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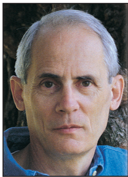
A Legend Looks Back At the Breakthrough of the 401(k)


Ted Benna

Talk about a living legend brimming with institutional knowledge.

Ted Benna is the brains behind the entire mass-market mutual fund industry. While working as a tax accounting executive for the **Johnson Cos.** in the 1970s, a section of the **IRS** tax code about qualified retirement savings caught Benna's attention. Without this 401(k) contribution spigot turned on in 1978, mutual funds would have remained investment vehicles for the very wealthy, and the hedge fund industry wouldn't have developed into one serving the ultra-high-net-worth.

Benna, known as the "**Father of the 401(k),**" and currently president of the 401(k) Association and chief operating officer of **Malvern Benefits Corp.**, has been honored by numerous news outlets, including *Money* magazine, *The Wall Street Journal* and *Defined Contribution News*.

Following is a special bylined contribution from Ted Benna.

An Historical Perspective on the 401(k):

The Inspiration Behind Mass-Market Retirement Savings

By Ted Benna

What inspired me to find a tremendous investing opportunity in the **Internal Revenue Service**'s tax code?

Back in the 1960s and the 1970s, Most Fortune 500 companies had traditional defined benefit pension plans and thrift/savings plans. Mid-sized to smaller employers had either a profit-sharing plan or no plan. There were exceptions, but this was the most common retirement plan scenario pre-401(k).

The typical thrift/savings plans had very liberal withdrawal provisions; therefore, the focus for most of these plans was short-term rather than retirement. Most of these plans were converted into 401(k) plans during the early 1980s, by adding a pre-tax employee deferral feature. This started a shift from short-term to longer-term savings for many employees at these companies, increasing the prospects for a financially secure retirement.

Employees working for an employer that offered only an employer-funded profit sharing plan were totally dependent on the profitability and generosity of their employers for retirement-income security. At that time, employees of these companies were not permitted to contribute to an IRA, even if the employer didn't make any contribution to the plan. There were examples of wildly generous profit sharing plans, but annual contributions to the more typical plan were below 5% of compensation ? considerably less than what was needed to provide an adequate level of retirement income.

These profit-sharing plans were redesigned during the early years of 401(k) to add employee deferrals and perhaps an employer matching contribution in addition to the employer profit-sharing contribution. Enabling employees to make pre-tax contributions (in addition to the employer contributions) increased the potential of having an adequate level of retirement income.

The third category of employers that joined the 401(k) party included those who never had any retirement plan. Most were businesses with less than 100 employees. The 401(k) was and, still is, appealing to many of these smaller businesses because there isn't any required employer contribution. An employer could offer a plan with an attractive matching contribution at a cost of 1% of payroll or less. This was the only type of retirement plan many of these smaller employers could afford to adopt.

The First 25 Years

The advent of the 401(k) added to the retirement income security of our nation during the next 25 years. Employees of the Fortune 500 companies accumulated substantial account balances, which, when combined with Social Security and their traditional pension benefits, enabled many of them to retire more comfortably than if 401(k) never happened.

Retirement income security also improved for employees who had been covered by employer-funded profit-sharing plans if they contributed to the plan when pre-tax contributions were permitted.

Offering a 401(k) plan has also enabled hundreds of thousands of small businesses help their employees save for retirement during the first 25 years that these plans have been on the market. Employees who have participated in these plans have accumulated retirement savings that otherwise would not have been possible.

The Next 25 Years

The demise of traditional defined benefit plans among larger employers began with the passage of the Employee Retirement Income Security Act (ERISA).

I know, because I used to sell defined benefit plans before ERISA. I knew nothing about defined contribution plans at that time. The market for defined benefit plans, other than for small professional organizations, died because ERISA gave the Pension Benefit Guaranty Corp. a claim to a portion of corporate assets. As news of this fact spread, employers were warned by their professional advisers to stay away from defined benefit plans. I had to shift to selling defined contribution plans because there was no longer any interest in defined benefit plans.

The reasons for avoiding defined benefits have increased dramatically since ERISA was enacted. The situation is so bad, in my opinion, that companies with defined benefit plans (traditional or hybrid) will continue to be under great pressure to eliminate them. As employers continue to shed their defined benefit plans, 401(k)s and other defined contribution plans will be the sole vehicles for accumulating assets for retirement among non-union employees.

The result will be to place an even greater burden on employees to plan for their future. The awareness of these facts is what led Congress to address some of the major weaknesses of 401(k)s when it passed the Pension Protection Act (PPA). PPA removed barriers and added incentives to encourage employers to automatically enroll employees, to automatically increase contributions, and to structure investments in a manner that would increase the likelihood for success. Helping employers add these features will improve the system during the years ahead, but there is a huge challenge.

I was contacted numerous times when Public Broadcasting TV was in the production stage for the show it did a couple of years ago on how well 401(k) retirees are doing. The producer of the show wanted to interview employees who had recently retired with 401(k) as their sole retirement benefit. His goal was to see how well these employees were doing a few years after they retired.

I told him such people didn't exist at the time because most of the recent retirees were from larger employers that had both defined benefit pension and 401(k) benefits. During the last conversation we had, he shared his frustration that he wasn't able to find any retirees that fit his profile. I told him there will be many such retirees 20 years from now.

Future generations of non-union workers will only have 401(k) or other defined contribution benefits plans available through their employers to provide retirement income.

The challenge of helping these employees accumulate enough for retirement and converting what they accumulate into an adequate income stream for the rest of their lives will be an unprecedented challenge, resulting in a huge opportunity for the financial services industry and financial advisors. How well will we as a country and as an industry do in the years that lie ahead in meeting this challenge?

It is obvious that all of us, regardless of our employer or the type of retirement plan we have, will be dependent on a strong economy and robust stock market during the next several decades. All retirement systems and structures whether they are personal, corporate or governmental are dependent on a strong economy and a robust stock market.

We can't control the economy or the stock market but we can control the quality of products and services we deliver to those who need our help. MME

Ted Benna also sits on the editorial board of *Money Management Executive.*

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