Father of 401k' disowns it

The man credited with creating the employee retirement savings plan evaluates the concept 30 years later. Would he do it again?

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This post comes from Jeremy Olshan at partner site SmartMoney.

Ted Benna, who three decades ago seized on an IRS loophole to transform American retirement savings, says he's proud to be "father of the 401k." He also thinks he created a monster.

The plans, which he intended to be as simple for employees as pensions, now offer too many investing options and too many opportunities to make mistakes, he says. "I would blow up the system and restart with something totally different," he told SmartMoney. "Blowing up the existing structures is the only way we can simplify them."

In 1978, when Congress passed the section of IRS code for which the plans are named, lawmakers aimed to limit the scope of cash-deferred plans being offered by some companies, but had no intent to revolutionize retirement. Benna, then the co-owner of the Johnson Companies, a benefits consultancy in suburban Philadelphia, was developing such a plan for a bank client when he happened on the idea that section 401k could allow an entirely new option.

The original 401k plans "could be explained to employees in just a minute," Benna, now 69 and semiretired himself, says. "There were two options, a guaranteed fund and an equity fund," he says. "With the guaranteed investment fund, we'd tell them this is what you will have when you retire. With the equity fund -- which was usually something like the Fidelity Magellan fund -- we'd say, you might have more, but you might have less. Most people would split their contributions 50-50 between the two."

Plans became too complicated

As the plans were embraced by employers and financial institutions, Benna says 401k's were made so complex one needed to be an investing pro to make sense of them. "Now this monster is out of control. We went to three options, then to six, then to seven, then to 15 -- it is far beyond what most participants were able to deal with," Benna says. "And I am not convinced we have added value by getting more complicated."

Better education was supposed to be the solution to intricacies of the plans, Benna says. If employees understood the options, the power of compound interest and dollar-cost averaging, and the advantages of making pretax contributions, it was believed they would do the right thing. "We're throwing tons of money away trying to teach participants how to become skilled investors -- we said, we are going to make people smart and savvy enough to make the right investment decisions, but it just hasn't worked." *Post continues below.*

Benna blames the newfound complexity on what he says was the small percentage of employees who wanted it. "What triggered this whole mess is that some of the more sophisticated participants were a pain in the butt," he says. "You'd have these troublemaker loudmouths push human resources, and say, 'Why don't we have this "flavor of the month" fund?'" These sophisticated employees are also the ones taking advantage of the education and advice being offered, he says.

Overwhelmed, employees made mistakes

The consequence of all the complexity is twofold, he says. First, employees felt they could be more active investors. "There is too strong a potential for employees to do the worst thing ever, which is moving in the wrong direction, panicking when things are bad and cashing out after they have been battered." Secondly, the current plans induce "a kind of gridlock -- employees get so overwhelmed they do not participate -- they do nothing," he says.

Education didn't work to stop employees from sabotaging their own futures, he contends, but legislation might. "We need a legislative mandate that when you change jobs, the money needs to be retained in a retirement account -- there cannot be an option of 'here's a check, you decide,'" Benna says. He also advocates mandating all employees be auto-enrolled in the plans, and that their contributions be automatically increased one percentage point per year to a maximum of 10% to 15%.

Despite these misgivings, Benna insists the plans are benefiting millions of employees. He gets rankled whenever someone suggests the workforce would be better off had the 401k never been born, noting that the pension system was more fraught that many remember. "I am not anti-defined-benefit plan -- in fact I sold them for decades -- they are great, but only for those who stay with the same company for 20 or 30 years."