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By Austin R. Ramsey and Ben Miller

Deep Dive

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- DOL’s final rule targets one-time rollover transactions

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A New York federal district court ruling tying TIAA to the alleged misconduct of its clients offers a rare glimpse at the upturned legal landscape awaiting pension servicers when a new 401(k) advice rule takes effect.

The effort to preserve a lawsuit against Teachers Insurance and Annuity Association of America for leveraging the data of workers participating in retirement plans to cross-sell high-fee investment rollover products to those same investors earned a US District Court for the Southern District of New York judge’s approval June 3.

In the unusual ruling, Judge Katherine Polk Failla said TIAA could be held liable as a knowing participant in the fiduciary breaches of its clients that sponsor the plans for their employees, even though the employers themselves aren’t defendants in the suit.

Recordkeepers like TIAA that track retirement assets and perform bookkeeping services have historically skirted strict fiduciary obligations under federal benefits law by operating on the fringes of a decades-old regulation defining those standards of conduct. The US Labor Department recently finalized a set of rules that would update those definitions, targeting exactly the kind of conduct in which TIAA is alleged to have engaged.

Benefits advisers say the TIAA litigation may serve as a harbinger of legal obstacles to come once the DOL's new rules begin going into effect in September, sweeping rollover advice into its updated definition of "fiduciary" under the Employee Retirement Income Security Act of 1974.

TIAA's cross-selling—a common industry practice —would likely qualify as rollover advice subject to fiduciary restrictions, they said.

"Nobody needs bad advice, and that's what's happening in this totally unregulated wild west out there," said Elizabeth Hopkins, a senior partner at Kantor & Kantor LLP and former trial attorney for the DOL.

Non-Fiduciary Wave

TIAA's cross-selling activity, which many recordkeepers engage in to help keep costs lower for their employer-sponsored plan clients has for now only resulted in claims of non-fiduciary liability.

ERISA extends to investors the right to sue "knowing participants" to fiduciary violations, a fact that was reinforced by the US Supreme Court in 2000. But non-fiduciary liability is rarely alleged because it requires plaintiffs to prove constructive knowledge and offers limited relief, said Douglas Pelley, counsel for Arnold & Porter Kaye Scholer LLP.

TIAA is accused of harvesting information about investors and using it to wage a "fear selling" campaign against certain participants, Judge Failla wrote in her opinion. The company allegedly "reaped massive increases" in revenue by selling individual retirement accounts and insurance contracts to participants near retirement.

The plan sponsors, which include Dartmouth College, Loyola Marymount University, Georgetown University, and the Pacific Institute for Research and Evaluation, could have feasibly ignored a fiduciary breach by allowing TIAA to target their workers, Failla wrote. Since TIAA was the primary actor, they were feasibly aware that those breaches occurred.

Many universities have been the target of other rounds of ERISA litigation alleging excessive fees.

"Now one has to wonder whether this is going to become a flavor du jour," said Andrew Oringer, partner at Wagner Law Group. "People are always asking what the next big wave in ERISA litigation is, and now one wonders if with this attempt to impose liability on a provider for successfully selling its product or services, if we're now about to see a door opening to what amounts to a new claim."

One-Stop Shop

Should the DOL's fiduciary rule survive emerging court challenges, it could combine with the early precedent set in the Southern District of New York to create a "significant one-two punch," broadening the definition of a fiduciary to more service providers, while also extending legal liability to even more third parties who still fall outside that category, according to Oringer.

A 2022 ruling by Failla in the litigation, which held that TIAA wasn't liable for the effects of its rollover recommendations, may have informed the DOL's explicit inclusion of one-time rollover advice as a qualifying factor for fiduciary responsibility in its new rule, Oringer said.

"All of this is going to start to change the risk profile for service providers if this is the way we go," he said.

TIAA didn't immediately respond to a Bloomberg Law request for comment.

Despite plaintiffs' best efforts, third-party service providers such as recordkeepers have been able to escape liability under a whole host of trending ERISA litigation themes, thanks to contractual indemnification clauses and nearly 50 years of procedural history.

Yet, the term "recordkeeper" is a bit of a misnomer in the modern retirement industry, said Hopkins.

Firms such as TIAA market themselves as one-stop shops for employer-sponsored retirement solutions.

Investment committees or human resources departments can leave certain plan decisions up to their recordkeeper until a lawsuit is filed, and only then are named fiduciaries left holding the bag, Hopkins said.

"It's often these service providers that are really running the show," Hopkins said. "The named fiduciary is a corporate person or committee at a very high level that's really relying on their expertise."

The case is Carfora v. TIAA , S.D.N.Y., No. 21-cv-08384 .

To contact the reporters on this story: Austin R. Ramsey in Washington at aramsey@bloombergindustry.com; Ben Miller in New York City at bmiller2@bloombergindustry.com

To contact the editors responsible for this story: Rebekah Mintzer at rmintzer@bloombergindustry.com; Jay-Anne B. Casuga at jcasuga@bloomberglaw.com

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