

401(k) Is Now the U.S.'s Leading Private Retirement Plan, November 2006

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At 25th Anniversary, 401(k)s Cover Twice As Many Workers as Traditional Pensions

Washington, DC, November 6, 2006— As the 401(k) plan turns 25, a [new study by the Investment Company Institute](#) finds that these defined contribution savings plans have become a mainstay of America's retirement security.

November 10, 2006, will mark the 25th anniversary of the 401(k) plan. Originally viewed as a supplement to traditional workplace pension plans, 401(k) plans now have 47 million active participants—more than twice the 21 million who participate in private-sector defined benefit pensions. 401(k) plans held \$2.4 trillion in assets in 2005, compared to \$1.9 trillion in assets in all private-sector defined benefit pensions.

Yet 401(k) plans had to overcome stiff headwinds from Washington to reach their current size and promise. The ICI study points out that in 1982, a worker and employer could make a total combined contribution of \$45,475 a year. Then Congress, concerned about the impact on the federal budget from deferring taxes on 401(k) savings, reduced the combined limit to \$30,000 in 1983 and effectively froze it at that level for 17 years. Despite recent legislative efforts to encourage saving for retirement, in 2006, the combined contribution limit is \$44,000—less in nominal dollars than the 1982 level.

"The 401(k) system has thrived despite complex rules and an often unfriendly climate in Washington," says ICI Senior Economist Sarah Holden, who coauthored the paper with Senior Economist Peter Brady and Assistant Counsel Michael Hadley. "The fact that it has grown to today's scale, in the face of those limitations, is testimony to the advantages that workers and employers see in this flexible and innovative retirement savings plan."

Other findings from ICI's paper:

- While 401(k)s were first offered as supplements to traditional pensions, the latest data shows that 90 percent of 401(k) plans are the only retirement plan offered by that employer. In 2002, some 350,000 employers offered 401(k) plans as their sole retirement plans. Three-fifths of those stand-alone plans were started in 1995 or later.
- The growth in 401(k) plans generally has been fueled by changes in the economy and the workforce—not by companies dropping traditional pensions in favor of 401(k)s. In particular, newer firms have tended to adopt 401(k) plans. Because traditional pensions generally favor employees with long service with one company, younger workers tend to place more value on defined contribution pension benefits.
- Mutual funds account for roughly half of the assets in 401(k) plans. Mutual funds have been instrumental in opening securities markets for workers participating in 401(k) plans, offering diversified investments, professional management, and innovative plan services.
- 401(k) plans offer a powerful savings tool that can provide significant income in retirement. In [research with the Employee Benefit Research Institute](#), ICI has found that more than half of today's young 401(k) participants can expect to retire with enough 401(k) assets to replace more than half of their pre-retirement income.
- [The Pension Protection Act](#), passed in August, offers the potential to sharply increase 401(k) participation and retirement income. The PPA makes permanent the updated 401(k) (and IRA) contribution limits; preserves catch-up contributions for workers age 50 or older; and encourages employers to offer automatic enrollment and better default investments in 401(k) plans.
- If companies fully implement the PPA's provisions, eligible workers can accumulate significant retirement income. In the lowest

income group, the median eligible worker could replace 52 percent of pre-retirement income if companies implemented automatic enrollment with a default contribution of 6 percent of pay, invested in a lifecycle fund. That's up from a 23 percent replacement rate for the median worker without those reforms.

"The Pension Protection Act signals that the 401(k) system is and will remain fundamental to our national retirement policy," said ICI President Paul Schott Stevens. "As that system enters its second quarter-century, we must make sure that it continues to develop and reach its full potential."

ICI's paper, "[401\(k\) Plans: A 25-Year Retrospective](#)," and [further information on 401\(k\) plans and ICI's 401\(k\) research](#) can be found on this website.

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