



## **The Emotional Intelligence of Serving as an ERISA Fiduciary.**

### **Summary**

ERISA is the federal law that governs the management of retirement plans. When a company that sponsors a retirement plan appoints a group of executives to manage the plan, those individuals are known as fiduciaries. The role of fiduciaries, first and foremost is to see that no one doing business with the retirement plan does harm to the plan's participants. The fiduciaries are supposed to serve as guardians on behalf of those people who have money in the retirement Trust.

In the overwhelming majority of cases fiduciaries work only a few hours every calendar quarter, receive little if any on-going training in the disciplines involved in their work, have no metrics with which to measure the success or failure of their plan management activities and are granted no compensation for their work regardless of its effectiveness. In the world of retirement plan fiduciaries there is virtually no personal accountability, no substantive oversight and no incentive to do a good job.

If this sounds like a recipe for a dysfunctional retirement plan system – it is. The last time we saw an economic system run like this we called it communism.

### **The Problem Isn't Technical.**

There are a myriad of technical issues ERISA retirement plan fiduciaries must know and understand to carry out their plan management responsibilities. Given the changes in the regulatory and capital markets over the past few years, the depth and breath to which technical issues must be examined has increased dramatically. For example, the concept of risk and its application to operations, investment management and plan governance is not the same in 2007 as it was in the year 2000.

These types of intellectual challenges notwithstanding, after 24 years of industry experience (having offered fiduciary advice and consulting on \$100+ billion of retirement assets) it is very clear that the greatest obstacles fiduciaries face are not matters of technical competence. Though daunting in scope, such things can readily be learned. The greatest obstacles reflect the individual fiduciary's state of emotional intelligence (EI) and the dysfunctional behavior generated by the "group think" dynamics with which many fiduciary Committees operate.

### **Background: Incentives Count**

Like it or not, in America's business culture, "honor" is not a highly prized incentive for influencing behavior. Any market based economist will tell you that other than by sheer luck the goals of any commercial activity are unlikely to be reached without properly structured incentives. In fact, without properly aligned incentives, all manner of extraneous actions will be adopted that are counter-productive to the intended purpose

of the activity. For America's retirement system this is a big problem because other than for the "honor" of it, the American retirement system contains no incentives to encourage fiduciary excellence on the part of those people responsible for plan management. Worse yet, while the legal framework in which fiduciaries work imposes significant responsibility upon them, as a practical matter, they are not held to account for the quality of their work.

**In any commercial endeavor where responsibility exists without individual accountability the result is a governance nightmare.**

With no incentives or accountability embedded in the system to assure purposeful plan management practices, counter-productive behavior has become epidemic. This behavior impacts everything from plan operations and investment management to governance. There are many factors that have created this condition. For example, the bull market in the 1980's and 1990's created an environment in which everyone made money. From this success a culture developed in which little outside scrutiny was applied to those organizations that delivered services to retirement Plan Sponsors and their participants. During this period poor fiduciary habits became ingrained in common business practices.

Another influence that has fostered and promoted dysfunction in the retirement industry has come from the very vendor community whose conflicts of interest Congress intended to protect working Americans from. Despite such Congressional intent, plan management practices that explicitly or implicitly promote a vendor's economic interests have been commonplace. They have heavily influenced fiduciaries to the point that the spirit of fiduciary duty is commonly violated and no consequences are incurred by the violators or by those allowing such violations to occur.

**If a retirement plan's fiduciaries are unfamiliar with or inattentive to the retirement plan's purpose and have no strategic plan in place by which all plan management practices are measured for their effectiveness at promoting that purpose, then ANY activity they engage in creates the *ILLUSION* of making progress in managing the plan.**

This illusion is the natural consequence of a Plan Sponsor's fiduciary culture that lacks the intellectual rigor of establishing well-reasoned metrics to assess the efficiency or effectiveness of plan management practices. This illusion is the clinical manifestation of a dysfunctional fiduciary governance system. Such dysfunctional business practices would never be tolerated in the Plan Sponsor's core business. Any manager holding on to such delusional thinking rather than focused on project metrics that quantify progress toward goals would pay a price with their reputation and eventually their job.

**The same principle that applies in core finance applications - if you aren't measuring it, it doesn't count - is applicable to fiduciary management as well.**

## **Fiduciary Illusions and Emotional Intelligence**

Emotional Intelligence was well recognized long before the term was coined.

Emotional Intelligence (EI) has been well documented and researched in the most elite of business publications such as the Harvard Business Review. A simple explanation of EI is “the self-awareness **and** acceptance which individuals have about the underlying motivation that drives their behavior”. The state of each individual’s EI is substantially derived from the emotional framework that shaped the formation of their personality.

An individual’s EI, sometimes called EQ (like IQ), is not a purely static phenomenon, like height or eye color. It is dynamic within each of us and responsive to many types of stimuli. Each of us has the experience of witnessing a high level of EI in someone else even if we aren’t used to calling it by that name. For example, we witness it when someone is willing to tell one on themselves – especially when those self deprecating comments are offered in a public forum. Such comments seem to have two components to them. First, the speaker recognizes that how they have dealt with that particular issue reflected a shortcoming in their character. Secondly, having self-acceptance that they have the shortcoming, the speaker can address the issue comfortably with others. They do not try to hide, mask or spin a story about it. There is no reason to do so as their shortcomings are not a source of emotional turmoil. This is what self acceptance brings – a release from shame, regret, sadness or angst.

To speak comfortably about one’s shortcoming a speaker must emotionally reconcile the impact the shortcoming has had in their life. An audience listening to such a speaker will admire the sincerity of that individual. Those listening feel and respect the candor and authenticity of the person speaking. Listening to such commentary is inspiring and makes us want to be better.

By contrast, the absence of highly developed EI is also very familiar to all of us although it too is known by other names.

For example, take my friend Jim (not his real name). Jim is in his late 40’s and lives in California with his 5<sup>th</sup> wife and two children. One day Jim called in a highly excited state. He had **finally** figured out “what it was with women”. From the animation in his voice I could tell that Jim’s revelation was profound for him. Having elaborated upon his discovery, I asked him if he recognized that HE was the only common ingredient in all of his five marriages. He was startled by the question and irritated by my interruption of his enthusiasm. Without hesitation, he dismissed the question, renewed his excitement and told me again of his A-HA moment.

Jim claimed to have discovered some principle regarding a pattern of behavior common to all of his wives. What he didn’t realize was that the conclusion he reached deeply discounted his responsibility in understanding the dynamics of HIS relationships with women. In short, he ignored the contribution his personality made in the construction of his own life. He thought his discovery was all about *THEM*. He couldn’t see that it really said more about *HIM*. He was blind to the vagaries of his emotional make up and

the thought process derived from it - even though I'd bet big money that his four ex-wives weren't.

Had Jim been willing to **reflect** on the question, rather than **deflect** it, a powerful self-discovery might have been available to him. It might have changed his life. Alas, it would have to wait for another day. Jim had no idea of the gem he passed over.

**Emotional blind spots are like that.**

Though very successful in business, Jim has a poorly developed EI when it comes to women. That's what having an emotional blind spot is; some aspect of your life for which you do not gather and process information that is otherwise visible to an independent and unattached observer. By definition, an emotional blind spot causes you to gather and interpret information in a manner that distorts the reality that an emotionally neutral person would have. Furthermore, the blind spot itself sustains the distortion until some other influence comes along with significant power to break up the illusion.

### **Emotional Blind Spots and Retirement Plan Management**

With no metrics to guide a self assessment regarding the quality of their own fiduciary conduct, "plan management" is more often a euphemism for benign neglect (or sometimes ignorance) than a conscious process engineered to produce a specific long-term result. This euphemism is sustained by a commonplace fiduciary culture that has as its fundamental premise "WE ARE GOOD PEOPLE HERE".

WE ARE GOOD PEOPLE HERE is a statement of identity. All too often, it is how fiduciaries think of themselves. The sentiment is used as a kind of emotional shield by fiduciaries to protect themselves individually and collectively from feeling badly about their conduct - regardless of the quality of their fiduciary conduct. Its unspoken acceptance as the cultural premise by a fiduciary committee limits the capacity of the fiduciaries to absorb any information that runs counter to the premise.

The author, never having met a malicious fiduciary, does not disagree with the statement that most fiduciaries are in fact well-meaning. However, being well-meaning is not a cause for celebration as to the quality of one's work. No experienced business person tells their boss that they are a well-meaning person and therefore, by virtue of that, they have done well at their job. However, this is exactly the emotional foundation with which most retirement plan fiduciaries operate.

**Unless metrics are used to assess the effectiveness of plan management practices, WE ARE GOOD PEOPLE HERE is nothing short of a linguistic substitute for arrogance and neglect. It is an obstacle that reflects a paucity of sincerity relative to the solemn duty of watching after someone else's financial interests.**

Though fiduciaries are morally and legally bound to serve in a guardianship capacity this group identity is the real (albeit unconscious) driver of their behavior. Its presence

discourages an authentic self-examination or rigorous **independent** examination of the group's efficiency or effectiveness in the exercise of its duties. Though the goal of serving in a fiduciary capacity is to be of service to others and to apply the highest level of responsibility to acting in a guardianship capacity, a WE ARE GOOD PEOPLE HERE culture is **all about the fiduciaries**. **It is NOT about the quality of the job done on behalf of the plan participants they serve.**

Organizational psychologists have a term for the behavior of small groups fueled by such a culture. It is "group think". In an ERISA fiduciary context WE ARE GOOD PEOPLE HERE is the clinical manifestation of group think. Such a culture thrives by deflecting any emotional challenge to the identity of the group. It operates as a kind of irresponsible creed: WE ARE GOOD PEOPLE HERE, that's how we know we do such a good job. If things don't work out – at least we meant well and that's what counts.

There are other emotional influences that also distort the purposefulness of a fiduciary's conduct in their individual capacities. Some of these influences are;

- the avoidance of blame,
- promoting the illusion of competency,
- the need for approval,
- the lack of self acceptance of making mistakes,
- the desire to look good,
- the willingness to acquiesce to the status quo rather than live out one's own values and last but not least ...
- the lack of personal courage to speak out.

There are a multitude of plan management details impacted by these emotional biases that distort plan management priorities away from fiduciary excellence. Here are a few examples:

- **Fiduciaries often work with brokers or advisors but do not intimately understand the nature of the broker or advisor's relationship to the Trust's assets.** Process improvement is a credible goal of any long-term business endeavor. However, sustaining a reputation free of tarnished image or blame has a higher emotional priority in fiduciary management than conducting a rigorous examination of service vendors.

This is the primary reason why individual fiduciaries are not held to account for the fulfillment of various statutory duties. A fiduciary doesn't "own" the duty if they aren't accountable to someone for it. The implications for plan participants regarding investment costs, inappropriate investment vehicles and tainted investment advice are substantial.

- **The industry's major vendors are trusted without that trust being verified.** Because most fiduciaries serve in a part-time capacity, the vendors are relied upon to provide perspective and counsel on many mission critical plan

management functions. Historically, that reliance was often mis-placed. Indeed, relative to the guardianship role, the duty of loyalty and the explicit duty to “monitor” parties in interest, the continuation of this reliance is inappropriate. In the real world, the economic best interests of vendors have often supplanted the economic best interests of the plan participants.

This is especially true in the new world of providing investment advice to plan participants. Few vendors can demonstrate that the advice they offer creates value. Very few can demonstrate that the advice they offer is valuable enough to pay for itself. If the service offers participant’s comfort – fine – charge a hand holding fee instead of a percentage of the participant’s account.

- The vendor’s interest in life-style and life-cycle funds that “automate” the asset allocation decision based on a plan participant’s age has embedded within it the self-interest the vendor has in maintaining the dominance of its investment management services in the 401(k) plan’s menu. This is counter productive relative to a Best-of-Breed approach and has technical flaws relative to managing investment risks that are mission critical for older workers.

Regardless of the lofty principles embedded in ERISA, the de facto operating condition of the fiduciary landscape is not a pretty sight. With \$10+ trillion of assets under ERISA’s umbrella, such a dysfunctional culture is clearly inconsistent with the spirit if not the letter of fiduciary principles. Another description of such a culture is to say that it fosters and maintains a very low level of emotional intelligence. Candidly, it is self centered, inauthentic (relative to purpose), delusional (like Jim), self-assured and unfortunately in the American retirement plan industry – common practice.

This isn’t to say everyone involved in the retirement plan industry is some kind of crook. Rather, this EI lens simply magnifies what everyone already knows. We all think in a manner that supports and validates our sense of Self and our economic interests – even when we have no metrics as to what value our activity has actually created.

Given the truth and gravity of this statement how can a retirement system, intended to represent the highest aspirations of trust and guardianship in law, recover a vision of its purpose and integrate the vision into the real world? Let’s start with something radical; how about being authentic.

### **Systematic Fiduciary Governance: When Structure Supports Purpose**

Responsibility without accountability has been the unspoken rule in ERISA. It is time that this change. The only credible solution to dysfunctional fiduciary conduct and the supporting cast of characters that promote it is to amend the current fiduciary governance practices of a retirement plan and install accountability that is visible to stakeholders at every segment of the plan management process.

There is no need to throw the entire system out. Rather, the efficiency of the entire system would be dramatically enhanced if a **systematic and transparent** approach to

fiduciary governance were implemented and all industry players were held accountable for their piece of it. The average American worker would be the winner.

### **Limiting the Impact of Low Fiduciary EQ and Incentivizing High EQ**

Let's go back to my friend Jim for a moment. He operated with an understanding of what was "wrong" with women and believed in the correctness of his perspective. He made his assessment and held it as truth because in his experience it **was** true. However, he reached his conclusion without including a self assessment as to how the vagaries of his own personality influenced his thought process and thus his conclusion. He just couldn't see it at the time **and** he didn't ask for an emotionally neutral (i.e., independent) pair of eyes to validate his hypothesis.

In similar fashion, most retirement fiduciaries and the support personnel around them do not engage in a critical self examination of their own conduct. Lacking a specific regulatory imperative to do so, initiating such an examination takes extraordinary courage. Investment managers, brokers, human resource fiduciaries, fiduciaries with a finance background, the attorneys and investment advisors who counsel fiduciaries, the Board members who serve as Appointing Fiduciaries and even the insurers who insure the above, all discount the contribution they make to supporting and sustaining dysfunctional fiduciary conduct within the industry. Everyone bears some amount of responsibility in the matter of this dysfunction.

All of these industry players have their reasons for doing what they do. Most of those reasons are related to their cash flow and market share. When all internal and external industry players are allowed to organize themselves in a manner such that no one is at the table speaking with a singular voice defending the interests of plan participants – the design of how the retirement security game gets played is fundamentally flawed.

When the maintenance of the status quo has a higher priority within the Plan Sponsor's fiduciary culture than does engineering more efficient or effective processes, something is wrong. The spirit of the fiduciary's duty has been subjugated. When fiduciaries give latitude to accommodate the self interest of service vendors a process has been initiated in which the incremental degradation of the duty becomes increasingly acceptable. **Only Rube Goldberg could be proud of such a convoluted architecture.**

### **So, What Is An Answer?**

In creating an answer to the dilemma posed by a low fiduciary EQ, there are two realities one must address. First, the regulatory burden upon business is already substantial. Additional regulatory burden will be resisted and any backlash will diminish the opportunity for real change. Secondly, the effectiveness of the retirement system has been compromised for many years. Therefore, a solution that is years in the making runs the risk of being an ineffective band aid or a smoke screen, neither of which are useful relative to engineering an effective and efficient solution that promotes retirement security.

The author is suggesting that a genuine safe harbor against fiduciary liability be offered to the Plan Sponsor of a retirement plan IF and only IF the Sponsor adopts and can demonstrate the operational effectiveness of a governance process that assigns individual accountability for the fulfillment of all statutory fiduciary duties, establishes metrics which provide a credible assessment of the effectiveness of plan management practices and visibly incorporates the following components of governance transparency.

1. The Sponsor must collect separate written disclosures of the economic self-interest of each and every party upon whose advice, counsel or services they depend in executing plan management activities. These disclosures must be made available to Trust beneficiaries in their entirety and plan participants must be made aware that such disclosures are available.
2. The Sponsor must create, implement and make visible to all Trust beneficiaries written disclosures regarding the process of self examination and/or independent examination of the Sponsor's fiduciary conduct relative to the statutory fiduciary duties already existing in law. A self examination must make use of a thorough documentation system that has embedded within it a very high standard of fiduciary care.

If these components of a fiduciary governance system were visible to all stakeholders (the plan participant, the Sponsor's shareholders and the federal regulatory agencies that oversee retirement plans) the transparency of such information would have the natural effect of improving the quality of plan management. Only when such information is collected, disclosed and published will the dysfunctional behavior that has influenced the industry be mitigated.

If such a mandate was not contaminated by the self interests of the investment management community it would warrant the granting of a genuine, complete and comprehensive safe harbor from fiduciary liability by the regulatory authorities. That's right. Other than stealing money or explicit fraud, fiduciary liability would be a thing of the past. The notion of having multiple conditional safe harbors for Plan Sponsors as were offered in the Pension Protection Act of 2006 is of marginal utility relative to a blanket safe harbor which provides real protection based on meeting the requirements of a rigorous governance documentation process.

The safe harbor from fiduciary liability would be offered specifically to the appointing fiduciaries of the Board of Directors. By doing so, it would generate interest at a level of corporate leadership for which the fiduciary governance processes can receive the internal support to allow these plan management practices to flourish. By requiring that the self assessment be reviewed and approved by the Plan Sponsor's Board of Director's, an additional incentive would be incorporated into promoting checks and balances in fiduciary governance.

***A missing link of the fiduciary system would be in place, operational and incentivized.***

The adoption of these changes would create a system that is more authentic relative to its purpose than what we have now. Such a system would impose few if any costs on the Sponsor or plan participants because a template can be promoted that would serve as the foundation of the system. Various plan costs would be examined in a new light – one that exposes the economic self interest of all vendor support personnel and organizations. The impact of such sunshine cast upon plan management practices will make it easier for fiduciaries to carry the guardianship shield on behalf of those who trust them to do so.

With all of the really important information on the table rather than under the table, the marketplace will naturally reward the provider of high quality services that actually make a difference.

To remove communist-like ideology from the retirement plan business, to simplify the process by which a Plan Sponsor knows they are fulfilling their duty and to offer a genuine safe harbor that relieves liability are all worthy goals.

Implement this solution and plaintiff's counsel, service vendors who obfuscate value and Rube Goldberg will all have to find something else to smile about.

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