CHAPTER 27

401(k) Plans: From Inception to the Present Day[1]

Ted Benna

BACKGROUND

The legislation that permits 401(k) savings plans as they exist today was enacted during the fall of 1978 with the passage of the Tax Reform Act of 1978. Paragraph (k) was added to Section 401 of the Internal Revenue Code (IRC) with little fanfare. Congress thought they were simply resolving a conflict involving cash-deferred profit sharing plans rather than setting the stage for the 401(k) savings plan that would drastically alter our national retirement system. How and why did this conflict originate?

Many of the major banks had cash bonus plans during the 1960s and 1970s. Typically eligible employees received one or two weeks of base pay as a cash bonus at the end of each year. These bonuses were intended to be performance-based compensation tied to the bank's financial results. The cash bonuses were paid to eligible employees on a year-by-year basis, and they were told not to consider them as annual

1 Editor's note: Ted Benna is credited with creating the very first 401(k) plan. A series of footnotes throughout this chapter details some of Mr. Benna's personal reflections on the initial thinking and confluence of regulatory and market conditions that were brought together to design the first 401(k)s.

guarantees. However, after employees received several annual bonuses they expected to receive them every year. As a result, the intended flexibility and incentive factors originally intended in these plans disappeared. This was particularly true since the bonuses were usually distributed during the holiday season.

Employers that offered a tax-qualified retirement plan during this period either had a defined benefit pension plan, a money purchase pension plan, or a deferred profit sharing plan. A deferred profit sharing plan was the plan of choice for employers that did not want to be committed to paying a fixed retirement obligation. Employers with these plans contributed a portion of their profits each year to the plan. The amount contributed was typically deposited into a trust and was invested as the employer directed. The assets of the trust were maintained in separate plan accounts where they accumulated until the participant retired. Typically, only the employer contributed to these plans and the entire employer contribution was placed in the participant's account. However, some plans did permit employee after-tax contributions. The investment income on both employer and employee contributions was tax-deferred until the money was withdrawn from the plan.

The next variation in plan design was a cash-deferred profit sharing plan. With this type of plan, half of the annual bonus amount automatically was deposited into a tax-qualified profit-sharing plan. This deferred half was not taxed until the employee left the employer and received a benefit distribution. The employee could elect to take the other half as a taxable cash payment—or alternatively could deposit it into the same tax-deferred profit-sharing plan.

This new arrangement gave employers an alternate to either a plan where all year-end profit sharing was paid as a taxable cash bonus or entirely was deposited into a tax-deferred retirement plan. These plans became popular among banks seeking to eliminate their cash bonus plans because they were not perceived as performance-based compensation. At this time, members of senior management had a strong personal interest in replacing the cash bonus plan with a tax-deferred plan since the top personal tax rate exceeded 50 percent.

Under such a plan, if a teller received a $400 bonus, $200 automatically would be deposited into the tax-qualified profit sharing plan. The teller could take the remaining $200 as a taxable cash payment or also deposit this half in the retirement plan. An executive who received a $20,000 bonus could tax-defer the entire amount rather than losing as much as $14,000 in taxes.

0855_Ch27.qxd 4/28/05 7:14 PM Page 687

Formal Legislative Recognition of 401(k) Plans

These cash-deferred plans were approved by the Treasury Department, even though no official provision for them existed in the Internal Revenue Code (IRC). As would be expected, higher-paid employees tended to defer the entire cash bonus to avoid taxes. Most lower-paid employees preferred to take half as a cash payment to cover immediate financial needs such as holiday shopping.

When the Treasury Department realized that a disproportionate share of the tax benefits was being enjoyed by higher-paid employees, they stopped approving these plans. In 1972 they prohibited any new cash-deferred plans, but allowed existing ones to continue. The Treasury Department announced that they would study these plans and ultimately would determine their future. However, Congress became involved with this issue when it passed the Employee Retirement Income Security Act (ERISA) in 1974. Congress blocked the Treasury Department from further action while the issue was studied further. Four years later Congress passed the Tax Revenue Act of 1978. The Act contained two additional requirements for Section 401(k) plans: a new nondiscrimination test and restricted access to the money contributed to the plan during active employment. Through these requirements, Congress provided a legislative basis for the continuation of these plans.

PLAN ADMINISTRATION

Nondiscrimination Testing

The nondiscrimination test, now known as the Actual Deferral Percentage or ADP test, tied the amount that the highest-paid third of eligible employees could contribute directly to the average percentage of pay that the lower-paid two-thirds of employees actually contributed to the plan. Without getting too deeply into the particulars of this test, which has been changed, here is an example. If the lower-paid employees contributed an average of 2 percent of pay, the top third could contribute an average of 4 percent of pay. The average percentage for the top third could be double the percentage for the bottom two-thirds, but the spread could not exceed three percentage points.

The nondiscrimination rules for 401(k)s have changed over the years. Currently the testing groups are defined as highly-compensated employees (HCEs) and non-highly compensated employees (NHCEs). As of 2005, the HCE group includes employees who earned more than

0855_Ch27.qxd 4/28/05 7:14 PM Page 688

$95,000 the prior year (adjusted for inflation) and any employee who owned at least 5 percent of the stock during either the prior year or the testing year. Certain family members of these employees are also included in the HCE group regardless of their pay levels. The permissible spread between the HCEs and NHCEs is now the greater of 1.25 times the NHCE average percentage or two times the NHCE average percentage but with a maximum spread of two percentage points when the two time multiple is used. For example, the HCEs may contribute an average of 6 percent of pay if the NHCEs contribute an average of 4 percent of pay.

The average percentages for the two groups have always been determined by first computing the actual percentage of annual pay each eligible employee contributes. These percentages are then totaled and the average for each group is determined by dividing this sum by the number of eligible employees. Other key facts regarding the ADP test include the following:

- Various definitions of annual compensation are acceptable.
- Actual total employee contributions for the year must be used.
- The law permits the NHCE results from either the prior or current year when performing the current year test.
- An employer can avoid these testing requirements with a specific plan design known as a "safe harbor" plan.
- Plans that have many HCEs may elect to include only those who are in the top 20 percent by pay category in this group for testing purposes; however, all 5 percent owners must be included in the HCE group regardless of their compensation level or the number of such owners.
- Employees who do not satisfy the minimum age and service requirements may be tested as a separate group.
- Employees who are eligible but do not contribute must be included in the applicable testing groups.

The regulations regarding non-discrimination testing are long and detailed. Therefore, do not consider the above synopsis to be a comprehensive treatment of this issue.

Employer Matching Contributions

The initial creation of the special nondiscrimination test for 401(k)s linking the average percentage of pay contributed by lower-paid employees to

0855_Ch27.qxd 4/28/05 7:14 PM Page 689

the average percentage of pay contributed by the higher-paid employees was an entirely new concept. This created an incentive for the higher-paid employees to encourage the lower-paid employees to contribute as much as possible to the plan. Obtaining a high participation rate among lower-paid employees was necessary to assure legal compliance for these plans. Also, something more than saving on taxes was needed to achieve this result. At the time, thrift or savings plans were popular at large companies and a few small employers also had them.

With a thrift or savings plan, employees contributed up to 10 percent of their after-tax income. Employers made a matching contribution as an incentive to encourage employees to contribute to these plans. Investment income and capital gains on both employee and employer contributions were exempt from tax until benefit distributions occurred. The employer matching contribution usually ranged between $.25 and $1.00 for each dollar the employee contributed. Matching usually was limited to the first 4 percent to 6 percent of pay an employee contributed, similar to today's 401(k) plans. For example, with an employer match equal to $.50 per dollar, an employee who earned $20,000 could contribute $1,200 and receive $600 of matching contributions if the employer matching was limited to the first 6 percent of pay the employee contributed. The employer match provided an attractive incentive for employees to contribute. As a result, 70 percent or more of the employees eligible for these plans usually contributed.

Combining Pre-Tax Employee Savings and an Employer Matching Contribution

The first 401(k) savings plans combined these features—employee pre-tax savings and an employer matching contribution. It should be noted that neither of these features were included in the statute or in the regulations. Although there was not a provision for employer matching contributions or employee pre-tax contributions, there also was not a legal prohibition that prevented these possibilities.[2] Matching employer

2 Ted Benna's personal reflection on the interaction between government policy-makers and practitioners: I had the opportunity to explain to the person who was writing the proposed regulations at the Treasury Department during early 1981, exactly how I was designing these plans. I was comforted by the fact that he understood the issues including the fact that when money is sent by an employer to be invested it is very difficult to monitor whether it resulted from salary reductions or employer contributions.

0855_Ch27.qxd 4/28/05 7:14 PM Page 690

contributions were already in place at most Fortune 500 companies through the after-tax thrift and savings plans.[3]

Employee pre-tax contributions to a 401(k) are accomplished by allowing an employee to enter into a salary reduction agreement with the employer. The employer then contributed this amount to the plan as an employer contribution. The employer actually deducted these contributions as an employer contribution to a retirement plan rather than as wages when the business tax return was filed.[4]

A concern with the early 401(k) plans was whether the Treasury Department would permit salary reduction contributions. Employees of most not-for-profit employers had been able to make pre-tax, salary reduction contributions for years to 403(b) Tax-Sheltered Annuity plans. The Tax Reform Act of 1978 created a similar opportunity for governmental employees to make such contributions to newly created Section 457 plans. Employee salary reduction contributions needed to be permitted with 401(k) plans; otherwise, employees of for-profit companies would be denied an opportunity that was available to just about all other types of employees. Fortunately the forthcoming proposed regulations

3 Ted Benna's personal reflection on the first 401(k) plan implemented at the Johnson Companies: The first 401(k) savings plan with employee pre-tax contributions and an employer matching contribution began on January 1, 1981 at The Johnson Companies where I was employed at the time. We accomplished this by converting our existing savings plan. Because I didn't know at the time whether Treasury would ultimately permit salary reduction contributions, we accomplished this by giving all employees a 6 percent salary increase effective January 1, 1981 as an employer contribution to the plan. We then permitted each employee to decide whether to let this money go into the plan or to take all or some of it as taxable compensation. I was confident this design would work regardless of the regulations but this method of "employee" funding would have been much more difficult to market than a pure salary reduction. Needless to say, I was relieved when the proposed regulations were issued during the fall of 1981 permitting both employer matching contributions and employee salary reduction contributions. Employer matching contributions were not subject to nondiscrimination testing at this time. As a result, there wasn't any limit on the spread between the higher and lower paid employees. By the way, the bank that I designed the plan for decided not to go ahead because their attorney didn't want them to be pioneers. We installed a plan for the bank a couple of years later.

4 Although employee pre-tax contributions were originally treated this way, subsequent legislation has changed this accounting treatment. The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) modified the definition of compensation beginning in 2002 to allow greater employer deductible contributions. Elective deferrals to qualified cash and deferred arrangements, i.e., 401(k) plans, which were previously excluded from the definition of compensation, are now included. Also, elective deferrals to cash or deferred arrangements are no longer deemed employer contributions and they are, therefore, not subject to the employer deduction limitations.

0855_Ch27.qxd 4/28/05 7:14 PM Page 691

were issued during the fall of 1981 permitting both employer matching contributions and employee salary reduction contributions.

Restrictions on Withdrawals

The hardship withdrawal rules were another key element that was introduced in this new Section 401(k). From a public policy standpoint, the Treasury Department was willing to give employees limited access to their money while still employed, but certainly did not want employees to have complete and unrestricted access to these funds. The rules have changed a bit since then, but access to employee pre-tax contributions prior to age 59½ while still employed are limited to financial hardships that satisfy the law and Internal Revenue Service (IRS) regulations.

The reason that 401(k) plans grew so rapidly once information about this new way to save for retirement gained press coverage was the conversion of after-tax savings plans among the Fortune 500 companies. The top personal tax rate was above 50 percent at the time. Executives of these companies favored converting their after-tax savings to pre-tax savings. An executive who was able to convert $20,000 from after-tax to pre-tax contributions received a big increase in take-home pay. All employees who changed from after-tax to pre-tax savings either received an immediate increase in take-home-pay or could put more money into the plan without a change in take-home pay.

Nevertheless, the more restrictive distribution rules were a hurdle when converting after-tax to pre-tax plans. Employees who put money into an after-tax savings plan could withdraw their contributions at any time for any reason. The employer matching contribution also could be withdrawn after two years for any reason. Because of these liberal withdrawal rules, many employees used these plans strictly for short-term purposes rather than to supplement their retirement income.

Employers changing from an after-tax savings plan to a pre-tax plan had to decide whether to permit only pre-tax employee contributions after the change. Most Fortune 500 companies were unwilling to make this change since many employees who were using these plans for short-term savings would not favor this change. As a result, the most common approach among Fortune 500 companies was to add a pre-tax feature giving employees the option to save pre-tax, after-tax or using a combination of the two. One problem with this design was that only the pre-tax contributions could be counted when performing the nondiscrimination test. This generally made it more difficult for plans

0855_Ch27.qxd 4/28/05 7:14 PM Page 692

that permit both types of contributions to pass the employee pre-tax ADP test.

Subsequently, a test known as the Actual Contribution Percentage (ACP) test was added with passage of the Tax Reform Act of 1986 (TRA '86). The ACP test is applied to after-tax employee contributions and employer matching contributions. TRA '86 also included a more restrictive ADP test and introduced for the first time a separate dollar limit for 401(k) pre-tax contributions ($14,000 as of 2005). These changes were more restrictive to 401(k) plans but were much more favorable than the initial draft version of TRA '86 which contained a provision to eliminate Section 401(k) altogether. This effort to revoke 401(k) failed due to a major lobbying effort from many of the participants who already were contributing to these plans.

ADOPTION BY SMALLER EMPLOYERS

Fortune 500 companies were not the only ones interested in this newly introduced plan. Many smaller businesses that either did not sponsor a retirement plan or just offered a deferred profit sharing plan were early adopters of 401(k)s. Most financial advisors agree that at least 10 percent of an employee's income should be invested into some type of retirement program to have a reasonable chance of accumulating a sufficient pool of assets to facilitate adequate retirement income. There are few small- to medium-sized employers that can afford to contribute 10 percent of compensation to a retirement plan. Many of these employers also are reluctant to adopt pension plans that involve a significant and ongoing financial commitment.

Generally, two types of employers tend to adopt a tax-qualified retirement plan: those seeking a plan to help attract and retain good employees and those who are interested primarily in a tax shelter for the owners. There are employers of course that want both. The comments here are oriented to employers that have a strong employee focus.

Profit sharing plans were the preferred plan of small- to mid-sized employers before 401(k)s were introduced. These plans were employer-funded but many plans did permit voluntary, employee after-tax contributions. The maximum amount employers could contribute to these plans was 15 percent of the gross compensation paid to all eligible employees. Subsequently the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) increased this limit to 25 percent of the gross compensation paid to all eligible employees. A few employers contributed the maximum amount, but most employers who had this type of plan

0855_Ch27.qxd 4/28/05 7:14 PM Page 693

contributed less than 5 percent of gross pay. Of course the vast majority of employers with less than 100 employees did not have any retirement plan for their employees.

401(k) created a new opportunity for small- and mid-sized employers that maintained a profit sharing plan with contributions that were substantially below the then applicable 15 percent maximum. These employers could add a 401(k) feature giving employees the opportunity to make pre-tax contributions to supplement those made by the employer. Doing so enabled employees to make sufficient pre-tax contributions to build an adequate retirement pool of assets. This ability to accumulate pre-tax assets heightened in importance following passage of the Tax Reform Act of 1986. Following passage of the Act, any employees covered by a profit sharing plan who were earning income above certain levels were prohibited from making pre-tax contributions to an individual retirement account (IRA), even if the employer did not make a contribution, or if the employer only made a token contribution, such as 1 percent of pay.

401(k) also opened the door for small- and mid-sized employers that did not offer any plan to do so. The employer does not have to contribute to a 401(k). Therefore, a small employer can start a plan without any employer contribution. The only cost involved is whatever fee is charged to set-up and to administer the plan. It should be noted; however, that an employer contribution is desirable to encourage lower-paid employees to contribute. Also, a 3 percent of pay minimum employer contribution is commonly necessary with small employers due to the top heavy rules that impact all qualified retirement plans.

These plans became so popular among smaller employers that more than 90 percent of the 400,000 plus 401(k) plans cover less than 100 employees. Figure 27–1 shows 401(k) statistics for 2003.

These numbers do not include savings incentive match plans for employees—individual retirement accounts (SIMPLE-IRAs) that were instituted with passage of the Small Business Job Protection Act of 1996 and first offered in plan years beginning after December 31, 1996. SIMPLE-IRAs are another attractive alternative retirement savings vehicle for small employers and their employees.

DESIGN OF EARLY PLANS

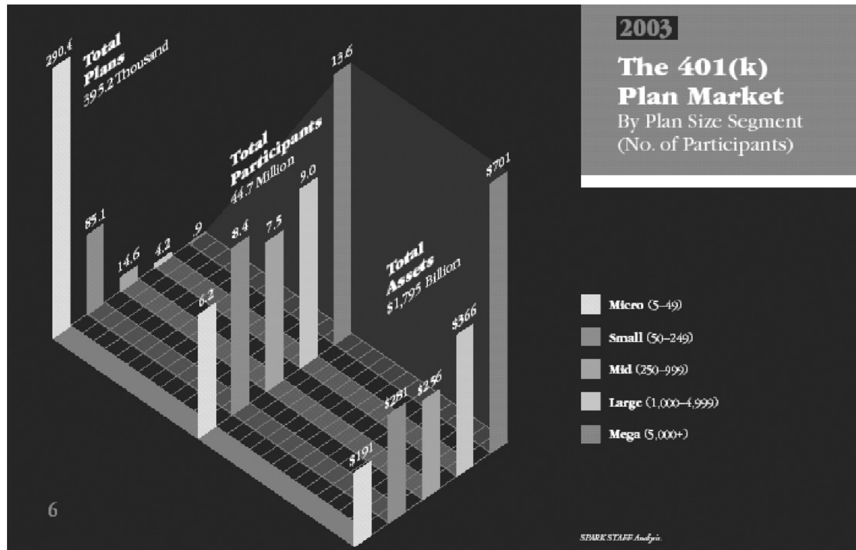
Typical Levels for Employer Matches

The early 401(k) plans typically restricted employee pre-tax contributions to a maximum of 6–10 percent of pay. The maximum percentage usually

0855_Ch27.qxd 4/28/05 7:14 PM Page 694

FIGURE 27–1

The 401(k) Plan Market by Plan Size Segment



was set to avoid or to minimize the excess contributions that would have to be refunded to HCEs as a result of failing the ADP test. There are other alternatives employers can utilize to correct ADP failures, but refunding excess contributions is the most commonly used method. Employer matching contributions, if any, usually were limited to the first 4–10 percent of pay that employees contributed. Amounts contributed above this level were not matched.

The most common matching amounts were \$.25 or \$.50 for each \$1.00 an employee contributed up to the applicable maximum. Amounts contributed above this level were not matched but they could still come from an employee's pre-tax income, subject to the ADP test results for the HCEs. These are still the most common matching arrangements, but there are many alternatives, including performance-related matches where higher amounts are contributed when employers have good profit years.

Many 401(k) plans also include a discretionary profit sharing feature permitting the employer to make such a contribution. Profit sharing contributions are usually made for all eligible employees including those who do not make employee contributions. A design issue for employers who want a performance-related contribution is whether to do this as an

enhanced match only for those employees who contribute or whether to make a profit sharing contribution for all eligible employees.

Generally a 401(k) plan is technically a profit sharing plan even if the only contribution is an employee contribution. This is because (k) of Section 401 was added to cover cash-deferred profit sharing plans. This demonstrates that Congress really never expected this Section to be used in this manner. At the time, one of the requirements for a profit sharing plan was that all contributions had to be funded from either current profits or retained earnings. This created some interesting situations: How could a not-for-profit employer adopt a plan that requires profits? How could a new business that had neither profits nor retained earnings have a plan?[5]

The law was changed eliminating the need for current profits or retained earnings and also to permit not-for-profit employers to adopt 401(k)s. This was an important change because it takes years for many smaller employers to become profitable and some never get there. Many small employers would not be able to permit their employees to make 401(k) contributions until the company became profitable. This is another instance where the drafters of Section 401(k) never anticipated what they were creating.

INVESTMENT AND OPERATIONAL STRUCTURE

Early Investment Choices

The early plans had only two investment options—a Guaranteed Investment Contract (GIC) and an equity mutual fund or company stock component. Participants were able to split their contributions among these two options in 25 percent multiples—0/100, 50/50 or 25/75. Explaining the investment choices was much more simplified as compared with current day investment choices and plan offerings. It was also easier for participants to make their investment decisions. They did not have to understand the differences between large-cap funds, mid-cap funds, or small-cap funds and investing styles such as value versus growth.

5 Ted Benna's personal reflection on the limitations originally imposed on profit sharing plans: I was personally involved in an even stranger situation with one of our clients. This client was one of the oldest U.S. steel companies. In a last ditch effort to keep the company alive, they were terminating their defined benefit pension plans and replacing them with a 401(k) without any employer contribution. The company had huge annual losses and they had wiped out a hundred plus years of retained earnings. As their consultant, I told them employee pre-tax contributions may not be permissible. This was the case since originally profit sharing plans required either a profit or positive net worth to make a contribution. As noted in the chapter, this requirement was later removed as a condition for making a contribution to a profit sharing plan.

0855_Ch27.qxd 4/28/05 7:14 PM Page 696

GICs provided very attractive returns in the early days of 401(k)—typically in the high single digit and even double digit range. In comparison, the stock market returns were rather erratic. As a result, some younger participants would elect to put all their money in a GIC with a 10 percent guaranteed return. The term "bundled" did not exist at this time. Plans at the large companies typically used a bank trustee, an independent recordkeeper, an insurance company for the GIC and a growth mutual fund from one of the major fund companies. All transactions were paper based. The participant requested a form from Human Resources, returned the completed form to Human Resources and then waited for weeks or months for the transaction to be completed.

Need for Communication

The 401(k) was the first plan, other than 403(b)s, that had to be sold to employees. This necessitated the development of enrollment materials, videos, etc. to help market these plans to employees. Of course, enrollment meetings became a necessity where these communication materials were used to explain new plans. The term "enrollers" evolved during this period. Enrollment materials have become much more colorful and user friendly over the years because major providers hired staff members with major consumer marketing skills.

Contribution Frequency—Payroll Issues

Prior to 401(k), most qualified retirement plans offered by for-profit employers were totally employer funded. As a result, contributions were usually made only once per year. Participants had no role other than receiving a benefit or account statement once a year and collecting their benefits when they left the employer. Since the 401(k) plan had employee and employer contributions, monies needed to be remitted monthly or more frequently to be tracked and invested.[6]

6 Ted Benna's personal reflection on the need for ongoing and continuous plan administration: I had a very difficult time convincing the person who headed our administrative area that his people needed to get involved during the early stages of 401(k) implementation so his team would be ready as soon as the plan started. He wanted to wait until all the loose ends were resolved. Such an approach was okay for an employer-funded plan where the employer made one deposit usually long after all the plan details were finalized. Such an approach was not possible with a 401(k) plan where ongoing contributions would occur with each payroll cycle. This requirement for ongoing and continuous administration was a revolutionary concept when these plans were introduced.

0855_Ch27.qxd 4/28/05 7:14 PM Page 697

HOW 401(k) CHANGED

Professional marketers were engaged with consumer product backgrounds to develop educational materials that have Madison Avenue appeal. Black and white communication materials with a staple in the upper left corner have been replaced by materials that have lots of color and are easy to read.

On the investment front, mutual funds became the vehicle of choice for 401(k) participants. This occurred primarily because mutual funds are ideally suited for 401(k) plans rather than as a result of the major mutual fund companies aggressively pursuing this market. The following are the major reasons why mutual funds have so much appeal to the 401(k) market:

- They are able to accept a constant flow of new investments.
- The minimum initial investment requirements and on-going minimums are small for most funds and many of these requirements are waived for the 401(k) and IRA products.
- Each mutual fund offers some degree of diversification.
- Money may be withdrawn at any time usually with little or no costs.
- They give small investors access to professional managers.
- The cost of investment is reasonable particularly for smaller investors.
- Shares may be bought and sold any day the stock markets are open.

Mutual funds that have gained a substantial share of the 401(k) market have done so largely because their offerings have market appeal. Those that are full service providers also have made and continue to make major investments in system and personnel to service these plans. In addition to mutual fund families, there are other very successful service providers including insurance companies, banks, third party administrators and even payroll firms, but all of these providers use mutual funds as the investment vehicle of choice.

Technology has had a major impact on how 401(k) plans operate. Generally paper forms and the long wait for transaction processing are gone. Voice response systems converted 401(k) participants into data entry clerks by enabling them to push buttons on their phones to obtain information about their accounts and to trigger transactions. This technology reduced the cost to administer plans while greatly enhancing the service participants received. Suddenly, participants could stay in touch with their 401(k) accounts on a continuous, round-the-clock basis.

0855_Ch27.qxd 4/28/05 7:14 PM Page 698

Then Internet applications provided another major improvement in customer service and plan management. In fact, the technology became so advanced in allowing rapid trading that it became necessary during 2003 and 2004 to implement some plan changes to restrict trading abuses. The Internet has made an incredible amount of financial information and support available to participants in a very cost efficient manner. As a participant, one can go on-line anywhere in the world with Internet access and move money from one investment to another and check the next day to verify that the change was correctly processed. In most instances, such a transfer occurs without human intervention.

This author personally designed the first 401(k) savings plan more than 25 years ago. This type of plan has been embraced by all types of employers, now covers more than 50 million participants, and has over $2 trillion in collective assets. These plans are attractive to employers of all sizes for a variety of reasons. Most employers that need to attract and retain good employees must offer a 401(k). This is one reason why companies of all sizes have them. Financial flexibility is another reason. Many companies were forced to stop or reduce their contributions during the early years of the millennium because of adverse economic conditions. While such actions are tough for employees to accept, flexibility to reduce costs when necessary without legal entanglements is important to most employers.

Employees have always known they should save for retirement, but they needed the appropriate savings vehicle to do so. The 401(k) emerged at a time when employee confidence in Social Security and employer-funded pensions began to wane. Talking to participants over the years has convinced me that the semi-forced payroll deduction feature is the most valuable benefit a 401(k) offers. The tax saving opportunity and employer match are beneficial, but the payroll deduction has the power to convert spenders into savers by placing savings first. The major reason that the 401(k) has been so successful is that it has met a real need—helping employees save for retirement. It is an imperfect human system but it is still the most effective long-term savings vehicle for most employees.

401(k) as we know it today is largely a product shaped by market pressures, legislation, regulation, and technology. The product has changed substantially over the years and it will continue to do so in the future.