financial impact to your organization.

To learn more, please contact your local USICG representative, visit our Contact Us page or reach out to us at information@usicg.com.

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An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

The MSCI Europe and Australasia, Far East Equity Index (EAFE) is a market capitalization weighted unmanaged index developed by Morgan Stanley Capital International to measure approximately 1,100 securities in 21 major overseas stock markets. It is a commonly used measure for foreign stock market performance.

The Barclays Capital U.S. Aggregate Index covers the U.S. Dollar denominated investment grade, fixed-rate, taxable bond market of SEC-registered securities.

The Barclays Capital U.S. Corporate High Yield Index covers the U.S. Dollar denominated, non-investment grade, fixed income, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moody's Fitch, and S&P is Ba1/BB+/BB+ or below.

The MSCI Emerging Markets Index (EM) is a free-float-adjusted market-capitalization index developed by Morgan Stanley Capital International. It is designed to measure the equity market performance of 26 emerging market countries.

The 10 Year Treasury Yield is the interest rate the U.S. government pays to borrow money for a 10-year period. In addition to influencing how much the government pays to borrow over this time-frame, the 10-year Treasury Yields also determines how much investors earn by investing in this debt and it is a good indicator of investor sentiment.

The higher the yield, the better the economic outlook.

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