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History of Pensions

This essay was originally published in Muhlenkamp Memorandum Issue 105, January 2013. *It was the first essay of the series,* The "FRIDAY FOCUS" on Retirement, *by Susen Friday, Client Service Regional Manager.*

Ahh…retirement. On a personal level, we save for it, plan for it, and dream about it. But did you ever wonder how the whole notion of retirement and funding it came about? How it has changed over time?

Believe it or not, it all started with the Ancient Romans back in 13BC. Augustus decided that he would like to reward his legionnaires for their years of service and to offer a carrot to other young men to join the army. For 20 years of service, legionnaires received between two-thirds and threefourths of their yearly income. Initially, Augustus funded the pension out of general taxation; later, it was covered by a 5% tax on inheritance. When Rome fell, the military pension system collapsed as well.

During the Dark Ages, many members of the nobility maintained standing armies. Some of them devised crude pensions for their military, often granting land to older soldiers.

As European history progressed into the late 1600s and the 1700s there are indications that some sort of pension payouts had been made to non-military persons. Such payouts were not wide spread, nor sanctioned by the government.

Up until this point, no one had given a thought about social insurance—a system of wide-spread coverage sponsored by the government. In 1889, however, Otto von Bismarck established the first such system in Germany. It consisted not only of a pension, but also accident and health insurance. The system has adapted well over time. In fact, my grandmother collected from this system until her death in 1966.

Much of industrialized Europe followed in Germany's footsteps and created programs of their own. There were two main types: insurance systems that were related to the earnings of the recipients, and minimum systems which were essentially welfare systems for the elderly.

Retirement in the United States was conceived as a three-legged stool: one leg was the Social Security System, the second was private pensions, and the third was personal savings.

In the United States, the Social Security System was created in 1935 by the Social Security Act. The System initially provided income to retired workers based on their earned income. Since then, it has been amended and expanded. Most notably, the changes are to cover those with disabilities and to provide medical coverage for those on public assistance.

The first private pensions established in the United States were by American Express (1875) and the B&O Railroad (1880). Many other companies followed suit, primarily in the banking, railroad, and public utility industries.

The "retirement industry" was born in the early 1900s when insurance companies began offering group annuity contracts to companies. Insurance companies have continued to play a major role in retirement plans ever since.

Over time, private companies were encouraged to provide pensions to their employees. During both World War II and the Korean Conflict, the U.S. government imposed price and wage stabilization programs. Since companies could not reward their employees with higher wages, they turned to providing benefits as an alternative.

The growth of pensions in the coal, automobile, and steel industries was a direct result of collective bargaining by their respective unions. The availability of retirement plans spilled over into nonunion companies and has been used as a means of being more competitive for skilled labor.

What's important to remember is that retirement plans are dynamic creations that change over time!

Plan design, or customization of individual plans, provides the framework within which a plan must operate. If the plan sponsor wishes to include a new feature in the plan, he legally amends the plan. Sometimes the government wants to change the rules under which qualified plans operate across the board. This is usually done by passing new legislation that is then implemented by either the Department of Labor (DOL) or the Internal Revenue Service (IRS). An example of this is the recent Regulation 408(b)(2), which requires greater transparency of plan expenses.

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Where are we today?

- Social Security, funded as a "pay as you go" system, is in effect.
- A wide variety of privately sponsored retirement plans, including qualified plans created by the Employee Retirement Income Security Act (ERISA) in 1974, are in effect. These plans are governed by the Department of Labor and the IRS. (There are also nonqualified plans that address special situations.)
- In addition to the above, there is the option of contributing to either a traditional Individual Retirement Account (IRA) or a Roth IRA.

Each of the above elements is treated differently at tax time.

The "FRIDAY FOCUS" on Retirement series includes:

'**Memorandum #105:** *History of Pensions*

'**Memorandum #106:** *Pension Plans—Types and Characteristics*

'**Memorandum #107:** *A Primer on IRAs*

'**Memorandum #108:** *Participant and Sponsor Challenges*

'**Memorandum #109:** *Planning for a Successful Retirement*

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