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ILLINOIS'S CONSOLIDATION OF PENSION FUNDS UPHELD BY SUPREME COURT

Recently, the Illinois Supreme Court upheld the consolidation of more than 600 police and firefighter "downstate" pension systems, condensing them into two separate funds: one for firefighters and the other for police officers. Pension consolidation did not include Chicago.

In 2019, Governor J.B. Pritzker enacted legislation which merged over 600 police and firefighter pension funds into two funds. Governor Pritzker's goal was to enable the police and fire fighter pension funds to access larger investments for greater returns. Additionally, consolidating the administrative costs between the individual pension funds is expected to save $70 to $95 million, while projected investment gains could reach $820 million to $2.5 billion.

In response to the legislation, several active and former first responders as well as several pension funds filed a lawsuit alleging the statewide pension system restricted their control over retirement benefits. Specifically, they argued the law violated the Illinois Constitution's Pension Protection clause, claiming they could no longer exclusively manage their investments and lost voting rights on investment decisions and risk management. The Pension Protection Clause states pension benefits for public employees, once granted, cannot be "diminished or impaired." However, the Court ruled that none of these issues constituted impairment of benefits.

The Illinois Supreme Court emphasized the ability to vote in elections for local pension board members or to have local control over pension funds is not constitutionally protected. The Court clarified decisions regarding benefit determinations are still made by remaining local boards. Rather, the Court explained, consolidation only changed a local board's ability to invest assets. Instead, the Court noted investment power was taken from one government created pension fund to another government created pension fund. These boards consist of executives from member municipalities, employees, and retirees elected by beneficiaries of the funds.

Currently, Illinois faces significant challenges with its pension system. Governor Pritzker allocated $700 million towards stabilizing pension payments over the past few years. Nonetheless, the state grapples with a pension debt of $140 billion, which continues to grow due to state payments not keeping pace with obligations to public employees and retirees. These pension costs now account for 25% of the state's budget and yet these actions taken by Governor Pritzker are not enough to meet the needs. Governor Pritzker's office is actively engaging with various policymakers and committees to address this issue, considering proposals such as tax increases and bond sales as potential solutions to the pension problem.

While the consolidation of the plans does not solve the ultimate funding problems, every little bit counts.

IBM UNFREEZES LEGACY PENSION PLAN

In late 2004, IBM froze participation in its defined benefit plan and froze accruals for pre-2005 hires at the end of 2007 in its $48 billion plan. Since 1999, the accruals had been in the form of cash balance benefits. At the time of the freeze, nearly all of IMB's 125,000 workers had an annuity-like or cash-balance plan. The resultant freeze left IBM benefits locked in place, based on salary and length of service. The accrual freeze meant any raises or more time with IBM would not result in a change in pension benefits. IBM predicted this would save the company quite a bit, somewhere in the ballpark of $3 billion from 2006 through 2010.

Instead, IBM opted to move to a 401(k) benefit for its employees. Under its 401(k) plan, IBM contributed up to 5% matching contributions and a 1% nondiscretionary contribution. Following IBM's decision, several other companies trended away from pensions into offering 401(k) plans exclusively to its employees.

In January 2024, IBM chose to stop matching contributions to its 401(k) plan and return to the defined benefit in the form of a cash balance plan—reopening its previously frozen plan. This unfreezing is timely. The plan is currently overfunded, IBM's U.S. pension assets exceed its liabilities by some $3.6 billion according to IBM's 2022 10-K filing. These surplus assets cannot be used to cover the cost of 401(k) or similar defined contribution benefits, for which IBM had contributed $550 million in 2022. Instead, by opting to return to a defined benefit plan, IBM can use that surplus to fund contributions.

Under IBM's new retirement program, employees will receive an initial 1% pay increase and a 5% pay credit towards their cash balance plan. Often described as a hybrid between defined benefit and defined contribution, a cash balance plan offers employees a "balance" each year based on salary credits and interest credits. Salary credits are an employer's contributions based on an employee's salary. Interest credits are defined by a plan document.

IBM is granting 6% interest on credits for the first two years and then interest will follow 10-year treasury yields. Employees additionally have the option to either withdraw their lump sum balance upon separation or retirement from IBM or convert their cash balance account to a guaranteed lifetime annuity upon retirement.

As IBM moves to unfreeze its pension, 3M announced in January 2024, it was freezing accruals to its defined benefit plan for non-union U.S. employees effective December 31, 2028. 3M will instead move to a 401(k) plan. In 2009, 3M had frozen the plan from new hire participation.

Whether other companies will once again follow suit of IBM's retirement program remains to be seen. Congressional changes to retirement laws, creative investment strategies, and keeping a competitive edge are likely be the motivation for IBM's shift alongside its overfunded status. But IBM is not alone, some studies indicate overfunded legacy pension plans may be in excess of $27 billion in assets. Meaning, other companies may soon be making the return to a defined benefit pension plan.

IN A NUTSHELL: PENSION-LINKED EMERGENCY SAVINGS ACCOUNTS

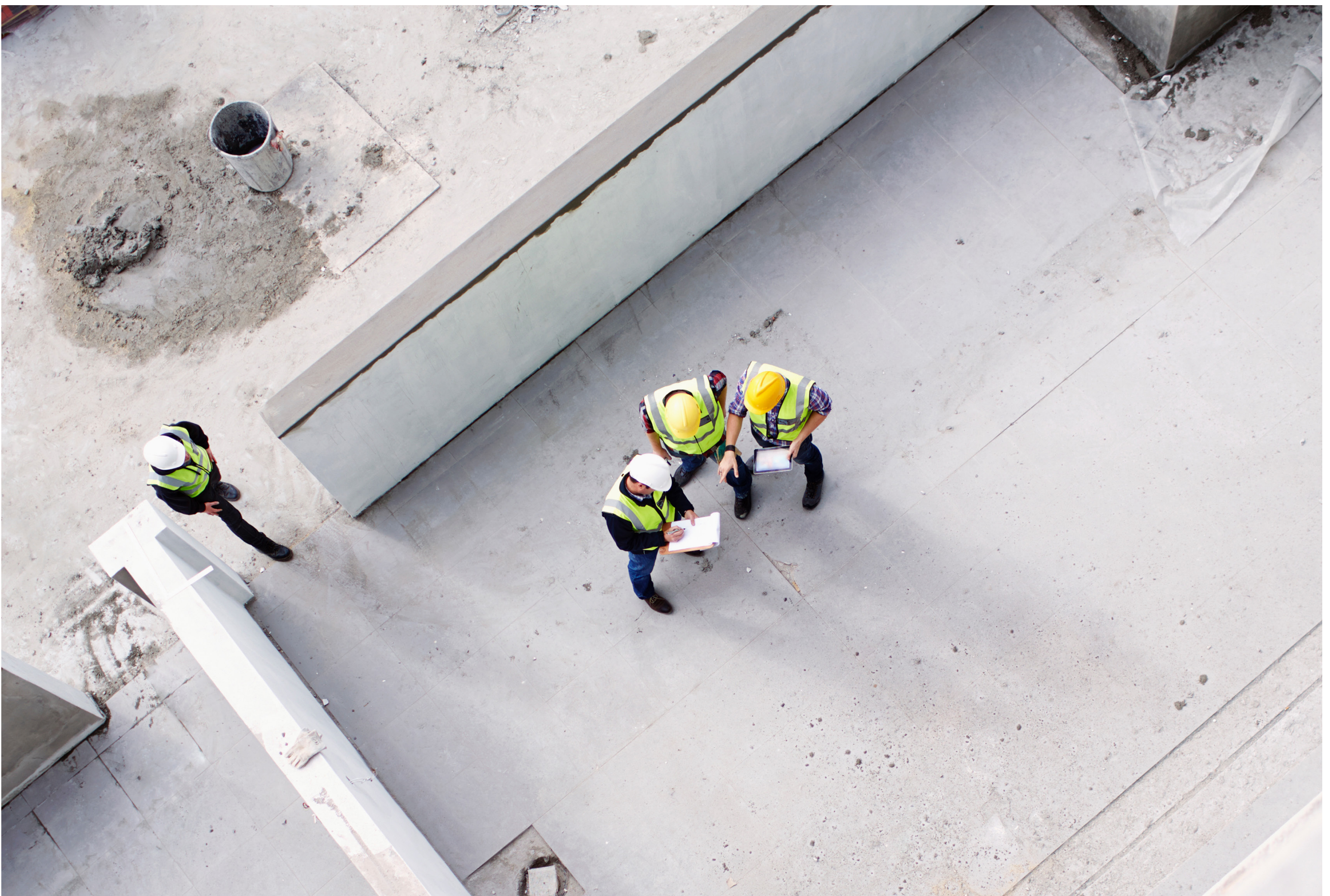
Participants may make withdrawals from their PLESA without incurring the tax penalties normally associated with early withdrawals from their regular retirement account.

Defined Contribution ("DC") plans are the primary retirement savings vehicle for most working Americans.[1] To help provide employees with a more rounded DC plan, many plan sponsors have taken steps to implement escalating automatic contributions and offer target-date funds to their participants. In addition, a recently published survey found that nearly half of plan sponsors have shown interest in adding emergency savings features to their retirement savings plans following the passage of the SECURE 2.0 Act in December 2022.[2]

In January 2024, the Department of Labor issued guidance regarding Pension-Linked Emergency Savings Accounts ("PLESAs"), which are short-term emergency savings accounts the SECURE 2.0 Act authorizes plan sponsors to establish and maintain *within* a DC plan, beginning January 1, 2024. Now that most, if not all, of the logistical questions have been addressed, many DC plan sponsors are expected to implement a short-term savings account feature into their plans.

EMPLOYEE CONTRIBUTIONS.

All PLESA contributions must be Roth contributions.[3] Roth contributions are those made post-tax. Participants may make withdrawals from their PLESA without incurring the tax penalties normally associated with early withdrawals from their regular retirement account. Further, participants are not required to demonstrate or certify the existence of an



emergency or other need or event in order for a participant to obtain a withdrawal from a PLESA. Rather, participants are entitled to make discretionary withdrawals as frequently as monthly.[4] The first four PLESA withdrawals in a Plan Year cannot be subject to any fees or charges, direct or indirect, based solely on such withdrawal.[5]

NO ANNUAL LIMIT REQUIREMENTS.

Placing an annual limit on a participant's PLESA contributions could restrict the participant from replenishing the funds in their PLESA following a withdrawal. Accordingly, participants are able to make contributions and withdrawals to their PLESAs on a rolling basis.[6] The maximum dollar amount a PLESA may hold at any given time is $2,500.00 (or a lower amount determined by the Plan Administrator). Once a PLESA has a balance of $2,500.00, additional contributions must cease until some or all of the balance is spent. Alternatively, Participants with a Roth account (under the Plan) can elect to reroute excess contributions into their Roth account.[7]

CONTRIBUTION REQUIREMENTS.

PLESA contributions must be held in either an interest-bearing deposit account, or an investment product designed to "maintain over the term of the investment the dollar value that is equal to the amount invested in the product and preserve principal and provide a reasonable rate of return, whether or not such return is guaranteed, consistent with the need for liquidity[.]"[8] The investment product also must be offered by a state-regulated or federally-regulated financial institution and may be subject to reasonable restrictions, as permitted by the Department of Labor.

EMPLOYER MATCHING CONTRIBUTIONS.

The same matching rate established under the plan must be used for matching PLESA contributions as for non-PLESA elective deferrals. All matching contributions, including those attributable to PLESA contributions, must be allocated to the retirement savings portion of the plan, and not to the PLESA. However, PLESA contributions count toward an individual's elective deferral limit ($23,000.00 for 2024).[9]

AUTOMATIC ENROLLMENT.

Automatic enrollment is optional. If the automatic enrollment/automatic contribution feature is utilized, the contribution percentage must be at a rate of 3% or less of the participant's compensation, unless the participant affirmatively elects a higher or lower percentage.

NO MINIMUM REQUIREMENTS.

Because PLESAs "shall not have a minimum contribution or account balance requirement,"[10] plans cannot impose either a minimum amount required to open a PLESA or a minimum balance required to be maintained in a PLESA. However, the portion of a PLESA attributable to participant contributions may not exceed the $2,500.00 maximum proscribed by ERISA (as periodically indexed for inflation).

FLEXIBLE CONTRIBUTION LIMITATION.

Plans can choose to either include or exclude earnings on the participant's contributions, so long as the portion of the account balance attributable to participant contributions does not exceed the $2,500.00 maximum.

Option 1: The "Inclusion" Approach

Plans can focus on a participant's total account balance (both contributions and earnings) and prohibit additional contributions if the total account balance would exceed $2,500.00. This approach is permissible because plans may limit the portion of a participant's account attributable to PLESA contributions to an amount less than $2,500.[11]

Option 2: The "Exclusion" Approach

However, if a plan caps participant contributions at $2,500.00, earnings credited to the account in excess of that amount would not constitute a violation of the $2,500.00 limit, because earnings are excluded from calculation of the limitation.

ANNUAL REPORTING RESPONSIBILITIES (FORM 5500).

As plans are first authorized to offer PLESAs beginning January 1, 2024, the 2023 Form 5500 does not have specific reporting requirements for PLESAs. At this time, the Department of Labor has indicated that it is currently working on adding a PLESA feature code for plans to indicate on the Form 5500 and Form 5500-SF that it offers a PLESA feature, as well as instructions for filers that information on PLESAs should be aggregated and reported in relevant line items, e.g., contributions, investments, fees, and expenses, and distributions, on the forms, schedules, and attachments.

For more information about how to add a Pension-Linked Emergency Savings Account to your DC plan, please contact our office.

[1] https://www.psca.org/sponsors-agree-retirement-income-has-become-%E2%80%98core%E2%80%99-dc-plan-purpose.
[2] https://www.pionline.com/defined-contribution/mfs-survey-says-45-plan-sponsors-look-add-emergency-savings-feature (the report is based on a survey of 141 plan sponsors conducted in September and October 2023, and includes information drawn from a survey of 1,000 U.S. adults conducted between March 22 and April 6, 2023).
[3] ERISA Section 801.
[4] ERISA Section 801(c)(1)(A)(ii).
[5] ERISA Section 801(c).
[6] Participants' contribution rights are subject to tax qualification contribution limits under the Internal Revenue Code ("IRC"), IRS guidance on anti-abuse constraints, and other issues under Section 402A(e) of the IRC.
[7] ERISA Section 801(d)(1).
[8] ERISA Section 801(c)(1)(A)(iii).
[9] IRC Section 402(g).
[10] ERISA Section 801(c).
[11] ERISA Section 801(d)(1)(a)(ii).

FDA APPROVES FLORIDA'S PROPOSAL TO IMPORT CANADIAN DRUGS IN BULK

Though the proposal has gained headlines for being a new avenue for cheaper Canadian drugs in America, the program itself is limited.

The rising cost of prescription drugs have long been a pressing issue, placing a heavy burden on patients, especially those with chronic conditions who rely on consistent access to medication. With the increase in prices showing no signs of slowing down, there continues to be a greater push for access to cheap drugs. Under Section 804 of the Food, Drug, and Cosmetic Act ("FDCA"), all new prescription drugs must be approved by the FDA prior to being legally marketed in the United States. Drugs approved by the FDA must also follow FDA approved packing and labeling standards. Foreign drugs with identical chemical composition but different packaging and labelling would face rejection and could not be legally imported into the U.S. The cost disparity between identical drugs in the U.S. and Canada have been glaring, prompting calls for innovative solutions to bridge the gap and reduce the financial strain on individuals and families.

Consequently, policy makers began their search on exploring avenues for cost reduction and providing more access to life saving medication. This search ultimately led them to importation as a means for lowering drug prices. In October 2000, Congress enacted the Medicine Equity and Drug Safety (MEDS) Act, which permitted importation of prescription drugs directly from certain industrialized countries. However, the FDA did not publish the final rule of the FDCA until 2020, twenty years after the initial MEDS Act was passed. According to the FDA, the final rule allows FDA-authorized programs to import certain prescription drugs from Canada under specific conditions that ensure the importation poses no additional risk to the public's health and safety, while achieving a significant reduction in the cost of covered products to the American consumer. The final rule permitted the FDA to work with States and Indian Tribes to develop and implement Section 804 Importation Programs ("SIPs"), the mechanism to submit importation proposals. Though U.S. pharmaceutical manufacturing standards are known for being amongst the most rigid, most say Canadian and European standards are comparable.

The FDA introduced its guidelines for SIPs in October 2020,

permitting select states to sponsor importation of Canadian versions of FDA-approved drugs. Under the guidelines, states have to meet several different requirements for their proposals to be approved. The criteria includes: the drug must have a U.S. approved counterpart; the drug must be approved by Health Canada; and the proposal must demonstrate use of the Canadian drug will lead to significant savings for American consumers, among other stipulations.

In a significant move aimed at addressing the soaring costs of prescription drugs for its residents, Florida was quick to submit their proposal in November 2020. After many revisions, the plan was finalized in October 2023. Florida's proposal underwent serious scrutiny to meet the requirements set forth by the FDA. The state had to demonstrate its ability to implement safeguards, protect public health, and reduce potential risks associated with drug importation. Nonetheless, Florida prevailed, and state officials have projected this program could save up to $180 million the first year.

Florida's proposal to import drugs from Canada gained traction as a promising approach to tackle the challenge of skyrocketing drug prices. Under the plan, the state aims to import prescription drugs from Canadian wholesalers, leveraging the comparatively lower prices in Canada to offer savings to American consumers. Though the proposal has gained headlines for being a new avenue for cheaper Canadian drugs in America, the program itself is limited. The drugs being imported under this program will only be available to patients under Florida Medicaid and other state sponsored health programs. Further, because of FDA limitations on the types of drugs that can be imported, many of the more expensive prescription medications will be excluded.

Even with the FDA approval, Florida still faces several hurdles including maintaining foreign suppliers who are willing and able to sell drugs for export to the U.S. under the proposal. Critics of drug importation have also raised concerns about potential safety risks and logistical challenges associated with the cross-border trade. Additionally, Canada has expressed concerns about potential drug shortages and price increases for their Canadian patients. For this reason, Health Canada emphasized the importance of safeguarding their drug supply to their citizens, casting doubt on the effectiveness of the bulk importation. Furthermore, pharmaceutical organizations including the Pharmaceutical Research and Manufacturing of America ("PhRMA") oppose the program from being implemented. PhRMA has previously initiated legal action, by filing a lawsuit and citizen petition, challenging the importation pathway and noting the overall health risks.

While the plan is well underway, the FDA states that imports will not begin immediately. There are still several requirements that need to be met for Florida to comply with U.S. drug standards before importation can begin. Nevertheless, while Florida's initiative marks a significant milestone, it could serve as a catalyst for broader action at the federal level. The success of this program could also pave the way for other states to follow suit, leading to a nationwide shift in how prescription drugs are sourced and distributed.

> *"The DOL has reported that the number of violations of child labor laws in 2022 increased 37% over 2021 and an astounding 283% over 2015."*

MANY STATES MOVE TO LOOSEN CHILD LABOR LAWS

While the Federal Department of Labor has stepped up enforcement of complaints of violations of child labor law, many states have gone the other way moving to weaken child labor laws for the first time in a century. At the beginning of the twentieth century, the United States started moving to protect child labor. After initial pushback, Congress passed the Fair Labor Standards Act of 1938 which outlawed non-agricultural work for children under 14, regulated work for children aged 14-16 to limited hours and professions, and outlawed children aged 16-17 from working in hazardous occupations. There are, of course, exceptions to this law including for family businesses and child actors, etc.

Since 1938, states have passed laws across the board with respect to child labor. Because of the Supremacy Clause of the United States Constitution, no laws can be less strict than the federal law—the Fair Labor Standards Act—but states are free to impose stricter regulations than those imposed by the Federal Government.

In the aftermath of the Covid-19 pandemic, many states have moved to loosen their child labor restrictions due to record high demand for employment while at the same time the DOL has reported that the number of violations of child labor laws in 2022 actually increased 37% over 2021 and an astounding 283% over 2015.[1]

In 2023, Iowa passed a bill[2] allowing children under 18 to work more hours and later into the night as well as allowing 16 and 17-year-olds to operate heavy machinery, work in laundries, “perform light assembly work,” and work in demolition, among other changes. In August of 2023, the US DOL sent Iowa a letter informing the state some of these provisions were violative of the Fair Labor Standards Act. A resolution is pending.

Iowa is just one of many states with such laws working their way through the legislatures. Minnesota has proposed a bill[3] that would allow 16 and 17-year-olds to work on construction sites. Nebraska has proposed a bill[4] that would allow a “subminimum wage” for minors. New Hampshire has a bill[5] that would lower the age to bus tables where alcohol is served and New Jersey is proposing[6] to extend work hours and increase the amount of time before giving required breaks. These are just some examples, and the vast majority of these bills are being pushed by various industry groups including Chambers of Commerce, Grocers’ Associations, and Restaurant Associations.

How these laws will interplay with the Fair Labor Standards Act remains to be seen. But many industry groups pushing these laws at the state level are likely gearing up to challenge federal laws on the same subject. J+K will continue to monitor these bills and laws especially as they apply to construction and other areas of work that are of interest to J+K clients.

[1] https://www.epi.org/publication/child-labor-laws-under-attack
[2] SF 167
[3] SF 375
[4] LB 15
[5] SB 345
[6] A4222

BLACKROCK COMMUNICATIONS A FOCAL POINT IN ESG LAWSUIT

In a proposed class action complaint filed in the U.S. District Court for the Northern District of Texas in June 2023, an American Airlines, Inc. ("American Airlines") pilot alleged the airline's 401(k) plan committee and administrators breached their fiduciary duties by prioritizing environmental, social, and governance ("ESG") factors over investment performance. The 401(k) plan's administrator, Fidelity Investments ("Fidelity"), and investment adviser, Edelman Financial Engines ("EFE"), were also named as defendants in the lawsuit.

Just over a year ago, the Department of Labor ("DOL") announced a final rule allowing retirement plan fiduciaries to consider ESG factors in designing plan investments. Previously, DOL guidance had limited fiduciaries to evaluating pecuniary factors only. Despite the updated rule regarding ESG, the plaintiff pilot sought for the entry of an injunction against American Airlines, Fidelity, and EFE prohibiting ESG-based investment decisions and removing those funds from the plan. In July 2023, Fidelity and EFE were dropped as defendants.

Although not a defendant in the case, the pilot alleges that the 401(k) plan's fiduciaries invested billions of dollars in retirement funds with BlackRock, Inc. ("BlackRock") and granted BlackRock proxy voting authority. As a result, the pilot asserts plan assets in stocks and index funds were ultimately damaged due to the ESG funds' costs, performance, strategy, and philosophy.

During the discovery process, the pilot demanded American Airlines provide all communications between the airline and BlackRock. American Airlines, however, refused to comply with this request. The pilot believes these communications are crucial for proving several points during the trial, including the business and financial relationships between American Airlines and BlackRock, the airline's motives for investing billions of dollars of retirement funds with BlackRock, and American Airlines' knowledge of BlackRock's ESG activism. American Airlines countered, arguing the pilot's request is excessive and costly. With over 130,000 employees, reviewing tens of millions of emails would be impractical. Although the Court has not yet ruled on the pilot's motion to compel the airline's production of the communications, American Airlines has already turned over communications between BlackRock and three senior members of its Employee Benefits Committee in hopes that it will satisfy the production request.

The ongoing conflicts surrounding ESG spans across various fronts, with lawsuits now targeting providers and fiduciaries alleging damages stemming from ESG investments. J+K will continue to track this case to monitor its eventual outcome.

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