Trying To Understand A Plan Sponsor's Irrational Decisions Isn't Easy

By Ary Rosenbaum, Esq.

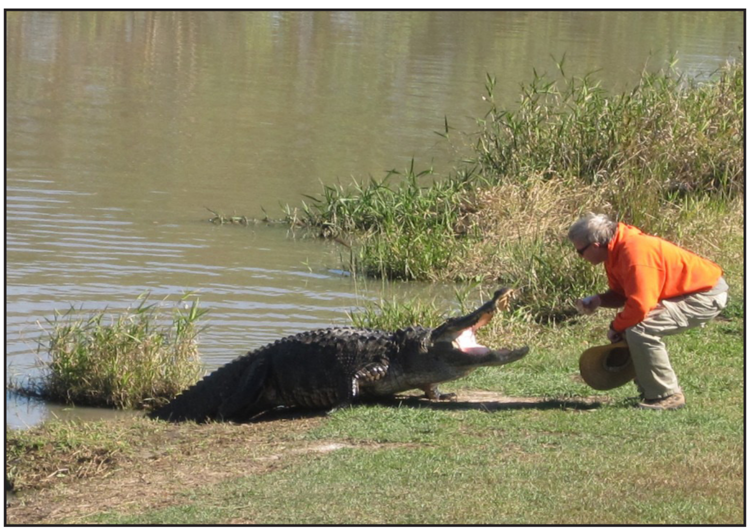
As retirement plan providers, we know that it's very hard to recruit new plan sponsor clients. Getting the attention of a plan sponsor is hard because many aren't interested in their fiduciary responsibility. Even after getting the attention of a plan sponsor, it's often difficult to get hired even if the current plan providers aren't very good or are just charging too much for too little service. The problem is that as quality plan providers, we only see things from our perspective and quite honestly, it's too blinding. This article is trying to make you see and understand that with a plan sponsor's decision making, there is more to the story on why plan sponsor may act irrationally in the providers they keep.

It's not wrong from where they see it

A big chunk of my newest book, "The Greatest 401(k) Book Sequel Ever", available on Amazon in Kindle and paperback (cheap plug) talks about dealing with other people, especially plan sponsors. Too often, as rational people, we go crazy trying to figure out irrational people and behavior. On paper, you might be the perfect solution as a plan provider to most plan sponsors out there, but those potential clients may not see it. We're often blinded by our view on what makes sense on a plan sponsor level of decision-making, but we know better since we're experienced as plan providers. Bad decisions made by plan sponsors in how they run their plan and the ineffective providers they retain are decisions that most plan sponsors think are correct. Their wrong decisions aren't wrong from where they stand and there is a lot of reason why that is. Trying to understand how other people, namely plan sponsors, think, will give you an edge because you'll have empathy and you'll probably understand whether a plan sponsor will hire you or not.

Plan sponsors often make bad decisions because they really don't know what they need to know

Probably the major reason that plan sponsors make bad decisions in running their plan is that they have no idea about their role as a plan fiduciary. They don't know a thing about fiduciary duty and that it requires the highest standard of care. While the talk about fiduciary responsibility has been dominating the 401(k) plan business for the last 15 years, there are so many plan sponsors that really don't know about it because they're too busy or too uninterested in learning about such an important topic. Time and time again, plan sponsors feel often betrayed by an incompetent plan provider without understanding that they're on the hook for liability when that provider goes rogue. Half the battle with getting clients is educating plan sponsors about their responsibility and why the current plan providers aren't helping them out in managing the process. The biggest problem in the retirement plan business why plans are still being mismanaged is because we still have many plan sponsors (especially on the small and medium-sized plans) that still can't identify that they can't set a retirement plan and forget it. So when dealing with plan sponsors and trying to solicit them as potential clients, just remember that many, if not most might be hesitant to hire you just because they don't know that they need to, to help them manage their plan in a prudent manner.



Plan sponsors have this strange sense of loyalty

Loyalty is an admirable trait, being supportive and having an allegiance is a quality that we want with our family, friends, and co-workers. I spent a chapter in my book talking about the greatest businessman that I personally know: my mechanic, Ralph. I've been going to Ralph ever since I got my first car with my first job: a 1998 Toyota Camry. I learned about Ralph through my father when he took his fairly new Nissan Maxima for issues dealing with his shocks and Ralph honestly told them that he should take the car to the dealer since it was still under warranty. 20 years and 5 cars later, I'm still using Ralph because he's honest, the service is impeccable, and he's transparent about his fees. Since the cars are mine, I'm under no duty to seek out a second opinion from another mechanic or to benchmark Ralph's fees. If Ralph's fees are a lot more than what other people charging, that's my problem. That's why I think that most plan sponsors have a misdirected loyalty to the providers that they keep. Loyalty is admirable to a plan provider if the provider is doing a great job and the plan sponsor isn't willing to leave that provider for someone who might be charging a few dollars less. Loyalty is completely misdirected if the plan sponsor is loyal to plan provider just because of the length of time as clients rather than the quality of service that the plan provider has provided. I think the most heartbreaking situation I saw as an ERISA attorney is when the owner of a defunct business realized that their actuary wasn't doing the job they were supposed to do for over 25 years and the Department of Labor (DOL) incorrectly assumed that the owner was embezzling from their plan based on guidance provided by the actuary. When the actuary died without providing valuation reports that would prove that the owner would be entitled to those benefits, the DOL could only assume that checks from the plan to another one of the owner's failing businesses was embezzlement. Loyalty to your spouse, loyalty to your friends, loyalty to your bosses and co-worker are admirable, having loyalty to a plan provider that might not deserve it is completely misguided. As a competent plan provider, just remember that many times, a plan sponsor won't hire you because they have this weird sense of loyalty to the incumbent provider. So when sitting down with a potential client, identify who the current providers and are and ask how long the relationships are. If the incumbent provider charges way too much and/or doesn't do a credible job, identify that some misguided loyalty may be part of the thought process on the part of the plan sponsor. So if you think that loyalty to the incumbent provider might not get you the job, make sure you address the loyalty issue and how it might conflict with or threaten the plan sponsor's fiduciary responsibility.

It might be all in the family or some other relationship out there

I live in Oceanside, New York and there are people on our school board that don't think there is anything wrong with hiring people related to school board members or their friends for the school district. Like with hiring school district employees, hiring plan providers because they're related to someone the plan sponsor knows, is wrong. Depending on the familial relationship (like hiring the owner's spouse as the advisor on the plan), it might be a prohibited transaction. Even if it's not a prohibited transaction, any form of nepotism implies that something underhanded was done in hiring plan providers when plan sponsors have a duty to make sure that plan provider hiring is an above the board process. Not only hiring a plan provider because they're related to someone is wrong, hiring one because of some existing financial relationship is wrong. Hiring the bank as a plan provider just because they're providing the plan sponsor a line of credit. Is just as bad as hiring someone's cousin as the plan's third party administrator (TPA). When speaking to plan sponsors, it might be important to identify whether any of the incumbent providers are "juiced in" because of family and personal relationships. By doing that, you could figure out whether you have any chance of netting the plan sponsor as a client if you're competing against a provider that has an underlying relationship with the plan sponsor. Knowing you're competing against the cousin may go a long way in managing your level of expectation of getting hired.

There might be something else out there that you can't identify

Loyalty and family are concepts that are easy to understand why the plan sponsor is still making poor decisions, but there might be something else out there that might explain it. The problem is that you may not know as a plan provider why a plan sponsor is making an irrational decision and as a rational person, you're wasting your time trying to figure out irrational decisions especially when you may not have all the facts in front of you. A perfect example is when I working as a TPA, a broker we knew was fired and it was dumbfounding. It was even more dumbfounding when the broker was quickly rehired and only at that time, did we know the soap opera that was taking place. We found out that the human resources director was fired for blowing the whistle on the fact that one of the executives had the broker fired and was being paid a kickback under the table by the new broker. So the whistleblowing cost the H.R. director their job, but that good broker got his job back. The problem with irrational decisions by plan sponsors is that often, you may not understand the reasons why until they're fully disclosed. So often, you can't figure out why plan sponsors make bad choices and you are wasting your time to rationally explain irrational behavior.

The idea of game theory

While game theory originally started as the study of mathematical models of cooperation and conflict among rational decision makers. These days, game theory is dealing with behavioral relations and it's a science of logical decision-making. I use game theory to try to identify how people will act and the decisions they will make. Now if I can only use that for poker. As discussed in my book, I was a Vice President of a Synagogue where I apparently was the only one fundraising and running events. When another Vice-President who was supposed to be my ally was about to become a President, she apparently cut a deal for a former President to serve as a Vice President again. My only problem with that is that the former President wanted to hire an unqualified member as a secretary and his wife was running the Hebrew School. This former President was awful at fundraising and recruitment and was only good at cutting costs. So I made an ultimatum to the incoming President that she had to make a choice between the former President and myself. All along, I knew what her decision was going to be because she was shortsighted and stubborn and that's why I made the ultimatum, it was an easy way out for me to leave the synagogue. When working with potential clients, always listen and try to understand their behavior, it's a great way to identify where their decision is heading.

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