United States | Human Capital | 15 December 2023

Rewards Policy Insider
2023-25

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California to Require Leave for Employees Experiencing Reproductive Loss

Starting in 2024, California employers with five or more employees will be required to grant leave to employees dealing with certain "reproductive losses," such as a miscarriage or stillbirth. California is the second state to enact such a leave policy, and more states may follow.

Overview of Law

On October 10, 2023, California enacted a law (S.B. 848) to require certain employers in the state to grant leave to employees for "reproductive losses." Under this new type of leave, which applies in addition to California's existing paid sick leave and paid family leave laws, employers must allow eligible employees to take up to five days of leave following a "reproductive loss event," defined as the day (or in the case of a multiple-day event, the final day) of a failed adoption, failed surrogacy, miscarriage, stillbirth, or an unsuccessful assisted reproduction (e.g., in vitro fertilization). (Note that abortion is not covered by the law.) If an employee experiences more than one reproductive loss event within a 12-month period, the employer is not required to grant a total amount of reproductive loss leave time over 20 days within that period. The days off may be nonconsecutive, and generally the employee has within three months of the event to complete the leave.

Employers subject to the new law are those that meet *either* of the following criteria: (1) an employer that employs five or more persons to perform services for a wage or salary; or (2) the state and any subdivision of the state, including cities and counties.

Reproductive loss leave can be unpaid unless the employer provides otherwise in an existing applicable leave policy. However, the employee must be allowed to use vacation, personal leave, sick leave, or compensatory time off for reproductive loss leave that is otherwise available to the employee. Employers are also prohibited from retaliating against employees who take reproductive loss leave.

The law will become effective on January 1, 2024.

Outlook

California is the second state to enact a reproductive loss leave statute. The first – Illinois – enacted a very similar law in 2022 (S.B. 3120), which amended the state's existing Child Bereavement Leave Act to expand unpaid leave for bereavement-related events, including miscarriages, failed adoptions, stillbirths, and other losses related to pregnancy and fertility. Some cities, such as Boston and Pittsburgh, have also enacted reproductive loss laws that apply to city government employees. While reproductive loss may be covered in a more general sense by many states' existing leave laws, because a high-profile state like California has now embraced reproductive loss leave, it may be more likely that other state legislatures will consider a similar policy in their upcoming legislative sessions.

Second Circuit Adds its Voice to Circuit Split Regarding What Gives Rise to a Prohibited Transaction

In a recent decision involving claims that a university caused its retirement plans to engage in a “prohibited transaction” by hiring service providers, the Second Circuit held that in order to sustain a prohibition transaction allegation, a plaintiff must allege in the complaint that the services in question were unnecessary or involved unreasonable compensation. The case contributes to a growing split among circuit courts on this issue, which tees up the Supreme Court to potentially resolve this disagreement in the future.

Background

Under ERISA section 406, plan fiduciaries may not cause the plan to engage in certain “prohibited transactions,” such as by causing the plan to furnish goods or services between the plan and a service provider. Because plans frequently need to hire service providers, ERISA section 408 provides an exemption from the prohibited transaction rules for the hiring of service providers where the services are necessary, the contract is reasonable, and reasonable compensation is paid for the services.

In *Cunningham v. Cornell University*, participants in Cornell University’s two 403(b) retirement plans sued the university, alleging that by hiring two service providers to assist with plan recordkeeping, Cornell caused the plan to engage in a prohibition transaction in violation of ERISA. (The plaintiffs also alleged that Cornell breached its fiduciary duty by failing to control recordkeeping fees and failing to offer appropriate investment options, but those claims are not the focus of this article.) The U.S. District Court for the Southern District of New York sided with Cornell and dismissed the prohibited transaction claim, finding that the plaintiffs failed to show that the contracts with the recordkeepers involved some sort of self-dealing or disloyal conduct.

Second Circuit Decision

The plaintiffs appealed to the Second Circuit, which on November 14, 2023 affirmed the district court’s decision. The Second Circuit held that in order to state a claim for a prohibited transaction in a matter involving a plan service provider, a plaintiff must allege in the complaint that the services were unnecessary or involved unreasonable compensation. The court concluded that, at the motion to dismiss stage of a lawsuit, it is not enough for the plaintiff to merely state that the hiring of a service provider is a prohibited transaction outright; rather, it is the plaintiff’s responsibility to demonstrate as an initial matter that there is an inference of disloyalty to the plan with respect to the plan fiduciary and the service provider. The court also reasoned that if ERISA section 406 was read to prevent plans from hiring service providers outright, this would hinder plans who need to outsource important tasks like recordkeeping and investment advising.

Circuit Split & Impacts on Plan Sponsors

The Second Circuit's decision in *Cunningham* contributes to a growing split among circuit courts regarding what is required of plaintiffs to sufficiently plead a prohibited transaction at the motion to dismiss stage of a lawsuit. The Second Circuit joins the Third, Seventh, and Tenth Circuits, which have held in recent years that ERISA section 406 does not prohibit plans outright from hiring third parties to provide services to the plan, such as recordkeeping and administrative services. On the opposite side of the circuit split, the Ninth and Tenth Circuits have adopted a much broader view of what gives rise to a prohibited transaction, generally finding that a plan hiring a service provider or even engaging additional services from an existing service provider creates a *per se* prohibited transaction. Under those rulings, the plan sponsor bears the burden of showing that an exemption to the prohibited transaction rules applies. (For a more detailed overview of Ninth Circuit case, *Bugielski v. AT&T Services, Inc.*, see Rewards Policy Insider 2023-18).

It is possible that the Supreme Court will consider this issue in an upcoming term in order to resolve the circuit split. That hypothetical decision by the Supreme Court would be of critical importance for plan sponsors, who fare much better under the court rulings with the narrower view of prohibited transactions – such as the Second Circuit's ruling – because the initial burden to provide evidence that a prohibited transaction was potentially harmful to the plan falls on the plaintiffs. Under the more expansive view, it is much more difficult for plan sponsors to get a court to dismiss the case, which makes it more likely that plans will need litigate the reasonableness of their fees paid to service providers.

IRS Issues Proposed Regulations for Long-Term Part-Time Eligibility Rules

IRS has issued proposed regulations relating to the long-term part-time employee eligibility rules for 401(k) and 403(b) plans, which were enacted as part of SECURE 1.0 and modified by SECURE 2.0.

Summary of Legislative Changes

The original SECURE Act (SECURE 1.0) amended the Internal Revenue Code to generally prohibit 401(k) plans from establishing participation requirements beyond: (a) one year of service (using the 1,000-hour rule); or (b) three consecutive years of service where the employee completes at least 500 hours of service ("long-term part-time employees" or "LTPT employees"). However, plans may still exclude employees before they attain the age of 21.

Employers may elect to exclude employees who are eligible solely because of the LTPT rule from testing under the nondiscrimination and minimum coverage rules, and from the application of the top-heavy vesting and benefit rules. Additionally, employers are also not required to make matching or nonelective contributions on behalf of these employees. This relief from the nondiscrimination, minimum coverage, and top-heavy rules ceases to apply to an LTPT employee as of the first plan year after the plan year in which the employee has at least 1,000 hours of service.

In the case of employees who are eligible solely by reason of the rule for LTPT employees, each 12-month period for which the employee has at least 500 hours of service is treated as a year of service for vesting purposes and shall not be treated as a one-year break in service. This special vesting rule does not cease to apply to an LTPT employee after they have a plan year with at least 1,000 hours of service.

For plan years beginning after December 31, 2024, SECURE 2.0 amended SECURE 1.0's special eligibility rules for LTPT employees to reduce the three-year part-time service rule to two years. Additionally, SECURE 2.0 amended ERISA's minimum participation and vesting rules for ERISA-covered 401(k) and 403(b) plans to incorporate SECURE 1.0's special rules for LTPT employees, as revised by SECURE 2.0. SECURE 2.0 also made conforming changes to Code section 403(b) in order to reflect the ERISA changes that newly extended to 403(b) plans. Finally, SECURE 2.0 made a series of technical corrections to the original SECURE 1.0 LTPT employee provisions.

Key Takeaways from Proposed Regulations

The proposed regulations address numerous issues regarding the LTPT employee eligibility rule. Some of the key takeaways are as follows:

- The proposed regulations would apply to plan years that begin on or after January 1, 2024. Additionally, the proposal indicates that it may be relied upon prior to the publication of final rules.
- Rehires may immediately return as LTPT employees, even, for example, 20 years later. The proposal does not include a break-in-service rule for purposes of determining whether an employee is eligible to participate as an LTPT employee. Thus, if a former employee who was eligible to participate as an LTPT employee is rehired by an employer maintaining the plan, then the 12-month periods during which the employee previously was credited with at least 500 hours of service with an employer maintaining the plan must be taken into account for purposes of determining whether the rehired employee is eligible to participate as an LTPT employee.
- Under the proposal, employees will only be treated as LTPT employees if they are eligible to participate "solely by reason" of having completed the requisite number of consecutive years of at least 500 hours of service. Employees who become eligible under any another service requirement, including employees who becomes eligible under a service requirement that is more advantageous or pursuant to the elapsed time method, would not be LTPT employees.
- For purposes of SECURE 2.0's special plan amendment deadlines, the proposal provides clarification and flexibility on when plan amendments may be made pursuant SECURE 1.0's and SECURE 2.0's changes impacting LTPT employees. As a reminder, SECURE 2.0's special plan amendment deadline is generally the end of the 2025 plan year (or the end of the 2027 plan year for governmental and collectively bargained plans).

Comments on the proposed regulations are due by January 26, 2024.

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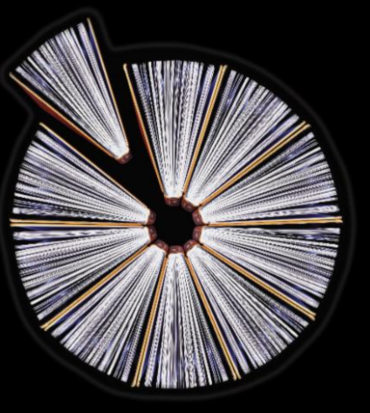

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