

The New York Stock Exchange and the Transformation of Retirement in America

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For my mother.

Judith Martin Gajewski, 1944 – 2009.

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INTRODUCTION

Retirement poses a challenge for a majority of Americans. Social Security payments are not adequate to maintain the standard of living that people enjoyed while working.¹ People rely on their retirement funds to make up the difference. These can take a variety of forms, including the 401(k), which is standard in the corporate environment; the pension, most commonly provided to government workers; and personal retirement accounts, such as the Individual Retirement Account (IRA). Besides their function, one thing all of these methods have in common is investment in the stock market.² The media is quick to remind us that 401(k) accounts fluctuate with the market, but pension plans also depend on the performance of their investments in order to make their seemingly more stable payments.³ Whether someone will have a comfortable retirement, or be able to retire when they wish, depends on the performance of the stock market, something that most Americans consider to be totally outside their control. How did this happen?

The short answer is that two tracks of government regulation – that of the private pension industry and that of the securities markets – crossed paths in an unexpected way in the mid-1970s. Simultaneous changes were happening in the way Wall Street operated, and in the way

¹ <http://wealthmanagement.com/retirement-planning/traditional-pensions-did-golden-age-ever-exist>. March 30, 2015. Mark Miller, Notes on Retirement. Social Security replaces a little more than one third of the median worker's pre-retirement income, and this is expected to decrease over time, according to the National Academy of Social Insurance.

² According to a 2009 study by the Employee Benefit Research Institute (EBRI), during the 2008 recession, 401(k) accounts with balances greater than \$200,000 lost, on average, more than 25% of their value. https://www.ebri.org/publications/ib/?fa=ibDisp&content_id=4192 The Impact of the Recent Financial Crisis on 401(k) Account Balances, February 2009, EBRI Issue Brief 326

³ See for example the CBS 60 Minutes Special, Retirement Dream Disappear with 401(k)s; 4/17/2009. <http://www.cbsnews.com/news/retirement-dreams-disappear-with-401ks>

that retirement pensions were being financed. The power and size of the institutions that were investing pension funds began to threaten the openness of the nation's capital markets. The New York Stock Exchange (NYSE), in response, was forced to allow open competition between stockbrokers for the first time in its history. This drew investing back into the Exchange, where it was under the regulation of the Securities and Exchange Commission (SEC). While this was happening, the NYSE began to actively seek out retirement investors, both institutional and individual, in order to recover from the upheaval caused by competition.

At the same time, Congress passed the first comprehensive private pension regulation, the Employee Retirement Income Security Act (ERISA), in an attempt to curtail the power of pension institutions and to guarantee the rights of employees with regard to their retirement. Instead of complying with the onerous regulations ERISA imposed, many retirement plan sponsors either terminated their plans or transformed them from a traditional defined benefit structure, in which retirement payments are fixed and guaranteed, to a defined contribution structure, in which only the amounts of the contributions to the fund are fixed, and the payments may vary.⁴ This change effectively shifted the responsibility of retirement investing from employer to employee. In attempting to protect private pensions, the government inadvertently created a situation in which not only were corporations able to transfer retirement onto the shoulders of individual employees, but also one in which the only way for individuals to bear that responsibility was to depend even more on institutions and Wall Street.

⁴ James A Wooten, *The Employee Retirement Income Security Act of 1974: a political history* (Berkeley and Los Angeles: University of California Press, 2004); Steven A. Sass, *The Promise of Private Pensions: the first hundred years* (Cambridge, MA and London: Harvard University Press, 1997); Dan M. McGill and Donald S. Grubbs, Jr., *Fundamentals of Private Pensions* (Homewood, Ill. : Published for the Pension Research Council, Wharton School, University of Pennsylvania by Irwin, 1989); William Graebner, *A History of Retirement: the meaning and function of an American institution, 1885-1978* (New Haven and London: Yale University Press, 1980); Martin Neil Baily and Jacob Funk Kirkegaard, *US Pension Reform: Lessons from Other Countries* (Washington, DC: Peterson Institute for International Economics, 2009), 386.

To understand the evolution of private pensions it is necessary to understand their changing purpose, which is in fact something that the pension industry has had trouble doing. Private pensions began as a gift from employer to loyal employee. Their intent was the same as that of early public pensions, which was to provide security.⁵

At the beginning of the twentieth century, there was no such thing as retirement as we think of it today. As the economy transitioned from agriculture into industry, workers faced an earlier obsolescence. The age limit for safely moving steel, for example, was much lower than that for planting crops. The first pensions provided subsistence level amounts, primarily to disabled workers or to survivors of workers killed on the job. The efforts of early reformers, which culminated in the creation of a national plan, Social Security, similarly focused on providing security. Their purpose was to keep the elderly from becoming destitute, but these plans were never intended to help workers maintain a similar standard of living after stopping work.⁶

The modern idea of retirement was created in the post-World War II period. Unions included pensions in collective bargaining, which helped change their status from a gift to a part of compensation, earned by and rightfully belonging to employees. Business realized, too, that the retired population, with increasingly longer life spans, free time, and disposable income,

⁵ Arthur D. Cloud, *Pensions in Modern Industry* (Chicago: Hawkins & Loomis, 1930), and following note.

⁶ Dora L. Costa, *The Evolution of Retirement: an American economic history, 1880-1990* (Chicago and London: University of Chicago Press, 1998); Daniel Béland, *Social Security: History and Politics from the New Deal to the Privatization Debate* (Lawrence, KS: University Press of Kansas, 2005); Thomas J. Mackell, Jr., *When the Good Pensions Go Away: Why Americans Need a New Deal for Pension and Health Care Reform* (Hoboken, NJ: John Wiley & Sons, Inc., 2008); Sylvester J. Schieber, *The Predictable Surprise: the unraveling of the U.S. retirement system* (Oxford: Oxford University Press, 2012); Larry W. DeWitt, Daniel Béland, and Edward D. Berkowitz, *Social Security: a documentary history* (Washington, D.C.: CQ Press, 2008); Carolyn L. Weaver, *The Crisis in Social Security: economic and political origins* (Durham, N.C.: Duke University Press, 1982).

created a new class of consumers. Employees embraced the idea that life after work should be enjoyed.⁷

Pension sponsors wanted a way to take advantage of the booming post-war stock market, and they needed to increase both the amount and flexibility of their funds. To do this, the basic form of the pension had to change. Early pensions were usually insurance annuities, which are very safe, stable, and predictable. But regulation prevented insurance companies from investing in common stock. So employers changed their plans, from insured to trustee. A group of trustees, chosen by management, could direct the investment of the pension fund in any way approved under the trust agreement. By putting pension money into banks, trust companies, and other financial institutions, corporations could cash in on the boom in equities.⁸

This widespread transition into the stock market caused two distinct problems, which the government tackled through different regulations. The growing power of the institutions threatened the stability of the NYSE as trading splintered among regional exchanges and in some cases left the open markets entirely. Both Congress and the SEC realized that over one billion dollars changing hands beyond the scope of any regulation posed a threat to the stability of the overall economy.⁹ The second problem was that pension investments became much more risky, because of market fluctuations, poor investment decisions, and the practice of investing a portion

⁷ Gary S. Cross, *An All-Consuming Century: why commercialism won in modern America* (New York: Columbia University Press, 2000); Carole Haber and Brian Gratton, *Old Age and the Search for Security: an American social history* (Bloomington: Indiana University Press, 1994); W. Andrew Achenbaum, *Shades of Gray: Old Age, American Values, and Federal Policies Since 1920* (Boston, Toronto: Little, Brown and Company, 1983); Graebner, *History of Retirement*.

⁸ Walter J. Couper and Roger Vaughan, *Pension Planning* (New York: Industrial Relations Counselors, 1954) and James A. Hamilton and Dorrance C. Bronson, *Pensions* (New York, Toronto and London: McGraw-Hill Book Company, Inc., 1958).

⁹ Wooten, *ERISA*; see also Bascom H. Torrance, "Legal Background, Trends, and Recent Developments in the Investment of Trust Funds," *Law and Contemporary Problems* 17 (1952): 128-161; Roger F. Murray, *Economic Aspects of Pensions: a summary report* (New York, National Bureau of Economic Research: distributed by Columbia University Press, 1968).

of pension funds in the sponsoring company's own stock. The rationale for this was that by tying the pension directly to the company's fortunes, employees would be encouraged to work harder. But if the company failed, or was purchased, or experienced a slump in performance, the amounts available to pay pensions dropped precipitously.¹⁰

Institutions began to leave the NYSE because the large size of their average stock trade incurred enormous fees under the Exchange's fixed commission rate system, in which the cost of a trade was based on the number of shares. The NYSE refused to either let the institutions join the Exchange (in which case they would be effectively paying themselves for trades), or to alter its commission policy. The SEC had already been questioning this policy, and achieved small success in forcing the street to adopt a high volume discount in the late 1960s. But when the SEC demanded that the fixed rate system be discarded in favor of negotiated rates the Exchange objected ferociously. Without fixed rates, they said, the Exchange would be destroyed.¹¹

The irony of the NYSE, an iconic symbol of American free-market capitalism, protesting the introduction of competition, was lost on the denizens of Wall Street. To understand how this situation could occur, and why the Exchange was so intractable, requires understanding the Exchange's conception of itself. The NYSE saw itself as the primary institution regulating the stock market; as a so-called self-regulatory body, the Exchange made and enforced its own rules. Acceding to the pressure for negotiated rates meant relinquishing control, and admitting that people from outside Wall Street might know what was best for the market. Letting in outsiders

¹⁰ James E. McNulty, *Decision and Influence Processes in Private Pension Plans* (Homewood, Ill.: Published for the Pension Research Council, Wharton School of Finance and Commerce, University of Pennsylvania, by R.D. Irwin, 1961) and Sass, *Promise*.

¹¹ Wexler, Bernard, "History of the Securities and Exchange Commission Draft" August 3, 1975; Papers collection of the SEC Historical Society; Section F.

like that went against everything the Exchange had worked to preserve since its creation in 1792.¹²

When a group of New York City stock brokers signed the Buttonwood Agreement, formally creating the Exchange, they imposed structure on a pre-existing system. Their purpose was twofold, to protect their business from new state regulations and to prevent outsiders from interfering in their affairs (and causing problems that might attract more government attention). The NYSE developed more as a gentleman's club than as a business; an unspoken code of behavior governed the operations of its members. At the core of that code was the fixed commission rate system, which had existed virtually unimpeded since the 1790s. The purpose of fixed rates was to create a level playing field between members of the Exchange. The brokerages might be of different sizes, and therefore have different levels of capability, but the fact that they had been admitted to the club meant that they were worthy of being protected. The membership of the NYSE looked out for each other, before they considered the needs of their investors, and this had to change for the Exchange to survive.¹³

With membership denied by the NYSE, institutions began to move to regional exchanges, where they could buy seats. Wall Street lost more business, because the institutions forced their trading partners to use their exchanges instead. More troubling was the movement away from exchanges entirely. The so-called Third Market was a decentralized market in which listed stocks were traded outside exchanges, without either exchange oversight or that of the National

¹² See especially Chris Welles, *The Last Days of the Club*, (New York: E.P. Dutton & Co., 1975)

¹³ Welles, *Last Days of the Club*; Alec Benn, *The Unseen Wall Street of 1969-1975 and Its Significance for Today*, (Westport, Connecticut: Quorum Books, 2000; Richard Sylla, "Origins of the New York Stock Exchange," in *The Origins of Value: the Financial Innovations that Created Modern Capital Markets*, eds, William N. Goetzmann and K. Geert Rouwenhorst, 299-312, (Oxford: Oxford University Press, 2005); Robert Sobel, *The Curbstone Brokers: the origins of the American stock exchange* (New York: The Macmillan Company, 1970) and Robert Sobel, *N.Y.S.E.: a history of the New York Stock Exchange 1935-1975* (New York: Weybright and Talley, 1975).

Association of Securities Dealers (NASD).¹⁴ Both of these moves decreased liquidity, and making investment capital harder to secure could depress economic growth.

Neither the SEC nor the Senate Finance Committee, which was working on new amendments to the Securities Acts, approved of what the institutions were doing. From the SEC's point of view the efficiency of the securities markets was declining; Congress saw huge sums of money changing hands outside the existing rubric of regulation.¹⁵ Both demanded that the fixed rate system end, and on May 1, 1975, Mayday, the NYSE switched to negotiated commission rates. When the dust settled, the surviving brokerages needed to make up for their lost commission profits by increasing trading volume. Fortunately for them, Congress and the media had for several years been investigating retirement pensions, and the NYSE saw retirement as something that might bring in business.¹⁶

¹⁴ The chief spokesman for the Third Market was Donald Weeden, of Weeden & Co., which still exists. His intention was not to move trading behind closed doors, but to speed the connections between buyers and sellers by using the latest technology. He was ahead of his time; what he was trying to create was not very different from the way stocks are traded today. At the time, though, the technology was not fast, affordable, or widespread enough. The NYSE regarded Weeden as a very large thorn in their side, and told the SEC that if they were worried about the Third Market they should just close those firms instead of having the NYSE change the commission policy. See various letters from Weeden to the SEC at <http://sechistorical.org>

¹⁵ See Harrison Williams, Remarks Before the Harvard Business Club of Minnesota at the Sheraton-Ritz Hotel, Minneapolis, MN, June 14, 1974, Box 1398, HAW Collection; Press Release #74-84, Box 1619, HAW Collection; Press Release #73-122, Box 364, HAW Collection.

¹⁶ Welles, *Last Days of the Club*; Benn, *Unseen Wall Street*; Joel Seligman, *Transformation of Wall Street* (New York: Aspen Publishers, 2003); Marshall E. Blume, Jeremy J. Siegel, and Dan Rottenberg, *Revolution on Wall Street: The Rise and Decline of the New York Stock Exchange* (New York and London: W.W. Norton & Company, 1993) "The Pension Funds: the Assets Keep on Climbing," *Business Week*, June 21, 1958, 97-100. Gregg A. Jarrell, "Change at the Exchange: The Causes and Effects of Deregulation," *Journal of Law and Economics*, Vol. 27, No. 2 (Oct., 1984), pp.273-312; "Wall Street's Taste of Freedom: Competition as Regulator," *Business Week*, March 17, 1975; John Carson-Parker, "Wall Street's Great Non-Event of 1975," *Business Week*, April 21, 1975; William F. Baxter, "NYSE Fixed Commission Rates: A Private Cartel Goes Public," *Stanford Law Review*, Vol. 22, No., 4 (April, 1970), p.675-712.; various press releases from the NYSE archives; "American brokers: Mayday on May Day?" *The Economist*, April, 26, 1975.

Following the failure of Studebaker's pension plan in early 1964, Congress began in earnest to investigate the state of private pensions. The conclusion was disheartening: many workers either did not receive a pension, or received less than they had been led to expect. In the rush to trustee plans and equity investment, too many companies had raided their plans' profits. Others lost money through risky investments, and virtually no plan made adequate provision for the future. One reason why things were such a mess was because the only regulation governing private pensions was the tax code. Senator Jacob Javits, a moderate Republican from New York, took the lead on crafting comprehensive legislation, but made little progress until Senator Harrison Williams became chair of the Labor Committee. Williams, a Democrat from New Jersey, was a shrewd politician and a masterful operator of the growing power of the news media.¹⁷

The result of the Senators' efforts was the law that would eventually be called the Employee Retirement Income Security Act, or ERISA. Its purpose was deceptively simple, to help more people qualify for a retirement pension and to make sure pension plans could pay the benefits they promised. In order to achieve these aims, though, ERISA touched on every aspect of the creation and operation of traditional defined benefit pension plans.¹⁸ The business community opposed such expansive legislation. Many unions were less than enthusiastic about ERISA, too, because they feared it might diminish their power in collective bargaining.

Why Congress fought for ERISA is a matter of some debate among those who study pensions. Legal scholar James Wooten, in his political history of ERISA, gives Congress credit

¹⁷ See Jacob K. Javits and Rafael Steinberg, *Javits: The Autobiography of a Public Man* (Boston: Houghton Mifflin Company, 1981) and The Harrison A. Williams Collection at Rutgers University Special Collections. (HAW Collection)

¹⁸ Merton C. Bernstein and Joan Brodshaug Bernstein, *Social Security: the system that works* (New York: Basic Books, 1988), 107-8. ERISA was "a statute of epic complexity."

for genuinely wanting to help people. In *The Promise of Private Pensions*, Steven Sass, of the Center for Retirement Research at Boston College, takes a more realistic, if cynical, view that pensions represented too much money changing hands outside the federal institutional framework. Historian Jennifer Klein sees ERISA as an outgrowth of the Liberal ideology of the New Deal; pensions were intended to be the private complement to Social Security and they were not fulfilling their function.¹⁹

At least some in Congress, particularly Javits, really did want to help people, but the picture becomes clearer when we zoom out to include more explanation of what was happening on the investment side. If the pension money was not being paid to workers as promised, then where and what was it being used for? The reason that private pensions went without regulatory oversight for so long was because their benefits outweighed their flaws. That money, channeled through institutions, helped drive the economy, especially infrastructural growth, during the 1950s and '60s.²⁰ When those institutions grew large enough to challenge the power of the NYSE, and when their transactions grew less and less transparent, Congress recognized the threat, both to its own power and to national economic stability.

Senators Williams and Javits succeeded in passing ERISA through a combination of showmanship and luck. Since there was no grassroots campaign for pension reform, the Senators crafted their own, by traveling the country holding hearings and by relentlessly promoting reform through the media, particularly the relatively new evening news programs.²¹

¹⁹ Wooten, *ERISA*, 15; Sass, *Promise*, 180; Jennifer Klein, *For All These Rights: business, labor, and the shaping of America's public-private welfare state* (Princeton: Princeton University Press, 2003), 11.

²⁰ Murray, *Economic Aspects of Pensions*, 70

²¹ Michael Schudson, *The Power of News* (Cambridge & London: Harvard University Press, 1995), 172; David L. Altheide, *Creating Reality: How TV News Distorts Events* (Beverly Hills and London: Sage Publications, Inc., 1976), 2-6; Bernstein, *Social Security: the system that works*, 106.

They received a lot of help from Ralph Nader, who launched his own campaign to fix the private pension system.²² Together, they brought pensions to the people. Williams refashioned the concept of the pension as deferred compensation, instead of the symbolic gold watch. Nader claimed that failure to pay pensions as promised constituted consumer fraud. This sensationalism and commodification of pensions helped fit them into the evolving concept of retirement. ERISA benefitted also from some fortunate timing; when the law went to a final vote its passage was relatively speedy because Congress was occupied with the impeachment of President Richard Nixon.²³

ERISA demanded a lot more work from pensions, and imposed more penalties if those pensions did not meet their requirements. Many companies decided that with the increased costs and risks, operating a pension was not worth the trouble. Of those, many of the smaller plans simply terminated, and the larger ones converted from a defined benefit structure to defined contribution, which was exempt from most of ERISA's provisions. The big difference between these plans is that the responsibility for making investment decisions moves from the plan sponsor to the participant. The sponsors facilitate the plan, but cannot be held legally responsible for the investment outcomes. The downside of defined contribution plans is that individual workers bear this responsibility, and the simplest way to do so is to rely on institutions, particularly the mutual fund companies that were taking advantage of the negotiated commissions on Wall Street. The NYSE also got a boost from ERISA's creation of the

²² Ralph Nader and Kate Blackwell, *You and Your Pension: Why you may never get a penny; What should be done about it* (New York: Grossman Publishers, 1973); "Ralph Nader Looks at Private Pension Plans," *Pensions & Investments*, September, 1971, 25-30. A report of Nader's speech at the legislative conference of the Association of Private Pension and Welfare Plans

²³ Although ERISA was signed into law in 1974, the majority of its provisions did not go into effect until 1976; the purpose of the delay was to allow pension sponsors to plan their necessary changes, and for the Labor Department and the IRS to sort out their responsibilities. See: Legislative history of the Employee retirement income security act of 1974 : Public law 93-406 (ERISA History)

Individual Retirement Account (IRA), which was a perfect vehicle to draw individual investors into the stock market.²⁴

A combination of increased fiduciary responsibility on the part of pension managers and greater attention to, and opportunities for, individual investment helped shift the burden of retirement toward the individual, and away from the corporation. With tacit federal approval of individual retirement planning, corporations could take an altruistic position, giving their employees freedom of choice.²⁵ By 2008, nearly 75% of the nation's private retirement assets were self-directed.²⁶ As of September 30, 2015, the combined assets of defined contribution plans and individual retirement accounts totaled \$13.8 trillion.²⁷

The combination of ERISA and deregulation produced a situation in which employees could no longer depend on the reliability of their employers to insure their pensions. Employers did not provide training for employees on how to arrange retirement investments. Investing in individual stocks was still prohibitively expensive for the majority of the population, and most individuals did not have access to the research necessary for informed investment decisions. Most unions were no longer trustworthy vehicles for pension funds. Individuals were given

²⁴ The administration bill, S. 1631, Individual Retirement Benefits Act of 1973, was amended into a Finance Committee retirement reform bill, which was then included in ERISA. ERISA History, beginning p. 325

²⁵ And even if they terminated the plan, employers reckoned that the Pension Benefit Guaranty Corporation would take care of the stranded retirees. Fran Hawthorne, *Pension Dumping: the reasons, the wreckage, the stakes for Wall Street* (New York: Bloomberg Press, 2008), 38.

²⁶ Schieber, *Predictable Surprise*, 205.

²⁷ <http://www.ici.org/research/stats/retirement>; of a total of all retirement assets of \$23.5 trillion

nominal freedom of choice in retirement investing, and the right to determine their own futures, but were spectacularly ill-equipped to do so.²⁸

Congress should have realized that these regulations were not being applied in a vacuum. They could logically expect that changes to pension regulation and securities regulation would affect one another. Perhaps, though, they can be forgiven for not understanding how those interactions would alter the landscape of retirement.

In the first place, ERISA was created with the advice of experts who confidently predicted that the defined benefit plan would become near universal as the pension became an integrated part of employee compensation. After all, the defined contribution plan form removed much of the stability and security that experts deemed necessary for a retirement pension. Its variable nature was not compatible with the premise of the pension as a guarantee of basic security in old age.²⁹

Also, the committee structure of Congress produced a situation in which the right hand did not know what the left was doing. The committees that created ERISA and the Securities Acts Amendments did not have any legislators in common, with the exception of a single person, Senator Williams. Even Williams had separate staffs to handle his responsibilities on the different committees. He was the only person who had all the pieces of the puzzle, and there is no evidence yet discovered to indicate he put them all together.

²⁸ Michael J. Clowes, *The Money Flood: how pension funds revolutionized investing* (New York: Wiley, 2000), 15-16; Wooten, *ERISA*, 280; Schieber and Shoven, 12-19; Thomas J. Mackell, Jr., *When the Good Pensions Go Away*, xx-4. Fran Hawthorne, *Pension Dumping*, xv: “Companies had come to realize that defined contribution plans were a lot cheaper for them: They could limit the amount of money they were obligated to pay, yet still claim to be providing a pension – of sorts.”

²⁹ John K. Kittredge, “Group Insurance and Pensions in 1975,” *Pension and Welfare News*, December, 1968, 37.

Everything is complicated by the contentious function of the private pension, and this is where a historical approach sheds light on the current status of retirement in America. Is the pension an instrument to provide economic security in old age, or is it a method to finance a period of leisure following a lifetime of work? The first private pensions were tools business used to manage the workforce. Their purpose was neither security nor leisure, it was to move individuals into and out of the labor pool at convenient intervals. Early reformers demanded security, reasoning that if a company stopped someone from working, then either the company, or society, had an obligation to make sure that person was able to survive. From this came Social Security, which had that very intention, to provide enough for security. Unions muddied the waters by making the pension part of their remuneration practices, and the idea grew that pensions might provide a bit more than was necessary for survival. The business community promoted life after work as a period to enjoy the fruits of one's labors; they began to see the financial advantage of a new class of consumers. The pension became something to which workers were entitled because they had earned it, instead of something they were grateful simply to receive.

ERISA legalized the idea that the pension was deferred compensation, but by leaving open the possibilities of how that compensation should be paid, i.e. by paving the way for defined contribution plans, ERISA failed to make a definitive statement about the purpose of the retirement pension.³⁰ This fundamental difference between old-age security and retirement remains problematic in discussion of both private plans and Social Security. These are two very different things, with different functions, which means that neither should be examined in terms of the other. In *Rightward Bound: Making America Conservative in the 1970s*, Bruce Schulman and Julian Zelizer address this dichotomy in their discussion of the proposal to allow individuals

³⁰ Press release 72-103, Box #1620, HAW Collection

to direct the investment of their expected Social Security payments; “it was one thing to talk about the virtues of private accounts and investor choice, but quite another to eliminate the safety net that millions of elderly citizens depend upon.”³¹ Social Security will not be “fixed” until Congress and the American public define its purpose once and for all. Similarly, private pensions will continue to be risky propositions for individuals until such time as Congress puts its metaphorical foot down and says that not only are pensions deferred compensation, but companies have a legal duty to ensure that they pay the correct amount at the correct time.

Within the tangled history of retirement compensation, private pensions have received comparatively less attention than Social Security from historians. One reason for this is the lingering concept of the business community as a monolithic and inflexible entity, perpetually at odds with individual rights.³² Much of this idea has grown from the work of Grant McConnell and the generation of political scientists and historians who drew inspiration from his *Private Power and American Democracy*, first published in 1966. While many of McConnell’s conclusions about regulation and the power non-governmental groups are useful for understanding the relationship between Big Business and Big Government in the twentieth century, it does not necessarily follow that any entity which exercises social power, but is not the government, creates negative consequences. All of this stems from the underlying premise that the wishes and needs of business are, by their very nature, the opposite of what is best for

³¹ Bruce Schulman and Julian Zelizer, *Rightward Bound: Making America Conservative in the 1970s* (Cambridge, MA: Harvard University Press, 2008), 291.

³² See Grant McConnell, *Private Power and American Democracy* (New York: Alfred A. Knopf, 1996). (Also see my review of Andrew M. Schocket, *Founding Corporate Power in Early National Philadelphia*, in *Enterprise & Society*, 10-2, (June 2009): 415-417)

individuals. No one will deny that business has done things without regard to those outside itself, but if we assume that every business action is automatically 'wrong,' then we lose the opportunity to understand how and why businesses make decisions, and how those decisions are influenced by the morals and ethics of the culture in which those businesses are located. "Business" in this case remains an incomprehensible other, situated outside society instead of properly within it.

Business historians have contributed to the situation through their reliance on Alfred Chandler's concept of efficiency. Chandler, through his analysis of corporate efficiency, gave historians a framework for understanding how businesses operate, their internal processes, instead of focusing on what they were producing or providing. Efficiency provides a definite measure of comparison across companies and industries, which is one reason why business historians have clung tightly to the Chandlerian paradigm. But many social scientists continue to take Chandlerian efficiency the wrong way. Political scientists in particular seem to regard efficiency as the "end" of business, when it is in fact only the "means." The desired endpoint of a business venture is a changeable subject, which varies over the short and long term and from company to company. However, efficiency is a constant in the struggle to reach that end, whatever it may be. While the Chandlerian approach is extremely useful for comparing the internal operations of business, it does not address the relationships between business and the broader culture in which it is situated.

Since the early 2000s, business and political historians have expanded their analyses to take into account that neither business nor government are constants, in their aims or their power. In a 2002 article, Jacob Hacker and Paul Pierson put forth the proposition that variations in the social influence of business are a basic characteristic of U.S. history. More recently, their joint

volume, *Winner-Take-All Politics*, attributes increasing income inequality in America not to economic forces, but to political influences.³³ Sometimes a change of perspective reveals connections where none were seen before, which is the case with ERISA, the NYSE, and the rise of the defined contribution plan. Other scholars continue to challenge the standard narrative, particularly Julian Zelizer, who challenges the New Left view that corporate interests, and Southern congressmen, are solely responsible for holding back the progress of state building post-New Deal.³⁴ Zelizer's frequent co-editor, Meg Jacobs, studies the growth of state power not just through grassroots movements, as preferred by social historians, but also through the lens of "popular politics and elite policymaking," creating a more integrated approach in *Pocketbook Politics*.³⁵ Kim Phillips-Fein, in *Invisible Hands*, examines the actual people behind the conservative movement, their social networks, and how their efforts culminated in the glorification of Ronald Reagan.³⁶ Of particular interest to business historians is an upcoming collaboration between Naomi Lamoreaux, William Novak, and The Tobin Project examining the development of the corporation and its evolving relationship with the American public.³⁷

³³ Jacob S. Hacker and Paul Pierson, "Business Power and Social Policy: employer and the formation of the American Welfare State," in *Politics and Society* 30, no.2, 2002: 277-325; Jacob S. Hacker and Paul Pierson, *Winner-Take-All Politics: how Washington made the rich richer and turned its back on the middle class* (New York: Simon and Schuster, 2010).

³⁴ Julian E. Zelizer, "The Uneasy Relationship: Democracy, Taxation, and State Building since the New Deal." , in *The Democratic Experiment: New Directions in American Political History*, Meg Jacobs, Julian E. Zelizer, William J. Novak, eds., Princeton, NJ: Princeton University Press, 2003.

³⁵ Meg Jacobs, *Pocketbook Politics: Economic Citizenship in Twentieth-Century America* (Princeton, NJ: Princeton University Press, 2005) 6.

³⁶ Kim Phillips-Fein, *Invisible Hands: the businessmen's crusade against the New Deal* (New York: W.W. Norton & Co., Inc., 2009). See also Bruce Schulman and Julian Zelizer, eds. *Rightward Bound: making America conservative in the 1970s* (Cambridge: Harvard University Press, 2008) and Steven Teles, *The Rise of the Conservative Legal Movement: the battle for control of the law* (Princeton, NJ: Princeton University Press, 2008).

³⁷ See www.tobinproject.org; tentative publication date is 2016, per Bill Novak's webpage: www.law.umich.edu/FacultyBio/Pages/FacultyBio.aspx?FacID=wnovak

One recent trend in business history, the study of Corporate Social Responsibility, offers a new body of work that may be helpful for understanding the conflicting and similar interests of the business community and the federal government toward retirement. Placing social responsibility and ethical behavior as goals in conjunction with efficiency creates a more nuanced analysis of the growth of business. The idea that sometimes business has done what was right, instead of what was efficient, should help historians present a more balanced view of the corporation's place in society.³⁸

The field of economic sociology may offer the best chance of explaining the issue that becomes the elephant in the room in any discussion of the evolution of the private pension system. The story of ERISA, the death of the traditional defined benefit pension, and the growing power of Wall Street and financial institutions prompts a reconsideration of the nature of American capitalism. Management consultant Peter Drucker pointed out in his 1976 *Unseen Revolution* that, following a strict definition of ownership of the means of production, the United States was the first truly socialist country in the world. Through the stock ownership offered in defined contribution and personal retirement accounts, the workers of America have in fact become capitalist owners. This is problematic on multiple levels, not least of which is the number of Americans who would rise in revolt if told they were really socialists. But this is where economic sociology enters the fray, because although retirement account holders do have ownership, they do not have *power*.³⁹

³⁸ In 2010, The Business History Conference awarded the inaugural CEBC Halloran Prize in the History of Corporate Social Responsibility; the 2014 theme of the BHC Annual Conference was The Virtues and Vices of Business. See also <http://www.cebcglobal.org/the-evolution-of-corporate-responsibility-in-american-business/>

³⁹ Peter F. Drucker, *The Unseen Revolution: how pension fund socialism came to America* (New York: Harper & Row, 1976); William O'Barr, John M. Conley, and Carolyn Kay Brancato, *Fortune and Folly: The Wealth and Power of Institutional Investing* (Homewood, Ill.: Business One Irwin, 1992), 22-23.

In his study of the rise of the industrial corporation, William Roy proposes a new theoretical methodology, counter to, but inclusive of the efficiency model. Roy defines power as the degree to which one actor's behavior influences that of another, and this matters because power can produce changes that are not necessarily efficient. Roy's basic assumption, underlying this power theory, is that "To explain why an actor behaves a certain way within a certain context, one must ask who else's behavior must be included in the explanation, with the assumption that the answer matters."⁴⁰ This premise is supremely useful in explaining what went wrong with ERISA. Congress neglected to take into account the reactions and behaviors of those who were involved in the pension system other than those who were workers expecting pensions. The executives, the plan managers, and the financial institutions that managed pension money all reacted to ERISA in predictable ways. The implementation of regulation proposed a decrease in their power, in much the same way as the SEC's demands threatened the power of the NYSE. Understanding the NYSE and its relationship to institutional investors becomes easier when examined through the prism of power; the fight over negotiated commissions was a fight over who would maintain, or gain, control.

If we define ownership as the degree to which someone can exert control over the thing they own, then American stockholders are not socialist, because their power is minute. The power of stock ownership resides with those who can control sizeable amounts of stock, for example, mutual fund companies. By divesting themselves of the operations of their pensions, corporations turned over a measure of their power to the financial institutions now doing the retirement investing for them. In order to exercise their power, these institutions are dependent on having a market in which to operate, and that is exactly what the NYSE provides. And that,

⁴⁰ William G. Roy, *Socializing Capital: the rise of the large industrial corporation in America* (Princeton, NY: Princeton University Press, 1997) 259.

in a very small nutshell, is one reason why Americans are dependent on the success of the stock market, whether or not they know it, or like it.

The first chapter of this dissertation explains the creation of the modern concept of retirement, and the evolution of the private pension from an instrument for labor relations to expected compensation. It argues that the shift in plan management, from insured to trustee, and the accompanying surge in equity investment created an imbalance in the economy because of the growing power of institutional investors.

The second chapter moves the story to the New York Stock Exchange, in order to understand why institutions posed such a problem, and why the NYSE was so adamant about putting the needs of its members above those of its investors. The NYSE was so reluctant to accept change because accepting competition between brokers was contrary to its founding ideals. Brokers feared that Mayday would destroy the club-like structure that governed the Exchange through a pattern of unwritten rules and expected behaviors.

Chapter three explains the fighting over commission rates, and how diverging opinions within the Exchange's leadership made possible a grudging acceptance of negotiated commission rates. Examining the aftermath of Mayday shows both how resilient the structure of the Exchange is, and how the NYSE adapted by using retirement investing, at both the institutional and individual level, to increase trading volume.

In Chapter four, the story returns to the pensions themselves, and how the shift to aggressive investment strategies endangered retirement for individuals. Congress took action through the Employee Retirement Income Security Act. Despite opposition, ERISA passed

because of the unique efforts of its sponsors, Senators Jacob Javits and Harrison Williams.

Although ERISA's purpose was to preserve pension rights, its regulations were so onerous that it instead destroyed the traditional defined benefit pension.

The final chapter brings ERISA and the NYSE together by explaining how ERISA drove pension plan sponsors to adopt a defined contribution form, and how the recent changes at the Exchange helped speed the transition. As employers shifted the responsibility for retirement onto individual employees, the power of the NYSE and financial institutions only grew, because individuals had nowhere else to turn.

CHAPTER I

The Creation of Retirement

The modern concept of retirement is a creation of the collective efforts of the business community, the federal government, unions, and individuals. Over the course of the twentieth century, the retirement pension changed from a gift, rewarded for loyal service, to a payment of previously earned wages. The problem of retirement was felt on a very personal level, but never treated on an individual basis. Employers, government, and unions argued over which should have authority over employee pensions, but often neglected to make allowances for the accompanying responsibility. In striving to attain true retirement security, unions, reformers, and policy makers in fact created an illusion of possibility, which gave rise to the myth of the golden retirement.¹

The public sector first adopted the retirement pension as a method of providing for elderly or disabled soldiers who could no longer earn their own living. In the 1920s and '30s, reformers protested for a national plan to provide adequate living expenses for the elderly. Social Security grew from these efforts. While early pension reformers fought for employees' "protection against the insecurities of an industrialized economy," following World War II a financially secure retirement came to be seen as a right rather than a privilege.²

¹ See Thomas J. Mackell, Jr., *When the Good Pensions Go Away: Why Americans Need a New Deal for Pension and Health Care Reform* (Hoboken, NJ: John Wiley & Sons, Inc., 2008); Sylvester J. Schieber, *The Predictable Surprise: the unraveling of the U.S. retirement system*, 2012.

² Dora L. Costa, *The Evolution of Retirement: an American economic history, 1880-1990* (Chicago and London: University of Chicago Press, 1998), 27.

In the private sector, the pension evolved as an instrument of labor control. Pensions served the dual function of securing a stable workforce and removing individuals from that workforce at a predetermined age.³ The evolution of America's industrial economy redefined the period of life between work and death, from a personal and private matter, to a public, communal time influenced by outside factors ranging from employers and unions to government. This shift in the treatment of old age paralleled the transition of the private pension into a public instrument, regulated by forces beyond supply and demand. The pension became a matter of public policy rather than just private investment.

Much of the federal government's prior attention to pension plans was because of their role in the payment or deferment of income taxes. As pensions changed form from insurance plans to investment funds, their increasing size and influence in the national financial markets drew attention to how the individual issue of retirement was being dealt with in an increasingly institutional context. Early pension plans invested through insurance companies; these insured plans were conservatively invested and provided a guaranteed return. Employers became increasingly aware of the benefits of more direct control of pension money, particularly through the possibility of high returns if that money was invested in the booming stock market. Many reconfigured their plans to be managed by a group of trustees, who oversaw investment of pension money through banks and other financial institutions.

These institutions came to exert enormous power over Wall Street, until their growth threatened the capital market provided by the New York Stock Exchange. Millions of pension dollars flooded into the nation's financial markets, propelling economic growth through the 1950s and '60s. But enough plans failed or fell short to draw public attention, and many

³ James A Wooten, *The Employee Retirement Income Security Act of 1974: a political history* (Berkeley and Los Angeles: University of California Press, 2004), 34-39. Graebner, *History of Retirement*, 13.

employees began to question whether their pensions were safe. As insured plans, pensions had fallen under the coverage of extensive life insurance company regulations. But pensions as unique financial instruments were not covered by specific federal regulation. No single law or group of laws governed private pension implementation and maintenance until the Employee Retirement Income Security Act of 1974 (ERISA).⁴ ERISA confirmed that the retirement pension was no longer a gift, but instead was deferred compensation.

The first American pensions were paid to U.S. Army veterans following the Civil War. The primary intent of this first official retirement system was disability compensation. The idea of a period of life between work and death as a time of leisure did not exist in nineteenth-century America. “Retirement” was an unhappy situation forced upon those too disabled or enfeebled to continue working. The federal government’s intent was to make suitable provision for men who had been injured in service to their country and could no longer work.⁵ In the case of veterans’ pensions, the government was attempting to resolve the private consequences of public action. The government outlook would remain the same for decades to come, with regard to both private pensions and Social Security – the focus was on basic security, disability and survivorship, not on income replacement. Other early systems included workers’ associations and mutual benefit societies, which provided aid to members and their families in times of distress, but were still far

⁴ Sylvester J. Schieber and John B. Shoven, “The Economics of US Retirement Policy: Current Status and Future Directions,” in *Public Policy toward Pensions*, eds. Sylvester J. Schieber and John B. Shoven, (London and Cambridge, MA: MIT Press, 1997), 1-39.

⁵ Costa, *The Evolution of Retirement*, 3; see Chapter 3, “Income and Retirement.” “By 1900, benefits payments to Grand Old Army veterans made up almost 30% of the federal budget,” p. 35.

removed from any sort of formal, codified system such as became familiar over the twentieth century.⁶

The first employer-sponsored pensions in America were a creation of the industrial economy. A railroad freight forwarding company called American Express created the first private pension in the United States in 1875.⁷ Pensions offered compensation to workers injured on the job, or to the families of those killed in industrial accidents.⁸ After 1900, a growing number of private corporations – notably in transportation and heavy manufacturing sectors – provided retirement pensions. From the employers’ point of view, the pension created provision for the hazards of industry. Plans were created and maintained solely at employers’ discretion, and could be terminated summarily. The focus of early pensions remained on provision for disability or accidental death.⁹

The evolution of the corporate form made possible the creation and development of company retirement plans. The pension became a full-fledged instrument of corporate efficiency when the Pennsylvania Railroad established an internal department to oversee its pension plan,

⁶ Such programs were voluntary, usually specific to religion or ethnicity in addition to type of work. See Glenn Porter, *The Rise of Big Business, 1860-1920* (New York: Wiley-Blackwell, 2005), 112-13.

⁷ Graebner, *History of Retirement*, 133. William C. Greenough and Francis P. King, *Pension Plans and Public Policy* (New York: Columbia University Press, 1976) 27.

⁸ Graebner, *History of Retirement*, 133. Greenough and King, *Pension Plans*, 27.

⁹ The pension was a unique feature of America’s industrial economy, and changes in its form and function parallel broader economic shifts. The hazards of employment changed from accidents and disability to the possibility of obsolescence resulting from technological advances and outsourcing. At the same time, retirement changed from a payment provided by an employer, to something that responsible employees are expected to manage for themselves.

keeping total financial and administrative control within management. This start of modern corporate personnel administration centralized policy decisions within the firm.¹⁰

As industry grew, the increasing depersonalization of the workforce made the pension a useful control over key aspects of worker behavior, particularly turnover and retirement from the workforce.¹¹ Pensions gave workers incentive to remain at a job where they could expect future benefits. The key element of employee control was the compulsory retirement age.¹² Workers were more inclined to retire when they could expect to receive pension income. And, by replacing older, higher-wage employees with younger, lower wage (or entry-level wage) workers, firms could achieve significant cost savings.¹³

By 1900 a few companies had made some sort of provision specifically for retirement security, usually through a plan tied directly to business performance.¹⁴ Despite the common characterization of ‘welfare capitalism,’ the pension relationship emphasized stability and efficiency more than employee welfare.¹⁵ Managers undertook employee welfare programs with

¹⁰ “Twelve Trends in Old Age Mortality in the United States, 1900-1935: Evidence from Railroad Pensions,” UC Press E-books Collection, 1982-2004 University of California Press. The PA RR first provided pensions to all workers over the age of 70 in 1889, and create the PARR Pension Fund in 1900. At the same time, the RR changed its hiring policy requiring that new workers be under age 35

¹¹ Steven A. Sass, *The Promise of Private Pensions: the first hundred years* (Cambridge, MA and London: Harvard University Press, 1997), 40-42; Daniel Béland, *Social Security: History and Politics from the New Deal to the Privatization Debate* (Lawrence, KS: University Press of Kansas, 2005), 51. (see Graebner, *History of Retirement*)

¹² Sass, *Promise*, 14; see also Costa, *The Evolution of Retirement*.

¹³ Sass, *Promise*; Wooten, *ERISA*.

¹⁴ Sass, *Promise*, 16-20; Elizabeth Fones-Wolf, “Industrial Recreation, the Second World War, and the Revival of Welfare Capitalism, 1934-1960,” *Business History Review* 60 (1986) 233-34.

¹⁵ See Stuart D. Brandes, *American Welfare Capitalism, 1880-1940* (Chicago: University of Chicago Press, 1984); David M. Gordon, Richard Edwards, and Michael Reich, *Segmented Work, Divided Workers: the historical transformation of labor in the United States* (Cambridge: Cambridge University Press, 1982) for a correlation between increased mechanization and higher rates of turnover; Daniel

the goal of placating a workforce dissatisfied with the regimentation and impersonalization brought by industrialization and mass production.¹⁶

The fundamental characteristic of early pensions was that the choice of how long to work became a decision made by the company, not by the worker. Steven Sass explains in *The Promise of Private Pensions*, that pensions “created a pattern of expectations, strengthening the social contract between employees and employer.”¹⁷ The pension created, as Sass explains, a promise of future income. In one respect, all of a company’s workers remained unified through the loyalty engendered by this promise. The pension created a virtual boundary between a company’s workers and the greater industrial realm within which that company operated. With pensions still legally defined as gifts, employees did not have legal claim to pension money until actually paid out, so leaving the company meant forfeiture of any accrued pension assets. This effective separation from the wider business environment created a powerful ideology of loyalty, and, correspondingly, stability, that enabled managers of American business to focus on growth,

Nelson, *Managers and Workers: origins of the new factory system in the United States, 1880-1920* (Madison: University of Wisconsin Press, 1995), particularly chapter 6, “The rise of welfare work,” and chapter 8, “World War I,” on the rise of personnel management. Also David Montgomery, *The Fall of the House of Labor: the workplace, the state, and American labor activism, 1865-1925* (Cambridge: University of Cambridge Press, 1987). Of course, some plans did reflect genuine concern for employee welfare; a famous example is Kodak’s plan, which included both insurance and vesting years before either was required by law: Sanford M. Jacoby, “Welfare Capitalism at Kodak,” in *Major Problems in American Business History*, eds. Regina Lee Blaszczyk and Philip B. Scranton (Boston and New York: Houghton Mifflin Company, 2006), 264-271.

¹⁶ see Jacoby, McCraw, Porter. Elizabeth Fones-Wolf argues that the Depression did not end welfare programs. See Fones-Wolf “Industrial Recreation, the Second World War, and the Revival of Welfare Capitalism, 1934-1960.” *The Business History Review*, Vol. 60, No. 2 (Summer, 1986), pp. 232-25. See also Jacoby, *Employing Bureaucracy: managers, unions, and the transformation of work in the 20th century* (Mahwah, NJ: Lawrence Erlbaum, 2004) for evidence of the persistence of welfarism into the 1930s. See Edward D. Berkowitz and Kim McQuaid, *Creating the Welfare State: the political economy of twentieth-century reform* (New York: Praeger, 1980), 135-37.

¹⁷ Sass, *Promise*, 54.

expansion, and the quest for greater operational efficiency. A stable relationship with the workforce freed industry to devote time and energy to self-improvement.

At the same time as the pension tethered workers collectively to their employers, it also divided them. The function of the pension differed depending whether or not the company considered the employee part of management. As a tool to keep people from leaving, the pension needed to be more attractive to some workers than others, because some were more difficult to replace. For hourly workers, the pension reduced turnover, but paying higher benefits had a diminishing rate of return. There was no point to providing impressive retirement packages to hourly workers because, while replacing them may have been a hassle, they were readily replaceable. The promised pension amount needed only to balance out the cost to train the replacement.

Managers, on the other hand, were much more difficult to replace. With their specialized knowledge, good managers were a significant asset to the company, and these were the workers that companies were willing to pay to retain. This only became truer as industrial technology evolved, and as the managerial profession became more specialized. The pensions offered to management matched the cost of their replacement, but were comparatively much greater than the pensions offered to wage workers. Pensions for salaried workers emphasized performance over loyalty. The loyalty was a given expectation, and the amount of the pension was tied to performance metrics. If we examine the pension as a component of overall compensation, it represented a much larger proportion of expected lifetime earnings for salaried workers than for hourly. The pension for an hourly worker was enough to get by, provided he (and the worker was almost invariably “he” during the early twentieth century) had saved some money and lived a modest lifestyle. For salaried workers, the pension could conceivably make up the bulk of their

compensation. Although the amounts were greater for salaried, and on paper their pensions appear much larger, the important measure to consider is the pension as a percentage of total compensation – only here is the huge size of executive pensions truly apparent.

Pensions both unified and divided the workforce. Corporate loyalty was required of all workers, but pensions emphasized the division between hourly workers and management. By the 1920s, the pension was a system wherein wage earners were compensated through high wages and minimal pension benefits. Salaries and pensions were inversely correlated. Executive salaries were purposefully kept too low to allow adequate retirement savings. As personnel critical to the continued health and functioning of the business, executives were induced to remain with the company through the promise of high pensions. Day laborers were a replaceable commodity, and the pension's value was in forcing them to leave work at an age their employers deemed appropriate.¹⁸

The pension created a strong division between managers and workers. This formality of relationships contributed to more efficient operations in a hierarchical system in which production speed and safety were prized over innovation or creativity. Despite the limiting effect on potential benefits, a vast majority of plans were noncontributory, that is, fully funded by the company without any contribution from employees.¹⁹ Management made the pension part of its operating functions, and by eliminating or preventing worker contributions also eliminated any potential worker complaints. Choice was in the hands of the employer, not the employee.

¹⁸ Sass, *Promise*, 48. This system took advantage of the tax structure; the Revenue Act of 1921 provided for pension benefits to be taxed at distribution, making it attractive for executives to divert a larger part of their salaries to pensions. Pensions were treated in similarly favorable ways by the Revenue Acts of 1926 and 1928, as well.

¹⁹ The difference between contributory and noncontributory plans would remain a critical feature of the pension reform debate; see chapter 3. Early labor organizations were more concerned with wage levels and work hours than old age security. (Sass, *Promise*, 9-10)

More than seventy-five percent of employer-sponsored pension plans created before 1930 were noncontributory. The employer controlled both the amount and frequency of contributions to the pension fund. With this structure, plans “appeared more as a gift from the employer than as a genuine source of economic security.”²⁰ Such pensions *were* a gift. As long as the pension was presented to employees as a reward for loyal service, employers were under no legal obligation to see that the pension provided secure income replacement or was even paid as promised.

The Supreme Court of New York defined the pension as a gift from employer to employee in the 1898 case of *McNevin v. Solvay Process Company*. James McNevin worked for Solvay from 1890 to 1895, and sued the company to recover the amount of fifty-two dollars and fifty-four cents, which he understood to be his pension. Solvay was a central New York chemical corporation that employed the patented Solvay process of using salt and limestone to create soda ash. The company provided passbooks, much like the account books used by banks, to each employee, in which to record regular amounts credited by the company to the employee’s pension. The front matter of the passbooks included a list of the company’s “rules for pensions.” Termination of employment, according to those rules, obligated Solvay to pay the balance in the pension account to the terminated employee, within five years of termination and including any accrued interest.

Solvay refused payment to James McNevin at his termination, and he first sued the company and won the case. On appeal, the decision was reversed, based on another of the rules listed in the passbook. The court backed the company in agreement with the rule stating that

²⁰ Béland, *Social Security*, 52. In 1920 private plans covered less than 5% of the workforce. Union-sponsored plans were “even less developed.” See also Hacker and Pierson, “Business Power and Social Policy: Employers and the Formation of the American Welfare State.”

pensions were company property until they were paid. Employees held no ownership rights to the money held in their names until the money was actually paid. Although the funds were readily available and ostensibly existed solely for the benefit of the employees, they were company property until paid, and the company exercised the sole right to determine their ultimate purpose.²¹

The idea of the pension as gift was confirmed in 1902. Employees sued to recover the pensions credited in their passbooks when the House of Dolge, a musical instrument felt manufacturer, went bankrupt. Although the convoluted language of the plan implied a responsibility for payment of pensions, the court ruled that it did not constitute a contract. Not only were the employees not primary creditors of the business, they were not creditors at all. Alfred Dolge had been praised for his efforts to improve the lives of his factory workers, but the pension scheme was “simply a benevolent plan.”²² The legal determination of the pension as a gift was a critical point in the development of funding and financing mechanisms. As gifts, pensions were not subject to regulation beyond the normal scope of business.

The system was flawed. As a gift from employer to employee, pensions were subject to minimal regulation. The result was an ill-managed system in which workers very often received only a small portion of the pension they were led to expect. Employees had no legal claim to pensions, and employers were not obligated to pay them. Those corporate leaders who did

²¹ Greenough and King, *Pension Plans*, 35-36. James McNevin, Respondent v. The Solvay Process Co., Appellant. 32 Appl. Div. New York, 4th Department, July Term, 1898.

²² Greenough and King, *Pension Plans*, 36-37. Dolge v. Dolge 75 New York Suppl. (1902). After the Solvay and Dolge cases, the passbook method was no longer much used for pensions, since it was “too close to an admission of liability.” Arthur D. Cloud, *Pensions in Modern Industry* (Chicago: Hawkins & Loomis, 1930), 128.

decide to include a pension among their employee benefits discovered that the task was not a simple one.

In the early days of pensions, employers structured the arrangements in varied ways. The basic idea was that an amount of money, whether broken into payments or as a lump sum, would be paid to those employees who could no longer work for a company. Individual companies made the decisions regarding any criteria which must be met before the money would be paid (length of service, age of retiree, etc.) No laws governed either how the pensions should be paid or where the money should come from to pay pensions. The legal determination of the pension as a gift provided a critical framework in the development of funding and financing mechanisms, because it gave employers free reign to structure their plans however they saw fit.

The terms “funding” and “financing,” although often assumed to be synonymous, mean different things with regard to pensions.²³ Funding a pension means calculating how much money will be needed to pay benefits, and determining how the initial money in the pension should be provided. An example of a funding decision would be whether the pension should be funded solely through employer contributions or whether employees would also contribute. Pensions to which employees contribute a portion of their own earnings are classified as contributory, and those to which only employers contribute are noncontributory. Employers strongly favored noncontributory plans, because that structure minimized the extent to which employees could claim ownership or attempt to exert control over pension money.

Financing a pension refers to how the money set aside to pay pensions is managed on a day to day basis. If a company funds its pension out of operating income, then no financing decisions need to be made, but if the company wants to make sure money is available to pay

²³ I use the terminology proposed by Walter Couper and Roger Vaughan in their 1954 study of pension planning; their explanation of pension operations is one of the most straightforward.

pensions at a future date, some determination must be made as to how the initial funding amount should grow. If the pension is a gift, as the early courts decreed, then financing loses importance. The company can decide whether or not to pay pensions as the situations arise, based on how much money is readily on hand. Many companies, not wanting to take a pension deduction as part of regular expenses, invested their pension money in annuities offered by insurance companies. Annuities provided a perfect financing method because they promised a guaranteed return at a specific date.²⁴

All pensions faced the challenge of creating a reserve fund. Past-service liability was an unavoidable problem of retirement. Benefit formulas typically calculated payments taking into account the years of service the employee had provided. Employees had different ages, and different distances from retirement. Younger workers could remain employed long enough for adequate amounts to accrue, but workers who retired within the first few years of the plan's establishment still needed to be compensated according to their years of service. This necessitated a large initial expense.

Problems became obvious as the first pension schemes themselves aged. Many businesses treated pension payments as regular labor costs, assuming them to be variable in conjunction with the general business environment. But running pensions from operating funds was not feasible. The number of pensioners remained relatively steady throughout business cycles. In fact, declining mortality rates through the 1920s meant that total number of pensioners rose at many businesses. Nor were benefit costs a variable expense. This meant that maintaining

²⁴ Donald T. Critchlow, "Introduction: Social-policy History: Past and Present," in *Federal Social Policy: the historical dimension*. eds. Donald T. Critchlow and Ellis E. Hawley, (University Park and London: Penn State University Press, 1988), 38. Annuity: a contract or agreement under which one or more persons receives annuities in return for prior set payments made by themselves or another (as an employer); annuity: an amount payable yearly or at other regular intervals (as quarterly) for a certain or uncertain period. Webster's Third New International Dictionary, 1986.

benefit levels in the absence of sufficient reserves was very difficult during economic downturns. However, employers realized very quickly that cutting benefits was bad for both labor relations and public image.²⁵

While pensions provided a valuable tool for managing labor relations in the early twentieth century, managers began to question the overall efficacy of the practice as the amounts of committed funds increased, and as the alternative uses of these funds began to appear more lucrative during the 1920s. Standard practice involved investing money intended for pensions in annuities offered by insurance companies. The guaranteed payment structure of an annuity was offset by low rates of return. Corporate pension managers could do little more than observe as growing sums were deposited with insurance companies. Management struggled to reconcile the interests of employee welfare with the responsibility to shareholders dictated by a growing corporate economy. To set pension funds aside for future payments to workers was one thing, but why should these funds not be available to further the growth of the business in the interim? As the prospect of uncertain, but large-scale, payments loomed, businesses began to transition pension policy away from the realm of labor relations and into a fully integrated corporate financial policy.

By the 1920s, social conditions were right for pensions to become successful propositions for both employers and employees. Due to the maturation of the industrial economy, income for post-work life was just beginning to be truly needed. As workplace safety improved, and life expectancies increased, the necessity of income during post-work life increased. Simply put, more and more people were living longer than their careers. The growing economy helped ease the burden of setting aside money to fund pensions. New financing opportunities offered higher

²⁵ Sass, *Promise*, 58-60.

rates of return than savings accounts or basic annuities. At the same time, federal tax policies encouraged the use of pensions as a method for sheltering income. Following a series of Revenue Acts, contributions to pension trusts and the investment income they earned were tax deductible. Employees were taxed at the time they received pension benefits, and then only on the excess of the amounts originally paid.²⁶ The value of private pensions increased from \$50M to \$500M between 1920 and 1929.²⁷

The Depression brought to glaring light the failings of private pensions. In the first place, pensions were still relatively rare; estimates vary, but “certainly fewer than 15 percent” of people older than sixty-five received any kind of pension income.²⁸ Many pension plan administrators had used the funds at their disposal to invest in both their own company securities and in high-risk securities during the 1920s, which resulted in decreased payments after the market crashed.²⁹ Some private pensions did do well during the Depression; many of these were contributory and included plan insurance.³⁰ The number of such plans increased from 420 in

²⁶ Sass, *Promise*, 102; Graebner, *History of Retirement*, 134; James Schulz, Guy Carrin, Hans Krupp, Manfred Peshke, Elliott Sclar, and J. Van Steenberge. *Providing Adequate Retirement Income: Pension Reform in the United States and Abroad* (Hanover, New Hampshire Published for Brandeis UP by the UP of New England, 1974), 114. Revenue Acts of 1921, 1926, and 1928.

²⁷ Carolyn L. Weaver, *The Crisis in Social Security: economic and political origins* (Durham, N.C.: Duke University Press, 1982), 47-8.

²⁸ Carole Haber and Brian Gratton, *Old Age and the Search for Security: an American social history* (Bloomington: Indiana University Press, 1994), 105-6.

²⁹ Daniel Kenneth Smartt, *Pension Funds: A Study in Growth and Investment* (M.A. Thesis, University of Texas, 1970). No regulations prohibited such investment practices, nor were there legal consequences for those losses. The Supreme Court supported management’s position that the pension was a gift to the employee, in *Pennie v. Reis*. Date.

³⁰ Plan insurance is exactly what it sounds like – an insurance policy that will pay the pensions in the event the fund is unable to make payments.

1930 to 750 in 1935; many of these even included vesting provisions.³¹ The economic crash did reveal that some pensions were being managed in financially risky ways, but, more importantly, it revealed that pensions were expanding too slowly, and too few workers were covered.

The federal government had considered and rejected proposals for a national old age relief program in 1909.³² In *Shades of Gray*, Andrew Achenbaum proposes that the Depression “forced a profound reevaluation of American individualism.”³³ With a quarter of the workforce unemployed, and wages down across the board, Americans could no longer maintain even the illusion of self-sufficiency. Drawing from the work of Robert Wiebe, Achenbaum theorizes that as the national political economy achieved its basic ‘modern’ form in the 1920s, so too did that period mark the modernization of old age. Modern old age policies presented new answers to what Achenbaum terms “enduring value dilemmas,” including tradeoffs between expectation and entitlement, private and public, and self-reliance and dependency.³⁴ Social Security was about just that – security in old age, which came to be defined as a public entitlement. The pension, however, remained a function of loyalty, an expectation within the private realm of business.

³¹ Larry W. DeWitt, Daniel Béland, and Edward D. Berkowitz, *Social Security: a documentary history* (Washington, D.C.: CQ Press, 2008), 5; Weaver, *The Crisis in Social Security*, 63-64. Vesting is a procedure for transfer of ownership – when an employee becomes vested in a plan, it means he owns his portion of it. This was usually granted gradually, with full vesting after the total required years of service. Also, plan insurance means that the assets of the pension plan were insured by an outside source. This is different from an “insured plan,” which is a plan financed by an insurance company.

³² W. Andrew Achenbaum, *Shades of Gray: Old Age, American Values, and Federal Policies Since 1920* (Boston, Toronto: Little, Brown and Company, 1983), 16.

³³ Achenbaum, *Shades of Gray*, 30.

³⁴ Achenbaum, *Shades of Gray*, 16-23; 28-30. Other tradeoffs included individual/family; equity/adequacy; work/leisure; novelty/tradition

Many early retirement proposals were impractical and quickly dismissed by policymakers.³⁵ In 1933, a California physician named Francis Townsend developed a plan that achieved a strong national following and helped pressure Congress to create a national plan for old age security. The basic idea of the Townsend Plan was that every citizen who was over the age of 60 and fully retired would be given two hundred dollars every month, with the stipulation that the entire amount must be spent within the month. The funding source would be a national sales tax.³⁶ Townsend's plan had the advantage of simplicity, which made it attractive to the layperson; across the country, Townsend clubs lobbied for its passage as a federal program. But the plan's simplicity was accompanied by functional impracticality.

A conservative estimate of ten million pensioners would require annual payment of twenty-four billion dollars, nearly triple federal tax revenues. All transactions would have to be taxed at a minimum of six percent to cover the payments, to be paid by businesses. While Townsend argued that any negative effects of such a tax would be offset by increased consumption by the elderly, how could any agency check whether each of those ten million people spent all \$200 every month? Although infeasible, the plan's popularity generated increased support for the creation of a workable national plan.³⁷

³⁵ The "Ham and Eggs Plan" called for a daily meal of ham and eggs served to the elderly; it never achieved more than a local following. (this was in California) (law article citation)

³⁶ Townsend Plan, in DeWitt, et al *Social Security: A Documentary History* 2008. 42-44.

³⁷ Ibid., and "Why the Townsend Old Age Revolving Pension Plan is Impossible" Jan. 1935 Committee on Economic Security paper in DeWitt, et al, *Social Security: A Documentary History* (originally unpublished); Witte, vi. Frances Perkins, former Secretary of Labor and chairman of the Committee on Economic Security, later described the situation in her 1962 foreword to Witte's published memorandum. It was "the Townsend plan which both drove us and confused the issue," but "to have accepted the Townsend plan would have been ridiculous."

The development of Social Security marks a pivotal moment in the evolution of America's private pension system. The technical effects of national old age insurance on private pensions are less important than the ideology affirmed by the Social Security Act. Social Security legitimized the idea of retirement, by acknowledging the necessity of financial support or continuing income during the period between the end of work and death. The question facing both management and employees was whether the pension, as it existed, could continue as a gift from employer to loyal employee, or whether an adequate retirement income should be considered a fundamental right of the working man. The New Deal embraced the reformers' insistence that every worker should have some form of guaranteed old age security. The creation of Social Security affirmed that idea, in theory if not in actual practice, beginning the transformation of the pension from gift to right.³⁸

The Social Security Act was created by President Franklin Roosevelt's Committee on Economic Security, under the leadership of executive director Edwin E. Witte, an economics professor at the University of Wisconsin. The Committee quickly rejected the Townsend plan's proposal for a national sales tax, concluding such a tax would have a devastating effect on American business.³⁹ Instead, the Committee proposed to fund a national old age security plan by means of a payroll tax. To avoid the problem of past service liability – not having enough

³⁸ Daniel Béland argues that the “underestimation of the policy impact of ideas is detrimental to our understanding of social policy reform.” (Béland, *Social Security*, 4) Americans have created institutions which continue to constrain policy decisions with regard to old age welfare. But we cannot deny the importance of ideology. Ideas force the creation of institutions and the ideas created by those institutions have retained power. When the ideas change, when questions of ownership or responsibility are resolved in new ways, policies must be adapted. See Jennifer Klein's argument about the provision of supplemental benefits as the “American way.”

³⁹ *Ibid.*, and “Why the Townsend Old Age Revolving Pension Plan is Impossible” Jan. 1935 Committee on Economic Security paper

money for immediate retirees – the plan called for several years of tax collections prior to the initial benefit payments in order to build a reserve fund.

One of the difficulties initially facing the creation of Social Security was the sheer magnitude of the amounts involved. President Roosevelt was particularly concerned when the calculations revealed a huge future deficit, which would have to be filled from other tax revenues.⁴⁰ In his memorandum, Witte describes serious objections coming from the Treasury Department. Conservatives wanted to keep government expenditures to a minimum, and to avoid measures that might alarm the business community. At the other end of the spectrum were those who did not think the Committee's proposals were far-reaching enough to be of value.⁴¹

The biggest legislative obstacle to the creation of a comprehensive national old age security system was an amendment proposed by Senator Joel Bennett Clark (D-MO). One objection the Committee had not anticipated was that of insurance companies financing existing private pension plans.⁴² Since many private plans provided better benefits than those proposed by Social Security, Senator Clark suggested that companies sponsoring qualified plans be exempt from the act. Otherwise, he reasoned, companies would choose to terminate their plans instead of paying for both private and public plans, leaving employees with fewer benefits. A

⁴⁰ Edwin E. Witte, *The Development of the Social Security Act: A memorandum on the history of the Committee on economic security and drafting and legislative history of the Social Security Act* (Madison, WI: University of Wisconsin Press, 1962), 74. (Edwin E. Witte, Executive Director, Committee on Economic security, 1934-1935) This instance is emblematic of the challenge faced by both public and private pensions. The most secure thing to do with pension funds is to let them quietly accumulate in a bank. But the size of the necessary sums is bound to attract attention - from members of Congress who think those funds could be used to grow the economy or provide immediate social relief, to businessmen who see a wasted growth opportunity, or labor leaders who would choose to increase current benefit levels.

⁴¹ Witte, *Development*, 72-73.

⁴² Witte, *Development*, 157. They feared that a national system would prompt employers to eliminate their existing plans, effectively destroying that line of business for insurers.

private alternative would provide “flexibility and freedom of choice,” and would force the government to run its own program in a financially sound manner.⁴³ The amendment “allowed large private firms with more than fifty employees and operating approved pension plans offering more generous benefits than the proposed federal program to withdraw from it.”⁴⁴ But this freedom of choice would be for business; those employees locked into employer-sponsored plans without benefit of Social Security would have been effectively trapped at one workplace.

Clark’s idea was contrary to the administration’s vision of a full-scale national system for old age security. On a fundamental level, proponents of Social Security did not consider retirement pensions and provision for old age security to be equivalent concepts. The businesses that lobbied in favor of the Clark amendment were, after all, insurance companies in the business of selling pension annuities, not the companies who bought such annuities themselves.⁴⁵ The pension was an instrument of business, so the decision of whether or not to continue or sponsor a pension plan was something to be considered independently of Social Security.⁴⁶ Regardless of its practicality, the Clark amendment was the last chance for provision for old age to remain under control of the private sector.

The Clark amendment passed in both the House and Senate, but the administration could not allow it to become part of the final bill. If any companies were exempt from the proposed

⁴³ Weaver, *The Crisis in Social Security*, 89-90.

⁴⁴ Béland, *Social Security*, 93.

⁴⁵ Witte, *Development*, 157-158.

⁴⁶ In practice, this was completely untrue.

payroll tax, the program would not have enough funding.⁴⁷ The amendment was sent to committee for further study before the bill came up for a final vote; when the committee reported that it would need at least two weeks to review it, the decision was made to table the amendment and go ahead with the vote. Social Security became law in 1935, and the Clark Amendment was never reconsidered.⁴⁸

Collection of payroll taxes to fund Social Security began in 1937. The program was modified even before it officially began, when Congress moved the initial benefit payment date from 1942 to 1940 and expanded coverage to include survivors.⁴⁹ The first Social Security

⁴⁷ Weaver, *The Crisis in Social Security*, 91 –part of the problem of past service liability– had to have younger workers pay for new retirees; Witte, *Development*, 161: the Committee saw no way to have any kind of exemption that would not end up destroying the overall plan

⁴⁸ Weaver, *The Crisis in Social Security*, 90-92. In retrospect, adoption of the Clark amendment would have completely altered the basic nature of Social Security. While the bureaucratic challenges it presented were sizeable, they were not insurmountable. But Social Security as a national welfare program could not have existed. Carolyn Weaver points out that many private plans then in existence offered better provisions than could be expected from Social Security. She argues that “If there was a proper role for the federal government in the provision of retirement income, it may well have been in promoting the more rapid development of pension plans or in hastening the formation of contractual relations for these plans.” “The advantages were clear of a contributory pension plan which could provide contractual claims for workers and beneficiaries over a compulsory federal program which would not.”(59-64). Government could have exerted considerable influence over plan development through changes in tax treatment, but such measures would not have had the universal impact necessitated by the Depression.

⁴⁹ DeWitt, et al *Social Security: A Documentary History*, 6-7; Edward Berkowitz and Larry DeWitt, “Social Security from the New Deal to the Great Society: Expanding Public Domain” in *Conservatism and American Political Development*, eds. Brian J. Glenn and Steven M. Teles, Oxford, 2009, 53-85, 64-71. 68: existence of Social Security seemed to stimulate interest in private products aimed at easing the problems of financial insecurity in old age.

The simplest argument for business acceptance of Social Security is that it was what David Béland calls a matter of “strategic accommodation.” (Béland, *Social Security*, 83) Better to make the best of it because the alternatives could be worse. The situation was of course more complicated. Berkowitz and DeWitt explain how some corporate leaders welcomed legislation that would not materially affect them (since it had the potential to replace or supplement their own pre-existing welfare programs), and could increase costs for their competition. (Berkowitz and DeWitt, “Social Security,” 58) Jacob Hacker and Paul Pierson give a more nuanced explanation, taking into account that while business can influence social change, this capability is nonetheless bounded by existing political and social institutions. Weakness brought on by the Depression, and the divergent goals of Northern industry and Southern agriculture mean that the business community was severely hampered in its ability to mobilize

benefit was paid in 1940, to Miss Ida Fuller, a retired law secretary, in the amount of \$22. With Social Security, workers were assured an adequate, if minimal, retirement annuity. Once corporations no longer needed to provide a safety net for lower paid workers, business could devote attention to pensions for those workers whose salaries fell above Social Security's initial wage ceiling of \$3,000.⁵⁰ The pension filled the gap between expected Social Security benefits and the desired level of retirement income. With tax rates as high as 70% on incomes above \$100,000, lower marginal tax rates on pension income pushed executives to shift current salary to deferred pension compensation.⁵¹ Throughout the 1930s, pensions became more skewed toward the affluent; with assets taxed only at distribution, the pension was an attractive tax shelter for high earners. This spurred the development of pension plans directed at salaried workers. By the late 1930s pensions covered approximately 4 million workers.⁵²

World War II produced "a boom in retirement plans," which predominantly benefited the highest earners.⁵³ In 1939 there were 659 private pension plans, and by 1946 there were 9,370.⁵⁴ The Stabilization Act froze wages, but exempted employer contributions to health and welfare

as a singular entity. Certainly some business leaders did not oppose Social Security, as a means to spread the costs of welfare capitalism, while some wanted to protect the low-wage, nonunion interests. For a good explanation of the particular complexities, see Colin Gordon, *New Deals: Business, labor, and politics in America, 1920-1935* (Cambridge and New York: Cambridge University Press, 1994), chapter 3, "The Social Security Act: the political economy of welfare capitalism, 1920-1935," as well as Hacker and Pierson, "Business Power and Social Policy: employers and the Formation of the American Welfare State" *Politics and Society* 30, no. 2 (2002) 277-325.

⁵⁰ Graebner, *History of Retirement*, 215; Béland, *Social Security*, 112. \$22.mo; she paid in less than \$100, but received over \$20,000 by the time of her death in 1975.

⁵¹ Sass, *Promise*, 77-88, 101; Béland, *Social Security*, 112.

⁵² Schulz, et al, *Providing Adequate Retirement Income*, 113.

⁵³ Wooten, *ERISA*, 30.

⁵⁴ Béland, *Social Security*, 112-113.

programs, including pensions. The Revenue Act of 1942 made all pension contributions exempt from income tax. With the tax on excess profits keeping declarable revenues low, pension contributions were a good alternative use of income. The tax structure meant that each dollar contributed to a pension had a real cost to the employer of only 14.5 cents.⁵⁵

The Revenue Act of 1942 included two other significant provisions. It permitted the integration of private plans with Social Security, so companies could factor in Social Security payments when calculating private benefits. This became critical to the enactment of the Act's stipulation that in order to qualify for full tax exemption private plans must cover broad groups of employees.⁵⁶ Although private plans had to include the majority of workers, by incorporating Social Security, "plans could provide greater proportionate payments to upper-income groups."⁵⁷ Corporate pension contributions grew 500% from 1941 to 1945, with 17% of corporate payroll going to pensions by 1946.⁵⁸

Social Security provided the illusion of security. The federal government failed to live up to the responsibility it promised during the New Deal. From the start, Social Security covered limited groups; by not initially including agricultural or domestic workers it disproportionately

⁵⁵ Sheryl R. Tynes, *Turning Points in Social Security: from "cruel hoax" to "sacred entitlement"* (Stanford, CA: Stanford University Press, 1996), 109-10. The remaining 85.5¢ would have gone to the government in taxes.

⁵⁶ *Ibid.*, Béland, *Social Security*, 112, also Wooten, Sass, and others.

⁵⁷ Graebner, *History of Retirement*, 216; Tynes, *Turning Points*, 109-110. Social Security payments, as a percentage of income, were higher for lower wage workers. If a worker is making \$200 a month, and Social Security is expected to pay him \$100 a month, that's 50% coverage. If a worker is making \$2,000 a month, and Social Security is expected to pay him \$400 a month, that's only 20%. The company was permitted to offer the higher wage worker a pension (of \$600/mo.) that would bring his expected income percentage up to the same 50% of the lower wage worker.

⁵⁸ Béland, *Social Security*, 112-113; Graebner, *History of Retirement*, 216.

prevented African Americans and women from receiving benefits.⁵⁹ The tax rate was scheduled to rise four times by 1949, but Congress kept it at the 1937 rate, 2%, until 1950, when it was raised to 3%.⁶⁰ By not taking measures against the declining real value of benefits, government pushed the pension burden back to employees, who turned to unions to force it back to employers.⁶¹ The national commitment to old age security had the strange effect of postponing decisive answers to the question of the nature of the pension.

If Social Security had become the program its proponents wished, the private pension would no longer be necessitated by the American workplace. The uncertainty of assistance from an employer or social network was replaced by the certainty of federal benefits. Provision for old age became “a social requirement” instead of a personal responsibility.⁶² But, by creating such good tax treatment for private plans, the government paved the way for pensions to be used to help reward executives. The pension could have remained in the realm of executives but for the allowance of benefits calculated including Social Security. Provision of Social Security for rank and file workers transformed the pension into more of a gift than it had ever been. The push to liberalize the pension then came from unions, who would make pensions into a primary point

⁵⁹ Nelson Lichtenstein, “Labor in the Truman era: origins of the “private welfare state,”” in Michael J. Lacey, ed., *The Truman Presidency* (Washington, D.C.: Woodrow Wilson International Center for Scholars; Cambridge, New York: Cambridge University Press, 1989), 128-155: 151.

⁶⁰ DeWitt, et al *Social Security: A Documentary History*, 9-11. Original calculations called for a tax rate of 6% by 1949, but projections put the rate at 6.5% for 1970. Politicians just couldn’t grapple with the size of the reserve fund being accumulated; calculations predicted amounts over \$40 billion by 1980, and neither Democrats nor Republicans were willing to keep that much money out of circulation.

⁶¹ Teresa Ghilarducci, *Labor’s Capital: the economics and politics of private pensions* (Cambridge, MA: MIT Press, 1992), 37. Social Security was not keeping up with inflation.

⁶² Graebner, *History of Retirement*, 199-200; Lizabeth Cohen, *Making a New Deal: industrial workers in Chicago, 1919-1939* (Cambridge, New York: Cambridge University Press, 2008, 2nd edition), 267-8; 272. Social Security did not address the problem of old age beyond the financial, the greater welfare of the elderly; according to William Graebner, “Social security, in short, should be recognized as a system that for all its benefits creates and perpetuates the inherent injustices of retirement.” (199).

of contention in collective bargaining. The pension came to function once again as an expression of goodwill from employer to employee, although now that goodwill was contractually required.

Following World War II, organized labor was unable to realize its vision of a fully participatory economy in which labor and management worked cooperatively under direct state supervision.⁶³ The conservative Congress elected in 1946 did not raise Social Security benefits, and blocked the Truman administration's attempt to implement national health insurance. With political options blocked, unions turned their attention to the construction of private welfare schemes. Unable to change "essential power relationships" as they had hoped given wartime experience, unions sought worker security through private channels. Nelson Lichtenstein argues that union leaders reasoned that if the responsibility, and costs, of pension and health benefits were borne by business, eventually the business community would push for federal welfare expansion.⁶⁴

The pension became a "standard demand" of collective bargaining agreements because of the 1946 coal strike by 400,000 miners of the United Mine Workers of America.⁶⁵ UMWA President John L. Lewis did not trust entities other than the union to oversee miners' pensions. The strike's resolution, decided between the union, the coal companies, and representatives of the Truman administration, was a victory for Lewis. The pension program was set up under a joint trusteeship of company, union, and independent trustees; by influencing the decision of the

⁶³ Stephen Amberg, *The Union Inspiration in American Politics: the autoworkers and the making of a liberal industrial order* (Philadelphia: Temple University Press, 1994), 226.

⁶⁴ Nelson Lichtenstein, *The Most Dangerous Man in Detroit: Walter Reuther and the fate of American labor* (New York: Basic Books, 1995), 282; Lichtenstein, "Labor in the Truman Era," 138-140.

⁶⁵ James A. Wooten, "'The Most Glorious Story of Failure in the Business': The Studebaker-Packard Corporation and the Origins of ERISA." *Buffalo Law Review* 49 (2001): 689.

“neutral” trustee, Lewis achieved effective control.⁶⁶ The UMWA’s success helped both diminish union demands for federal welfare programs and promote expansion of private union negotiated plans.⁶⁷

Then in the 1949 Inland Steel case, the Supreme Court decreed that management’s failure to include fringe benefits in the collective bargaining process was an unfair labor practice.⁶⁸ The official sanction of pensions as an appropriate inclusion sparked a “rush of collective bargaining,” resulting in extension of coverage to more than 5 million workers by mid-1950.⁶⁹ The pension presented the best of both worlds for unions and employers. Union leaders could tout a benefit increase in place of a wage raise, and employers could effectively postpone payments to a “surely inflationary” future.⁷⁰ Coverage of the private workforce expanded from 19% in 1946 to 41% by 1960.⁷¹

The primacy of pensions in labor wage agreements was enshrined in American welfare ideology by the famous “Treaty of Detroit” signed between the United Auto Workers and

⁶⁶ Jennifer Klein, *For All These Rights: business, labor, and the shaping of America’s public-private welfare state* (Princeton: Princeton University Press, 2003), 197-198; Ghilarducci, *Labor’s Capital*, 38.

⁶⁷ Lichtenstein, “Labor in the Truman Era,” 153; Ralph C. James and Estelle Dinerstein James, *Hoffa and the Teamsters: a study of union power* (Princeton, N.J.: Van Nostrand, 1965), 215.

⁶⁸ Lichtenstein, *Dangerous*, 282.

⁶⁹ Graebner, *History of Retirement*, 219.

⁷⁰ *Ibid.*, see James, *Hoffa*, 216; Béland, *Social Security*, 114.

⁷¹ Béland, *Social Security*, 114; see Sass, *Promise*, 126-132; Jill Quadagno, *The Transformation of Old Age Security: class and politics in the American welfare state* (Chicago: University of Chicago Press, 1988), 162-171. Andrew Achenbaum gives two primary reasons for expanded pension coverage during the 1940s and 50s: greater interest in supplemental benefits as a result of Social Security, and the pension’s inclusion in labor negotiations; the number of workers covered by private pensions was 19 million by 1958 (Achenbaum, 60) (see also Drucker, *Unseen Revolution*, 6-7; Eugene A. Friedmann and Robert J. Havighurst, with William H. Harlan and others, *The Meaning of Work and Retirement* (Chicago: University of Chicago Press, 1954), 183.

General Motors. Among labor leaders, the UAW's Walter Reuther was "by far the most forceful and effective propagandist" for pensions.⁷² Reuther had two objectives for auto worker pensions: to establish plans with sound funding and to make pensions an additional payment on top of Social Security.⁷³ Unlike Lewis, Reuther did not insist on union control of the funds; he wanted agreements that made arrangements for payment of regular costs plus a provision for amortization of past service liabilities. Business had been using Social Security, "either explicitly or implicitly," as an offset to pension costs.⁷⁴ Reuther wanted pensions kept separate from Social Security, so that an increase in federal benefits would not mean a corresponding decrease in private benefits. In the agreement with GM, both these goals were achieved. The pension would be paid on top of federal benefits, and would be properly funded, in addition to other beneficial provisions such as reduced health insurance costs and cost of living adjustments.⁷⁵ The signing of similar contracts at Ford and Chrysler began "a pattern-bargaining process in which the 'Big Three' gave almost identical benefits to all their UAW workers in successive long-term contracts covering the next twenty-nine years."⁷⁶

⁷² Lichtenstein, *Dangerous*, 283.

⁷³ *Ibid.*, Steve Jefferys, *Management and Managed: fifty years of crisis at Chrysler* (Cambridge; New York: Cambridge University Press, 1986), 115. Sass, *Promise*, 136: Reuther's idea of full funding meant payment of accruing normal costs plus amortization of past service liabilities

⁷⁴ Graebner, *History of Retirement*, 222; Nancy Altman and Ted Marmor. "Social Security from the Great Society to 1980: further expansion and rekindled controversy." In *Conservatism and American Political Development*, edited by Brian K. Glenn and Steven Michael Teles, 154-187. (Oxford: Oxford University Press 2009) 156-157.

⁷⁵ Jefferys, *Management*, 116.

⁷⁶ Jefferys, *Management*, 117. The plan with Ford initially granted \$100/month after 30 years' service; the UAW got \$125 at GM. (see Lichtenstein, *Dangerous*, 283.)

The pension began as a gift. Social Security moved provision for old age security to the realm of the government, leaving the pension in an ill-defined position. Security was no longer merely a reward for loyal service, but neither was the pension directly acknowledged as part of wages, except under certain collectively bargained agreements. As pensions became more associated with executive rewards the appearance of the gift reemerged. The pension became a gift employers were forced to give, a gift with strings attached. This was problematic because of the lack of regulation and the corresponding lack of reliability.

Private pensions left employees in no position to make demands, at least not outside the collective bargaining process. Non-union workers could only rely on their employers' beneficence. Such a situation is tenable only for as long as the economy is growing and companies do not have difficulty meeting payment obligations. By 1960, though, workers regarded payment during retirement as a definite corporate obligation, although this was not legally the case.

The concept of retirement was an invented idea. The pensions provided by early fraternal societies were never intended to replace worker incomes at a level beyond subsistence. Any payment would help with basic survival for a retired worker's last few years, and hopefully cover funeral expenses and leave a small amount for dependents. This was the best case scenario. Welfare plans paid more attention to disability or provision for survivors in cases of accidental injury or death. Reformers fought, not for the leisure we today associate with retirement, but so that the nation's elderly did not live in absolute poverty and lack basic medical care when they could no longer work. With lower life expectancy, many people didn't live that long after stopping work anyway. The emphasis was on creating some degree of security. And it was this

basic level of security that the government created with Social Security.⁷⁷ As Jennifer Klein explains, “the New Deal did not simply create the welfare state; it launched a new economy of welfare in which the ideology of security proved a powerful construct.”⁷⁸

The idea of “retirement” – a period of well-deserved leisure after a lifetime of work – was the creation of the pension ideology that developed after WWII, when pensions had taken a firm position as an executive reward, and when unions began to use pensions as an important plank of their collective bargaining platform.⁷⁹ The creation of retirement meant that the purpose of retirement had changed. With Social Security poised to cover a retiree’s basic needs, the private pension became supplemental.⁸⁰ The rhetoric of pension supporters kept the pension an expected and demanded part of compensation packages.

Retirement of the 1950s was the frontier of leisure and consumption. For the first time, theorists attempted to define and describe this period of life.⁸¹ Social status was decided by one’s career or profession, but quality of life was determined by how Americans spent their leisure time.⁸² The idea of retirement as leisurely, but meaningful, was promoted for reasons of economy and expediency. Insurance companies promoted retirement as a period for life to be enjoyed, courtesy of the pensions they sold. At the same time, the elderly found it necessary to

⁷⁷ Carole Haber and Brian Gratton, *Old Age and the Search for Security: an American social history* (Bloomington: Indiana University Press, 1994), 168: Social Security made retirement an “established norm for the elderly;” it enabled the elderly to stop working before death.

⁷⁸ Klein, *For All These Rights*, 4.

⁷⁹ In his memorandum on the creation of Social Security, Edwin Witte does not use the term “retirement.” Retirement was the act of stopping work; life after retiring was “old age.”

⁸⁰ Scholars of the subject would likely argue that Social Security has seldom, if ever, truly met the needs of the retired. But that is another dissertation.

⁸¹ Graebner, *History of Retirement*, 227.

⁸² Achenbaum, *Shades of Gray*, 59.

present themselves as active and purposeful, in order to qualify for health insurance coverage. The American Association of Retired Persons was founded in 1955 by Dr. Ethel Percy Andrus with this goal.⁸³ According to contemporary writers, retirement gave the middle class an opportunity to “build new lives on a foundation of leisure.”⁸⁴

Leisure, however, did not mean a lack of activity. Staying active and productive was a means of preserving masculinity in old age.⁸⁵ Retired men were advised to avoid housework and the accompanying dangers of submission and feminization. The 1950s saw the creation of literal and figurative spaces where men could be at home but retain their manhood. The “den” and the garage began to be standard features of new suburban construction. Activities such as shuffleboard and golf grew in popularity.⁸⁶

“Free time” was not free, though. Spending on golf equipment alone was over \$60 million by 1958.⁸⁷ As retirement became “a permanent paid vacation,” retired persons discovered they had time to buy and enjoy consumer goods, and the manufacturers of those

⁸³ Graebner, *History of Retirement*, 231-5.

⁸⁴ Gregory Wood. *Retiring Men: Manhood, Labor, and Growing Old in America, 1900-1960*. (New York: University Press of America, Inc., 2012), 84. See: David Riesman, ed., *Individualism Reconsidered and other essays*, (Glencoe, Ill.: The Free Press, 1954); Irving Salomon, *Retire and Be Happy* (NY: Greenberg, 1951); Otto Pollack, *Positive Experiences in Retirement* (Philadelphia: University of Pennsylvania Press, 1957); Raymond P. Kaighn, *How to Retire and Like It* (NY: Association Press, 1951); Joseph C. Buckley, *The Retirement Handbook: a complete guide to planning your future* (NY: Harper and Row, 1953); Theodor Greene, *How to Enjoy Retirement for the Rest of Your Life* (NY: Exposition Press, 1957); Ray Giles, *How to Retire and Enjoy It* (NY: McGraw-Hill Book Company, 1949); Walter B. Pitkin, *The Best Years: how to enjoy retirement* (NY: Current Books, 1946).

⁸⁵ Women didn't get to retire; the authors did not consider their daily labors as “work.”

⁸⁶ Wood, *Retiring Men*, 184-199.

⁸⁷ Wood, *Retiring Men*, 199.

goods found a new and potentially very profitable market.⁸⁸ By 1960, retirement was the pinnacle of the American dream, an enjoyable and enviable time of life.⁸⁹ Pensions were necessary to pay for that dream. As society moved from acceptance of a guarantee of subsistence income to the idea of a retirement in which one's highest achieved standard of living could be maintained, the expectations and demands placed on private pensions grew in kind.⁹⁰

The key shift in pensions that took place through the 1950s was in how pensions were managed. Having answered the question of who was entitled to old-age security – all Americans, and deciding who would provide the funding – both government and business, the pension industry turned to the question of financing. The point of contention was how the growing sums of money would be managed. Executives were increasingly aware of returns they were unable to earn on money earmarked for pensions. Whereas the previous emphases for control of pension money had been security of the funding and tax avoidance, the postwar economy offered possibility, particularly through equity investment.

By the 1950s, the pension was an absolute requirement of business, as evidenced by the production of a new body of literature: pension planning guides directed at corporate executives and pension professionals. Both Walter Couper and Roger Vaughan's *Pension Planning* (1954), and James Hamilton and Dorrance Bronson's *Pensions* (1958) agree on the necessity of a pension plan.⁹¹ The differences in their use of language reveal a shift from emphasis on

⁸⁸ Gary S. Cross, *An All-Consuming Century: why commercialism won in modern America* (New York: Columbia University Press, 2000), 187.

⁸⁹ Graebner, *History of Retirement*, 240; 214.

⁹⁰ Julian Gumperz, "Pension Funds in an Age of Discontinuity" *Financial Analysts Journal* 26 (Nov-Dec 1970), 24.

⁹¹ Walter J. Couper and Roger Vaughan, *Pension Planning* (New York: Industrial Relations Counselors, 1954) and James A. Hamilton and Dorrance C. Bronson, *Pensions* (New York, Toronto and London:

pensions as an important element of employee welfare to pensions as integral to corporate financial planning. Couper and Vaughan acknowledge a widespread belief that Social Security benefits were not “satisfactory.” While implementing a plan was formerly a measure taken to earn employees’ goodwill, the reason by the early ‘50s was to avoid “vigorous criticism” for lacking a plan.⁹² Just a few years later, Hamilton and Bronson focus less on employees and more on sound corporate policy. Pensions are good for public relations, they say, but also for ridding a company of workers whose “efficiency has begun to decline.” Through pensions, “maintenance of a young and progressive organization is facilitated.”⁹³

The fundamental requirement of a pension plan was that it be properly funded, so that money would be available to pay benefits. And those benefits needed to be substantial enough to avoid employee or public criticism.⁹⁴ Despite admonishments to make arrangements for adequate funding based on conservative actuarial estimates, pension advisors offered loopholes.

McGraw-Hill Book Company, Inc., 1958). Hamilton and Bronson used much less humanistic language, with more business jargon; they took their working definition of a pension from the 1954 Internal Revenue Code (121): A pension plan within the meaning of section 401(a) is a plan established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits to his employees over a period of years, usually for life, after retirement. Retirement benefits generally are measured by, and based on, such factors as years of service and compensation received by the employees. The determination of the amount of retirement benefits and the contributions to provide such benefits are not dependent on profits. Benefits are not definitely determinable if funds arising from forfeitures on termination of service or other reasons may be used to provide increased benefits for the remaining participants instead of being used to reduce the amount of contributions by the employer. A plan designed to provide benefits for employees or their beneficiaries to be paid upon retirement or over a period of years after retirement will, for the purposes of section 401(a) be considered a pension plan if the employer contributions under the plan can be determined actuarially on the basis of definitely determinable benefits, or, as in the case of money-purchase pension plans, such contributions are fixed without being geared to profits.

⁹² Couper and Vaughan, *Pension Planning*, 97

⁹³ Hamilton and Bronson, *Pensions*, 2: The authors claimed that getting rid of older workers opens room for promotion and improves employee morale. One presumes that the morale of the older workers is immaterial.

⁹⁴ Couper and Vaughan, *Pension Planning*, 177; Hamilton and Bronson, *Pensions*, 5-6.

Couper and Vaughan state outright that adequate funding is “not necessary . . . if it can be assumed that the employer will continue in business and always earn enough money to pay pensions out of pocket.” Surely, they reasoned, companies of such size and management as General Motors or American Telephone and Telegraph will continue to exist well into the future and always have enough positive cash flow to meet their obligations.⁹⁵ Hamilton and Bronson are a touch more circumspect. Large, well-managed companies do need to make careful plans for pension funding, except “in some instances, [of] temporary conditions or expediency, such as war conditions of unusual industrial activity, union demands, short-term tax advantage, or competition in the labor market.”⁹⁶ The astute observer will note that this range of conditions might be expected, not unreasonably, to be present for virtually the entire life of a business.

The UAW’s strike at Chrysler was because of Walter Reuther’s insistence on full funding of the pension plan.⁹⁷ Reuther wanted to insure that the money would be there when pensions needed to be paid, but “Chrysler’s reply to the union was, in effect, it didn’t know and couldn’t figure what the pension costs would be, and anyway costs were none of the union’s business.”⁹⁸ Steve Jefferys, the author of a history of Chrysler, recounts a telling objection from Chrysler’s Chairman, B.E. Hutchinson, which was symptomatic of widespread business feeling: “he was against tying up \$45M of ‘his’ money in the low-interest securities that a properly funded plan and fixed cents per hour commitment would demand.”⁹⁹

⁹⁵ Couper and Vaughan, *Pension Planning*, 28. They were wrong.

⁹⁶ Hamilton and Bronson, *Pensions*, 5-6.

⁹⁷ Lichtenstein, *Dangerous*, 283: “despite much evidence that few autoworkers understood the concept of an “actuarially sound” pension plan.”

⁹⁸ *Fortune*, June 1950, 70-72.

⁹⁹ Jefferys, *Management*, 116.

Not all unions were as prudent as the UAW. In particular, Couper and Vaughan express “very grave doubt” about the long-term feasibility of the United Mine Workers’ plan.¹⁰⁰ The UMWA had insisted on ‘pay as you go’ financing despite employers’ offer to provide full funding. This meant higher current benefits, but left the plan saddled with a “chronic” liability for past service.¹⁰¹ The plan was funded according to output, instead of by the hour, because of miners’ fears of increasing mechanization. The money was deposited in a no-interest checking account at a union owned bank. The union used it to purchase stock in utility companies to promote the sale of coal.¹⁰² The UMWA’s attitude was representative of the labor environment of the 1950s. Benefit increases were more important than the question of pension fund management.¹⁰³

The trend in pension management since the war was a shift away from insured plans to trustee, or trust fund, plans.¹⁰⁴ An insured plan is one financed by an insurance company; pension funds are paid to an insurance company which then guarantees payment of the pensions purchased, commonly in the form of basic fixed annuities.¹⁰⁵ The result for pensioners was a guaranteed benefit in which both the amount and timing of payments were predetermined. Trustee plans are those in which funds are paid to and invested by a trustee (a trust company or

¹⁰⁰ Couper and Vaughan, *Pension Planning*, 28.

¹⁰¹ Ghilarducci, *Labor’s Capital*, 38; Sass, *Promise*, 128-9.

¹⁰² Ghilarducci, *Labor’s Capital*, 38; Sass, *Promise*, 183.

¹⁰³ Ghilarducci, *Labor’s Capital*, 40.

¹⁰⁴ Couper and Vaughan, *Pension Planning*, 6; Hamilton and Bronson, *Pensions*, 392.

¹⁰⁵ Couper and Vaughan, *Pension Planning*, 29.

bank), with the intent to use those funds and their returns to make future payments to retirees.¹⁰⁶

The key difference, from the point of view of the employee, was that insured plans are guaranteed but trustee plans are not; they are “fundamentally different forms of commitment.”¹⁰⁷

For plan sponsors, the biggest difference between insured and trustee plans was equity investment. Insurance companies were well-regulated and required to maintain a balance of very secure investments, which meant strict limitations on equity holdings. Banks and trust companies had much more freedom to invest in riskier, but potentially more profitable, common stocks. Pensions were costly, requiring a commitment of between 5 and 15 percent of payroll; the pension was usually the most expensive portion of a company’s employee welfare plan.¹⁰⁸

Trustee plans were flexible in ways insured plans were not. Insured plans required higher contributions earlier in the life of the plan, and these contributions were contractually fixed. With a trustee plan, not only could payments be level (on the assumption of the trust as a perpetually going concern), but a sponsor could fall behind schedule. If the sponsor missed or

¹⁰⁶ While banks and trust companies were the most common trustees, any entity could be designated as a trustee – an employer or union could be the trustee for its own plan; unless specific provisions were made in the contract, the trustee could operate the plan in any way he saw fit. (Smartt, “Pension Funds,” 8) Couper and Vaughan, *Pension Planning*, 29; Hamilton and Bronson explain: “Under a trust-fund plan, the contribution feeding the fund, whether paid by the employer alone or by the employer and employee jointly, are normally determined annually (although payment may be spread over the year) on an actuarial basis according to such assumptions regarding mortality, interest, and other elements as the actuary of the plan may have recommended. The annual measurement of the obligations of the plan on these assumptions is called the *actuarial valuation* of the system. The experience in any year may show a “profit” or “loss” owing to the actual experience differing from that assumed in the previous year’s actuarial valuation. Such profit or loss will be taken into account in determining the following year’s contribution requirements. The fund is built up with the trustee, its growth guided by the actuary, and, if all contributions are paid in when due, the fund may be expected to meet its objective of furnishing all benefits due and accrued during the life of the plan.” (*Pensions*, 119-120).

¹⁰⁷ Hamilton and Bronson, *Pensions*, 120.

¹⁰⁸ Hamilton and Bronson, *Pensions*, 5.

delayed a payment, then the fund would be short that amount, but there were no other repercussions. An annuity had to be fully purchased before it could begin making payments, but a trust fund was a going concern; this alleviated the problem of funding past-service liability.¹⁰⁹ This flexibility also permitted calculation of benefits based on final salaries, usually an average of the final five or ten years' service.¹¹⁰ Trusteed plans made it easier to use present employees' earnings to take care of retirees, but the problem with that is that the business must continue in perpetuity in order for all the future obligations to keep being met.

The calculation of the amount needed to fund a pension required relying on estimates of items such as turnover, disability, mortality, and wage increases. With an annuity, such estimates must be considered at the time of purchase. To make sure the pension is sufficient, all variables need to be taken account of at the beginning of the process, and if too much money has been set aside it may be refunded at a later date. For a trusteed plan, though, employer contributions may be discounted to begin with; an annuity is a fixed instrument but a trusteed plan can be changed throughout the life of the plan. Trusteed plans used older mortality tables than did insurance companies. Older tables meant the mortality assumptions were higher; less money is needed in the fund when the retirees are assumed to die quickly. Trusteed plans were less expensive to start, and to keep in operation.¹¹¹

¹⁰⁹ Couper and Vaughan, *Pension Planning*, 40-41; Hamilton and Bronson, *Pensions*, 125. It should be noted that past-service liability was still very much a problem, it was just easier to avoid – a trusteed plan was easier to operate on a pay as you go system – there was no legal penalty for not setting aside money for future payments.

¹¹⁰ Hamilton and Bronson, *Pensions*, 125.

¹¹¹ Couper and Vaughan, *Pension Planning*, 41-51; Hamilton and Bronson, *Pensions*, 121-124. Hamilton and Bronson describe how some methods of determining benefit estimates were “difficult if not impossible to fit within the necessarily very formal, precise, and complete clauses of an insurance contract.” (121)

Trusteed plans had the potential to earn more, since no specific regulations limited their purchase of equities. With an insured plan, the common assumption throughout the 1950s was that earnings would be between 2 and 2 ½ percent. Insurance companies could only hold limited amounts of common stock, based on state laws, but trust agreements generally set their own investment rules, exempting the trustee from state regulations. By 1958, a majority of agreements left investment decisions solely up to the trustee. There were some limits to how trust funds could invest; for example, there were restrictions on the purchase of debentures issued by the corporate sponsor. However, sponsor equities, in reasonable quantities, were considered a sound investment. The idea was that by tying the fortunes of the pension plan directly to those of the company, workers would have a greater incentive to perform well. Equities were considered a good hedge against inflation, and, in the booming postwar economy, offered an attractive rate of return.¹¹²

The corporations who sponsored plans began to see benefits to maintaining more financing control within their own organizations. The way to do this was through a plan in which financing was directed by management-approved trustees. The direct financing could then be done by a bank or trust company. Employers could lower the amount they contributed to the funds, freeing capital for business development. Those plan administrators who worked with fund trustees began to exert more control; trustees were amenable to specific direction, as long as they were absolved of fiduciary responsibility under state laws. Many chief financial officers took control of pension decisions from personnel departments, recognizing the pension's uses

¹¹² Couper and Vaughan, *Pension Planning*, 45-49, 178-9; Hamilton and Bronson, *Pensions*, 127-8. By 1956, private pensions were the largest single source of equity capital in U.S. markets. See Bascom H. Torrance, "Legal Background, Trends, and Recent Developments in the Investment of Trust Funds," *Law and Contemporary Problems* 17 (1952): 128-161.

“as a source of funds, an investment outlet, and a general reservoir of balance sheet slack.”¹¹³ In his 1961 study of private pensions, James McNulty found that most employers evaluated pension plan finances “in conjunction with their broader enterprise financial planning,” and that federal tax law provided “substantial room for financial maneuver by employers.”¹¹⁴

Unions did not object to the growing integration of pensions into corporate finance because management control of pensions made it easier for unions to negotiate increases to current benefits. At the same time, though, companies gained greater leverage over unions by the immediate threat of lowering pension contributions. The system became a vicious circle, with pensions ever more dependent on the continuing success of business. In 1950, insured and trusteed plans held reserves of \$5.6B and \$6.5B, respectively. By 1965, pension funds had experienced a huge overall increase, and trusteed plans had grown to more than twice the size of insured, at \$58B and \$27B.¹¹⁵ By the end of 1968, estimates from the Institute of Life Insurance counted only one-fifth of privately covered workers under insured plans.¹¹⁶

Hamilton and Bronson explain that the combination of high profits and high taxes creates a situation in which higher current benefits are favored over contributions to past service costs. But they caution that if profits go down, so will contributions, and the result will be increased

¹¹³ Sass, *Promise*, 172.

¹¹⁴ James E. McNulty, *Decision and Influence Processes in Private Pension Plans* (Homewood, Ill.: Published for the Pension Research Council, Wharton School of Finance and Commerce, University of Pennsylvania, by R.D. Irwin, 1961), 36-37. “The manifestations of this financial integration take a number of forms, involving such things as choice of funding agency, annual contribution rates, management of the investment of pension fund assets, and changes in actuarial and investment valuations to go along with the general financial position of the client firms.” (McNulty, 114). Steven Sass talks about the “vertical disintegration” of the pension from part of labor policy to financial instrument (Sass, *Promise*, 86).

¹¹⁵ Roger F. Murray, *Economic Aspects of Pensions: a summary report* (New York, National Bureau of Economic Research: distributed by Columbia University Press, 1968), 70-71.

¹¹⁶ Smartt, “Pension Funds,” 6.

past service liabilities and greater likelihood of plan terminations.¹¹⁷ The authors are insistent that the company pension is not intended to provide for employees' full retirement needs. Both pension guides make vague assertions of ethical behavior or assumed responsibility on the part of the plan sponsor, which were not unreasonable given the general prosperity and growth of the immediate postwar era.¹¹⁸ However, they insist that the employers' primary responsibility is employee education, to explain the operation of the pension plan, but also to emphasize individual responsibility.¹¹⁹

The pension is characterized by Hamilton and Bronson as the middle level of a full program of old age security. Social Security forms the base, which is then supplemented by the pension, but the top level is individual thrift. Today's sacrifice for tomorrow's wants is the American way, they say, and the virtue of thrift is a cornerstone of the America democratic philosophy.¹²⁰ The authors believe that personal savings are so necessary because they doubt that federal benefits will ever provide more than a very basic level of subsistence. If pensions are not adequate to make up the shortfall, the real problem lies with a lack of employee education and individual preparation. Couper and Vaughan agree:

it is of the utmost importance to emphasize to employees at the time of installation of a pension plan—and to re-emphasize on every appropriate occasion—that the company pension plan and social security benefits will not of

¹¹⁷ Hamilton and Bronson, *Pensions*, 385.

¹¹⁸ The authors seem loathe to consider that these responsibilities may not be fulfilled or that economic conditions might change in such a way as to render corporate promises impossible to keep. Inflation remained less than 2% for the period between 1947 and 1964, so it is a bit difficult to blame people for failing to anticipate the economic downturn of the 1970s. (Marshall E. Blume, Jeremy J. Siegel, and Dan Rottenberg, *Revolution on Wall Street; the rise and decline of the New York Stock Exchange* (New York: W.W. Norton, 1993), 57-9.)

¹¹⁹ Couper and Vaughan, *Pension Planning*, 179-181.

¹²⁰ Hamilton and Bronson, *Pensions*, 8. Much like the typical argument for Social Security as one leg of a three-legged stool

themselves provide a comfortably adequate retirement income without some supplement by each employee's own savings program.¹²¹

The private corporate pension in America began as an instrument of welfare, a gift from employer to loyal employee. As a gift, payment of the pension was not legally enforceable. Following the creation of Social Security, pensions became a popular method for avoiding taxes, by deferring a portion of employee wages until retirement. As the conception of retirement changed from a time of weakness and dependence to a period of leisure and consumption, American workers began to rely more heavily on promised pensions. Under collectively bargained agreements, organized labor secured legal enforcement of those promises, and campaigned to increase benefit payments. As sums committed to pensions grew ever larger, sponsors switched from insured to trustee plans in order to take advantage of the higher returns offered by equity investment. As productivity and wage inflation increased in the 1960s, the calculation of benefits on the basis of final salary pushed pension payments higher and higher.¹²²

The pension moved from a privilege of employment to a corporate obligation, what Steven Sass calls a "recognized social responsibility."¹²³ But questions remained with regard to true responsibility. As business schools taught that the key principle of management is the maximization of shareholder value, corporate leaders began to disregard pension security in favor of gambling for high returns on the stock market. The treatment of pensions as contributing to corporate finances, as opposed to stewardship of employee funds, echoed the comment made by U.S. Rubber's Cyrus Ching in 1928, "In other words, are you justified in

¹²¹ Couper and Vaughan, *Pension Planning*, 173.

¹²² Gumperz, "Pension Funds," 24.

¹²³ Sass, *Promise*, 134. I would liken the (nonunion) pension of the late 50s and 60s to a gratuity – very nice to receive and certainly expected, but not required and certainly not enforceable.

taking the stockholders' money out of the business?"¹²⁴ What pension professionals did not take into account was the possibility that something bad would happen to the business and the pension would be destroyed along with it. Should a company fail to meet its pension obligations, in most cases the employees had no recourse. Even under union agreements, general practice was to write a legal separation between the company and the pension into the contract.

Pensions were stuck in a sort of public-private limbo. Accepting that provision for retirement is a social responsibility of business, that business plays a vital role in society that extends beyond its function as a conduit of shareholder returns, the question becomes whether or not pensions should be subject to regulation. If the obligation of business extends beyond the shareholder, what are the limits of that obligation? What role should federal regulatory agencies play in enforcing social obligations? This would become the question of the latter twentieth century, as Congress embarked on creation of health, safety, environmental, and other socially-conscious regulation. Acknowledging pensions as deferred wages implies a commitment to their payment. As economic growth slowed, mergers, acquisitions, and bankruptcies began to take a toll on the fortunes of pension funds. Employees, having witnessed the growth of the stock market, demanded corresponding pension increases.¹²⁵ The nature of institutional investment, however, was changing in such a way that high returns were becoming more difficult to obtain, and to realize, as the market became saturated. As more workers faced reduced or terminated pension payments, the question of comprehensive pension legislation took on a new urgency.

At the same time, the growing power of institutional investors highlighted and exacerbated an upheaval underway on Wall Street, one which would lead to the dissolution of the cartel structure of the New York Stock Exchange (NYSE). The problems institutions had in

¹²⁴ Quoted in Sass, *Promise*, 78.

¹²⁵ See Gumperz, "Pension Funds."

dealing with the NYSE drew attention from the SEC and the Department of Justice to an issue long-avoided in American financial regulation, fixed commissions. By collectively fixing the price of their brokerage services, members of the NYSE had operated as a cartel since the Exchange's formal creation in 1792. The Securities and Exchange Commission ordered the New York Stock Exchange to end its policy of fixed commission rates as of April 30, 1975. "Finally, on May 1, 1975, free enterprise came at last to the securities business which had for so long been preaching the blessings of competition - - for other people;" stockbrokers called it "Mayday."¹²⁶

¹²⁶Wexler, Bernard, "History of the Securities and Exchange Commission Draft" August 3, 1975; <http://sechistorical.org> Papers collection of the SEC Historical Society; Section F; Ron Chernow, *The House of Morgan* (New York: Atlantic Monthly Press, 1990), 602. Chernow attributes the name 'Mayday' to Morgan Stanley's Bob Baldwin, a Navy veteran.

CHAPTER II

Pensions Challenge the Traditions of the New York Stock Exchange

*That sink of sin, the Brokers' Board,
Visit in mercy, gracious Lord,
Break thou their horns and draw their claws,
That they may turn and fear thy laws.¹*

As retirement pensions shifted into equity investment, Wall Street became the primary locus for millions of unregulated dollars circulating throughout the economy. The New York Stock Exchange was the vehicle through which institutions bought and sold shares of American business, driving the nation's economic growth in the 1960s. As institutional investing grew, so did the fees institutions paid, which translated to profits for stockbrokers. Unhappy with their growing costs and Wall Street's refusal to change, institutions began taking their business elsewhere. This was a problem for the economy, because capital markets were becoming less liquid. Such conditions have the potential to slow economic growth, and to consolidate the power behind it in the hands of those few who do possess full knowledge of market conditions, in this case, large financial institutions.

The Securities and Exchange Commission (SEC) took up the mission of preserving the open market of the NYSE; after all, the government needed to know where all that pension money was in order to make sure it was available to pay the pensions. The SEC wanted to allow commission rates to float, so that investors could negotiate the best price for a broker's services. Healthy competition between stockbrokers would draw both institutions and individuals back to

¹ Hannibal Tri-Weekly Messenger, May 25, 1858; reprinted from the Charleston Mercury, "Revival among the Wall Street Brokers" (refers to the Bull and Bear descriptions first used in the mid-1800s)

Wall Street. But the Exchange balked at this attempt to regulate their internal affairs. Fixed commission rates were sacrosanct.

To understand why floating rates were so vehemently opposed, and how they were finally accepted, it is necessary to understand the creation and evolution of the Exchange as a self-regulatory body. The function of the Exchange's governing board was not only to make sure the market ran smoothly, but also to preserve the power of the NYSE. In the early years of the Exchange, panics spurred investigation at the state level, but "the state legislators in Albany were easily, and frequently, bribed into rescinding threatening regulations."² Still, Exchange Members were able to avoid stringent regulations. Under external pressure, such as the Crash of 1929, the people of Wall Street, the brokers, dealers, and Exchange officers, traditionally banded together to face the challenge as a united front. The structure of commissions made volume a more important determinant of broker incomes than stock price level, so the Exchange was able to rebound from the Depression with enough volume. "The clubby atmosphere . . . was left intact," and the SEC was reluctant to make harsh demands.³ The power of the SEC itself had since been only marginally effective in forcing the NYSE to change. So the fixed commission structure remained fundamentally unchanged for over 170 years, and many on Wall Street simply could not conceive how the Exchange would survive without it.

² Lance Davis and Larry Neal, "Micro Rules and Macro Outcome: The Impact of Micro Structure on the Efficiency of Security Exchanges, London, New York, and Paris, 1800-1914," *The American Economic Review*, Vol. 88, No. 2, Papers and Proceedings of the Hundred and Tenth Annual Meeting of the American Economic Association (May, 1998), 43.

³ Edwin J. Perkins, *Wall Street to Main Street: Charles Merrill and Middle-Class Investors*, (New York, Cambridge: Cambridge University Press, 1999), 140-141; Chris Welles, *The Last Days of the Club*, (New York: E.P. Dutton & Co., 1975), 13-14.

The founding document of the NYSE was the Buttonwood Agreement, signed in 1792. It created an association of brokers who pledged to give preference to business with one another and to collectively decide the rates for their services.⁴ The Buttonwood Agreement did not create a securities market; its purpose was an imposition of regulation on an already thriving system.⁵ Nor did Buttonwood create a formal business; it was an agreement of mutual respect between gentlemen, born of the collegial atmosphere of the coffee house. Buttonwood signers, and later Exchange members, were not supposed to compete on the basis of price, since this was contrary to their code of behavior.⁶ This explains much of why fixed commission rates were so psychologically significant to the Exchange of the 1960s and '70s.

How did this code of behavior develop, and how did the NYSE membership keep the system thriving for so long? Privacy and confusion worked in their favor. The unknown and

⁴ Early brokers were buying and selling securities not only on their own accounts, but on behalf of clients, whom they charged a commission. Buttonwood signaled a preference to conduct trades within an established circle, and an agreement about setting commission levels.

⁵ Marshall E. Blume, Jeremy J. Siegel and Dan Rottenberg, *Revolution on Wall Street: the rise and decline of the New York Stock Exchange* (New York and London: W.W. Norton & Company, 1993), 21-26. The founders were trying to get around New York state regulations; they welcomed the monopoly power afforded by a cartel structure. See Stuart Banner article.

⁶ Basic economic theory holds that unrestricted competition leads to the mutual satisfaction of wants, and an equilibrium of the forces of supply and demand. The imposition of outside regulation or control mechanisms erodes the efficiency of the market. "Financial market efficiency is conceptually distinct from the productive or process efficiency associated with corporate analysis. The efficiency of a market is directly shown in its volatility, which is equated with the riskiness of the market. Efficiency is so important because of its effect on investor perceptions of risk, which are then reflected in the movements of securities prices. The specific rules by which a market operates influence its efficiency "in terms of cost, scope, volume, and the level of penetration.'" Davis and Neal, "Micro Rules and Macro Outcome," 40. The premise of economic sociology, however, is that markets are not merely economic structures, but are better characterized as complex social networks. James Burk, *Values in the Marketplace: The American Stock Market under Federal Securities Law* (New York: Walter de Gruyter, 1988), 8-9; Ingo Walter, ed., *Deregulating Wall Street: commercial bank penetration of the corporate securities market*, Wiley Professional Banking and Finance Series, Edward I. Altman, ed., New York: John Wiley & Sons, Inc., 1985, 3; Wayne Baker, "The Social Structure of a National Securities Market," *The American Journal of Sociology*, Vol. 89, No. 4 (Jan., 1984), 776.

indecipherable are difficult to regulate. Also, there is some truth to the Exchange's oft-trumpeted claim of providing a valuable service to the national economy.⁷

Although the New York Stock Exchange incorporated in 1817, it continued to operate more like a gentlemen's club than a modern corporation, and, "After all, what is the point of a club unless it exclusively serves the interest of its members?"⁸ While the fundamental paradigm of business history is Alfred Chandler's archetypal corporation, in which managerial organization achieves optimal efficiency of production, this framework is inadequate for explaining the nature of the NYSE. Although the Exchange is a corporation, its fluid structure and socially-regulated behaviors make the application of the Chandlerian model irrelevant. Brokers' relationships are hierarchical and seemingly formal, as in the classic Chandlerian corporation, but these hierarchies are actually comprised of informal networks, enforced by customs and traditions.⁹

In such a situation, the typical reaction to attempted external regulation is a reinforcement of the power of internal leadership. The only way an outside agency can effect change is by

⁷ Allowing that the provision of a nationwide market for the purchase and sale of securities does constitute a valuable, necessary service for economic growth, it does not follow that the NYSE was, or is, the only entity capable of providing said marketplace.

⁸ David Kynaston, *The City of London, Vol. I: A World of Its Own* (London: Chatto & Windus, 1994), 50.

⁹ Recognition that efficiency is social as well as economic provides a sociological method for market analysis which is more explanatory than economic theory alone. Baker, "Social Structure," 808; Walter, *Deregulating*, 9; see Alfred D. Chandler, *The Visible Hand* (Cambridge, Mass.: Belknap Press, 1977); Oliver E. Williamson, *Markets and Hierarchies, analysis and antitrust implications: a study in the economics of internal organization* (New York: Free Press, 1975); Roy, William G. *Socializing Capital: The Rise of the Large Industrial Corporation in America* (Princeton: Princeton University Press, 1999); , John Steele Gordon, *The Great Game; the emergence of Wall Street as a world power, 1653-2000* (New York: Scribner, 1999); Edward Chancellor, *Devil take the hindmost: a history of financial speculation* (New York: Farrar, Straus, Giroux, 1999); Steve Fraser, *Every Man a Speculator: a history of Wall Street in American life* (New York: HarperCollins Publishers, Inc., 2005); Robert Sobel's collected works on the NYSE and American stock markets; also the works of Richard Swedberg, Mitchell Abolafia, and Mark Granovetter.

taking advantage of internal divisions, which helps explain the limited effectiveness of the SEC.¹⁰ NYSE leadership maintained strict control, and it was when factions arose from within to challenge that leadership that the SEC had an opportunity to enforce change. The factions within the Exchange followed the same pattern throughout the twentieth century, with the Old Guard opposing change and the reformers looking for ways to improve Wall Street's reputation and, crucially, trading volume. The NYSE resisted deregulation because brokers had never operated on an openly competitive basis, but ultimately capitulated because the appearance of openness was necessary to improve volume and to maintain the viability of the Exchange.

The New York Stock Exchange grew out of the city that began as New Amsterdam, which was founded by the Dutch West India Company in 1624. The colony was an important component of Holland's mercantile system during the golden century of Dutch history.¹¹ While ostensibly mercantilist, the empire's success was primarily due to the government's leniency toward private merchants. Close ties between merchants in Amsterdam and New Amsterdam integrated the cities in such a way that profitable trade was possible both under the auspices of the West India Company as well as outside the bounds of company regulation.¹² Like

¹⁰See McConnell, Grant. *Private Power and American Democracy* (New York: Alfred A. Knopf, 1966), 341. Recognition of a group's right of self-regulation (which was a precursor of New Deal securities regulation) often has the effect of reinforcing the power of internal leadership of that group.

¹¹ Oliver A. Rink, *Holland on the Hudson: An Economic and Social History of Dutch New York* (Ithaca and London: Cornell University Press, 1986), 18; Lisa Jardine, *Going Dutch: How England Plundered Holland's Glory* (London: HarperCollins Publishers, 2008), 320. John Adams Dix. *Sketch of the Resources of the City of New York* (Arno & NY Times, 1970, Original 1827) 10. Selma Berrol, *The Empire City: New York and its People, 1624-1996* (London: Praeger, 1997), 1-2. See also Russell Shorto, *The Island at the Center of the World: the Epic Story of Dutch Manhattan and the Forgotten Colony that Shaped America* (New York: Doubleday, 1994); Joyce Goodfriend, *Before the Melting Pot: Society and Culture in Colonial New York City, 1664-1730* (Princeton, NJ: Princeton University Press, 1991).

¹² Rink, *Holland on the Hudson*, 18, The Dutch just did everything better than their competition: "preeminence in shipping, warehousing, currency exchange, marine insurance, and credit financing." Jardine, *Going Dutch*, 319-325. Et al. The English couldn't close the regulatory loopholes either; these

Amsterdam proper, New Amsterdam was much more than a marketplace for goods. The city functioned as a communication center and information clearinghouse, a vital role in an economy of widely separated merchants bound together by trade and credit. Early colonial merchants rarely specialized; they sought to take advantage of immediate and variable market conditions. The fast and reliable transfer of information was therefore an absolutely crucial function of the city's merchant community.¹³ Unlike many American colonists, early New Yorkers did not arrive with "any moral impulse," and scruples about religion or ethnicity seldom hindered efficient and profitable business relationships.¹⁴ From the start, New Amsterdam, and then New York City, existed for the purpose of trade and the accumulation of wealth.¹⁵

Before the Revolution, trade centered around two basic functions, the transfer of commodities and the sale of land. Commodities were easily transferable through the use of instruments called warrants, which were first used by the East India Company in the 1730s.

merchants always operated according to the law of profit - which is going to cause somewhat treasonous activity in just about every conflict in the area, through the War of 1812.

¹³ Jardine, *Going Dutch*, 325, 334; Perkins, Edwin J. *The Economy of Colonial America* (NY: Columbia UP, 1988) 122-5. The degree of specialization among NYC merchants is a subject of some debate in the historiography; Bruce Wilkenfeld and Philip White argue for a greater specialization among traders of furs and spirits.

¹⁴ Nan A. Rothschild, *New York City neighborhoods: the 18th century*, (San Diego: Academic Press, 1990), 9; Jardine, *Going Dutch*, 323; Dix, *Sketch*, 11.

¹⁵ The colony of New York was unique in its strong commercial focus and cosmopolitan nature. See Jardine, Dix, Nan A. Rothschild, *New York City neighborhoods: the 18th century*, (San Diego: Academic Press, 1990); Russell Shorto, *The Island at the Center of the World : the Epic Story of Dutch Manhattan and the Forgotten Colony that Shaped America*, (New York: Doubleday, 1994); Mary Lou Lustig, *Privilege and Prerogative: New York's Provincial Elite, 1710-1776*, (Madison, NJ: Fairleigh Dickinson University Press; London; Cranbury, NJ: Associated University Presses, 1995); Oliver A. Rink, *Holland on the Hudson: An Economic and Social History of Dutch New York*, (Ithaca and London: Cornell University Press, 1986). Oliver A. Rink, *Holland on the Hudson: An Economic and Social History of Dutch New York* (Ithaca and London: Cornell University Press, 1986), 18; Lisa Jardine, *Going Dutch: How England Plundered Holland's Glory* (London: HarperCollins Publishers, 2008), 320. John Adams Dix. *Sketch of the Resources of the City of New York* (Arno & NY Times, 1970, Original 1827) 10. Selma Berrol, *The Empire City: New York and its People, 1624-1996* (London: Praeger, 1997), 1-2.

Warrants enabled a transfer of ownership without requiring an actual physical transfer of goods.¹⁶ The major business development of the eighteenth century was the transformation of the factor from a commodity salesman into a commission merchant, actively engaged in speculation of commodity and land prices.¹⁷

Business was generally conducted over long periods of time, and was very much a personal endeavor. The majority of financial instruments represented some kind of personal investment, be it a formal document such as a mortgage or a personal note resembling nothing so much as a glorified IOU.¹⁸ The disposal of goods imported from a shipping venture was a process that could take months to be completed, forcing merchants to keep a set of books running to keep track of ongoing figures such as commissions, discounts, interest, or advances. The ultimate profitability of a venture could take a long time to be determined, and merchants needed to be able to get on with other projects in the meantime. The typical businessman held an interest in multiple projects, each of which would require some measure of his personal attention. Bills of exchange took the form of currency, which merchants used themselves and honored on their clients' behalf. Often the merchant's position was that of the bill collector, trying to find a way to reconcile his clients' accounts in order to ultimately be paid.¹⁹

¹⁶ Henry Crosby Emery, *Speculation on the Stock and Produce Exchanges of the United State*. (New York: Columbia University Press, 1896), 35-36.

¹⁷ Virginia D. Harrington, *The New York Merchant on the Eve of the Revolution* (New York: Columbia UP, 1935), 68.

¹⁸ Harrington, 127. Joseph Stancliffe Davis, "The Rise of Stock Speculation, 1784-1791" chapter IV in *Essays in The Earlier History of American Corporations*, Cambridge: Harvard UP, 1917, 199: "As early as 1783 or 1784 there were men who made a temporary business of journeying hither and yon through the country, either as agents or on their own account, to pick up securities at bargain prices. As early as this, also, brokers dealing on commission began to advertise."

¹⁹ Harrington, 127; 71.

As Americans began fighting for independence, they discovered the challenge of financing a revolution. Provisioning and paying soldiers required money the states and the Continental Congress did not have. The solution to this dilemma took multiple forms, from state loan certificates, to militia land rights, to Continental notes. The result was the creation of a secondary market for such instruments. Buyers anxious for cash in hand offered such securities for sale at prices below par value, which led to the development of a new type of businessmen, disparagingly referred to as speculators. Their modus operandi was to send agents into the countryside to buy securities, at low prices, and return with them to the cities for resale. This practice occurred in all of America's major cities, but New York was the center of such activity.²⁰ The fledgling federal government was caught then between the necessity of funding the public debt and the perceived unsavory market influence of speculators. In 1782, when faced with the argument against using such financing because it encouraged speculative behavior, Superintendent of Finance Robert Morris opined that, "speculators do least mischief where they are left most at liberty; . . . that it is not in human prudence to counteract their operations by laws, whereas when left alone they invariably counteract each other."²¹ The idea of self-regulating securities markets existed well before the New York Stock Exchange claimed it.

By necessitating nationwide cooperation, the Revolution established greater communication between merchants, which enabled the creation of a truly national market for securities. Every increase in the legitimacy of the new national government provided a corresponding boost to the reputation, and value, of its securities.²² Congress first met in New

²⁰ Pomerantz, 180-181.

²¹ Davis, "The Rise of Stock Speculation," 182.

²² Davis, "The Rise of Stock Speculation," 178-9. Communication was still time consuming, but the war forged new relationships and the necessary level of trust to do business over great distances.

York City in April, 1789, and inaugurated George Washington as the nation's first President at the end of the month. On August 4, 1790, Congress legalized the national assumption of state debts and the funding of these and Continental certificates. By September, Congress approved an act organizing the Treasury Department, with Alexander Hamilton as its Secretary.²³

Hamilton used his position to maintain and increase the value of the nation's debt instruments, rather than to simply retire the debt as expediently as possibly.²⁴

Not only did the assumption of the debt provide the guarantee of the nation's full faith and credit, but it also standardized the form of government securities. The division of national debt certificates into three classes – six per cents, three per cents, and deferred six per cents – simplified valuation, and the new ease of trading fed a speculative frenzy in both Philadelphia and New York.²⁵ Thomas Jefferson wrote in a letter to James Monroe in the summer of 1791, “It is impossible to say where the appetite for gambling will stop.”²⁶ Shopkeepers, mechanics, and people from all walks of life began to ignore their regular business in favor of speculation.²⁷ By the time the market was flooded with comparatively dependable federal securities, a group had emerged whose primary interest was the purchase and sale of financial instruments. These

²³ Davis, “The Rise of Stock Speculation,” 174.

²⁴ Davis, “The Rise of Stock Speculation,” 194.

²⁵ Davis, “The Rise of Stock Speculation,” 196.

²⁶“VI. Thomas Jefferson to James Monroe, 10 July 1791,” Founders Online, National Archives (<http://founders.archives.gov/documents/Jefferson/01-20-02-0076-0007>, ver. 2013-06-26). Source: *The Papers of Thomas Jefferson*, vol. 20, *1 April–4 August 1791*, ed. Julian P. Boyd. Princeton: Princeton University Press, 1982, pp. 296–298. <http://founders.archives.gov/documents/Jefferson/01-20-02-0076-0007> he continues: “The land-office, the federal town, certain schemes of manufacture, are all likely to be converted into aliment for that rage.—But this subject is too copious for a letter and must be reserved for conversation.”

²⁷ Davis, “The Rise of Stock Speculation,” 207.

specialists took a pledge before New York City's Mayor to "truly and faithfully execute the duties of a Stock Broker."²⁸

The specialized broker occupied a very small part of New York society. A 1789 occupational survey recorded almost three hundred "merchants," but only twenty-seven "brokers."²⁹ Merchants directed their attention primarily to shipping and its attendant commodities trading. The trading of securities began as an ancillary business; merchants and traders made deals outside the scope of their daily work, and these were most often conducted inside the coffee house, where a large group of potential business connections gathered, and where customers had access to the city's newspapers.³⁰

The coffee house was the location of the development of the auction system, and the place where stock broking became an occupation. The city's commercial life operated through the mediation of coffee, clubs, and trade associations. During the early eighteenth century city merchants met at an open-air Exchange on the corner of Broad and Water Streets, next door to the coffee house. When the Merchants' Exchange gained a building in 1752, the room above the

²⁸ Pomerantz, 182.

²⁹ Bruce Martin Wilkenfeld, *The Social and Economic Structure of the City of New York 1695-1796* (New York: Arno Press, 1978), 170.

³⁰ See, for example, the *New York Packet* of 1790-1792. A typical New York newspaper of the 1790s, the *Packet* reveals a world both personal and petty as well as worldly and philosophical. Regular notices included sales of Bibles and historical writings, examples of poetry or narrative, and advertisements for everything from tea and cloth to a cure for breast cancer. The newspaper was the source not only for local lottery announcements, but also for news from around the world – one part local community paper, one part serious international review. Anyone who regularly read the papers would have been very well versed in both American and European current events. The newspaper was the place to find announcements of upcoming public auctions or sales of everything from basic commodities to loan certificates or other securities. People placed ads in search of employment, or in search of missing relatives, or even for runaway slaves or spouses. Usually such ads included a disclaimer from the husband or wife denying any responsibility for debts incurred by the absconded spouse. Notices of insolvent and absent debtors were common, as was the inclusion of women, who were not necessarily transacting the business themselves unless forced by the necessity of divorce or widowhood, but typically were included on property mortgages or land documents.

trading floor was a coffee house. This was a domain of “masculine sociability,” providing information, in the form of official news, rumor, and gossip. The informal social interactions of early brokers constituted their business organization, such as it was; an offering of shares took place in or near the coffee house, made known via a newspaper advertisement, which would likely have been read in a coffee house.³¹

Brokerage was incidental to the businesses of auctioning commodities, speculating on shipping voyages, or selling insurance. The business began as a necessary part of lengthy transactions. The merchant was in the position of brokering exchanges between suppliers making promises of future delivery and buyers promising future payments. The notes and receipts physically exchanged became the brokers’ currency. A broker could buy a loan certificate from a merchant, providing specie more immediately useful. The market expanded as merchants started buying and selling such notes between themselves. The value, and therefore

³¹ Robert Sobel, *The Curbstone Brokers: The Origins of the American Stock Exchange* (New York: The Macmillan Company, 1970) 10. Sobel does not delve into the question of advertising as much as I would have wished. But Janice Traflet’s dissertation explains how direct advertising of securities became taboo. (Janice M. Traflet, “Spinning the NYSE: Power and Public Relations at the Big Board.” Dissertation, Columbia University, 2004). I think early advertising was acceptable practice because of the small scale of the market, and the ease with which colonial traders could presumably establish each other’s creditworthiness. Still, unscrupulous traders are not a modern phenomenon; witness the panic of 1792, and the swindle in Serena Zabin’s *Dangerous Economies*. Brokers, both in the US and London, have historically opposed the interference, or very presence, of outsiders within their social space. London’s early brokers met at Jonathan’s coffee house until business was impeded by the presence of too many on-lookers; then they created a members-only coffee house, New Jonathan’s, which was shortly afterward renamed the Stock Exchange. See Markman Ellis, *The Coffee House: A Cultural History* (London: Weidenfield & Nicolson, 2004) 127, 179-80. This book provides a fascinating analysis of the history of the social structures associated with coffee, from its use by scholars struggling to stay awake in fifteenth century Mecca, to the sale of coffee that is more milk and sugar than actual coffee at today’s Starbucks. Ellis’s book is not a business history in the literal sense, because coffee houses left very few records; he relies on government documents (there was a lot of spying in coffee houses), newspapers, legal records, diaries, and literary sources.

the price, of such notes fluctuated, based on the perceived ability of the bearer to eventually convert them into cash.

One such businessman was Peter Anspach, the senior partner in the firm of Anspach & Rogers, who signed the document that symbolically founded the New York Stock Exchange, the Buttonwood Agreement, in 1792. In April of 1790, Anspach and partner Charles Platt Rogers moved their business from No. 55, Smith-Street, to No. 203, Water-Street, “a few doors below the Coffee-House; where they continue to buy and sell all kinds of Public Securities, Jersey Money, and Military Rights of Land.”³² Anspach managed the city operations, while Rogers often traveled into the countryside and to neighboring states on “adventures.”³³

The partners bought and sold a variety of notes and certificates, both official government issues and personal notes. These certificates are more equivalent to modern bonds than stock certificates. That is, they represent debt rather than ownership. Most made provision for payment of interest and principal, and making those payments was the responsibility of the issuer

³² New York Packet. April 24, 1790. Charles Platt Rogers had a very interesting career following his time in partnership with Anspach. The details are incomplete, but he later set up business as Charles P. Rogers & Co., and was associated with Thomas Vermilya, an attorney, and Zephaniah Platt (who was, I believe, a respected state judge). Rogers and Vermilya both purchased quarter share interests in the ship *Ganges*, which was built in 1794. Intending to sail to Europe on the ship’s next voyage, Rogers left Vermilya with his power of attorney. Vermilya performed a series of maneuvers involving selling shares in the ship and buying them back, with the result that by January of 1797, Vermilya legally owned three-fourths of the ship and Rogers owned the remaining fourth. The *Ganges* was chartered for a voyage from London to Java, but was seized by the French on its return trip. The French kept the ship, and the partners were left owing the United States over \$28,000 in customs duties. This forced Rogers and Vermilya into bankruptcy. Vermilya worked to have his bankruptcy discharged (see N-YHS records), but Rogers’ fate is unknown. (Greg H. Williams, *The French Assault on American Shipping, 1793-1813: A history and comprehensive record of merchant marine losses* (Jefferson, NC and London: McFarland & Company, Inc., Publishers, 2009), 388-389.)

³³ NYHS, Anspach & Rogers, Correspondence Files, July 6, 1790, Public Securities: Adventure to Jersey, C.P. Rogers; “Consignment trading, broadly speaking, covers all marketing where the goods are put in the care of – consigned to – an agent for sale. Thus it includes those speculative enterprises properly and contemporaneously dubbed “adventures,” which were in essence attempts to take advantage of favorable prices or to try one’s luck in a new or difficult market.” “Adventures often took the form of trading voyages, the goods being peddled around from port to port in search of the best terms.” Harrington, 90-91.

of the debt, for example the state of New Jersey, regardless of the owner of the certificate. Payment for the purchase or sale of such a certificate in the secondary market could be completed by cash, check, or through an exchange of certificates. The methodology of transactions was not well codified; extant records at the New-York Historical Society include a collection of receipts and records on scraps of paper, often with calculations scribbled in the margins or on the reverse. Official documents, such as the notes themselves or property transfers or mortgages, would have been more formal documents, with real estate transactions being signed and notarized. Rogers' practice, while on adventures, was to keep a running tally of his transactions, mostly purchases of certificates. He would mail this multi-record receipt back to Anspach in New York, adding his own expenses for lodging, hiring a horse, and so on.³⁴

Usually Rogers bought several certificates at a time from an individual who was, like Rogers, not the original bearer of any of the notes. The pertinent information Rogers sent to Anspach for their records included the date of issue, the number and descriptor of the certificate (often Jersey, but sometimes North Carolina or South Carolina), to whom it was issued, and by whom, if a personal note. One Jersey adventure included certificate No. 2735, dated March 30, 1779, issued by Jos. Borden to Catherine Low.³⁵ Most of Anspach & Rogers' clients were men, but some were women, particularly in real estate transactions. Customers did not need to be literate in order to trade, when a mark could be accepted as a signature.³⁶ There is no evidence that the partnership was discriminating in their choice of clientele – ownership of a certificate was enough.

³⁴ See NYHS, Anspach & Rogers, Correspondence Files

³⁵ Citation NYHS Anspach & Rogers, Correspondence Files; see for example Folder: Bills and Receipts, A-Ad, 1790-1791; bought of Allenor & Bogart, certificate no. 1822, issued to Rebecca Anderson

³⁶ John van Embergh, his mark, certificate in Anspach & Rogers, Correspondence Files

The prices and values of debt certificates fluctuated constantly, adding to the mathematical complexity of the process. Amounts were typically recorded in both dollars and pounds sterling, which meant an exchange rate had to be specified, and that calculations were done using both decimals and fractions. In one example, the partners recorded at “Morris Town, May 8th 1790: received of Mr. Isaac Miller a Thompson Certificate of = 135 16/90 Dollars @ eight Shillings in the pound Amount-ing to twenty one pounds Twelve Shillings +16 in Specie or N. York Currency which we promise to pay to the said Isaac Miller on his order on Demand,” signed Anspach & Rogers.³⁷

For calculating interest, units of time were given in years, months, and days. The length of time in which payment of loan certificates was promised could vary immensely, from as little as 15 days to more than 15 years. Some certificates remained in circulation for some time: Anspach and Rogers bought one from Leon. Bleecker, loan Office Certificate no. 11, dated 3 April, 1777, for 500 dollars (£200@5/4 - £53.6.8), for which Bleecker signed to signal receipt of payment dated May 13, 1789.³⁸

Records show that Anspach & Rogers operated primarily on their own account, at least in non-urban areas, but that they did do commission business as well. Customers could send notes “which I wish you to sell for me to the best advantage.”³⁹ Many times the transactions were completed via an intermediary acting on behalf of the partnership in another location; one William Bailey served such a function regularly. Success depended on effective and accurate communications, not only between the partners but especially between Anspach and his business

³⁷ Citation of same. Anspach & Rogers, Correspondence Files.

³⁸ Citation of same, Anspach & Rogers, Correspondence Files.

³⁹ NHYS, Anspach & Rogers, Correspondence Files; Correspondence, Bitters & Rogers, B-Bi, May 28, 1790 letter from Charles Bitters

correspondents. Some of these relationships were purely business, some were friendships, most were a mix of both, and all were important. These relationships did not exist in static isolation; a review of Peter Anspach's correspondence reveals not only the width of his connections, but also the relationships between those men as well.

One of Anspach's most frequent correspondents was Philadelphia merchant Standish Forde. A "social climber," Forde was in partnership with John Reed.⁴⁰ In addition to their dry goods business and Western land speculation, Reed & Forde "engaged in foreign commerce both on their own account and on commission, and owned and operated their own ships."⁴¹ Forde's letters to Anspach have a formal, businesslike tone, and are addressed to "Mr. Peter Anspach, Sir," even after a working relationship of at least five years.⁴² Sometimes in more than one letter per day – one letter from Feb 27, 1792, opens "Referring you to my letter by this mornings (sic) post" – Forde is usually informing Anspach of actions taken on his behalf, which could include purchasing shares, waiting for a better price, or consulting with another mutual associate, often Captain William Graham.⁴³ Forde does not spend time on pleasantries; there is no mention of

⁴⁰ Thomas M. Doerflinger, *A Vigorous Spirit of Enterprise: merchants and economic development in Revolutionary Philadelphia*. (Chapel Hill : Published for the Institute of Early American History and Culture, Williamsburg, Va. by the University of North Carolina Press, 1986), 295.

⁴¹ Arthur P. Whitaker, "Reed and Forde: Merchant Adventurers of Philadelphia," *Pennsylvania Magazine of History and Biography*, LXI (1937) 237-262: 240. Whitaker's primary focus is on the partnership's trade connections with New Orleans; his conclusion is "that prominent among the eastern capitalist-commercial groups responsible for the development of the Mississippi trade, and consequently for our acquisition of Louisiana, were those adventurous merchants, Reed and Forde of Philadelphia." (262) Reed and Forde are portrayed as almost, but not quite, swindlers, who were interested in a great multitude of money-making schemes and perpetually in debt, despite their sales and loans to a number of prominent colonial Americans, including George Washington.

⁴² See Whitaker FN, compare to dates on NYHS correspondence

⁴³ Citation see also April 12, 1792 ltr; Feb 2, 1792

the weather, nor are there any reports or inquiries of family news. This relationship was strictly business.

In contrast, Anspach's relationship with John W. Checkley of Savannah was much warmer; their friendship took priority over any business they might have done. Anspach was "Dear Peter," and Checkley, "Your truly affect. Friend."⁴⁴ Checkley wrote that business was declining in Savannah, due to the great number of adventurers, and he contemplated either a move to New York City or a return to Boston. He expressed a wish to meet "the Lady with whom you [Anspach] have formed a connection," and "your young family." His own "dear little Girls," he reported, were in good health.⁴⁵ Checkley includes the news from Georgia, of the imprisonment of men accused of kidnapping Negroes from Martinique for illegal resale. He closes his missive with a listing of current commodity prices.⁴⁶

Checkley was also acquainted with Captain Graham, who seems to have been both a friend ("Your assured Friend") and a general man of business to Anspach. His letters, sent from his home in Philadelphia, include both business and family news updates. Anspach's surviving papers include a memorandum of certificates forwarded by Checkley to Anspach through Graham.⁴⁷

Such complicated transactions, conducted over time and distance, and often via an intermediary, were not without risks. With promissory notes and loan certificates changing hands numerous times within the span of time before the principal payment was due, situations

⁴⁴ June 9, 1792 letter from Checkley to Anspach, NHYS, Anspach & Rogers, Correspondence Files.

⁴⁵ This particular letter implies that Checkley's daughters are in Boston; I presume he is part of that city's well-known Checkley family, and came himself to Georgia, as an adventurer, sometime previous.

⁴⁶ June 9, 1792 letter from Checkley to Anspach, NHYS, Anspach & Rogers, Correspondence Files.

⁴⁷ Memo, NYHS, Anspach & Rogers, Correspondence Files.

often arose in which the amount, date, or even fact of that payment became highly questionable. The coffee house appeared a supremely informal place, but, below the surface, activity was strictly regulated by a code of gentlemanly behavior born of self-interest.⁴⁸ Peer pressure was the chief mechanism of control, and intimidation or threat of exclusion served to keep brokers in line. Sometimes the situation got out of control notwithstanding, forcing the matter into the courts, which could be a lengthy process. As more people became involved, business only became more complicated.

Everyone was trying to get in on the action in New York. With the federal assumption of state debts at full funding, “an entire class of property quadrupled in price in three years.”⁴⁹ The atmosphere of the city was one of personal gain, which led John Adams to remark about the lack of good breeding among New Yorkers.⁵⁰ As the nation’s first capital, the city was the source of both fact and rumor about what the Treasury Department was doing. Foreign investors, now interested in American bonds, purchased them through New York-based American agents, who could easily register said bonds at the Treasury there.⁵¹ Those businessmen who specialized in brokering securities began to feel threatened by the burgeoning competition, and reacted by adopting regulations to restrict trading in late 1791.⁵²

⁴⁸ Ellis, *The Coffee House*, 180-81; 177.

⁴⁹ Doerflinger, *Vigorous Spirit*, 311.

⁵⁰ Said Adams of New Yorkers, “there is very little good breeding to be found ... They talk very loud, very fast, and altogether. If they ask you a question, before you can utter three words of your answer, they will break out upon you again and talk away.” *The Works of John Adams*, Vol. II (Boston, 1850) page 353.

⁵¹ Doerflinger, *Vigorous Spirit*, 311. Foreign purchased of US bonds were required by law to be registered with the Treasury.

⁵² Richard Sylla, “Origins of the New York Stock Exchange,” in *The Origins of Value: the Financial Innovations that Created Modern Capital Markets*, eds, William N. Goetzmann and K. Geert Rouwenhorst. Oxford University Press, 2005, 299-312, 307.

The spring of 1792 brought double disasters to the markets, because of the William Duer speculation scandal, and because of a banknote bubble – and crash – brought on by the Bank of the United States initially flooding the market with notes but then sharply curtailing credit.⁵³ Public opinion was already opposed to the speculative activities promoted by brokers. One open letter to the Bank of New York, published in the *New York Packet*, declared, “I wish there was a law enacted to oblige every man having the use of his own limbs and senses, to transact his own business, under a large penalty in case it should be found that he employed any broker.”⁵⁴ The market crash did not help matters, and in April of 1792, the New York legislature passed “An Act to Prevent the Pernicious Practice of Stock-Jobbing, and for Regulating Sales at Public Auction,” which banned the sale of securities at public auction.⁵⁵

Brokers needed drastic measures to preserve their livelihood; the public auction was the cornerstone of their business. If public sales were out of bounds, the solution was found in the creation of a method for private sales. On May 17, 1792, twenty-one individuals and three partnerships signed an accord:

WE, the Subscribers, brokers for the Purchase and Sale of Public Stocks, do hereby solemnly promise and pledge ourselves to each other that he will not buy or sell from this date, for any person whatsoever, any kind of Public Stocks at a less rate than one-quarter of one percent Commission on the Specie value, and that we will give preference to each other in our Negotiations.⁵⁶

⁵³ Ibid. (Sylla, 307) Duer, assistant to Alexander Hamilton at the Treasury, and some of his associates attempted to corner a portion of the new government issues. When prices declined they were wiped out, and their defaults set off a panic.

⁵⁴ NY Packet, Feb. 29, 1789. “From Honestus to the President and Directors of the Bank of New York”

⁵⁵ Sylla, “Origins,” 307. The act “also made contracts unenforceable for sales, transfers, or wagers (sometimes called time bargains) on the future price of government debt and company equity shares, unless the securities in question were actually owned by the seller or wagerer.”

⁵⁶ Sobel, *Curbstone*, 12 and Sylla, “Origins,” 308.

According to legend the group met under the shade of a buttonwood (sycamore) tree, hence the Buttonwood Agreement entered the historical record as the founding document of the New York Stock Exchange.⁵⁷ The NYSE developed as a club, with the privileges and obligations inherent in a system of selective membership.⁵⁸

Buttonwood laid out two key principles of Exchange member behavior that would be reaffirmed by subsequent Exchange constitutions, fixed commissions and member preference. Robert Sobel explains Buttonwood as an agreement with two main social rules. First, Exchange members will not attend other auctions; that is, they will not trade with nonmembers. Second, the cost of a trade will be a fixed amount; the Exchange will regulate commissions across the board for all members.⁵⁹

The very fact that Buttonwood was intended to constrain, rather than to create, holds implications about the ideologies and intentions of early brokers. Although the NYSE claims Buttonwood as its formal creation, the mechanisms of trade were already well-established.

⁵⁷ The formal name of the organization would not become the “New York Stock and Exchange Board,” and then the NYSE, for many years, but the underlying organization remained the same. I have chosen to use the terms Exchange; NYSE; and New York Stock Exchange throughout for greater clarity.

⁵⁸ See Andrew Trees, *The Founding Fathers and the Politics of Character*; Joyce Appleby, *Capitalism and a New Social Order*; Jack Greene, *Pursuits of Happiness*; Cathy Matson, *Merchants and Empire*: “No voices in colonial New York believed they freely chose values and lifestyles, and if at times some of them shunned the greater civic consciousness that republicanism taught, they never forgot their place in networks of kin, community, and polity that undergirded all of their economic efforts” 314; J.E. Crowley, *This Sheba, Self: the Conceptualization of Economic Life in Eighteenth-Century America*; also the works of Swedberg, Granovetter, Nee, Lindblom, Roy, Mizruchi, Buchanan, Otteson, to name a few.

⁵⁹ Sobel, *Curbstone*, 12. The case of New York is not very different from the City of London; the formal organization of the London Stock Exchange in 1734 was in response to public uproar over the South Sea Bubble, and over the increasing frequency of trading in securities which very much resemble modern derivative instruments. Kynaston, David. *The City of London, Vol. I: A World of Its Own* (London: Chatto & Windus, 1994) 16.

Expanding the definition of a market system to include the moral order, as does Max Weber, gives much more credence to the Buttonwood document. If it did not create, then it at least codified the cultural construction that provides the foundation of social behaviors on the Street.⁶⁰

What makes the Buttonwood Agreement such a peculiar document is how assiduously it was followed. Buttonwood laid the foundation for the Exchange's development and controlled the method of its expansion. The pre-eminence of personal relationships created a strong foundation of tradition and also a reluctance to question accepted practices. The rule of fixed commission rates made the Exchange a cartel by eliminating the need for competition based on price.⁶¹ Close personal ties between members discouraged open competition; members were supposed to give preference to each other, even over their customers.⁶² The principle of member preference was emphasized to the extent that the New York Stock Exchange evolved more as a gentleman's club than the mere business association it actually was.

Following the Exchange's founding as a purposefully exclusionary group in 1792, membership developed into an 'inner circle' in the manner described by theorist Michael Useem: a socially cohesive group within which "acquaintanceship networks are dense, mutual trust and obligation are widespread, and a common sense of identity and culture prevail."⁶³ To become a

⁶⁰ See Robert Wuthnow, *Meaning and Moral Order: explorations in cultural analysis* (Berkeley and Los Angeles: University of California Press, 1987). Liam Stone, "Max Weber and the moral idea of society," *Journal of Classical Sociology* May 2010 10:123-136.

⁶¹ See William F. Baxter, "NYSE Fixed Commission Rates: A Private Cartel Goes Public." *Stanford Law Review*, 22 (1970): 675-712; 676-679.

⁶² Sobel, *Curbstone*, 9-11.

⁶³ See Sobel, Seligman, Blume, and Davis on reasons behind the Buttonwood Agreement and measures taken to limit the influence of the NY state government; Michael Useem, *The Inner Circle: large corporations and the rise of business political activity in the U.S. and U.K.*, (New York, Oxford: Oxford University Press, 1984), 63-66. Financial markets are characterized by moral order. Michael Oakeshott terms this the transactional mode of association; Talcott Parsons says markets exhibit utilitarian social theory. The origins of their moral concepts are in Durkheim's theory of the noncontractual bases of

member of such a group was expensive, but membership brought privileges of social rank as well as financial opportunity; money created social mobility.⁶⁴ The long held rule that members were forbidden to sell stock in their own firms to the general public was a means by which the Exchange ensured that the wealthy and their chosen friends maintained control of the informal Exchange club.⁶⁵ Members of the Exchange conformed to an “upper-class” social network structure through similarities in education, personal style, familial contacts, and financial assets.⁶⁶

The NYSE experienced initial success because it offered the opportunity for trading outside the legal boundaries enforced by the state, and because it offered security and stability within the risky world of finance.⁶⁷ Personal relationships and kinship ties were crucial

contract. The disagreement between economic sociologists is over the causality of this moral order. While Oakeshott and Parsons determine the moral order of a market to be the result of the pursuit of self-interest by its members, Max Weber’s structuralist perspective assigns causality for moral order to larger society. According to Weber, markets are incapable of creating their own such order, and exhibit a value system derived from the beliefs of the society in which they are located. (Hence the important consequences of the “Protestant ethic” for American business.) James Burk approaches the issue using a “modified structural perspective,” in which the moral order of a market is constrained by larger social forces but is largely created by its own social actors. This approach provides a useful framework for explanation of the actions of the New York Stock Exchange and its members. Burk, 7-11.

⁶⁴ Lendol Calder, *Financing the American Dream: A Cultural History of Consumer Credit*, (Princeton and Oxford: Princeton University Press, 1999), 79. See Stuart Banner, *Anglo-American Securities Regulation*. “substantial benefits to membership”

⁶⁵ Alec Benn, *The Unseen Wall Street of 1969-1975 and Its Significance for Today*, (Westport, Connecticut: Quorum Books, 2000), 1. See also Welles, Sobel, WSJ among others for common usages of ‘Exchange as a private club’ terminology.

⁶⁶ Useem, 66; Pierre Bourdieu uses the terms social, cultural, and economic capital to describe the connecting qualities of an upper-class inner circle.

⁶⁷ Quickly part of the trading patterns in London and Amsterdam too. Thomas Fortune’s *Epitome of the Stocks and Publick Funds (containing everything necessary to be known for perfectly understanding the nature of those securities)* Second edition published in London in 1796, includes appendix of information on US securities as well. Dividends easily received in London and Amsterdam, through the Bank in Philadelphia. Fortune, Thomas. *An epitome of the stock and public funds. Containing every thing necessary to be known for perfectly understanding the nature of those securities, ... To which is annexed,*

components of access to credit.⁶⁸ A man's word was his bond; this was the generation of the Founding Fathers, and a society in which the pledge of sacred honor held deep meaning. When the signers of the Declaration of Independence put their honor on par with their lives, they meant it. In the absence of an established bureaucracy, the new federal government depended on "the personal reputation and honor the nation's political elites."⁶⁹

Public life was also intensely personal; a man's character was the foundation of his reputation, influence, and political power. Character or reputation was dependent on personal honor, which was "the core of a man's identity, his sense of self, his manhood."⁷⁰ Joanne Freeman describes the code of honor that governed gentlemanly behavior in the Early Republic as setting "standards of conduct and ... a controlled means of handling their violation;" the code of honor "limited and defined acceptable behavior."⁷¹ Honor was ambiguously connected to wealth (or sensibility) and to credit.⁷² Good credit was a measure of more than finances; credit was also a measure of personal worth: "people with good credit were trustworthy enough to merit financial risks."⁷³ The Buttonwood Agreement offered an assurance of credit; as a public

a copious equation table, ... Together with an appendix, ... second edition with additions. London" printed for T. Boosey; J. Debret (sic), 1796.

⁶⁸ Peter Mathias, "Risk, credit and kinship in early modern enterprise," in *The Early Modern Atlantic Economy*, eds. John J. McCusker and Kenneth Morgan, Cambridge: Cambridge University Press, 2000. 16.

⁶⁹ "The Democratic Experiment: New Directions in American Political History," Meg Jacobs and Julian Zelizer in *The Democratic Experiment: New Directions in American Political History*, Meg Jacobs, Julian E. Zelizer, William J. Novak, eds., Princeton, NJ: Princeton University Press, 2003, 1-19: 9.

⁷⁰ Joanne Freeman, *Affairs of Honor: National Politics in the New Republic* (New Haven & London: Yale UP, 2001), xvi.

⁷¹ Freeman, xv.

⁷² See Trees

⁷³ Freeman, xx.

pledge of good faith between brokers it was a powerful document. Buttonwood was much more than an agreement to do business together. Instead, it was a public statement of mutual accountability, and the creation of a code of honor among brokers. The Buttonwood system was protectionist, and intended to preserve the privileges of a select group, but within that system, the brokers prized their ability to work independently.

Since competition on the basis of price was not permitted by Buttonwood, it developed in patterns very similar to the personal relationship structure between members. The result was a code of honor among brokers, which dictated that open competition was contrary to membership ideals, but that covert competition based on personal connections and informal contracts was the approved and preferred way of doing business. Gentlemen did business with one another in the comfortable environs of the Street, where a man's word was his bond and relationships between friends were more important than professional or even familial relationships. Any behavior was acceptable that did not interfere with fellow members, regardless of its legality or its effect on the clients of Wall Street.

The Exchange later tried to position itself as one of the great historical institutions of American tradition, "a living reflection of the Founding Fathers' creed that we all have the right to own property."⁷⁴ As a heroic figure of American capitalism in the 1950s, the Exchange promoted its own mythical origin story. Before Buttonwood, business "was mostly unorganized and people were reluctant to invest unless they had assurance they could sell their securities when they wanted to do so," the NYSE claimed.⁷⁵ The implication was that the original Buttonwood brokers gathered with a collective will to remedy this situation, to open the

⁷⁴ *Understanding the NYSE*, information booklet published by the NYSE, 1953, 3.

⁷⁵ *Understanding the NYSE*.

possibilities of commerce to the citizens of New York. Business was indeed unorganized circa 1792, but the reason was because there was so much of it happening.⁷⁶ Whatever business one may have wanted to transact would likely have been more possible in New York City than elsewhere in America in the 1790s. So while the creation of the Exchange did create a market expressly devoted to the purchase and sale of securities, and the level of organization may have conveyed a sense of trustworthiness, the Buttonwood Agreement is best considered an attempt to protect the interests of its original signatories.

The Exchange continued to operate in this manner, relying heavily on personal trust, through the early 1800s. Booming business, thanks to an extension of the public debt, made a formal constitution a necessity in 1817.⁷⁷ Growth meant a need for new members, but that also meant increased settlement risk. The 1792 state law was still in effect, so members had no recourse but to increase self-regulation in order to monitor complex transactions.⁷⁸

A formal Constitution was needed, too, because of the “private pique or prejudice” that tended to constrain the growth of membership.⁷⁹ The expansion of a system based on principles

⁷⁶ Contrary to the idea of an inability to sell securities, a glance through any newspaper of the times reveals a plethora of options to buy and sell securities, not only through the office of a broker devoted to that business, but through a variety of establishments. The office of Theodosius Fowler & Co., at No. 27 Water-Street, was open to “buy, sell and negotiate all kinds of Continental, Connecticut and New York Securities.”⁷⁶ Customers in need of quick cash could see Hamilton Stewart, Money Broker, at No. 7 Water-Street; to dispose of a Militia land right or warrant, William Henderson was located at No. 186. For convenience, patrons could buy and sell public securities at the shop of John Ramsay, at the same time as they purchased tea, sherry, gun powder, or handkerchiefs. *NY Packet* 2-2-1790; *NY Packet* 10-10-1789; *NY Daily Gazette* 3-9-1789

⁷⁷ Emery, *Speculation*, 75.

⁷⁸ Sylla, “Origins,” 309. Settlement risk is the risk that a deal will not be completed, that either the payment of the securities will not change hands as agreed upon. Honor notwithstanding, it was not always easy to get someone on the losing end of a deal to pay.

⁷⁹ Armstrong, *Stocks and Stock-Jobbing in Wall-Street, with Sketches of the Brokers, and Fancy Stocks*. By A Reformed Stock Gambler (William Armstrong) NY, 1848. 8

of personal honor made certain formalities or operating procedures necessary. In a system based on trust, certain principles must be inviolate, and paramount to brokers was the timely completion of contracts. Sales “in the regular way” were to be settled by the close of business on the following day, and contracts for differing lengths of time needed likewise to be concluded promptly.⁸⁰ Timeliness and fixed commission rates were the foundation of the system.

The only guarantees of contract fulfillment were the personal honor of the parties involved and whatever pressure the Exchange could bring to bear. Formality and regularity helped prevent misunderstandings. Still, William Armstrong in his 1848 Stocks and Stock-Jobbing, cautioned his readers to be aware of “rascally transactions,” because “As a general, and almost an invariable rule, you had better not place any dependance (sic) upon any body’s honor or honesty, certainly not, until you are well acquainted with the business and operators generally.”⁸¹

In the 1840s and ‘50s, brokers did not generally subscribe to the theory of buy and hold, nor did they devote a lot of attention to corporate analysis. Brokers spent their time actively trying to influence the market; stock prices rose and fell based as much on rumor and innuendo as anything else. The objective was to corner or control the market. Brokers divided into two groups: the Bulls, who looked for an advance in prices, and the Bears, who predicted a decline. Each side used whatever means they could to influence the outcome of the day’s trading in their

⁸⁰ Armstrong, *Stocks*, 9. The issue of time is vital to the survival of the auction exchange system; the length to settlement is figured into the price, so a delay would fundamentally alter the basis of a transaction. This helps explain why the paperwork crisis of the late 1960s was much more serious than simply a lack of filing systems or missing information. In addition to the millions of dollars worth of securities that were misplaced, the entire vitality of Wall Street was threatened, because of doubts about the trustworthiness of the Exchange. See Chapter 3 for an explanation of these events.

⁸¹ Armstrong, *Stocks*, 12; 24.

favor. The only way to learn the system was through experience, “a dear schoolmaster,” and woe to the uninitiated. The nineteenth century market was one where an outsider could be easily fooled or manipulated.⁸²

‘Respectable’ men of the times did not conduct their own transactions, but hired brokers to act for them on commission. By 1850, the job of stock broking had evolved into something more resembling its modern equivalent than the original brokers, who primarily identified as merchants, or sometimes auctioneers. A broker could be hired in secret, which was “frequently desirable, as it does not at all add to the business credit or reputation of a mercantile man to be known as an operator in stocks.”⁸³ Without any clear methodology for stock valuation, the public regarded buying stocks as behavior equivalent to gambling. Whether it was better at any given moment to be a Bull or a Bear seemed purely a matter of chance, most rationally decided by the flip of a coin.⁸⁴ Taking a chance on the Exchange had “all the excitement and uncertainty of cards and dice, and is consequently as seductive and alluring.”⁸⁵

The Great Depression and Reform

Between September, 1929, and July, 1932, the value of the stock listed on the New York Stock Exchange declined by 83%.⁸⁶ As part of their search for answers to the cause of the

⁸² A Reformed Stock Gambler (William Armstrong), *Stocks and Stock-Jobbing in Wall-Street, with Sketches of the Brokers, and Fancy Stocks* (New York: New-York Publishing Company, 1848), 20.

⁸³ Armstrong, *Stocks*, 7-8

⁸⁴ Armstrong, *Stocks*, 23.

⁸⁵ Armstrong, *Stocks*, 27.

⁸⁶ Joel Seligman, *Transformation of Wall Street* (New York: Aspen Publishers, 2003), 1.

Depression, the Senate Banking and Currency Committee began investigating the Exchange, under the leadership of Counsel Ferdinand Pecora. The Pecora Hearings, according to financial historian Joel Seligman, turned the Exchange into a scapegoat; financiers' salaries had no bearing on the market crash but they made good headlines.⁸⁷ However, the hearings revealed a host of other problems besides outrageous salaries – from insider trading and breaches of fiduciary duty to blatant stock manipulation.⁸⁸ The focus of the Securities Act of 1933 was on disclosure. The government theorized that the best course of action was ensuring that investors had all the accurate information available before making investment decisions. It became apparent very quickly that the Act alone was inadequate to restore investor confidence.

The creation of the Securities and Exchange Commission was possible because of fighting. It was fighting within the Exchange membership that created the possibility of such an agency existing at all, and it was fighting between New Dealers and their opponents that gave the agency its form. A reform faction at the Exchange, led by Edward A. Pierce and Paul Shields, was desperate to restore Wall Street's reputation, as a crucial step to rebuilding trading volume. Pierce and Shields represented commission brokers, who dealt with the public, and who made up the larger percentage of membership on the NYSE. The governance of the Exchange, however, was in the hands of the specialists (market makers) and floor brokers. The message from Exchange President Richard Whitney and the Old Guard was that further reform was unnecessary, since the NYSE was already performing a great national service by providing an open market.⁸⁹

⁸⁷ Seligman, *Transformation*, 2-47.

⁸⁸ Wexler, SEC History Section IV, Subsection B, Point #2.

⁸⁹ Seligman, *Transformation*, 74-75.

Meanwhile in Washington, President Franklin D. Roosevelt was searching for a compromise in order to stave off what would have been his first major legislative defeat. Senator Carter Glass was suspicious of the extent of New Deal influence at the Federal Trade Commission, which had authority over the securities industry. He proposed moving securities oversight to a new, independent agency, to be called the Securities and Exchange Commission, or SEC, created by the Securities Exchange Act of 1934.⁹⁰ The wrangling over its creation was so intense, though, that Congress basically punted the problem of meaningful reform to the agency, without giving it a clear mandate. The SEC could require companies and exchanges to file disclosure reports, and could issue rules in the “public interest” or to “protect investors.” What exactly that meant had yet to be determined.

The SEC adopted as its mandate the first clear instructions Congress gave it in the Public Utility Holding Company Act of 1935. Under the Holding Company Act, the SEC was charged with cleaning up the nation’s utility industries, and it had plenty to keep busy without worrying over the underlying structure of the stock exchanges.⁹¹ In this case the agency’s name has perhaps robbed it of some due honor, because with utilities reform the SEC actually realized great success.⁹² As far as securities went, the SEC actively pursued action against fraudulent companies or individuals, but it lacked the combination of resources and inclination to pursue wholesale change at the NYSE.⁹³

⁹⁰ Seligman, *Transformation*, 93-97; SEC History Section IV, Subsection B, Point #2.

⁹¹ Seligman, *Transformation*, 123-140.

⁹² Wexler, SEC History Section IV, Subsection C.

⁹³ Seligman, *Transformation*, 150.

The first chairman of the SEC, Joseph Kennedy, took what he termed a “cooperative” approach to dealing with the Exchange. The result was a “self-perpetuation of the ‘in’ group” on the Exchange’s Governing Committee.⁹⁴ SEC Chairman James Landis discovered that the stop order powers granted by the 1933 Act enabled the SEC to write effective letters, which became standard operating procedure.⁹⁵ The “letter of comment” provided a way for the agency to let its concerns be known, without the necessity of formal proceedings. The “no-action letter” gave the agency a way to make an informal ruling on an unclear point of law. Such letters proved invaluable given the volume of work involved in overseeing adequate disclosure relating to securities issues.⁹⁶

Under the chairmanship of William O. Douglas the agency was able to develop “a coherent policy framework.”⁹⁷ He pushed the NYSE for reforms in the late 1930s, and secured them, albeit via threats rather than through direct action. As was already the pattern at the NYSE, change was only possible in cases of extreme internal turmoil. The SEC’s creation and early inactions had not resolved the conflict between the Whitney faction and the would-be

⁹⁴ Seligman, *Transformation*, 111-119.

⁹⁵ Seligman, *Transformation*, 149.

⁹⁶ Wexler, SEC History, Section IV, Subsection C, Point #9. “The SEC, especially, appeared successful. It brought credibility and order to the securities industry, although the exchange’s leading historian has written that reform “involved at most a redistribution of power and economic rewards among existing groups.” Thomas K. McCraw has suggested that the commission succeeded in large part because the agency’s chairman, James M. Landis, recognized the value of close relations with the stock industry. For example, the SEC provided “advance opinions” in response to specific regulatory questions, a dramatic departure from the formal procedures followed by both the ICC and FTC. Success came also because stock salesmen had no other way to restore public confidence following the speculative frenzy of the late 1920s.” Donald J. Pisani, “Promotion and Regulation: Constitutionalism and the American Economy” *The Journal of American History*, Vol. 74, No. 3, *The Constitution and American Life: A Special Issue* (Dec. 1987), 740-768. 763.

⁹⁷ Seligman, *Transformation*, 157. Douglas implied that the Exchange was “a private club,” with “elements of a casino.”

reformers. Douglas managed to force the Exchange to adopt its own internally-proposed reforms by threatening to take harsher official action if they refused. There was a great deal of bluffing on Douglas's part; the SEC had to tread carefully lest it be terminated entirely after the 1940 elections. But Douglas was good at influencing the Exchange's public reputation, and the path was cleared when Richard Whitney was charged with grand larceny.⁹⁸

So the Exchange got a new President, one unaffiliated with the NYSE, and the new Board of Governors was re-structured to favor the concerns of commission brokers over those of the floor brokers. Douglas was fine with the Exchange's policy of self-regulation, but wanted it under close supervision.⁹⁹ Change happened at the NYSE because Douglas knew how to exploit differences between the members, but not because of any specific action on the part of the SEC.¹⁰⁰ In some respects, Douglas's success was unfortunate, because it meant that "the SEC surrendered its opportunity to regulate the Exchange more directly."¹⁰¹

The agency was under duress, especially after the passage of the 1940 Investment Company Act; trying to regulate so many aspects of American capitalism took the SEC in too many directions, and limited its effectiveness. The emphasis was necessarily on front-end disclosure rather than enforcement after the fact. The NYSE's self-regulation took some of the

⁹⁸ Seligman, *Transformation*, 160-167; After serving five terms as President of the NYSE, Richard Whitney was convicted of grand larceny and sentenced to prison at Sing-sing. This was only enough to persuade the Exchange to undertake minimal reforms. See Perkins, 140-141; Chris Welles, *The Last Days of the Club*, (New York: E.P. Dutton & Co., 1975), 13-14.

⁹⁹ Seligman, *Transformation*, 167, 158.

¹⁰⁰ Seligman, *Transformation*, 178-179.

¹⁰¹ Seligman, *Transformation*, 231.

burden off the SEC, but the result was that the SEC overlooked or ignored how fixed commission rates profited brokers to the detriment of investors.¹⁰²

During and immediately following World War II, the SEC went through a period of “virtual invisibility.”¹⁰³ Under the Truman administration, the appointment to commissioner became a political favor.¹⁰⁴ The number of commissioners, and their lack of financial or legal expertise, grew, and the commission, still lacking a clear direction, became “intellectually stagnant.”¹⁰⁵

Ralph Demmler, the chairman appointed by Dwight Eisenhower, took a very hands-off approach to dealing with Wall Street, and informed the Exchange that approval was no longer required, however perfunctory, for every policy change.¹⁰⁶ In 1953 the Exchange raised commission rates by 18 percent, and rescinded some of its restrictive trading rules, signaling a return to unbridled speculation. Between 1955 and 1961, both the number of investors doubled, as did the value of shares traded, creating an environment perfect for fraud.¹⁰⁷ J. Sinclair Armstrong, a former Commissioner and Chairman of the SEC, wrote in 1960 that, “The public, which has been fleeced in illegal or shady transactions beyond the Commission’s reach, is apathetic. Congress had found, for its own reasons, that it is better to deny the Commission the

¹⁰² Seligman, *Transformation*, 167.

¹⁰³ Wexler, SEC History, Section IV, Subsection C.

¹⁰⁴ Seligman, *Transformation*, 238-241.

¹⁰⁵ Seligman, *Transformation*, 246.

¹⁰⁶ Seligman, *Transformation*, 272; Seligman says that Republicans assumed large businesses could discipline themselves (269).

¹⁰⁷ Seligman, *Transformation*, 273-277.

necessary tools and support while loudly criticizing occasional failures of alleged slip-ups, than it is to enact the Commission's program."¹⁰⁸

The SEC's letters were formal and detailed, but non-punitive. Over time, fear of what the SEC might do turned into recognition that the agency itself was unsure what it could do, so the letter process became more and more lip service. There are limits to the effectiveness of threatening letters, particularly when the authoring entity appears weak. Wall Street continued to operate as it always had. When historian Robert Sobel began studying financial markets in 1955, he found a system run as much by tradition as by logic; "only in such a tightly knit community, where tradition was alive, could so many deals be made based upon the honor and the word of participants, with the written agreements often being completed after the arrangement was ended."¹⁰⁹ Insider trades and shady deals exploiting member-privileged information were not only permitted but encouraged as one of the benefits, even purposes, of membership.¹¹⁰

The nature of trading had already changed by 1975; the profusion of institutional, rather than individual, traders both created the necessity for deregulation and made possible a continued, adapted, existence for the NYSE after commission rates were allowed to float. The NYSE's preeminent concern has always been volume. The language brokers use to discuss volume varies depending on the audience, from market liquidity to effective use of national resources, but volume is the heart of the matter. Problems arise on the Exchange when the membership becomes divided over whether volume increases or the preservation of traditional privilege takes the highest priority. This is what happened in the 1930s and what happened in

¹⁰⁸ Wexler, SEC History Section IV, Subsection C, Point #2.

¹⁰⁹ Edwin J. Perkins, *Wall Street to Main Street: Charles Merrill and Middle-Class Investors*, (New York, Cambridge: Cambridge University Press, 1999), 77; Sobel, Robert, *Inside Wall Street: Continuity and Change in the Financial District*, (New York: W.W. Norton & Company, Inc., 1977), 9.

¹¹⁰ Welles, *Last Days of the Club*, 13.

the 1970s. In both cases, the calls for volume eventually won. At root, both recovery from the Depression and the matter of fixed commission were the same issue, convincing the public that it was safe and financially rewarding to do business with the NYSE. As a profoundly conservative institution, reform was never most valued simply for reform's sake. Reforms meant increased consumer confidence, which meant increased volume, and therefore higher commission payments to brokers. The commission rate problem was notable because it was an outgrowth not of failure but of success. The Exchange literally could not handle the volume of business. Practical inefficiencies drew attention to a problem – and that problem was brokers' collective failure to put the investors' needs first.

CHAPTER III

The New York Stock Exchange Fights Deregulation

On May 1, 1975, the New York Stock Exchange formally ended its policy of setting fixed commission rates for its members. Stockbrokers called it Mayday, because they feared that the competition caused by floating rates would be the downfall of the Exchange. The SEC forced the NYSE to adopt negotiated commissions as a culmination of federal investigations of pension mismanagement and of the growing power of financial institutions responsible for investing those pensions.

As corporations integrated pension plans into their financial operations and took advantage of trustee plan investment strategies, the lack of distance and transparency between pension funding and other financial decisions provided plentiful opportunity for the creative manipulation of funds.¹ The finances of pension plans became increasingly tied to stock market fluctuations. The situation was complicated by the number of entities involved in operating pensions, which could include any combination of corporate financial or human resources officers, banks, insurance companies, trust companies, unions, or private financial advisors. The percentage of corporate pension fund assets invested in common stock rose from 23% in 1956 to 39% in 1962. In terms of market value, roughly half the value of private pensions was in

¹ James E. McNulty, *Decision and Influence Processes in Private Pension Plans* (Homewood, Ill.: published for the Pension Research Council, Wharton School of Finance and Commerce, University of Pennsylvania, by R. D. Irwin, 1961), 114. It was very easy to alter pension contributions/estimates/management in order to accommodate a company's larger financial position.

common stock by 1962.² Not only that, but by the late 1960s, institutions controlled half of all outstanding common shares.³ As pension funds, collectively, climbed into billions of dollars, politicians and regulators began to pay more attention to how that money was being used. The line of questioning took two directions – first to potential pension mismanagement, intentional or otherwise, and second, to the growing economic power of the institutions entrusted with pension investment.

The NYSE did acknowledge the growing power of the institutional investor.⁴ Throughout the 1960s, institutions began to trade more actively; the average size of institutional transactions and corresponding commission payments increased as well. Change was certainly not necessary at the NYSE when the problem, as they saw it, lay elsewhere.⁵ At first, institutions reconciled themselves to paying commissions, and negotiated elaborate reciprocity arrangements with brokerages in order to get more for their money. The practice of some institutions, primarily mutual funds, of passing costs back to their customers, prompted the SEC to push the NYSE to implement volume discounts. Many institutions took their business to less costly regional exchanges, and some began to clamor for membership on the NYSE itself, which would allow them to trade at the lower member rates. Each of these tactics was inadequate, and caused other problems, for the Exchange and potentially the economy. Ultimately, the solution

² Ralph and Estelle James, *Hoffa and the Teamsters: a study of union power* (Princeton, NJ: D. Van Nostrand Company, Inc., 1965), 238.

³ Mark B. Smith, *The Equity Culture: the Story of the Global Stock Market* (New York: Farrar, Strauss, and Giroux, 2003), 165.

⁴ “Important but Not All Powerful,” *Business Week*, July 18, 1964, 92-94.

⁵ NYSE Archives, Press Releases, Boxes 22-23: 1/6/65, 1/12/65, 12/15/65, 2/2/67, 3/7/67, 6/1/67, 8/14/67.

to the problem of institutional investment, as both the SEC and Congress saw it, was to un-fix commission rates and let stockbrokers compete on the basis of price.

Under the pressure of an SEC ruling, and the upcoming passage of the Securities Acts Amendments of 1975, the NYSE capitulated, and adopted negotiated commissions of its own volition. The reason why the Exchange finally accepted change, though, was because enough Exchange members realized that transaction volume, and the corresponding profits, would continue to decrease if institutions moved retirement investment away from the NYSE. By not adapting to its investors' needs, the Exchange was only hurting itself. This is not to say that change was seamless; Mayday drastically re-formed Wall Street. But the NYSE emerged stronger than before, bolstered by the return of institutions, and by a renewed focus on individual investment for retirement.

The Senate began a two-year investigation of union welfare and pension plan mismanagement in 1954. Its subsequent attempts to rectify the situation focused on more stringent disclosure requirements. Business, under the leadership of the National Association of Manufacturers and the Chamber of Commerce, opposed measures it did not think went far enough to curb union power. Unions argued against increased regulation they deemed unnecessary. The Landrum-Griffin Act was ultimately passed in 1959; it imposed uniform standards of conduct and disclosure requirements. In this "worst defeat for organized labor" since Taft-Hartley, unions bore the brunt of justifying their operations in face of an expanding Congressional witch-hunt.⁶

⁶ Elizabeth Fones-Wolf, *Selling Free Enterprise: the business assault on labor and liberalism, 1945-1960* (Urbana and Chicago: University of Illinois Press, 1994), 266-278.

The most extreme case of union pension mismanagement, and the one that garnered perhaps the most public revulsion, was that of the International Brotherhood of Teamsters. The Teamsters, under the leadership of Jimmy Hoffa, established the Central and Southern States Pension Fund in 1955.⁷ Hoffa immediately seized the opportunity to further the union's broader goals, building connections to dominate the national transport industry; "we are in this business to make friends," he said.⁸ The CSPF was set up as a trustee fund, to avoid the investment restrictions and potential tax liabilities of an insured plan. Financing decisions were made by majority vote of the board of trustees, which included both corporate and union representatives. Hoffa basically held the board hostage. Union trustees followed his orders, and company representatives followed suit out of fear of individualized retaliation, in the form of strikes or more extreme violence. The most important decision controlled by Hoffa was the choice of the plan actuary. Under IRS regulations, a pension plan could qualify for tax exemption of contributions and investment earnings if its benefit formula, the calculation of expected payments and required contributions, was crafted by a qualified actuary. The IRS did not check the actual calculations or whether or not the actuary made reasonable assumptions; the only thing that mattered was that an actuary signed off on the plan.⁹

The Teamsters' money was not centralized in one bank or investment company, but spread across the country in Teamster-controlled banks and the coffers of some union locals. From these banks, Hoffa and his top associates ran a private real estate empire, investing pension

⁷ James, *Hoffa*, 216.

⁸ Steven A. Sass, *The Promise of Private Pensions: the first hundred years* (Cambridge, MA and London: Harvard University Press, 1997), 182; see also James, *Hoffa*.

⁹ James, *Hoffa*, 222-224.

funds almost exclusively in trustee-selected mortgages.¹⁰ General practice was to grant mortgages to “friends” at roughly half the going rate. This gave Hoffa, and the CSPF, ownership stakes in everything from hotels, to strip malls, to medical offices, to restaurants.¹¹ Poor returns and bankruptcies were a severe drain on the fund. In his 1962 *Report on Western Conference of Teamsters Pension Plan*, Murray Latimer estimated that 60% of workers covered by the CSPF would never receive any benefit payment.¹² But, as Hoffa biographers Ralph and Estelle James discovered, “A large fund with a continuous influx of new resources and an adept schemer at its helm can thereby extricate itself from the obvious appearance of financial difficulty for a long time.”¹³

In 1963, Jimmy Hoffa and six of his associates were indicted for conspiracy to defraud the CSPF. The case involved separate investigations by 29 grand juries and amounts over \$20 million. Not only had the CSPF’s reserves been used to finance questionable projects, but loans had been made on the basis of expected future contributions to the fund. The finances were so convoluted that Hoffa’s 1964 conviction came as a surprise. The CSPF was in such a mess that observers doubted whether the government would be able to pinpoint specific instances of wrongdoing.¹⁴

¹⁰ James, *Hoffa*, 237. This went on from the late 1950s through 1965.

¹¹ James, *Hoffa*, 294-95; 246. By 1962-63, roughly 60% was in hotels.

¹² Latimer, in James, *Hoffa*, 366.

¹³ James, *Hoffa*, 295. Hoffa agreed to let the Jameses shadow him and his staff; estimates from his own data put the CSPF loss at around \$15 million by 1963.

¹⁴ James, *Hoffa*, 237; 311-317. Despite a great deal of publicity (mostly because of the antagonism between Hoffa and Attorney General Robert Kennedy), the CSPF case did not spur widespread outcry over the state of private pensions. By this point the public was not really surprised by anything that came to light regarding the Teamsters.

The Labor Department was authorized by the 1958 Welfare and Pension Plan Disclosure Act to obtain exactly that – disclosure of plan information – but was not granted the power to take action on perceived breaches of conduct. The Teamsters’ wrongdoing was not typical, and unions feared stronger legislation would equate to labor persecution. Nor did the business community see a need for more extensive regulation.¹⁵ Serious and far-reaching reform of pension regulation would become a perennial issue throughout the 1960s, finally culminating with the Employee Retirement Income Security Act of 1974.¹⁶

Investing by Institutions

The faults of trustee plans became obvious as the combined Wars on Poverty and in Vietnam produced rapid inflation and general economic unrest. The shift of pension money from secure fixed instruments to riskier common stock was eroding the stability demanded by the traditional pension, just as Americans wholeheartedly embraced the ideology of retirement.¹⁷ But pension funds were contributing to a development that by the early 1970s threatened the stability of the entire U.S. financial system: the growing power of institutional investors and the disappearance of the individual from the stock market.

¹⁵ Sass, *Promise*, 192-3. “the Department of Labor was soon flooded with mail detailing horrors and begging for help. [re: the Teamsters] But the department was powerless to act.”

¹⁶ Sass, *Promise*, 193. JFK was part of the committee that crafted the 1958 legislation and would build on that experience – considering pensions for the first time beyond issues of tax avoidance or misconduct, as a nationwide system.

¹⁷ Marshall E. Blume, Jeremy J. Siegel, and Dan Rottenberg, *Revolution on Wall Street: The Rise and Decline of the New York Stock Exchange* (New York and London: W.W. Norton & Company, 1993), 57; W. Andrew Achenbaum, *Shades of Gray: Old Age, American Values, and Federal Policies Since 1920* (Boston and Toronto: Little, Brown and Company, 1983), 130: “Consequently, Americans have become increasingly disenchanted and disillusioned at the very moment that they have escalated their demands and begun to get progressively more generous benefits.”

Investment by institutions such as mutual funds, insurance companies, and pension funds increased by 218% in the period from 1949 to 1957, growing to over \$30B. Among institutions, the pensions presented the strongest growth. Common stock holdings of pension funds increased from \$500M to \$5.7B, a gain of 1040%.¹⁸ In pursuit of high returns, pensions were devoting over 35% of their income to common stock by the late 1950s.¹⁹ The implications of growing institutional holdings were “deeply disturbing” to social scientists.²⁰ They feared an “institutionalization of private property,” a situation in which institutions held majority control of American publicly-traded corporations. Peter Drucker would later refer to this phenomenon as “pension fund socialism,” calling it one of the most significant social problems of the modern era.²¹ Recent campaigns by the New York Stock Exchange to promote individual stock ownership had created a sharp division between institutions on the one hand and millions of investors, each holding a very small percentage of shares, on the other.²²

Fear of inflation and hope for high returns kept pension funds committed to equities. Pension funds left restrictive insurance companies in favor of banks, prompting the insurance industry to devise new investment methods so that they, too, could offer common stock investing options. The Prudential first championed use of annuities that paid variable, instead of fixed,

¹⁸ “The Startling Impact of Private Pension Funds,” *Business Week*, January 31, 1959, 88-105.

¹⁹ “The Pension Funds: the Assets Keep on Climbing,” *Business Week*, June 21, 1958, 97-100. The majority of the remaining reserves were invested in corporate and government bonds.

²⁰ “The Startling Impact of Private Pension Funds,” *Business Week*, January 31, 1959, 88-105.

²¹ Peter Drucker, “American Business’s New Owners,” *Wall Street Journal*, May 27, 1976; Thomas C. Cochran, *200 Years of American Business* (New York: Basic Books, Inc., 1977), 233.

²² “The Startling Impact of Private Pension Funds,” *Business Week*, January 31, 1959, 88-105; see Julia Ott, “The “Free and Open” “People’s Market”: Public Relations at the New York Stock Exchange, 1913-1929” *Business and Economic History On-line*, vol. 2, 2004; also Janice M. Traflet, *Spinning the NYSE: Power and Public Relations at the Big Board*, Columbia University Dissertation, 2004.

amounts.²³ Variable annuity accounts were exempt from SEC regulation; the SEC applied the same logic to them as it did to the investment funds sponsored by banks. These instruments were sold to “sophisticated” investors on a one-to-one basis, and were therefore not required to be registered under federal securities law.²⁴ By the mid-1960s, insurance companies adopted the tactic of creating separate common stock accounts as part of pension portfolios. Competition for pension money was intense. “We were pushed into aggression by the banks,” said John M. Hines, a vice president at Equitable. “Now we hope to push them aggressively.”²⁵

Through the 1950s and 1960s, pensions were a booming business, in terms of both investments and disbursements.²⁶ Pension plans grew larger and larger, often as unions merged multiple funds into single plans, and attractive benefit packages prompted workers to take early retirement.²⁷ The stock market boomed through most of the 1950s; the compound annual return for the period from 1950 to 1960 was over 18%.²⁸ Pension trustees were encouraged by plan sponsors in the 1960s to adopt aggressive investment strategies.²⁹ In 1964, pension funds were the most important purchasers of new stock issues; by the end of that year institutions owned just

²³ “The Pru Leads Fight to Sell a New Kind of Annuity,” *Business Week*, June 28, 1958, 110-122.

²⁴ Matthew P. Fink, *The Rise of Mutual Funds: an insider’s view* (New York: Oxford University Press, 2008), 71-72.

²⁵ *Business Week*, June 26, 1965, 132-32.

²⁶ “The Pension Funds: the Assets Keep on Climbing,” *Business Week*, June 21, 1958, 97-100.

²⁷ *Business Week*, August 8, 1964, 36-37; *Business Week* January 8, 1966, 84. In 1964, the International Ladies Garment Workers Union merged 47 funds, for reasons of greater stability and efficiency. The UAW opened over 10,000 jobs in 1965, through early retirements made possible by generous pension benefits.

²⁸ Blume, Siegel, and Rottenberg, *Revolution*, 106. Bonds were pretty much stagnant for the same period.

²⁹ Julian Gumperz, “Pension Funds in an Age of Discontinuity,” *Financial Analysts Journal*, Nov-Dec, 1970, 120.

over 20% of the market value of all outstanding common stock. Pensions increased both their sales and purchases of common stock, making record profits, \$378M.³⁰

During the 1960s, the average daily volume of the stock market quadrupled.³¹ Pension funds purchased billions of dollars' worth of equities, achieving "spectacular" returns.³² Before 1960, less than 2% of trading volume came from large block trades made by institutions, but in 1964 the New York Stock Exchange for the first time recorded a day in which trading by individuals accounted for less than half of total volume.³³ Institutions were drawn into active trading in the early 1960s, by the success of the "go-go funds" and the rise of the so-called "cult of performance," the new practice of following the performance of individual fund managers instead of brokerages. Fund managers Jerry Tsai and Fred Mates became stars on Wall Street because of their new strategy of making frequent trades, rather than following the traditional conservative fund strategy of buy-and-hold with blue chips. The difference between institutional and individual trading was size. The base unit for a stock trade was a round lot, 100 shares, but institutions traded in huge blocks of tens of thousands of shares. With commissions fixed on a per share basis, brokers could profit tremendously from executing just a few trades.³⁴ "As late as

³⁰ *Business Week*, July 18, 1964, 92-94; *Business Week*, June 5, 1965, 100. Record private placement of new securities with institutions occurred again in 1965 (\$15.8B), *Business Week*, February 5, 1966.

³¹ James Burk, *Values in the Marketplace: The American Stock Market under Federal Securities Law* (Berlin and New York: Walter de Gruyter & Co., 1988), 96.

³² Gumperz, "Pension Funds," 121.

³³ Gregg A. Jarrell, "Change at the Exchange: The Causes and Effects of Deregulation," *Journal of Law and Economics*, Vol. 27, No. 2 (Oct., 1984), pp.273-312, 277; *Business Week*, June 5, 1965. Block trades in this case are considered to be 10K shares or greater.

³⁴ "Big Blocks Make More of a Splash," *Business Week*, January 15, 1966, 110-112. The top brokerages who dealt with institutions were Goldman, Sachs, & Co. and Bear, Stearns & Co. The largest single transaction up to that time occurred at Chicago's Midwest Stock Exchange on January 5, 1966; 262,000 shares of Pennsylvania Railroad sold for \$17,488,500, with a resulting commission of \$70,000. (almost \$500,000 adjusting for inflation to 2012)

1968, a sale or purchase of 100,000 shares carried a broker's commission of 1,000 times the commission on a trade of 100 shares."³⁵

By 1975, institutional investing made up roughly 70% of Wall Street's volume, and institutional ownership was greater than \$400 billion.³⁶ Pension fund investing changed "from a stagnant backwater of the investment business to the center of action in Wall Street, providing a bonanza in fees."³⁷ But institutions began to resent their position as the providers of that bonanza, and looked for ways around paying such high commissions. As these large investors took steps to circumvent the NYSE, they moved more stock outside of the central marketplace. Institutions made their trades on smaller, regional exchanges, or through a shadow marketplace known as the Third Market, where independent participants traded exchange-listed stocks in an over-the-counter (OTC) fashion, but without oversight from either any exchange or the National Association of Securities Dealers (NASD), which oversaw OTC trading. The NYSE lobbied the SEC to eliminate the Third Market, but the SEC recognized that the root of the problem was the necessity of change at the NYSE itself.

The NYSE fought first to prevent and then to postpone regulatory reforms. Exchange members eventually accepted operational reforms because of changing market and economic

³⁵ Lease, Ronald C., Wilbur G. Lewellen, and Gary G. Schlarbaum, "The Individual Investor: Attributes and Attitudes" in *The Journal of Finance*, Vol. 29, No. 2, Papers and Proceedings of the Thirty-Second Annual Meeting of the American Finance Association, New York, New York, December 28-30, 1973 (May, 1974), 413; "Wall Street's Taste of Freedom: Competition as Regulator," *Business Week*, March 17, 1975.

³⁶ Chris Welles, *The Last Days of the Club*, (New York: E.P. Dutton & Co., 1975), 27-31; "Commission Rates Keep Tumbling Down," *Business Week*, May 26, 1975. By the early 1970s, pension funds held more than \$100B worth of common stock, and institutional trades dominated Wall Street, making up more than half of volume. Burk, *Values*, 97-98, 157; Blume, Siegel, and Rottenberg, *Revolution*, 105; Jarrell, "Change," 277.

³⁷ "The Pressure on Pension Funds to Perform," *Business Week*, September 11, 1971, 88.

conditions. The fight between the Exchange and the federal government was never truly about the necessity of change; rather, the fight was over which entity would retain control over American securities markets. Federally-imposed regulation was a threat to the substantial power of the NYSE. The Exchange was far from the only securities market in America, but it was the dominant one. The NYSE offered economies of scale; its large size provided good liquidity and dissemination of information, critical to the functioning of an auction market. Through its self-regulatory structure, the governing board of the Exchange oversaw the behavior of its members, many of whom traded in multiple markets. The importance of the NYSE to the securities industry extended even beyond its role as the nation's central marketplace.³⁸ This vaunted self-regulation gave Wall Street an appearance of fairness.³⁹ The most visible aspects of regulation were the NYSE's strict control over membership and its policy of fixed commission rates.

The prospect of competition on the basis of price terrified the NYSE. Exchange Chairman James Needham regarded the elimination of fixed commissions as “tantamount to ordering the demise of the New York Stock Exchange.”⁴⁰ While the deregulation of an industry necessarily involves some measure of upheaval, the required structural adjustment is not sufficient to explain the panic on Wall Street. Any suggestion of deregulation was a threat to the NYSE's control, and an assault on the nature of the Street itself.

The Exchange's position on the problem of high fixed commissions on institutional trades was that it was not a problem. The give-ups, trade-offs, and favors that the system

³⁸ Jarrell, “Change,” 275; Wyatt Wells, “Certificates and Computers: The Remaking of Wall Street, 1967 to 1971,” *The Business History Review*, Vol. 74, No. 2, (Summer, 2000), p. 193-225. 197.

³⁹ Blume, Siegel, and Rottenberg, *Revolution*, 33.

⁴⁰ John Carson-Parker, “Wall Street's Great Non-Event of 1975,” *Business Week*, April 21, 1975; NY Times article; 1973 speech (NYSE Archives)

spawned, and which the public found so distasteful, provided an efficient method to distribute commission revenues and research services more equitably. The Exchange dismissed criticism with the simple claim that “reciprocal arrangements are a part of business life.”⁴¹ The implication was that those outside the system had neither the right, nor the understanding, to question its inner workings. In fact, NYSE President Keith Funston’s warning that the commission business was only doing well because of “extraordinarily high volume” prompted the Exchange Board to request SEC approval to raise commissions.⁴²

Institutional investing spurred the creation of increasingly complicated systems of competition. Regulations permitted transactions of dubious legality; the most insidious of these was known as a “give-up.” The rules of the Exchange allowed the manager of an institutional fund to direct a broker, who actually performed the requested transaction, to share part of the commission with other brokers, as specified by the fund manager. Commissions for institutional trades were so high that brokers were willing to accept only a portion of the minimum required commission fee. The broker was said to ‘give up’ part of his commission, sometimes as much as seventy-five percent.⁴³ This enabled fund managers to accept ‘free’ research or other services from brokers, and then ‘pay’ them by directing commissions to be paid to them. Fund managers and brokers alike benefitted from this and similar systems; every transaction was based on a principle of reciprocity. Institutions gained access to privileged data, and fund managers grew rich from kickbacks from brokers. Brokerages raked in high profits from commissions, and maintained both customer loyalty and the balance of power within the Exchange club. Give-ups

⁴¹ NYSE Press Release 1/12/65.

⁴² NYSE Press Release 6/1/65

⁴³ Wexler, Section E; William F. Baxter, “NYSE Fixed Commission Rates: A Private Cartel Goes Public,” *Stanford Law Review*, Vol. 22, No., 4 (April, 1970), p.675-712, 681.

accounted for an estimated sixty percent of the total commissions on institutional orders.⁴⁴ It was “an age of rebates, reciprocity, and kickbacks of highly doubtful legality and ethicality.”⁴⁵

In order for small firms to compete with the ‘free’ services offered by the larger brokerages, the commission rates had to be moved higher and higher. Also, the research generated as part of the reciprocity process was seldom made available to individuals. As a result, individual investors were pushed even further out of the stock market. Those that still wished to invest moved to institutional funds. “Such a decision may reflect a feeling that he [the individual] lacks the requisite portfolio management expertise, that necessary information on companies he might invest in is not available to him on the same basis as it is to the professional, that the commitment of time and energy needed to become both informed and skillful is too great, or that transactions costs for the modest investor are excessive.”⁴⁶

When Robert Haack became the Exchange’s new president in the fall of 1967, conditions on Wall Street were if anything a little too good. Haack’s first challenge was what became known as the Paperwork Crisis. Trading volume was so high that the NYSE had already taken the emergency step of closing trading ninety minutes early. Commissions were not the only facet of trade affected exponentially by increased block trades. The paperwork was increased by the same magnitude, and this was before the use of computers was widespread.⁴⁷ In the same way commissions were determined on a per-share basis, every lot of a transaction had to be

⁴⁴ Jarrell, “Change,” 279. (note 14)

⁴⁵ Welles, *Last Days of the Club*, 66.

⁴⁶ Burk, *Values*, 93; Lease, Lewellen, and Schlarbaum, “The Individual Investor,” 414.

⁴⁷ “Haack’s Task: Easing the Pains of Growth,” *New York Times*, September 17, 1967; Wells, “Certificates,” 193: “prosperity almost destroyed the stock market;” “Top Exchanges May Alter Specialist Setup Due to Large-Block Trading by Institutions,” *Business Week*, January 26, 1968; “Why the Street Closed Down,” *Business Week*, June 15, 1968, 121-124.

settled individually, and could involve up to sixty-eight distinct steps.⁴⁸ Automation would remedy the situation eventually, but computers were expensive and posed their own challenges.⁴⁹ A trade not settled within 5 days constituted a “fail.” Fails were over \$4B by the end of 1968.⁵⁰ As the NYSE and SEC pushed firms to straighten their accounts, many faced the reality that they had no idea about the state of their own finances. When failures became imminent, the Exchange did everything it could to mitigate the damages, sending in its own regulators to help arrange mergers between firms approaching bankruptcy and stronger competitors. The NYSE had to put on a brave face to maintain consumer confidence, but the facts spoke for themselves.⁵¹ From 1969 through 1970, over 100 firms ceased to exist, because of either mergers or failures.⁵² Outsiders were beginning to suspect that brokerage management was incompetent; some began to question, with good reason, whether managers had actually *stolen* funds from customers. The

⁴⁸ Wyatt Wells explains: “The process revolved around the stock certificate: a seller had to transmit to the buyer the appropriate certificate, signed and notarized. The buyer then had to send this document to the issuer’s transfer agent, usually a large bank, which formally recorded the change in ownership for the payment of dividends and the like and issued a new certificate in the purchaser’s name. Certificates for more than 100 shares were rare. An investor who purchases 500 shares of a stock would usually receive five 100-share certificates. As a result, the quantity of paper changing hands on Wall Street was immense. One study estimated that in 1968 firms listed on the New York Stock Exchange had to issue 100 million new certificates.” Wells, “Certificates,” 201.

⁴⁹ Wells, “Certificates,” 211.

⁵⁰ Wells, “Certificates,” 213.

⁵¹ Wells, “Certificates,” 220-228. This situation led to the creation of the SIPC, the Securities Investor Protection Corporation.

⁵² Wells, “Certificates,” 232-234. More on this in Chapters 4 and 5; computers and better administration would help deal with volume and also enable diversification of services, which allowed firms to expand business into new areas, often by managing retirement plans such as IRAs or 401(k)s.

SEC's recent market studies cataloged numerous areas ripe for reform, but, as with any government entity, no action could be undertaken without pressure from the public.⁵³

The NYSE controlled access to information about its members very strictly because of the necessity of public confidence in order for the market to function. But the press was relentless about investigating the deals made behind closed doors; at least one broker/institution party was documented in which call girls were auctioned off for soft money.⁵⁴ Such juvenile behaviors had a place within the old boys' club atmosphere of Wall Street, but the NYSE had bigger problems than the occasional embarrassing indiscretion. The bad publicity gave the SEC the ammunition it needed to demand answers to its serious questions about commissions. If the rates were so high that brokers could give up part of their commissions, to be used for nonprofessional purposes, why could the Exchange not at least implement a discount for volume.⁵⁵ The Justice Department asked the same question; if commissions are big enough to give up, why should there be a minimum?⁵⁶ The SEC used this pressure to ban the give-up and impose a volume discount on commissions for trades larger than 1,000 shares in 1968. The "V.D." was the first crack in the Exchange cartel.⁵⁷

The economic downturn, and Wall Street's problems, notably the failure of Goodbody & Co., one of the country's largest brokerages, and the near-failure and rescue of DuPont by Ross

⁵³ Welles, *Last Days of the Club*, 21; Wexler, SEC History; Alec Benn, *The Unseen Wall Street of 1969-1975 and Its Significance for Today*, (Westport, Connecticut: Quorum Books, 2000), 114. The pay scale at the SEC hindered reform as well. Government work did not pay well; some worked at the SEC for experience and some because they loved the work, but most were worth what they were paid.

⁵⁴ Welles, *Last Days of the Club*, 79-89.

⁵⁵ "Brokers Howl at Fee Plans," *Business Week*, June 8, 1968, 48.

⁵⁶ *Business Week*, June 15, 1968, 124.

⁵⁷ Welles, *Last Days of the Club*, 79-89; Jarrell, "Change," 283.

Perot, brought renewed attention from Congress. At the beginning of 1971, Senator Harrison Williams sent questionnaires to fifty brokerages as part of an investigation by the Securities Subcommittee of the Senate Banking Committee. Williams was particularly interested in the roughly \$130B controlled by pensions, in what he called “the most unwatched and unregulated reservoirs of money in the U.S.”⁵⁸

Unwatched they may have been, but pension funds had certainly not been idle through the late sixties, nor had other institutional investors. Those institutions that preferred not to pay high commissions, whether as give-ups or not, conducted their trades on smaller regional exchanges, and in the OTC market. Many also traded in the so-called Third Market, in which exchange-listed stocks were traded off the Exchange floor. Some institutions took the unusual step of joining regional exchanges as members. Waddell & Reed, Inc., the sponsor and distributor of United Funds, Inc., & Investors Diversified Services, Inc., the nation’s largest mutual fund, joined the Pacific Coast Stock Exchange in 1965 to cut costs. That same year, the PCSE granted “trading privileges” to Bank of America, allowing a 25% commission reduction.⁵⁹

The 1968 ban on give-ups increased interest in trading off the NYSE. Over 35% of block trades took place somewhere other than the NYSE in 1970. By 1971, institutions exercised control, if not outright ownership, over 83 seats on regional exchanges. As exchange members, institutions could direct NYSE firms to execute trades on “their” exchanges.⁶⁰

⁵⁸ *Business Week*, January 30, 1971; “A Searching Look at Pension Plans,” *Business Week*, April 10, 1971, 40. For Congressional regulation of pensions, see Chapter 3; for Congress’s side of the argument over negotiated commissions, see Chapter 4.

⁵⁹ Jarrell, “Change,” 279; “Big Blocks Make More of a Splash,” *Business Week*, January 15, 1966, 110-112; *Business Week*, February 5, 1966.

⁶⁰ Jarrell, “Change,” 279-283.

The Exchange's initial position was that if trading on other markets caused any problems, then the SEC should regulate those markets. The worry was that the splintering of trading would depress the liquidity of pension funds, creating a situation in which retirees would not be paid on time. With benefit payouts increasing, some feared a return of pensions to more dependable fixed income.⁶¹ If the concern in 1964 was that institutions did not trade enough to maintain liquid markets, the situation took a reversal in 1967-68. By then, institutions were trading so much, and so frequently, that the markets were under an enormous strain of another kind.⁶²

What institutional investors really wanted, if they could not have negotiated commissions, was membership on the NYSE itself.⁶³ The Exchange at first refused to countenance such a measure; seat ownership by institutions would "undermine the cartel."⁶⁴ At the start of 1971, NYSE brokerages were feeling the pinch, though, with 30% of trading volume now at regional exchanges or the Third Market. The Exchange Board expressed willingness to consider applications for membership from Dreyfus Sales Corp. and Jefferies & Co., a subsidiary of Investors Diversified Services, Inc.. At first, the NYSE's review committee indicated that approval might be "desirable," under certain conditions. After almost a year, however, both applications were rejected.⁶⁵ Fund managers pointed to the fact that at least fifty brokerages had started their own money management subsidiaries. If brokers can be fund managers, they argued, what was wrong with fund managers becoming brokers? Institutions grew increasingly

⁶¹ "Important but Not All Powerful," *Business Week*, July 18, 1964, 92-94.

⁶² "Top Exchanges....," *Wall Street Journal*, January 26, 1968.

⁶³ Burk, *Values*, 95.

⁶⁴ Jarrell, "Change," 283; Baxter, "Fixed Rates," 678.

⁶⁵ "Institutions Get a Foot on the Floor," *Business Week*, January 30, 1971, 15-16; "The Jefferies Case: Cracking the Exchange," *Business Week*, October 16, 1971, 73.

displeased with both the Street's commissions and attitude; said the partner of one institution, "the funds have an ax to grind when it comes to the rates they pay just to do business."⁶⁶ But institutional membership carried the threat of both lowering commissions, and taking business away from established brokers. That was a chance the NYSE was not willing to take. Nor was institutional membership the ideal solution from the government's point of view, since institutions might still be trading on their own accounts, and would be difficult to regulate.

The SEC's solution was to move forward with negotiated commissions. The results of discounting volume were enough to convince the SEC that negotiated rates would be a viable alternative to the fixed rate system; at one point the SEC actually considered setting commissions through its own bureaucracy.⁶⁷ The real kick start to SEC action came from the proposed bill on securities reform in Congress. Representative John Moss (D-CA) held hearings on the state of the securities industry beginning in 1971, and battled the Exchange for reforms. Moss was not impressed by the New York Stock Exchange; *Business Week* quoted him, "I'll be damned if I see any sign that these people [the securities industry] want any part of free enterprise."⁶⁸

When rumbles of discontent first sounded from the general direction of the Department of Justice in the early 1960s, the New York Stock Exchange did not pay much heed. If there were any problems on Wall Street, the Exchange would find and implement its own solutions. The question of membership for institutional investors was dismissed summarily by the Exchange's Costs and Revenues Committee. Exchange President Keith Funston communicated the decision on the matter to the membership at large in 1965: institutional memberships did not

⁶⁶ "Institutions Get a Foot on the Floor," *Business Week*, January 30, 1971, 15-16.

⁶⁷ "Wall Street's Taste of Freedom: Competition as Regulator," *Business Week*, March 17, 1975.

⁶⁸ Benn, *Unseen Wall Street*, 136; *Business Week*, April 7, 1975. see www.johnemossfoundation.org

merit serious consideration. The Committee could not conceive that institutional investors would be willing “to subject themselves to the exacting standards to which Exchange members must subscribe.”⁶⁹ Membership was a privilege and an honor, but carried the responsibility of conforming to the Exchange’s self-regulated code of acceptable behavior.

For most of its existence, the NYSE comfortably ignored the illegal implications of fixed rates. Neither members nor clients questioned the policy. The reason for this is that the primary function of brokerages was to offer stocks and raise capital for their corporate clients; most revenues came from underwriting rather than trading. Fixing rates provided an easy method of keeping commissions at what the membership considered a ‘reasonable’ level and helped maintain market liquidity. Commission profits were a side effect of maintaining a market in which underwriters could best function.⁷⁰ Although some members had proposed changes to the system over the years, none were able to convince the Wall Street community to give up the golden goose of fixed commissions. In the 1930s, Paul Shields and E.A. Pierce, managing partners of commission houses, supported reforms that would increase disclosure, which they rightly supposed would increase the public’s confidence in the Exchange and boost volume. In the 1950s, Merrill Lynch experimented with putting stockbrokers on salary, but “the experiment only lasted a decade or so, before the incentives of the commission system became too great and

⁶⁹ Press Release, 1/12/65, Funston to Members and Allied Members re: Additional Recommendations of Costs and Revenues Committee, NYSE Archives, Press Releases, Box 22. Previously president of Trinity College, the “ruggedly handsome” G. Keith Funston was president of the NYSE from 1951 to 1967. Funston is a notable character in the story primarily because he made so few enemies. His primary skills were promoting the Exchange and soothing ruffled feathers. Still, Funston had a sharp grasp of overall market conditions, and had in fact proposed volume discounts in 1952. Members rejected the idea. Benn, *Unseen Wall Street*, 23; Welles, *Last Days of the Club*, 146; Blume, Siegel, and Rottenberg, *Revolution*, 132-33. For more on Funston and Exchange promotion, see Janice M. Traflet, *Spinning the NYSE: Power and Public Relations at the Big Board*, Columbia University Dissertation, 2004.

⁷⁰ Perkins, Edwin J., *Wall Street to Main Street: Charles Merrill and Middle-Class Investors*. (New York, Cambridge: Cambridge University Press, 1999), 68-71.

Merrill Lynch went back to the old ways.”⁷¹ The difficulty of reform was that it never seemed to promise immediate results. Change might be good for the Exchange in the long run, but members did not want to trade the certainty of current profits for the possibility of future gains. Then, too, reform was unnecessary when Funston’s spirited promotions of the NYSE presented a “well-run, public-spirited marketplace” and deflected public attention from the fact that the Exchange was a true price-fixing cartel.⁷² Insider trades and shady deals exploiting member-privileged information were not only permitted but encouraged as one of the benefits, even purposes, of membership.⁷³

Negotiated Commissions

The official position taken by the NYSE in early hearings was that the result of a transition to negotiated commissions would be rate cutting chaos. Without a commission differential between members and nonmembers, the Exchange feared the incentive to become a member would no longer exist. The result would be a loss of trades to the over-the-counter and third markets and a contraction of overall market liquidity. Exchange Chairman Bernard Lasker commissioned a study of the securities industry by William McChesney Martin, a former Exchange president and Federal Reserve Chairman. The Martin report agreed, in tone, with the traditions of the Exchange; the members were pleased with Martin’s conclusions that much should remain the same as always on the Street. But the report did not make an effective counter

⁷¹ Perkins, *Wall Street to Main Street*, 138; Kenneth Lipartito and Carol Heher Peters, *Investing for Middle America: John Elliott Tappan and the Origins of American Express Financial Advisors*, (New York: Palgrave for St. Martin’s Press, 2001), 177.

⁷² Welles, *Last Days of the Club*, 40.

⁷³ Welles, *Last Days of the Club*, 13.

argument against fixed rates; conditions on Wall Street were so bad by the early seventies, and so many firms had gone out of business, that Martin could not argue how fixed rates could possibly make things any worse. The report concluded that fixed rates might not help the Exchange, but that they couldn't hurt.⁷⁴

Members resorted to dire predictions of the failure of the market system in an attempt to get the SEC to back down. The Exchange's own economists recognized that the current system was unsteady at best, and the economic downturn of 1969-70 alerted members forcefully to its fragility, but the Exchange Board insisted that it, not the SEC, should be the entity to enforce the necessary changes, which did not include violating the sacrosanct principle of fixed rates.⁷⁵ But although the Exchange's arguments against a negotiated rate structure did provide an economic rationale for maintaining the current fixed rate system, none could convincingly prove that Mayday deregulation would cause the widespread market failures many members anticipated. Brokers recognized that commission rates would fall if not fixed, promoting greater competition and greater volume.

The crux of the NYSE's argument was that if the market opened to competition too much, the result would actually be a decrease in market efficiency, due to increased differentiation. Decreased liquidity would raise overall stock prices, and investors would be left with "a better commission rate on a worse price." Conversely, if the volume of the market following Mayday was too low, then many brokerages could be forced out of business, which would also decrease liquidity and create a similar situation.⁷⁶ The SEC remained unconvinced of

⁷⁴ Welles, *Last Days of the Club*, 100-107.

⁷⁵ *Wall Street Journal* and *Business Week*, 70-71; See Benn, *Unseen Wall Street*, especially the F.I. DuPont-Glore Forgan near collapse of 1970.

⁷⁶ "American brokers: Mayday on May Day?" *The Economist*, April, 26, 1975.

the evils of negotiated rates. Scholars of the subject argued that the stock exchange was not a natural monopoly; it was a cartel operating as a monopoly. If commissions were allowed to fluctuate, many firms would likely go out of business, having been sheltered by artificially high commissions, but the resulting industry would be stronger and better serve investors.⁷⁷

Despite a vocal opposition to deregulation, the Exchange's arguments against negotiated rates were weakened by inconsistencies in its position on the matter.⁷⁸ When the wrangling over how to pacify the SEC first began, some members saw the inevitability of negotiated commissions. Donald T. Regan, then Chairman of Merrill Lynch, saw the absurdity of continuing the fixed rate system: "Wall Street is hiding behind a protective pricing system while it preaches capitalism and free markets. This is like catching Carrie Nation tipping in the basement."⁷⁹ I.W. Burnham, II, the head of Drexel, Burnham, took the opposite view: "This industry isn't ready for competitive rates. The effect would be disastrous. I don't think the Exchange would survive six months." . . . "When you start competing on price it'll be a dog-eat-dog battle. It'll be a cutthroat survival-of-the-fittest kind of thing. The big firms will get bigger and put everyone else out of business. It'll be awful."⁸⁰ The commission problem came to symbolize a deep-seated philosophical divide on Wall Street, between those who wanted to preserve the Exchange as it had always been and those who saw a need to change with the times

⁷⁷ New York Stock Exchange, *Economic Effect of Negotiated Commission Rates on the Brokerage Industry, the Market for Corporate Securities, and the Investing Public*, 1968, and *The Economics of Minimum Commission Rates, Reply to Memorandum of the Antitrust Division of the Department of Justice*, January 17, 1969, NYSE Archives; see Baxter for a thorough rebuttal of the NYSE position.

⁷⁸ See Senator Harrison Williams's complaints on the matter, esp. press releases of 1973, Williams Papers.

⁷⁹ Perkins, *Wall Street to Main Street*, 138; Lipartito & Peters, 177; Carson-Parker, *Business Week*, April, 21, 1975.

⁸⁰ Welles, *Last Days of the Club*, 5.

in order to maintain a dominant position in American securities markets, a position they saw rapidly slipping away.⁸¹

The Old Guard on the Street wanted to maintain their virtual monopoly, and espoused the view that the Exchange, as a self-regulatory organization of professionals, was in the best position to determine how the market should be run. The guiding presence of the Exchange kept things running smoothly; the party line was that true competition was ‘not in the public interest.’ But many on the Street, shaken by first the paperwork crisis and then by the severe volume drop and accompanying failures of 1970, saw the commission problem as a chance to alter the rigid club structure. The argument in favor of deregulation, among financial professionals, was that “the secrecy and exclusiveness that had prevailed in Wall Street circle for decades had been fundamentally self-defeating because they had unduly restricted the size of the pool of investors.”⁸² The bailouts thinly disguised as mergers, and the growing evidence that NYSE oversight was inadequate caused the press to call for greater transparency from the securities industry. Sheer size meant the club structure was no longer quite so trustworthy: “When the financial community asks 31-million investors to trust it in handling their funds, it is not enough for its members to be gentlemen. They must be financially responsible gentlemen, and they must be prepared to prove it.”⁸³

The Exchange’s internal conflict had become glaringly visible after the presidency passed from the likeable Keith Funston to Robert Haack in 1967. Bob Haack was chosen to succeed Funston because of his proven record in negotiating with the SEC; however, he had done so not

⁸¹ Sobel, *NYSE*, 334.

⁸² Sobel, *NYSE*, 332; Perkins, *Wall Street to Main Street*, 173.

⁸³ “Stop the Cover Up,” *Business Week*, August 29, 1970, 84.

on behalf of the NYSE, but in his previous position as president of the National Association of Securities Dealers (NASD). Haack was a professional financier, with an MBA from Harvard and years of experience as part of the NYSE, but he had gained a new perspective from his time at the NASD. Haack's objective was to make the NYSE the best securities market, and he came to realize that changing the status quo was necessary to achieve that goal. This put Haack in direct opposition to the one other person most respected as a spokesman for the Exchange, Chairman of the Board Bernard, "Bunny," Lasker.⁸⁴

Bunny Lasker was a champion of the traditions of the Exchange. He began his career as a runner for a modest-sized Jewish brokerage, Hirsch, Lilienthal & Co., in 1928 at age seventeen. Although he never attended college, he worked his way to a partnership in Kaufmann, Alsberg & Co. before the age of thirty. Lasker became a partner at E.H. Stern & Co. in 1947, transforming it eventually into a highly profitable specialist firm, Lasker, Stone & Stern. An ardent Republican, he was a key fundraiser for Richard Nixon and counted the president as a close friend. Lasker loved the Exchange, for its sense of brotherhood and belonging as much for any financial profit. Bunny Lasker was part of the inner circle of the Street in a way Bob Haack was not and could never be.⁸⁵

In many ways, Haack was the opposite of Lasker; Chris Welles portrays him as introspective, righteous, and internally tormented by the conflict between his own opinions and the official Exchange views. Haack's career had taken him outside the Exchange environment, both geographically and psychologically. He was also a Liberal Democrat, an unusual position

⁸⁴ *Wall Street Journal* 4/26/67; *NY Times* 4/22/67; *Wall Street Journal* 4/20/67; *NY Times* 9/17/67; Box 23, PR, NYSE.

⁸⁵ Benn, *Unseen Wall Street*, 5, 13, 124; Welles, *Last Days of the Club*, 18; Gordon 276-77; Sobel, *Inside*, 178.

for anyone associated with the Street. Through 1968, Haack kept to the party line, giving a spirited defense of the fixed rate system at Congressional and SEC hearings.⁸⁶ Congress was investigating on behalf of the individual investors, and Haack argued that negotiated commissions could lead to higher investment fees for individuals. Haack was a realist, though, and in his remarks to the 2nd Annual Institutional Investor Conference in January, 1969, the president of the Exchange suggested that the securities industry, if left to its own devices, would have likely ended the fixed rate system on its own in time.⁸⁷

This was exactly the sort of remark that made Chairman Lasker uneasy, because it confused Congress and the general public. He knew that they often neglected to remember that strange sort of dominance that the Exchange saw as its right to control its own affairs. The principle of self-regulation was so ingrained in the securities community that, even when explicitly questioning it, it was still a countervailing force underlying all decisions. There could be conflict over how those decisions should be made, but no one questioned the idea that it was the Exchange itself that was most qualified, indeed, one could even say ordained, to make the decisions. But then Bob Haack stunningly did exactly that, in a speech to the prominent businessmen of the New York Economic Club on November 17, 1970. He openly agreed with the recommendations of the SEC for fully negotiated rates. This was a startling pronouncement from the President of the NYSE, but Haack took a step further out of line when he declared that “whatever vestiges of a private club atmosphere which remain at the New York Stock Exchange must be discarded.”⁸⁸ This was “heretical blasphemy” to most members and to Lasker in

⁸⁶ *Washington Post* 1/3/68; *Wall Street Journal* 1/26/68; *Washington Post* 8/20/68; *NY Times* 8/20/68; *NY Times* 12/31/68.

⁸⁷ *LA Times* 1/8/69; *NY Times* 8/27/69; also NYSE archives Haack speech 1/22/69.

⁸⁸ *NY Times* 11/22/70.

particular. Haack was challenging not only the incomes of the brokers, but also their way of life, and their political power. After the speech, Haack was not asked to resign, as this would have created unpleasant publicity, but he did spend increasingly more time at his home in Maryland. When his contract ended in 1972, the Exchange threw him a polite farewell dinner, according to tradition, and hired a new president who was willing to learn from Haack's unfortunate example.⁸⁹

The Exchange's new leader, James Needham, stood firmly in line with the Wall Street traditionalists. Young and aggressive, the former SEC member was a good choice to fight the good fight; he denied absolutely that "allegedly high commission rates" were in any way inhibiting individual investors. Individuals were staying out of the market, but the reasons, Needham said, were dissatisfaction with market trends and a sense of unease caused by disruptions in international economic conditions.⁹⁰ By the end of 1973, though, Exchange members saw the writing on the wall; Needham's inflammatory rhetoric may have slowed the process, but the SEC was standing firm on its deadline for deregulation, May 1, 1975.⁹¹ The efforts of Congressman John Moss and Senator Harrison Williams, the Securities Acts Amendments, were following hard on the heels of the SEC, so any delay the NYSE could have obtained would have been of short duration.

Good market conditions of early 1975 allayed some fears about negotiated rates, but Exchange members were not prepared for the full force of free competition, having never truly

⁸⁹ Welles, *Last Days of the Club*, 16-21; Benn, *Unseen Wall Street*, 128; Sobel, *NYSE*, 333-38.

⁹⁰ *NY Times*, 5/16/76; Needham Remarks at Luncheon of the Boston College Alumni Association, NYC, June 5, 1973: O'Donohue Papers, Box 41, Folder 2, NYSE archives.

⁹¹ Series of letters between SEC and NYSE, primarily those from 72, NYSE archives

experienced it before. The Street was very nervous, with some expecting that rates would fall through the floor, driving brokers “out of business in droves.”⁹² Insecurities about whether the industry could maintain itself without fixed commissions erupted into what the *Wall Street Journal* called a “two-fisted bare knuckles brawl.”⁹³ As soon as brokers realized that plentiful volume would prevent the full effects of Mayday from appearing instantaneously, they began to worry about the future. The results of deregulation could take years to become fully apparent, and could bring losses of hundreds of millions of dollars.⁹⁴

May 1 fell on a Thursday in 1975, and the week ended without a precipitous drop in commission rates. Goldman Sachs had circulated their internal estimates of a maintainable discount of 8% (the “Goldman Guidelines”), and the upper echelon of brokerage houses managed to hold the line reasonably well through Friday. Top tier firms kept to “realistic” discounts of between 8% and 15%. On Monday, May 5, however, the discounts began to fly. As one broker put it, “the whores are coming out of the woodwork.” By the end of the week the Street was involved in a full-blown price war. Discounts on commissions ranged from 45% to 80%. And by the end of May, “Wall Street brokers found themselves blasting away in a full-scale price war.” Some aggressive discounters were offering up to a 90% rate cut.⁹⁵ The older, larger firms tried to hold back the rising tide of discounts by refusing to lower their own rates

⁹² *Business Week*, May 5, 1975.

⁹³ “Wall Street: the Bulls,” *Newsweek*, April, 14, 1975; John Carson-Parker, “Wall Street’s Great Non-Event of 1975,” *Business Week*, April 21, 1975; “Competition Bites Wall Street Brokers,” *The Economist*, May 31, 1975; Welles, x.

⁹⁴ *Business Week*, May 26, 1975. The conservative initial estimate was \$300M, which is over \$1.2B adjusting for inflation.

⁹⁵ Welles, *Last Days of the Club*, 119-20; “Commission Rates Keep Tumbling Down,” *Business Week*, February 26, 1975; David Pauly, Pamela Lynn Abraham and Rich Thomas, “Securities: War on the Street,” *Newsweek*, June 9, 1975.

below what was “reasonable.” One rumor was that Morgan Stanley would blackball any firm that cut rates below the guidelines. But turning away business produced such a loss that by the end of the month every firm had to join the fray. Oppenheimer circulated an industry-wide memo, announcing its intention to use whatever rates necessary in order to maintain its share of the market; this announcement by one reputable firm was enough to convince the rest. The atmosphere on the Street was one of open conflict; brokers refused to publicize their own rate-negotiating platforms for fear of being undercut, but were rabid to discover the policies of their competitors. With the “smoke and dust of battle . . . hanging heavy over the field,” the true levels of commission discounts were incredibly difficult to pinpoint. At the end of May, losses to exchange members were estimated at \$25 million.⁹⁶

Member firms that had specialized in research services raised their fees to cover their commission losses, but the proliferation of discount houses meant that few institutions were willing to pay those fees, and institutions accounted for 75% of trading volume in early 1975.⁹⁷ Many firms went out of business, and brokers scrambled to find work; “Wall Street is going through one of its greatest personnel shuffles in history, the clearest sign yet that fully negotiated commission rates have hit the industry very, very hard.”⁹⁸ Gradually, members accepted that negotiated rates were pushing the market to equilibrium by lowering the artificially high

⁹⁶ “Competition Bites Wall Street Brokers,” *The Economist*, May 31, 1975; “Commission Rates Keep Tumbling Down,” *Business Week*, February 26, 1975; Chernow, *Morgan*, 602; Welles, *Last Days of the Club*, 120. Jarrell, “Change,” 280: mean commission reduction of 25%, after commission had continuously risen for the previous 40 years

⁹⁷ Blume, Siegel, and Rottenberg, *Revolution*, 105.

⁹⁸ Welles, *Last Days of the Club*, 3, 75; “Research Specialists Scramble to Survive,” *Business Week*, August 18, 1975. The investment industry suffered outside the Street as well. Much of the volume on smaller regional exchanges was the result of investors’ attempts to circumvent the New York Stock Exchange’s fixed rates; Bob Baldwin’s prediction that between 150 and 200 regional firms would fail as a result of Mayday turned out to be a low forecast, see Welles, *Last Days of the Club*, 85 and Chernow, *Morgan*, 602.

commission rates created by the reciprocity competition systems. The choice for the future was between high quality offerings at high prices or high quantity offerings at low prices. “The only way to recoup the discounts on institutional commissions is to increase market share,” said Peter T. Buchanan, executive vice-president at First Boston Corp. “To do that, you’ve got to have a very strong research and execution capability.”⁹⁹ The research provided by the Street was intended for institutions rather than individuals, though, and was very expensive to produce. Without commission profits, many brokerages could not afford to maintain their level of research services; back office researchers and staff economists were fired in huge numbers. The only viable method of business after Mayday was through increasing trading volume, but the Exchange needed to find a way to both restore the research capabilities institutions expected and boost overall volume.¹⁰⁰ Brokers were forced to expand the market for research services by offering to share information, and the costs to produce it, with individual investors, who had previously lacked access to the sort of information required for successful investing.¹⁰¹

One year after Mayday, volume was maintaining the revenues of larger brokerages, but “the swing to negotiated rates (was) making life hell for many medium-sized brokerage houses that are finding it hard to get their volume high enough to offset the lower commissions.”¹⁰² With regular but flat commissions secured from institutional investors, the Exchange increased

⁹⁹ “Research Specialists Scramble to Survive,” *Business Week*, August 18, 1975.

¹⁰⁰ Burk, *Values*, 119; Walter, *Deregulating*, 1; *Business Week* May 26, 1975 and August 18, 1975.

¹⁰¹ John Carson-Parker, “Wall Street’s Great Non-Event of 1975,” *Business Week*, April 21, 1975, 114. “American Brokers: Mayday on May Day?” *The Economist*, April 26, 1975, 118; “The Bulls Trample May Day Worries,” *Business Week*, May 10, 1976, 88. Press Release May 14, 1973, Box 1254, HAW Collection, Rutgers Special Collections; Ronald C. Lease, Wilbur G. Llewellyn, and Gary G. Schlarbaum, “The Individual Investor: Attributes and Attitudes,” *The Journal of Finance* 29.2 (1974): 413-433.

¹⁰² “The Bulls Trample May Day Worries,” *Business Week*, May 10, 1976, 88; William Wolman, “Interest Rates Signal a Rise in Confidence,” *Business Week*, March 1, 1976.

its attention to pre-existing programs to sponsor individual investment. The challenge of increasing individual participation on the Street was compounded by the fact that brokers were accustomed to dealing with a very particular kind of individual. While individual investors dominated the stock market until well after WWII, they could not be called 'typical' Americans. Their social characteristics were such that they belonged in the world of investment, and did not question the decrees of the Street. According to a study by the Wharton School, over half the individually owned stock in 1971 was owned by the top 1% of the population, whose annual incomes were greater than \$50,000.¹⁰³ The results of a study of individual investors by Lease, Lewellen, and Schlarbaum in 1973 reach a similar conclusion. Investors were "heavily male, relatively old, and reasonably affluent." The most telling result of this study, however, was the attitude toward investing displayed in the results of the study's questionnaire. Individuals, they found, "invest in common stocks to the virtual exclusion of everything else, with any funds they have left after satisfying their family's core living needs; the ratings suggest that the survey group's passion for direct market participation has its origins in considerations of fun as well as profit."¹⁰⁴ If individual investors, then, did not seem to care about commission rates, and were investing as much for the fun of speculation as for any deeper motive, how were brokers to convince them to invest more, and how were they to find new individuals willing to 'play' the market?

¹⁰³ Calder, *Financing the American Dream*, 124; Welles, *Last Days of the Club*, 33. \$50K in 1971 is approx. \$270K adjusting for inflation.

¹⁰⁴ Lease, Ronald C., Wilbur G. Lewellen, and Gary G. Schlarbaum, "The Individual Investor: Attributes and Attitudes" in *The Journal of Finance*, Vol. 29, No. 2, Papers and Proceedings of the Thirty-Second Annual Meeting of the American Finance Association, New York, New York, December 28-30, 1973 (May, 1974), 417, 430-431.

In order to convince regular Americans to invest, the Exchange could fall back on a lure it had used before with limited success: retirement preparedness. But Wall Street faced the challenge of overcoming its own negative reputation.¹⁰⁵ The combination of negotiated commissions and the new regulations coming with the Securities Acts Amendments would not be adequate to draw individual investors into the stock market; consumer ambivalence cannot be resolved by regulation alone. Money has long been an inextricable part of the American concept of good character. From Victorian times, morality was displayed through the virtues of frugality and thrift. But opposition to the vice of gambling formed the typical American attitude toward the stock market.¹⁰⁶

Wall Street's public image as a risky, irresponsible, and potentially dangerous place was a relic of the mid-1800s, when the Street frequently was vilified by the popular press. Society there was "rotten to the core."¹⁰⁷ According to the *South-Side Democrat* of Petersburg, Virginia, a young man became a broker "When he became too lazy to work on the farm and had not yet learned to steal, he yielded to the instincts of his organization, and left home to try his fortunes in New York." There he could make his fortunes through "petty frauds" and "confidential" lies. His "unrivalled rascality" provided him with a good life and a nice house for "his wife and flashy

¹⁰⁵ Kynaston, *The City*, 19-20.

¹⁰⁶ "By the late 1930s, millions of Americans, probably the majority, were convinced that any investment in common stocks was closely akin to gambling; that is, persistent losses were the likely outcome for all except the unusually knowledgeable and lucky." The outcry for reform during the Depression was the result of the public's perception that stockbrokers made money by selling investors 'bad' securities for commissions and then profited when stock prices dropped. When stock prices began to rise after 1932, and even with the panacea of the SEC, "the reputation of stockbrokers remained somewhere on a par with used car salesmen." Burk, *Values*, 4; Calder, *Financing the American Dream*, 87; Lipartito & Peters, 113; Perkins, *Wall Street to Main Street*, 9-11, 148.

¹⁰⁷ "Picture of a Wall Street "Operator", *South-Side Democrat* (Petersburg, VA) July 16, 1854 .

girls, who will marry for convenience, and love for pleasure.”¹⁰⁸ *The Illinois State Register*

declared that gambling was the same whether carried on in brokers’ shops or oyster cellars. The amounts differed, but

...it is a difference of reputability rather than of principle. In one respect, the advantage is decidedly in favor of the oyster cellar; the gambler there bets money that he actually possesses and very possibly has earned; if he loses he pays, and is very thankful that the police let him alone; but the Wall street gambler bets hundreds of thousands of dollars – no one know how many – that he has not and never had; so if he wins and the loser can pay, he is complimented as a sagacious and successful operator, and buys a couple of blocks of stores with the proceeds; while if he loses and can’t pay, he simply stops, and lets the winners whistle for their money.¹⁰⁹

Writing on the subject of speculation in 1896, Henry Crosby Emery lauded the New York Stock Exchange’s tradition of privacy, “the settled policy of the Exchange to keep its affairs as secret as possible, to attend strictly to its own business, and to resent any interference from without.”¹¹⁰ Emery acknowledged that the NYSE did not seem to be subject to the law in the manner of other businesses, but to him this was evidence of the ability of private actors to satisfy public demands. He proposed that speculation was not at all the same thing as gambling. Gambling, in his view, created winners and losers, but in the case of speculation one man’s gain was not necessarily offset by the loss of another.¹¹¹

¹⁰⁸ “Picture of a Wall Street “Operator”, *South-Side Democrat* (Petersburg, VA) July 16, 1854 .

¹⁰⁹ Jacob Little, the Broken Broker” *Illinois State Register*, Dec 13, 1856
<http://www.nytimes.com/1865/04/01/news/funeral-of-mr-jacob-little.html> (7/29/13) NY Times
Obituaries: Funeral of Mr. Jacob Little April 1, 1865 “well-known broker and financier” born March 17, 1794, died March 2, 1865 service at Grace Church

¹¹⁰ Henry Crosby Emery. *Speculation on the Stock and Produce Exchanges of the United States*. New York: Columbia UP, 1896. 16.

¹¹¹ Emery, *Speculation*, 98-100.

The general public's prejudice against Wall Street was based in part on ignorance of how the investment market actually operated. However, there was some truth to the comparison between gambling and investing. The Exchange is a marketplace for speculation, and every activity on the Street involves some degree of risk. Brokers behaved accordingly. The culture of the club was a fertile breeding ground for a culture of gambling. Brokers had "varying ethical standards in regard to customer relations."¹¹² Many customers distrusted the advice of their brokers, to the extent that they would refuse to leave securities on deposit with a brokerage house for safekeeping. Brokers would call clients pushing hot stock tips in much the same way bookies would call their regulars with hot horse race tips, for example. By the early seventies, though, the new phrase that substituted for "stock tips" was "financial planning."¹¹³

A specific conundrum of the club structure of the NYSE was the concept of advertising.¹¹⁴ Advertising was regarded as attempting to steal customers from fellow members, and for decades had been seen as the height of unethical behavior. Any individual or corporation that needed to do business on Wall Street should be personally connected with one of the brokerages, or should have a reference from an existing client or member. Public ignorance about the workings of the Street kept the system running smoothly.¹¹⁵ The only acceptable method of self-promotion for many years was the tombstone, the public announcement of stock

¹¹² Perkins, *Wall Street to Main Street*, 69. DC

¹¹³ Perkins, *Wall Street to Main Street*, 9; Welles, *Last Days of the Club*, 34.

¹¹⁴ See Traflet dissertation and EBHS articles, particularly Janice M. Traflet and Michael P. Coyne, "Ending a NYSE Tradition: The 1975 Unraveling of Brokers' Fixed Commissions and its Long Term Impact on Financial Advertising," *Essays in Economic and Business History*, Vol. XXV, 2007, 131-141: importance of *Bates v. State Bar of Arizona*: the Supreme Court ruled that professional bans on advertising are a violation of free speech.

¹¹⁵ Walter, 57; Welles, *Last Days of the Club*, 12.

offerings that appeared in the Wall Street Journal. The names of brokerages responsible for underwriting a stock appear in order of importance; this is how public reputations were built.¹¹⁶

Brokers did have two facts working in their favor. Greater dissemination of research information could reassure individual investors that they were making rational business decisions when investing.¹¹⁷ Also, Exchange members could convince individuals that investing was a prudent financial decision by pointing to the market's long run average return of approximately 10%.¹¹⁸ Retirement was the brightest, if not the only, possibility for the long term success of Wall Street. Every American would need money at some future date in order to retire. Charles Merrill's early goal in educating middle-class America about the process of investing was to convince people to move their retirement savings from life insurance policies and low-return savings accounts to blue-chip stocks.¹¹⁹

Retirement had become a harder sell in the decades since Merrill began promoting it. Individuals trusted the pension plans of their employers, which were managed by banks and other institutions. In addition, the prevailing social philosophy in the 1970s did not encourage personal provision for the future. Many brokers feared the growth of the welfare state would transform the act of saving money into a "luxury" for the rich.¹²⁰ Harry Keefe, president of Bruyette & Woods, testified before the Subcommittee on Securities in 1974 that any growth in the desire for personal savings would be directly transmitted to the institutional investor, rather

¹¹⁶ Chernow, *Morgan*, 623. For example, the Great Alphabet War of 1976.

¹¹⁷ Walter, *Deregulating*, 10; "The Bulls Trample May Day Worries," *Business Week*, May 10, 1976.

¹¹⁸ Check citation convention.

¹¹⁹ Perkins, *Wall Street to Main Street*, 207.

¹²⁰ Welles, *Last Days of the Club*, 26-33.

than to the securities market, because of “the basic economic structure of our country.” Said Keefe, “I don’t need to save for sickness and I don’t need to save for education.” “We have a social philosophy that does this. . . . I submit that the individual investor no longer has incentives he had twenty years ago to participate in the market. He no longer has the incentive to save for retirement. His company is doing that for him.”¹²¹ Keefe was correct about the expansion of pension coverage; in 1975 more and more people were being covered by corporate retirement plans, and they were retiring earlier and demanding greater benefits than ever before.¹²²

But corporate pension plans were undergoing a reformation of their own, one which would ultimately work to the advantage of both Wall Street and institutional investors. The Employee Retirement Income Security Act of 1974 for the first time imposed federal regulation on private pensions. Pension plan sponsors reacted by shifting more of the investment responsibility to their employees, in a move to bypass ERISA’s stricter provisions. The NYSE survived Mayday by embracing a new role as the primary mechanism for individual retirement investment. At the same time, the stronger survivors of Mayday consolidated their institutional relationships, further confirming the dominant role of the NYSE in American retirement planning.

¹²¹ Sobel, *NYSE*, 372.

¹²² Welles, *Last Days of the Club*, 26.

CHAPTER IV

Congress Achieves Meaningful Pension Reform

“I got cheated but it was done legally – and the only way we can correct these things is to have the laws changed around to protect the workingman,” John McMaster, laid-off at the plant closing of Baldwin-Lima-Hamilton Corporation.¹

Pension reform became necessary in the mid-twentieth century for two reasons. The first was that the concept of the retirement pension changed, from a gift in return for loyal service to deferred compensation. Employees increasingly demanded a pension adequate to maintain the same standard of living they had enjoyed while working, but many businesses could not provide that. Some scholars have argued that the first comprehensive federal pension legislation, the Employee Retirement Income Security Act of 1974 (ERISA), was truly the result of altruistic motives, and this is partially true. Congress did want to help the nation’s elderly. However, there was a larger, perhaps more practical, reason why pension reform was necessary. Pension funds represented a huge sum of money, which was not subject to existing legislation. The amounts, and their method of investment through financial institutions, threatened to destabilize not only financial markets but possibly the economy as a whole.

The process of achieving reform was not easy, because many in the business community did not want to change the existing system. Some unions, too, feared that new regulation would hamper their ability to bargain with management. The two senators primarily responsible for ERISA, Jacob Javits and Harrison Williams, cleverly built a campaign for reform by reaching

¹ Testimony before the Senate Subcommittee on Labor, of the Committee on Labor and Public Welfare, July 17, 1972, Philadelphia, PA; Private Welfare and Pension Plan Study, part 3, page 1116.

out directly to the public. By holding their hearings on location, instead of in Washington, and by shaping media coverage of retirement issues, they built a grassroots base of support – albeit from the top down. Their success was due in part to the way they presented the issue. Instead of treating retirement pensions as an instrument of labor relations, they shaped the pension into a consumer problem, one in which the nation’s elderly were defrauded by pension failures. The media played up the social perspective; instead of a union worker being shortchanged, a failed pension plan meant someone’s grandfather might have trouble affording food or heat. Even with the public outcry, ERISA might not have passed without very fortunate timing. The law was long and complicated, the product of years of study, and many Congressmen could not spare the time to understand it thoroughly. Congress turned its collective attention to the Watergate scandal and impeachment hearings, which allowed ERISA to pass with relatively little fuss.

ERISA touched on nearly every aspect of the traditional defined benefit pension plan structure. The law settled questions of ownership, transportability, and responsibility. Its authors, and the experts they consulted, predicted that such pensions would become a standard feature of business, the new normal. Their regulation would insure that these pensions operated responsibly and paid as they promised. But Congress underestimated the corporate reaction to the added costs and risks ERISA brought to operating a traditional pension. Nor did they realize how changes on Wall Street were simultaneously affecting retirement investing. Many businesses changed their plans to defined contribution, which were both exempt from many of ERISA’s provisions and transferred the investment responsibility to individual employees.

By the late 1960s, economic conditions were right for private pensions to become truly multi-use financial instruments, able to achieve dual goals of retirement security and profitable

rates of return. Stable economic growth and positive returns on equities provided a perfect scenario for expansion of the nation's private pension system.² Moreover, more and more people were retiring, only to discover that Social Security was inadequate to maintain their lifestyles. Unfortunately, many people also discovered that their company-sponsored pensions provided less than anticipated and in some cases nothing at all.³

Congress recognized that retirement had become a collective social promise, and that Americans had nowhere to turn when that promise was broken. Although reform efforts had been underway since the 1962 appointment of a Presidential committee to study American private pension and welfare systems, Congressional reform attempts did not gain traction until Senators Harrison Williams and Jacob Javits began to publicize stories of pain and disappointment revealed in their hearings on pension plan failures. The refashioning of the pension from a problem of labor relations to an issue of social welfare and consumer fraud enabled the 1974 passage of the nation's first comprehensive retirement legislation, the Employee Retirement Income Security Act (ERISA).⁴ While ERISA failed to become the all-encompassing safety net its creators envisioned, the passage of such broad legislation was remarkable in the face of the initial skepticism and outright opposition from not only big

² Carolyn L. Weaver, *The Crisis in Social Security: economic and political origins* (Durham, N.C.: Duke University Press, 1982), 47-8.

³ Greenough and King, *Pension Plans and Public Policy*. 1976. 4-5: in 1900 4% of the population was age 65 or older (3.1 million); in 1970 the figure was 10%, 20 million people.

⁴ P.L. 93-406, 88 Stat. 829 (Sept. 2, 1974). ERISA is codified at §§1001 to 1453 of title 29, United States Code and in §§ 401-415 and 4972-4975 of the Internal Revenue Code; see extensive literature on the pension as a promise

business and Congressional conservatives, but also many within both organized labor and the pension industry.⁵

Put simply, ERISA's stated intent was the preservation of retirement benefit rights for workers covered by private retirement plans. The challenge for meaningful reform of the private pension system was that it had become exactly that – a system, an institution within the context of the national economy, consisting of billions of unregulated dollars. Throughout the late 1950s and 60s, many retirement plan sponsors changed the financing structure of their plans from insurance annuities to investment funds. More pensions took large equity positions, contributing to the explosive growth of institutional investment in the late sixties.

At the same time, retirement had become an intensely personal and individual experience. When money set aside for pensions was used in other ways; when pension funds failed; or when promised returns never materialized, those who suffered were individual American workers. The public concept of security for the aged had become synonymous with the private ideology of retirement. As the right to an enjoyable retirement became an extension of the right to an “American standard of living,” federal pension regulation became not only legitimized but required.⁶ Reformers turned this dichotomy to their advantage, mobilizing popular support to influence policymaking. The resulting legislation, ERISA, attempted to resolve an individual problem within an institutional context, to regulate and direct the growth of a massive economic institution.

⁵ Cite Schieber in Gale, et al here; I use the term “pension industry” here to refer to those banks, insurance companies, and actuarial firms active in pension management and investment.

⁶ Meg Jacobs, *Pocketbook Politics*, 5; 8. Postwar Americans fully absorbed the Keynesian idea that thrift was no longer a virtue. See Robert Collins, *The Business Response to Keynes, 1929-1964*.

The Studebaker automobile company declared bankruptcy in 1963. This was not wholly unexpected. The company's flagging performance in recent years created expectations that it would likely either go bankrupt or let itself be acquired by a competitor. The failure of the Studebaker pension plan, though, was a shock to the American public, an "instant national scandal," bringing to light the flaws inherent in the private pension system.⁷ The uproar came from the fact that Studebaker's pension funding methods met all the legal requirements for private pensions. The Studebaker plan followed all the accepted practices for fund investment, and was in many ways a model plan, yet the pension still failed. At termination, the plan was short by fifteen million dollars. Retirees and the retirement-eligible over age sixty received their full pension, but vested employees under sixty received a payment worth only fifteen percent of their pension entitlement and non-vested employees received nothing. Roughly 7,000 workers were left unemployed, with little or nothing to show for decades of service.⁸

Another reason why the Studebaker failure surprised the nation was because it was one of the plans of the United Auto Workers. UAW pensions were highly regarded by the public, and thought to be secure.⁹ For the most part this was true, if only because companies as large as Ford or General Motors were financially strong and unlikely to escape strict union oversight. Collective bargaining between Studebaker and the UAW Detroit Local #5 crafted the company plan in accordance with union standards. The UAW, however, was not unaware of the

⁷ Steven Sass *The Promise of Private Pensions*. 203.

⁸ Wooten, "The Most Glorious Story of Failure," 731.

⁹ Sass, *Promise*, 183-84.

shortcomings of its pensions.¹⁰ By the time the Studebaker failure hit the national press, the United Auto Workers were prepared to use the situation to gain political capital.

The UAW had begun planning a proposal for federal insurance of pension plans several years earlier, after Studebaker acquired Packard and was forced to eliminate the Packard pension when its plant closed. The Packard closure left UAW officers scrambling for a solution. By the time Studebaker folded, they were ready to capitalize on the publicity. Union actuaries coordinated with Indiana Senator Vance Hartke to create “The Federal Reinsurance of Private Pensions Act” in 1964.¹¹ The bill died, mainly because it did a better job of presenting the problem than proposing a workable solution. But it served its purpose: to put pension reform in the public eye.

In the case of defined benefit plans like the UAW’s, the amount of the pension payment to retirees was predetermined. Every plan participant knew from the time of entry into the plan what the monthly payout would be upon retirement. Actuarial calculations helped determine how many years retirees could be expected to live and how long they would need to be paid. The problem for employers was that an employee starting in the plan at age forty-five could be expected to live the same length of time in retirement as an employee who began at age twenty-five. The employer needed to put aside the same amount of money for the older employee, but had twenty fewer years in which to do so. The amounts necessary to put aside to ‘catch up’ all of a company’s older employees constituted the pension plan’s past service liability. Businesses

¹⁰Sass, *Promise*, 185-87.

¹¹ Wooten, “The Most Glorious Story of Failure,” 734-735; Sass, *Promise*, 207; Fortune Sept 1964: “LBJ’s Romance with Business.” Note on terminology: pension reform literature refers to both insurance and reinsurance with regard to pensions, but the meaning is the same – money available in case something happens to the pension plan. Since pensions were considered to be a form of old-age insurance, and because funds were often invested in insurance company annuities, insurance on them was technically reinsurance. However, this is an unwieldy explanation, so reformers dropped the “re.”

faced the problem of providing pensions covering decades of employees' past service to the company.¹²

Paying for past service liability presented a significant challenge to most pension plans. This past service liability could be a sizeable sum; the liability for U.S. Steel was estimated at \$560 million in 1950.¹³ No company could afford to set aside such an amount, even if funds were readily available. Common practice was to amortize this amount over a period of decades, in a similar manner to paying off a mortgage. The UAW insisted on "full funding," requiring an annual payment of normal costs plus amortization of past service liabilities, with a maximum period of 30 years to pay off past service.¹⁴ But very often pensions were negotiated on the basis of "sound" funding, as opposed to "full" funding.¹⁵ As long as the past service liability was scheduled to be amortized over a "reasonable" period, both sides were satisfied.

The advantage of paying less toward the past service liability was that more of the employer's contribution could be directed toward current benefit payments. When unions negotiated for higher current benefits, employers could agree to their demands by increasing the length of time over which the past service liability was amortized. The pension plan could provide higher payments to current retirees by reducing its accumulations on behalf of younger

¹² The federal government tried to avoid this problem by collecting Social Security taxes for several years before it began making payments. This lessened the problem but did not eliminate it.

¹³ James A Wooten, *The Employee Retirement Income Security Act of 1974: a political history* (Berkeley and Los Angeles: University of California Press, 2004), 58.

¹⁴ Sass, *Promise*, 136.

¹⁵ Full funding does not mean that all the money is available to pay all of the expected pension commitments; rather, it means that accounting arrangements have been made that will insure that those commitments are met in future based on a set of actuarial assumptions. The term "sound funding" is more an indication that the money within the pension fund is being treated in a responsible manner, so that every year's current benefits are able to be paid. The difference is "we are paying this debt off in x years" versus "we have a plan to pay off this debt eventually, we promise."

workers. With this method, the union could show an immediate increase in benefits, and the employer would not have to increase his overall pension expenditures. Re-amortizing pushed any funding deficit into the future. The pension might be short of funds, but the problem would not be evident to retirees or shareholders until thirty or forty years in the future.

Because of the desire to increase current benefits, the UAW did not include vesting provisions in its plans until 1955. Vesting is a means of securing ownership of pension funds. An employee has a legal right to the total amount of his pension once he becomes fully vested. Professor Dan McGill, founding director of the Pension Research Council at the Wharton School and arguably the nation's preeminent pension scholar, defined vesting as "protection of accrued benefit rights of pension plan participants against forfeiture from failure to continue a given employment status or relationship."¹⁶ In a situation with limited funds, better vesting provisions means lower immediate benefits. If the funds set aside for employee pensions legally belonged to those employees, i.e., if the employees were fully vested, then the company would be unable to 'borrow' funds earmarked for younger employees to increase the benefits of those in or nearing retirement. Any negotiated increase in benefits would require more direct contribution on the part of the employer, which would make employers much less likely to accede to union demands for increases to current benefit payments.

Full vesting went against the UAW's vision of the purpose of pensions. On one hand, pensions certainly were intended to help support workers after they retired, but their more important purpose was to encourage workers to retire in the first place. Following World War II, America's factories were dominated by older workers who had been there throughout the war. In a system where seniority took precedence, younger workers had no opportunity to advance.

¹⁶ Dan M. McGill, *Preservation of Pension Benefit Rights* (Homewood, IL: Irwin, Inc., 1972), 1; Klein, *For All These Rights*, 260-1; Javits, *Autobiography*, 379.

One of the primary goals of union pensions, and, indeed, of unions themselves, was to encourage the retirement of older workers in order to provide job security for the younger. High pension benefits were a very good way to accomplish this.

Pensions had become so integrated into corporate finance that the fate of the pension fund was dependent on the company's long term survival prospects. A key flaw in union pensions was that even the best managed among them was predicated on the continued success of the business.¹⁷ Even a well-run plan like Studebaker's became useless when the company's income stream stopped and payments to the pension fund ceased. The Studebaker plan, like all UAW plans, was created as a legal entity separate from the business itself. The *plan* owed employees their pensions, *not* Studebaker.¹⁸ This provision was intended to protect retirees from the dangers of commingling funds. The idea was that by making the plan a separate entity, the company would not be able to use pension funds as it wished. In practice, however, companies could still easily arrange loans from separate and distinct plans. And, as in the case of Studebaker, the plan's income stream was still fully dependent on payments from the company. When Studebaker could no longer make payments to the plan, the plan could no longer make payments to retirees. Employees were left with no recourse since they were unable to sue

¹⁷ United Mine Workers retirement payments corresponded with the price of coal. This gave workers an incentive, by having employees share in the companies' success, but also tied retirees' pensions directly to the industry instead of to their actual work experience. Ghilarducci, *Labor's Capital*, 38: \$100/mo plus Social Security for workers with 20 years or more service; pay go financing – according to output and not by the hour; this way the miners were not hurt by the burgeoning mechanization of the industry. Klein describes John L. Lewis as trying to keep the union independent, but he still “owed a great deal to the intervention of the state and sympathetic government officials.” 197-99. The UMW opposed pension reform recommendations of the President's Committee in 1965. Sass, *Promise*, 200.

¹⁸ Klein, *For All These Rights*, 260-1. “Employers also avoided liability by asserting in plan documents that workers' claims were against the plan, not against the assets of the corporation.” Also, Sass, *Promise*, 184-6.

Studebaker as legitimate creditors. There was no point in suing the plan, since it was out of money anyway.

Smaller unions usually did not have the wherewithal to set up pension plans independent from employer control, and non-union plans were invariably structured by employers.¹⁹ The difficulty for employers was keeping pension funds completely separate from corporate financial affairs. The temptation to integrate corporate and pension affairs took a number of forms. Corporate executives made the seemingly innocuous decision of which bank to employ for pension deposits, which led to the temptation to borrow money from the pension, perhaps to use for capital improvements like building a new plant. Such a move was arguably to the benefit of the pension, since the purpose of new facilities was to increase production and income. Pension funds could be used for more foolhardy schemes, such as investing in high risk stocks. All of these decisions carried some risk of losing money, but, depending on the wording of the pension plan, all were completely legal.²⁰

That the Studebaker plan was short by only \$15 million, and was able to provide a full pension to workers over age sixty, is a testament to the fact that Studebaker was a conscientious custodian of its retirement plan. But if the Studebaker employees had no recourse, what were the prospects for America's other workers? What about the hundreds, perhaps thousands, of companies that had not adhered to such stringent standards? The Studebaker failure gave the UAW the opportunity it had been waiting for to point out the deficiencies inherent in the private pension system.

¹⁹ This is not to imply that employers were actually handling day to day administration of nonunion plans; rather, the employer exercised primary control over decisions related to plan administration – selection of bank, insurance co., trustees, etc.

²⁰ McNulty, *Decision and Influence Processes in Private Pension Plans*. 1961. 114.

In 1965, the Presidential committee reported on a host of instances in which retirees failed to receive some, or all, of the pension promised them. Many plans did not have adequate funding; however, neither employers nor unions were overly concerned with paying down a plan's liability for past service. Inadequate vesting was compounded by a lack of portability. Employees earned pension credits for time worked, but these credits were not transferable.

In his history of the Employee Retirement Income Security Act, legal scholar James Wooten argues that an examination of the motives behind its creation reveals more than just a tangled web of competing interest groups. In answering the question of how Congress came to pass a labor reform law that was opposed by many in both big business and organized labor, Wooten concludes that underlying the competing political and material interests was a purer motivation. He argues "that the public officials who drafted ERISA and the legislators who voted for it believed they were making good public policy. They were not the greedy rascals that journalists and social scientists often depict."²¹ To Wooten, ERISA represents a genuine attempt to achieve retirement security for American workers.

If the view of ERISA as a Congressional good deed seems a little too rose-colored, pension historian Steven Sass offers a more pragmatic conclusion: "ERISA, in the end, was government's attempt to expand the private pension and fit it into the institutional structure of the U.S. economy."²² Money set aside for private pensions was funneled through banks and insurance companies, financing the mortgages behind the postwar growth in housing and infrastructure.²³ As Ohio blacksmith Donald Logdon put it, "When you are talking \$140 billion

²¹ Wooten, *ERISA*, 15. See 1-16.

²² Sass, *Promise*, 180.

²³ Murray, *Economic Aspects of Pensions*, 1968. 70.

worth of unregulated money in the United States you are not talking peanuts.”²⁴ Pension plans grew larger and larger, often as unions merged multiple funds into single plans.²⁵ By the late 1960s, institutions controlled half of all outstanding shares of common stock.²⁶

The supposition that Congress would like a say in directing the use of that money is not unreasonable. Jennifer Klein argues that “New Deal liberals consciously and inadvertently encouraged the development of this “supplemental” social security system [private pensions], first, through tax laws and amendments to the Social Security Act and, second, by accepting the ideological arguments for private supplementation of the public welfare state.”²⁷ In this respect, Congressional liberals spearheaded ERISA as an attempt to bring the errant system they had created under federal control. As Social Security started to fail to live up to its promises, perhaps the private pension system could augment the American retirement system, by providing money and security where Social Security was inadequate.

ERISA also forestalled a threat to the federal government’s political power by the growing power of pension institutions. As the financial power of institutions expanded, so did their reach over the private lives of American citizens. According to Grant McConnell, any entity that can so wholly control the lives of people not directly connected to it is exercising power that should only be properly exercised by governments.²⁸ To business, the pension is a

²⁴ Donald Logdon, Pension Hearings, 960.

²⁵ *Business Week*, August 8, 1964, 36-37; *Business Week* January 8, 1966, 84. In 1964, the International Ladies Garment Workers Union merged 47 funds, for reasons of greater stability and efficiency. The UAW opened over 10,000 jobs in 1965, through early retirements made possible by generous pension benefits.

²⁶ Mark B. Smith, *The Equity Culture: the Story of the Global Stock Market* (New York: Farrar, Strauss, and Giroux, 2003), 165.

²⁷ Klein, *For All These Rights*, 11.

²⁸ Grant McConnell, *Private Power and American Democracy* (New York: Alfred A. Knopf, 1966) 3-8.

financial instrument used as a tool of employee relations. However, pensions affect not only employees but their families as well. Pension decisions therefore should encompass not only financial but also personal and ethical considerations.

The nature of private pensions forced corporations and unions to operate beyond the context of profit and loss decisions. Financial considerations, which were limited by the market, were often antithetical to the ethical or moral considerations engendered by the pension system. A conflict of interest often existed between what was best for the entity running the plan, and what was best for the plan's ultimate beneficiaries. Business was forced to choose between employees and shareholders, and unions were caught between the oppositional goals of their leadership, senior membership, and the active workforce.

Workers were forced into a decision about how best to plan for the last decades of life, a period outside the scope of employment, within a singularly work oriented context. Employees were trapped by the pension system. "They [management and union officials] are getting away with this practice because it is constantly told to you "if you don't like your job and conditions, QUIT.""²⁹ Yes, workers could quit, but with a skill set limited by industry, and industry controlled by similar managers and the same unions, they had nowhere to go. Starting afresh every twenty years was unfeasible. Quitting meant forfeiting pension credits, giving up years of work, and starting over from scratch.

By confining employee choice, business and unions were exercising a form of public political power, which put the private pension system in limbo between private operation and public purpose.³⁰ To resolve this dilemma, Congress needed to either reclaim that power for

²⁹ James Ancypowic, salaried employee of Ballantine Brewery, Pension Hearings, 543.

³⁰ McConnell, *Private Power and American Democracy*, 296.

itself, or cede it entirely to the private sector.³¹ Accepting that provision for retirement is a social responsibility of business, and that business plays a vital role in society that extends beyond its function as a conduit of shareholder returns, the question becomes the extent to which pensions should be subject to regulation.



Harrison A. Williams³²



Jacob Javits³³

In 1962, President John F. Kennedy created a Cabinet-level committee to study America's private pensions. In 1965, the President's Committee on Corporate Pension Funds released its official report, recommending expansive regulation of private pensions, with provisions including vesting requirements and plan insurance, among others.³⁴ In January 1968, the Cabinet committee urged President Lyndon Johnson to propose pension reform legislation.³⁵ The Committee could not press for its recommendations to be put into practice, but by this time,

³¹ Examined within a vacuum, ERISA could have put private pensions under federal control. This did not happen, in part because the system was too well-entrenched, but also because Congress was simultaneously creating legislation that defeated this purpose. (see the next chapter) See McConnell, *Private Power and American Democracy*, 245-46, and Meg Jacobs and Julian Zelizer, "*The Democratic Experiment: New Directions in American Political History*."

³² <http://bioguide.congress.gov/scripts/biodisplay.pl?index=w000502> Feb 8/2014

³³ <http://bioguide.congress.gov/scripts/biodisplay.pl?index=J000064> Feb 8/2014

³⁴ More on this in the first chapter.

³⁵ Wooten, *ERISA*, 116-117.

the furor over pension reform was substantial enough to draw the attention of Senator Jacob Javits, the ranking minority member of the powerful Committee on Labor and Public Welfare.

By the late 1960s, other groups began lobbying for pension reform, including the National Association of Life Underwriters, the National Association of Manufacturers, the Chamber of Commerce, and the American Iron and Steel Institute.³⁶ The problem these groups faced was dealing with representatives from Treasury, Labor, and ongoing Cabinet Committee. At this time, no single person or organization was spearheading the effort toward reform. With so many groups desiring a voice, and so little concrete research on private pension operations, administration officials approached the issue of reform with extreme caution. Meanwhile, the Labor and Treasury departments each put forth their own proposals for reform.³⁷ The first comprehensive pension reform bill was introduced by Javits in March 1967.

Jacob “Jack” Javits was a liberal Republican from New York City. He served as a Congressional Representative from 1947 through 1954, and as U.S. Senator from 1957 to 1981.³⁸ His active interest in providing security for America’s old age population dated to the mid-1960s; he credits Frank Cummings, the minority counsel of the Committee on Labor and Public Welfare, with alerting him to the seriousness of the problems of the nation’s private pension system.³⁹

³⁶ Wooten, *ERISA*, 120.

³⁷ Wooten, *ERISA*, 120-127.

³⁸ House Document No. 108-222, Biographical Directory of the United States Congress 1774 – 2005 <http://www.gpoaccess.gov/serialset/cdocuments/hd108-222/index.html> pp. 1325-26.

³⁹ Jacob K. Javits and Rafael Steinberg, *Javits: The Autobiography of a Public Man*, (Boston: Houghton Mifflin Co. 1981), 380.

Born in 1904, Jacob Koppel Javits was the son of Morris Jawetz, a Talmudic scholar who supported his family by working as a janitor in tenements in the Lower East Side. After attending night classes at Columbia University, Javits graduated from the New York University Law School in 1926, and joined his older brother Benjamin in joint practice in 1927.⁴⁰ Deemed too old for active service, Javits served as a Chemical Warfare Officer during World War II, an experience that reinforced his conviction to seek public office. Experiences with the Tammany political machine had influenced his decision to become a Republican, and public dissatisfaction with Democratic local government aided his election to Congress in 1947. The same year, at age 44, he married Marian Boris, with whom he had three children.

While Javits developed a reputation as the most liberal member of the Republican Party, he maintained that healthy political parties should accept a wide variety of beliefs. By the time Javits began work on a proposal for comprehensive pension legislation in 1966, he had already gained recognition for his service on behalf of American labor, working for minimum wage, child labor laws, and equality for minorities and women in job training and hiring.⁴¹ Javits believed the government could and should actively promote the welfare of individual Americans. His proposal for comprehensive pension reform, however, faced opposition because of its all-inclusive nature.⁴²

⁴⁰ *Autobiography of a Public Man*. The specialty of Javits and Javits was bankruptcy; Javits had worked in debt collections, which may help explain his understanding and compassion towards poverty.

⁴¹ *Autobiography of a Public Man*. Javits died in 1986 (ALS) cite obit; big supporter of Civil Rights; supported LBJ; most known perhaps for support of gifted education.

⁴² Other proposals focused on more stringent accounting regulation or increased disclosure requirements, which did not provide an adequate solution to the problem as Javits saw it. Javits, *Autobiography*, 380. Sass credits Javits with being the first to present all the necessary aspects of reform within one piece of legislation, Sass, *Promise*, 211.

The situation changed in 1971, when Senator Harrison “Pete” Williams (D-NJ) became chairman of the Committee on Labor and Public Welfare. Williams had a very pro-labor reputation, and he put it to work to help Javits create and pass the legislation that in 1974 became ERISA, the Employee Retirement Income Security Act.⁴³

Harrison Williams was born in 1919, in Plainfield, New Jersey, and grew up in a conservative Republican household; his father operated a burial vault business. A graduate of Oberlin College, Williams served as a naval aviator during World War II. On his return to civilian life he worked briefly in the steel industry, joining the United Steelworkers of America, before earning a law degree from Columbia University.⁴⁴

After deciding to seek public office, Williams suffered a series of election losses; he was a Democrat in a heavily Republican district. His first victory came as a surprise in 1953, when he was elected to serve the remainder of Clifford Case’s term as U.S. Representative following Case’s resignation. The Democratic National Committee considered the election unwinnable, so Williams financed the campaign himself. His election was the first Democratic victory in the district’s history.

Elected to the Senate in 1958, Williams served for 24 years until his resignation in 1982, earning a reputation as a champion of social issues and minority rights, and working on behalf of migrant workers, women, organized labor, and marine mammals. Significant legislation

⁴³ Javits, *Autobiography*, 380.

⁴⁴ <http://www.nytimes.com/2001/11/20/nyregion/ex-senator-harrison-a-williams-jr-81-dies-went-to-prison-over-abscam-scandal.html>; also HAW files and House Document No. 108-222, Biographical Directory of the United States Congress 1774 – 2005 <http://www.gpoaccess.gov/serialset/cdocuments/hd108-222/index.html> pp. 2167-68. chairman, Special Committee on Aging (Ninetieth and Ninety-first Congresses), Committee on Labor and Public Welfare (Ninety-second through Ninety- fifth Congresses), Committee on Human Resources (Ninety- fifth Congress), Committee on Labor and Human Resources (Ninety-sixth Congress)

attributed to Williams includes the Occupational Safety and Health Act, the Coal Mine Safety and Health Act, the Urban Mass Transportation Act, and the Williams Act regulating tender offers.⁴⁵ From 1967 to 1971 Williams chaired the Senate Special Committee on Aging. He was someone with the clout to get things accomplished. Williams was in a unique position with regard to the problem of private pension funding because he was also chairman of the Senate Banking Committee's Subcommittee on Securities, which happened to be overseeing changes to securities regulation at the same time.⁴⁶

Javits regarded the private pension system as “deceptive, unsafe, and unjust.”⁴⁷ The problem as Javits saw it was that pensions had begun growing during the WWII wage freeze, encouraged by Congress's creation of tax incentives for pension contributions, resulting in millions of workers looking “forward to a retirement made more comfortable by a private pension.” But when they actually reached retirement, the benefits were not there. In many cases, not enough money had been set aside, the company went bankrupt, or the worker had switched jobs. Many people were disqualified on technicalities.⁴⁸

Williams wanted the system to be “fair,” so workers promised pensions would receive them.⁴⁹ Retirement was not a gift, he insisted. Pensions represented workers' deferred compensation, and workers had a right to receive fair payment for their years of service.

Regulation would signal to the business community that retirement was not a managerial tool;

⁴⁵ A tender offer is a form of stock buy-back – a very important tool with regard to mergers & acquisitions.

⁴⁶ More on this in the previous chapter.

⁴⁷ Javits, *Autobiography*, 378.

⁴⁸ Javits, *Autobiography*, 378-9.

⁴⁹ Harrison A. Williams Collection, Rutgers Special Collections Press Release May 1, 1972 (HAW PR 5-1-72)

regulation could legitimize pensions as deferred wages, part of compensation payable at retirement, thus returning income to American workers. While discussing congressional hearings on private pension failures in 1972, Williams said, “Many American workers today have deep concerns, and genuine fear, that their retirement benefits are mere illusions.” “Unfortunately,” he added, “in too many instances their concern has turned out to be well-founded.”⁵⁰

Under Williams’ leadership, the Subcommittee on Labor of the Senate Committee on Labor and Public Welfare held a series of hearings across the country, for the purpose of examining private welfare and pension plans. Each of these hearings began with a recitation of the Committee’s understanding of the problems associated with the private pension system, and went on to profile specific cases of pension failures. At every stop, Senators met with workers, union representatives, business managers, actuaries, and lawyers, all of whom were equally dissatisfied with the system, and also equally adamant that the problems needed to be resolved by federal intervention.⁵¹

The primary failing of the private pension system, the Subcommittee concluded, was inadequate vesting.⁵² An employee’s membership in the plan did not provide an automatic legal claim to pension benefits, although many employees assumed it did. Many workers conceptualized pensions this way because of the way pension plans had been structured

⁵⁰ Although this press release was primarily about securities reform, it also mentioned pensions, because those were the two big topics Williams had been attending hearings about. Harrison Williams press release #72-23: “Williams says “*Time for decisions has come: in reforms for securities industry*” Williams said today that, “the natural evolutionary process of the securities market has been retarded by fixed commission rates.” “The markets,” he added, “simply cannot manifest the dynamic ability to meet the changing needs of investors under fixed rates.” HAW Collection, Rutgers Special Collections.

⁵¹ NB: seldom is only one union affiliated with any one business; the process of creating a plan was much more complicated than the simple equation of labor/management might indicate.

⁵² Senator Thomas Eagleton, Pension Hearings Part 1 Page 2.

originally. Benevolent corporations (typical welfare capitalists), in order to convince employees of their benevolence, would provide records, often in a form resembling a bank account passbook, showing contributions to a pension fund made in an employee's name. However, such arrangements did not convey to the employee a legal right to that money.⁵³ The idea underlying the pension was that a certain amount of money was set aside on a regular basis with the *intent* to be paid to a specific employee at a future date.

Vesting is the transfer of legal rights to pension assets. If an employee is not fully vested, the plan administrator is not legally obligated to pay a full pension to that employee at retirement, regardless of whether the pension was promised or expected. Plans provided for vesting according to a set of requirements, typically including an employee's age, length of service, and continuity of service. For example, an employee at GM or Ford, covered by a standard UAW plan, was eligible to begin vesting at age 29, after 10 years of continuous service. Vesting was seldom granted in one fell swoop. An employee could be partially vested for many years before becoming fully vested, but the problem with this requirement was the concept of continuity. Service must be continuous without interruption. However, this definition was open to interpretation. Under generous circumstances, "continuous" could mean being full time employed by the company for a certain number of years. But, a period of working part time would reset the clock. Similarly, some plans insisted an employee perform the same job for a period of time. In such cases, a temporary reassignment from one area of the factory floor to another could reset the vesting period. Employers would intentionally reassign employees' positions to prevent them from fully vesting.

⁵³ The Supreme Court upheld that pensions presented as such constituted a gift from the company, rather than a legally enforceable promise.

The problem was obvious – if an employee was not vested and the plan terminated, he was not legally entitled to receive anything. If he was not part of a multiemployer union plan, he had no way to transfer those years of service to another company. Inadequate vesting was problematic in and of itself. What was worse was that employees very often were disqualified from receiving pensions on the basis of inconsequential technicalities.

Senator Thomas Eagleton (D-MO), presiding over hearings in St. Louis, discussed the termination of the Union Employees' Retirement Income Plan at Benson Manufacturing Company, in Kansas City, Missouri. That no employees were fully vested mattered little in face of the fact that the present value of the vested benefits (the amount legally owed to employees) was greater than current plan assets by over \$600,000. The more pertinent issue in this case, Eagleton concluded, was that money could have been recovered if some insurance system existed for private pensions, a system akin to the FDIC.⁵⁴ A letter from the executive director of the Older Adult Special Issues Society, Inc. of St. Louis, Gilbert Murphy, troubled the senator even more. Mr. Murphy expressed serious concern over the possibility that in many cases company managers purposefully manipulated vesting requirements in order to secure their own pensions at the expense of those employees lower on the management ladder.⁵⁵

Testifying before Senator Walter Mondale (D-MN), Dave Roe, the president of the Minnesota AFL-CIO, identified the dilemma of changing attitudes in management with regard to pensions. Companies treated pensions as part of wages during collective bargaining negotiations, promising to put money toward pension benefits instead of current wages, but when

⁵⁴ Pension Hearings, 13; Eagleton, Pension Hearings, 379.

⁵⁵ Murphy, Pension Hearings, 417-18: "reason to suspect that a deliberate polity exists which controls vesting of low management personnel for the purpose of assuring the vesting rights for persons having controlling management of the company"

the time came to actually make contributions to the pension fund, business considered pensions “like charity.”⁵⁶ “Some seem to think the assets of the fund are part of the assets of the company,” he said, calling for civil and criminal penalties for those employers who failed to meet their financial obligations.⁵⁷

Mondale began the hearing estimating that only 15% of employees covered by pension plans actually received any benefits.⁵⁸ The case before him was the closing of the Minneapolis-Moline plant of White Motor Corporation. Workers knew that White planned to close the plant, and they believed that finding other employment in advance of the layoff would mean forfeiting all rights to their pensions.⁵⁹ While this was not the actual situation, workers had no way of knowing. Neither union nor company officials would provide a satisfactory answer. The prevalence of such deception led the Subcommittee to include in ERISA the requirement that the contents of private pension plans be fully explained to all employees, in comprehensible language, at least once a year.

Herbert Phillips, Vice President of Personnel & Industrial Relations of White Motor, proposed that the problem, not only with their plant, but also at many others, was a recent drastic increase in benefit levels, combined with more liberal amounts set aside to pay for past service liabilities. Company funding could not keep pace with the increases because the money simply was not there.⁶⁰ From 1963 to 1972, the maximum years of service used to calculate the annual

⁵⁶ Roe, Pension Hearings, 657-58.

⁵⁷ Ibid.

⁵⁸ Mondal, Pension Hearings, 655-56.

⁵⁹ Pension Hearings, 676-77; this wasn't strictly the case, but was widely believed.

⁶⁰ Phillips, Pension Hearings, 725.

pension increased from 25 to 34, which increased the potential amount payable to retirees. The average annual pension increased from \$819 to \$2,478.⁶¹ Phillips pointed out that a constant stream of benefit increases was not financially feasible. This situation occurred in industries other than automotive as well; the difficulties faced by brewing companies were the direct result of trying to match benefits at plants on the East Coast to the high retirement packages secured by the most powerful union representatives in the Midwest.⁶²

“If something isn’t done soon, we – the workers of America – will have to unite and join with other protestors and march on Washington to see that our demands are met.” Harvey Wickman, president of the Local 932, Minneapolis-Moline Company⁶³

“We help everybody else in this country. We better start helping our own people.” Francis Jeffrey, International Representative of the UAW⁶⁴

Donald Logdon, a twenty year employee of GarWood Industries, was laid off when the Findlay, Ohio, plant was purchased by Sargent Industries and subsequently closed. He was 38 years old and unemployed, with four children to support. He had been earning \$3.68 an hour, while also serving as financial secretary of the Local 1194 of the International Association of Machinists and Aerospace Workers. Logdon and 113 others with vested pension rights received nothing when the plant closed, because the pension plan was underfunded by over \$1 million.

⁶¹ Ibid.; for comparison, the 1974 median income for families with heads of household age 65 or older was \$7,298 (Greenough and King, 13).

⁶² See Ballantine Brewery case in the Pension Hearings.

⁶³ Wickman, Pension Hearings, 669. Demanding some kind of reinsurance bill for pensions. Not sure which local this is – either UAW or Steelworkers; go back to session description to see if recorded at the start of the hearings for that day.

⁶⁴ Jeffrey, Pension Hearings, 895.

“That’s the workers’ money,” Logdon said, “The fat cats have got it in their pockets.”⁶⁵ He knew that the money for pensions existed somewhere beyond the reach of the employees. Logdon’s story, and those of workers like him, became primary talking points for Senators Williams and Javits, along with others who supported the reform movement. The claim of ‘helping workers’ was a powerful tool for achieving policy goals.

The force of public opinion should not be ignored when examining retirement reform. Scholars have argued that an easy dismissal of the power of ideas limits our understanding of the process of social policy reform. There are instances in which social movements have legitimate power. For example, Townsend clubs lobbied for the passage of old age security legislation in the early twentieth century. Although the Townsend proposal was declined, the insistence of its club members forced Congress to take seriously the idea of developing legislation which later became the Social Security Act.⁶⁶ ERISA was built on practical considerations of politics and economy, but it also marked an important populist moment, because Congress manipulated popular opinion to help pass public reform.

The movement to regulate private pensions did not originate at the grassroots level. Historian Jefferson Cowie describes the years between 1968 and 1974 as a period of social fragmentation. He explains that, “one of the key reasons for the failure of the uprisings and organizing of the early seventies in particular was that they were, symptomatic of the decade itself, too fragmented and dispersed to constitute anything close to a single unified movement.”⁶⁷

⁶⁵ Logdon, Pension Hearings, 927; 960.

⁶⁶ Sheryl Tynes, *Turning Points in Social Security*, 7; Béland, *Social Security: History and Politics from the New Deal to the Privatization debate*, Lawrence, KS: UP Kansas, 2005. 4.

⁶⁷ Jefferson Cowie, *Stayin’ Alive: the 1970s and the last days of the working class* (New York: New Press: Distributed by Perseus Distribution, 2010), 70.

The movement to achieve pension reform succeeded because it was a populist movement built from above, rather than from below. Pro-reform Congressmen and consumer activists like Ralph Nader used the public press and popular media to rally support for their proposals. ERISA's supporters were able to use the public response to their claims of pension failings in their favor. ERISA gathered the strength to pass Congress from the stories, letters, and testimony gathered and carefully shaped by members of Congress and labor unions working through the media.

The American public was frustrated and dissatisfied in the late 1960s and early 1970s. Abroad, Vietnam had become an expensive quagmire, and at home, the Great Society was losing its appeal. Americans were disenchanted with political leadership from both parties.⁶⁸ In 1967, Senator Jacob Javits began working on legislation to reform what he called "an institution built on human disappointment."⁶⁹ He made little progress until he enlisted the help of New Jersey's Harrison Williams, chairman of the Senate Labor Subcommittee. Together they developed a comprehensive reform proposal that included minimum standards for funding and vesting, expanded fiduciary responsibility requirements, portability, and plan termination insurance to be administered by a new agency called the Pension Benefit Guaranty Corporation.

As stagflation stymied economic growth, and the Watergate scandal took center stage in the national media, Senators Javits and Williams saw pension reform as a much-needed way to restore public confidence, in both the political process and the economy. The general malaise of American society found one form of expression through calls for an improved retirement. In a period when workers faced a grim future of repetitious industry, the promise of retirement

⁶⁸ Donald Critchlow, *The Conservative Ascendancy: how the GOP right made political history* (Cambridge, MA: Harvard University Press, 2007), 78.

⁶⁹ See *Business Week*.

became the light at the end of a long tunnel.⁷⁰ Pension reformers turned this situation to their advantage. Just as “retirement” became a social construct of the mid-twentieth century, so too did pensions take on a new identity within the realm of American consumerism.⁷¹ Congressional treatment of private pensions, as portrayed through the popular media, transformed the pension from an issue of workplace rights or union bargaining to a problem of consumer fraud and deception.

The person who presented the situation most starkly was America’s champion defender of the voiceless consumer, Ralph Nader. Beginning in the late 1960s, political activist Ralph Nader began to actively protest for reform of the private pension system. Using the collective resources of his group of reform-minded young people, known as Nader’s Raiders, the obstinate social activist lobbied for the federal government’s protection and regulation of pension fund money. However, the money should be invested in such ways as to gain the greatest returns for both businesses and individuals. Nader popped up at various gatherings of pension and actuarial professionals, promoting his own plan for retirement reform, which ironically closely mirrors the retirement practices of the early twenty-first century. Nader wanted a plan that would be managed by the government, but would give participants freedom of choice as to how their money would be invested. Nader’s persistent lobbying helped force Congress on the issue of pension reform.⁷²

⁷⁰ Cowie, *Stayin’ Alive*; Bruce J. Schulman, *The Seventies: The Great Shift in American Culture, Society, and Politics* (New York: The Free Press, 2001); Bruce J. Schulman, and Julian E. Zelizer, eds., *Rightward Bound: making America conservative in the 1970s* (Cambridge, MA: Harvard University Press, 2008).

⁷¹ See Chapter One.

⁷² Today the most common form of retirement plan is the 401(k), in which employees do have more freedom of choice to direct their own investments, as Nader wanted, but rather than being a government program, individuals’ 401(k) plans are managed by investment companies and overseen by employers. See Ralph Nader and Kate Blackwell, *You and Your Pension: Why you may never get a penny; What should be done about it* (New York: Grossman Publishers, 1973).

The televised debates between presidential candidates John F. Kennedy and Richard Nixon in 1960 opened many people's eyes to the potential power of the news media in the political process. Beginning in the 1960s, television, and the evening news in particular, became a way for politicians to connect directly with the public.⁷³ In 1963, the national television networks extended their news programs from fifteen to thirty minutes.⁷⁴ In the battle for ratings, television stations began to personalize the news, and to focus on the "human interest dimensions of news stories."⁷⁵ They needed to create personal relevance in order to increase viewership. Although evening news programs did not often go into great detail on social issues, the broadcasting and repetition of such issues increased their importance in the public mind.

The evening news helped interests like pension reform become national issues in two ways. As viewership increased, more and more people turned to the news to find out what was important; the act of being featured on a news program created significance in its own right. Also, television stations copied content from each other in attempts to maintain or grow ratings, so news stories became widely known through this "amplification process."⁷⁶ The issue of private pension reform represents one of the first times that politicians purposefully fed news stories to the national media with the intent to shape public opinion.⁷⁷ Congress used stories from their own hearings and from union hearings to transform the issue of pension reform into something that concerned all Americans.

⁷³ David L. Altheide, *Creating Reality: How TV News Distorts Events* (Beverly Hills and London: Sage Publications, Inc., 1976), 2-6.

⁷⁴ Michael Schudson. *The Power of News* (Cambridge & London: Harvard University Press, 1995), 172.

⁷⁵ Altheide, *Creating Reality*, 6.

⁷⁶ Altheide, *Creating Reality*, 25-27.

⁷⁷ *Pensions: The Broken Promise*, (NBC, 1972).

Speaking before a conference of employee benefits professionals, Ralph Nader denounced the private pension system as “one of the most comprehensive consumer frauds that many Americans will encounter in their lifetime.”⁷⁸ Nader’s declaration that half of plan participants would never see any benefits was of dubious validity, as were many of the Labor Subcommittee’s similar statistics, but they all served the purpose of increasing public support. Pension historian Sylvester Schieber was correct that “Senators Javits and Williams were less concerned with statistical validity and more interested in headlines that would stir the public.”⁷⁹

Javits publicized study results showing that for every plan participant who earned vested rights, five employees with more than 15 years of service forfeited all pension rights – for every one person who gets the pension, five are disqualified. He claimed that, “The release of these statistics caused a sensation in the press and was a significant factor in directing public attention to the flaws in private pension plans.”⁸⁰ Nor was Williams shy about peppering speeches with similar rhetoric. He began campaigning using the statistics he gathered through a series of twenty-five personal interviews with members of the United Mine Workers and a collection of more than twenty thousand letters.⁸¹ When speaking before a convention on health, welfare, and pension plans, Williams revealed the results of a survey of 87 large pension plans, which held twenty percent of all plan assets and represented a cross section of industry. He claimed that fewer than twenty-five percent of all participants who retired under those plans since 1950

⁷⁸ Nader and Blackwell, *You and Your Pension*, appendix C.

⁷⁹ Sylvester Schieber, *The Predictable Surprise: The Unraveling of the US Retirement System* (Oxford: Oxford University Press, 2012), 143.

⁸⁰ Javits, *Autobiography*, 381-82.

⁸¹ Harrison A. Williams, 9/24/73 Review of wage-benefit compensation packages, Remarks Before the Detroit Chapter of the Financial Executives Institute.; HAW Collection, Box 1215.

received any benefits at all. The results may not have been statistically significant, but Williams was a master of presenting personal stories to support his findings.⁸²

The senators received thousands of letters from reform supporters, and from workers whose pensions had disappeared. Frank Cummings, staff attorney for the Labor Committee Republicans, maintained a repository of these letters, categorized by state of origin.⁸³ This collection became a useful source base for news correspondents. When Congress was inactive over the weekend, reporters still needed a story to send back home for the Sunday paper. Cummings could provide “a heart-breaking story about a worker losing a pension” for a good portion of the country.⁸⁴ These news stories prompted more people to write letters, both to the Committee as well as to their own Congressman.

As opposed to traditional hearings, in which interested parties were invited to travel to Washington, D.C., to present before Congress, Senators Javits and Williams took their show on the road. Going out to the people was a crucial part of creating the kind of grassroots support the pension reform movement lacked. The more personal stories the Senators could gather and disseminate, the more support for reform grew. A flurry of calls and letters prompted Congressmen to request a hearing in their constituency. This would bring to town what has been

⁸² Harrison A. Williams, 3/27/73 Annual Convention of Eastern Conference of Health, Welfare, and Pension Plans, HAW Collection, Box 1215.

⁸³ <http://www.fcummingsdc.com/> 2/23/14 Previously he served as Minority Counsel for the U.S. Senate Committee on Labor and Human Resources and was Administrative Assistant/Chief of Staff to U.S. Senator Jacob K. Javits during the development of ERISA. He designed and drafted the original Javits pension reform bill (1967), which was the first of Senator Javits' proposals that eventually became ERISA. He is currently an Adjunct Lecturer in Law at the University of Virginia School of Law (Charlottesville, VA), an Adjunct Professor of Law at John Marshall Law School (Chicago), and an Adjunct Professor of Law at Earle Mack Law School of Drexel University (Philadelphia).

⁸⁴ Fran Hawthorne, *Pension Dumping: the reasons, the wreckage, the stakes for Wall Street* (New York: Bloomberg Press, 2008), 44. “Considering their lack of interest-group allies, they accomplished wonders.”

called “one of the most brilliant pieces of political theater in U.S. history” – the menagerie of the Labor Committee, their various aides and assistants, and their press retinue, all under the leadership of a local representative who was now on the reform bandwagon.⁸⁵ As Frank Cummings recalled, “some Congressman ... would call Williams and Javits and ask, ‘Would you hold a field hearing in my state and let me sit on the dais with you in my town?’” “The hearings would present the stories,” Cummings continues, “and Williams and Javits would say, ‘If my bill were law, this wouldn’t happen.’”⁸⁶

Merton Bernstein credits television news programs with generating widespread public concern on the matter of private pension reliability. The program “60 Minutes” first devoted a segment to problems with private pensions in 1971, with an emphasis on the difficulty of meeting plan eligibility requirements. Correspondents Robert MacNeil and Jim Lehrer presented a special hour-long program on the plight of the employees of a Pennsylvania bakery, many of whom had testified before a Labor Committee hearing. In this case, the problem was a lack of adequate funding, and a disconnect between the requirements of the company plan and the multi-employer plan to which it belonged.⁸⁷

The program that really made pensions front page news was a documentary special aired by NBC in the fall of 1973, called “Pensions – The Broken Promise.” The program fell under journalistic scrutiny for failing to present a balanced view of the issue. Most of the facts and examples were provided by Labor Committee staffers, a fact that caused complaint by pension and insurance companies. But NBC presented private pension failings as a full-blown issue of

⁸⁵ Hawthorne, *Pension Dumping*, 44.

⁸⁶ Hawthorne, *Pension Dumping*, 44.

⁸⁷ Merton C. Bernstein and Joan Brodshaug Bernstein, *Social Security: the system that works* (New York: Basic Books, 1988), 106.

consumer fraud.⁸⁸ The program shows clearly how the pension issue was being manipulated to fit a new ideology of modern retirement as earned leisure, or at least respite from labor. The reality is that retirement pensions were not, and have never been, the sort of topic to capture the interest of the American public, at least not those under retirement age. However, as reformers discovered, wrongdoing attracted more attention than did negligence. Those who took the time to consider the issue soon realized that the underlying problem was not necessarily neglect of the nation's elderly so much as it was the unclear ownership of hundreds of millions of dollars.⁸⁹

"I could dream that I'm going to get something some day, but to be truthful with you, I know that I'm not going to receive anything." Norman Hoey, twenty year veteran driver for Ballantine Brewery⁹⁰

The case of Ballantine Brewery encapsulated all the problems that Congressional reformers sought to alleviate through ERISA. When the brewery closed, 1,150 employees lost their jobs. Roughly 700 workers not yet eligible for pensions lost their entire accredited service and had to start from scratch, and many others suffered a 35% loss to their monthly pension benefit. Ballantine had inadequate vesting; employees did not hold a legal claim to the full amount of pensions they had technically earned. Pensions were not portable; service credits could not transfer with employees, even if they moved to another brewery. The plan was underfunded and uninsured.

⁸⁸ Bernstein and Bernstein, *Social Security*, 107.

⁸⁹ Adaptation of New Deal ideals that still resonated with a liberal Congress – new ideology of rights; combined with the reality of business.

⁹⁰ Hoey, Pension Hearings, 443-4.

And, as if that were not enough, dialogue among the company, the related unions, and the employees was so poor that no one had a clear idea of how much money was available from the pension fund, or even where some of the money was invested. Twenty-nine year employee Raymond Sagendorf complained that no one seemed to have the answers –everyone you ask gives a different response, “Then you look at the book and you throw everything up in the air and you forget it.”⁹¹ Harrison Williams described the problem in terms of an ideological change related to retirement. Retirement pensions had become payment of deferred wages, instead of a “gold watch” for loyalty, but employers had not kept up with such radical change.⁹² I. Philip Sipser, Special Counsel for the New Jersey Brewery Workers Joint Local Executive Board, summed up the situation: “Ballantine says, ‘Me? I’ve done everything I’ve got to do.’ Falstaff (the brewer Ballantine was sold to) says, ‘I’ve got nothing to do with it.’ All the employees are in the runaround.”⁹³ No one was willing to assume responsibility, and the result was lost money and lost pensions.

Business was not keen to support new federal pension regulations. The National Chamber of Commerce described the 140 billion dollars of private pension assets as “the pot of gold at the end of the rainbow – ripe for federal takeover.”⁹⁴ The business community did not welcome the prospect of a new set of regulations, because, aside from the ideological imposition, regulation presented a practical bureaucratic problem. There would be new forms to file, and new employees paid to file them. More importantly, private pensions had become something of

⁹¹ Sagendorf, Pension Hearings, 441.

⁹² Pension Hearings 429-30. (Williams)

⁹³ Pension Hearings, Sipser, 603.

⁹⁴ Theodore Schuchat, “Washington Letter,” *Pensions & Investments*, October, 1971.

a revolving capital fund for America's corporations. The life insurance companies that managed the funds invested that money in low risk, stable instruments. The highest yields could be gained from conventional mortgages and corporate direct placements, a specific private investment made by one corporation in another entity. In other words, pensions were financing the expansion of American business.⁹⁵ Pension funds offered an easy way to get capital without meeting requirements to offer either equity or bonds, and the money went back into the businesses from which it came. Business would not want to rid itself of a reliable and steady source of capital. Depending on the terms of the pension fund agreement, some businesses could use their own pension funds as a source of capital. Those which could not could still access the pension money of other companies set aside in insurance investments. Through increasing investment in national equity markets, pension fund managers increased the pool of available capital. Subsequently, big business was reluctant to interfere with the existing private pension structure.⁹⁶

Pension funds were typically quite illiquid, but corporations were amending plan restrictions in order to permit increased equity investment. High rates of return on common stock during the late 1960s made the stock market an attractive proposition for pension investment. That business would try to gain the greatest return is a sensible proposition from the perspective of management and shareholders, but market analysts were naïve to assume that profits generated in excess of pension requirements would be directed toward future pension contributions.⁹⁷ Excess earnings from pension equity investment went directly into corporate

⁹⁵ Murray, *Economic Aspects of Pensions*, 70-72.

⁹⁶ Béland, 112: this system was made possible by the tax incentives and loopholes that encouraged the expansion of the private pension system.

⁹⁷ Murray, *Economic Aspects of Pensions*, 74.

coffers. The regulations proposed by ERISA would effectively destroy this opportunity for profit, one that was low risk to employers, although high risk for employees.

“Now, that union is playing with my money. I have got it coming to me, I want it.” Michael Ulichnie, 65 year old retiree, denied a pension due to a change in the United Mine Workers plan regulations, despite 30 years as a coal miner, with union dues paid since 1934.⁹⁸

The United Mine Workers, along with the AFL-CIO and many other unions, did not initially support the pension reform measures proposed under ERISA. Only the United Auto Workers and Steelworkers fully endorsed Congressional recommendations for reform from the beginning. The pension had become a key element in the relationship between employers and union management. Many unions wanted to preserve their power by maintaining control of those negotiations. Unions could also use pensions as a way to bolster their reputations, both publicly and among their membership. Under fire from organizations such as the National Association of Manufacturers, unions could offer increased benefits instead of negotiating for higher wages, thus deflecting accusations of contributing to the wage price spiral of higher wages leading to higher prices, leading to still higher wages.⁹⁹ Unions did not favor reforms if it meant they could no longer make grandiose, pie in the sky, promises. Moreover, if elected union leaders could not present a wage increase to those who elected them, they could at least promise increased future compensation in the form of pension benefits.¹⁰⁰ Most unions, like business, did

⁹⁸ Ulichnie, Pension Hearings 963.

⁹⁹ Jacobs, *Pocketbook Politics*, 254-55.

¹⁰⁰ Through the 1950s, unions were more concerned with increased benefit levels and vesting than with actual control over the investment of pension funds, according to Theresa Ghilarducci, *Labor's Capital*, 41. See also Jennifer Klein and James Wooten on this.

not welcome a new set of rules or a new level of public interference in their operations. The intention of the 1958 Welfare and Pension Plan Disclosure Act had been to create greater transparency to help workers understand the pension process, but rapidly became a means to attack union oversight. Leaders were understandably fearful of “witch-hunts.”¹⁰¹ As unions became equivalent in size and power to corporations, leadership did not wish to relinquish their control.

Groups like the AFL that operated multiemployer plans most strongly opposed ERISA because they opposed vesting requirements. Greater vesting was not necessary, they argued, because under the multiemployer format the likelihood of plan termination was so low. Multiemployer plans covered the employees of multiple companies, all of whom worked in the same industry.¹⁰² Each company contributed to their plan on behalf of its own workers. However, the plan pooled the funds from all the covered companies to make payments to retirees. If one company failed to fulfill its pension fund obligations, the union could either draw from the pool or demand greater contributions from the others, which obviated the need for plan insurance, as well as provisions for portability. The union presumed that workers moving from one job to another would nevertheless stay in the same industry and therefore remain covered by the same union pension plan. If a particular company closed and terminated its pension, employees could rely on the union to fund the amounts due to them. If Congress implemented

¹⁰¹ Sass, *Promise*, 192. Given the growing negative opinion of unions this is not a far-fetched idea. (see Jacobs)

¹⁰² Standard definition.

a new set of requirements, the costs of administering the plan would increase, which would force a decrease in current benefit levels. This was absolutely the last thing unions wanted.¹⁰³

Given the sheer number of members, the private pension system was unsustainable. Recognizing that they were going to run out of money because they paid higher current benefits at the expense of providing for the future, the UAW and Steelworkers demanded reforms. Therefore, UAW President Walter Reuther visited Lyndon Johnson in early 1964 to make the case for pension insurance.¹⁰⁴ He found Johnson sympathetic, but reluctant to support anything so controversial during an election year. Johnson had supported the Welfare and Pension Plans Disclosure Act of 1958, and proposals to strengthen it, but needed to avoid calling for wholesale reforms in order to maintain support from the business community.¹⁰⁵

In terms of old-age legislation, Congress continued to approve increases to Social Security benefit payments every election year. The year 1965 was groundbreaking for Social Security because Medicare was added, over the protests of the American Medical Association, who predicted it would diminish the quality and profits of medical service. After Richard Nixon became president, the main legislative activity regarding old-age security remained centered on Social Security. Nixon wanted to make the cost of living adjustment (COLA) an automatic, permanent feature of the system, pegged to economic indicators, instead of letting the Democrats gain political credit every time they raised benefits. He managed to achieve this in 1972, but was forced in exchange to accept the new Supplemental Security Income (SSI) program addition to Social Security. The addition of low income welfare payments to the existing social security

¹⁰³ Sass, *Promise*, 200-202.

¹⁰⁴ Wooten, "The Most Glorious Story of Failure."

¹⁰⁵ *Ibid.*

system transformed social security from an old age benefit program to a national level public welfare system.¹⁰⁶

President Nixon shied away from the more expansive recommendations of pension reform, which was not difficult to do from a conservative standpoint. In 1973, the Subcommittee on Aging of the Committee on Labor and Public Welfare stated that budget studies of the old age population might be interesting, but “provide no basis for knowing whether any particular level of income is “adequate” under varying sets of circumstances.”¹⁰⁷ Nixon was not going to increase costs to business without definitive proof that the nation’s elderly were inadequately compensated for their past service. However, the ERISA provision that did originate with the Nixon administration was the Individual Retirement Account. While the administration could not support increased costs to business, it could support a method by which workers could become better prepared for retirement on an individual basis.¹⁰⁸ After early 1972, the Nixon administration had little time to devote to pension reform in any case, because of the Watergate scandal.

Pension reform was caught in the same trap that initially constrained Social Security. The far Right did not like the proposed expense, while the far Left did not think the proposal encompassed enough. The liberal majority in Congress, combined with an increasing lack of

¹⁰⁶DeWitt, Béland and Berkowitz, *Social Security: a documentary history*. 2008. 17. Nixon pushed through the COLA right before the economy *really* tanked and caused a huge problem with double-indexing –Social Security was overcompensating for inflation; Congress did fix this, otherwise Social Security would have run out of money by the early 1980s. Stagflation: inflation rising but no growth and unemployment also going up.

¹⁰⁷ Schulz et al 227. Milton Friedman wanted to get rid of Social Security altogether. 257.

¹⁰⁸ See Paula K. Gajewski, “The President, Financial Planning, and American Retirement Planning,” in *The Presidency and American Capitalism since 1945*, edited by Mark Rose and Roger Biles, Gainesville: University of Florida Press, *forthcoming*.

attention from the conservative administration, made significant reform possible, but the extent of Senator Javits's proposed reforms challenged even the most liberal members of Congress.

Meanwhile, the administration had been investigating the issue of private pension reform since 1965 when the Cabinet Committee on Corporate Pension Funds, created by President John F. Kennedy, first reported the results of its studies. In 1971, President Richard Nixon sponsored the White House conference on aging, which resulted in two bills proposed by the Departments of Labor and Treasury. In 1972, a special task force on aging under the direction of the Secretary of Health, Education, and Welfare also recommended a series of improvements to private pension regulations, including improved vesting, disclosure, and portability.¹⁰⁹

In 1973, the Labor and Public Welfare and Finance Committees of the Senate each produced a version of pension reform legislature. These bills were joined in a compromised measure S.4. The text of this bill was incorporated in H.R.4200, a minor House bill created to continue certain servicemen and former servicemen's survivor annuity benefits.¹¹⁰ After the Senate passed H.R.4200 in September, 1973, the Education and Labor and Ways and Means committees of the House each passed their own versions of the pension legislation, which were then combined as H.R.2 and passed in February of 1974. The Senate passed H.R.2 as well but the text differed from H.R.4200, although the two bills were the same in substance. By August, the joint House and Senate conference on H.R.2 completed its revisions. After final debates, H.R.2 was signed by President Gerald Ford and became Public Law 93-406, the Employee Retirement Income Security Act, on September 2, 1974.

¹⁰⁹ Legislative History of the Employee Retirement Income Security Act of 1974: Public Law 93-406, United States. Congress. Senate. Committee on Labor and Public Welfare. Subcommittee on Labor. Washington, DC: U.S. Govt. Print. Off., 1976, hereafter ERISA History, 205

¹¹⁰ ERISA History, 4251.

In January of 1973, Senators Harrison Williams and Jacob Javits reintroduced the Williams-Javits Pension Reform Bill, S.4.¹¹¹ Javits had first introduced a bill for pension in 1967; the Senate held hearings on the Javits bill and similar measures but took no action. The House held hearings on pension reform throughout 1969 and 1970, but achieved no concrete results. In 1971, Javits reintroduced a bill for comprehensive private pension reform. This bill, S.2, was submitted for study to the Senate Labor Subcommittee, which was then chaired by Senator Harrison Williams.¹¹² Williams and Javits joined forces to produce a joint version of S.2 which first was introduced in May, 1972. Williams and Javits had a good working relationship with each other, which helped gain publicity and support for reforms. Speaking before the full Senate, Javits said, “I am delighted to engage in this partnership which has been one of the most satisfying of my entire career.”¹¹³ The Williams-Javits bill was reported out of the Labor Subcommittee in the fall of 1972, but “it was stripped of its key provisions,” by the Committee on Finance.¹¹⁴

In early 1973, Williams reintroduced the pension reform bill as S.4, “a bill to strengthen and improve the protections and interest of participants and beneficiaries of employee pension and welfare benefit plans.” Speaking on the three-year efforts of the Labor Subcommittee, Williams declared that, “private pension plans repeatedly fail to fulfill their promise of retirement security.” Williams described the public hearings the committee held around the country, and how “workers eloquently expressed the shock and despair they felt when they

¹¹¹ ERISA History, 90.

¹¹²ERISA History, 205.

¹¹³ERISA History, 206.

¹¹⁴Javits, in ERISA History, 204.

learned that their dreams of living out retirement years in economic security were never going to come true.”¹¹⁵ S. 4 included provisions addressing each of the major problems the Senators had identified during hearings and statistical analysis of private pensions.

The primary goals of S. 4 included setting minimum requirements for funding and vesting of private pension plans, so that the money would be appropriately allocated to pay pensions, and workers would be legally entitled to receive their full pensions. S.4 also provided for measures to improve the conduct and oversight of plan fiduciaries, including increased reporting to meet broader disclosure requirements. In addition, Williams and Javits called for the establishment of an insurance program to cover plan terminations, and a voluntary program to increase the portability of pensions between employers. S.4 granted the appropriate powers to the federal government to enforce its provisions, and proposed the creation of an Office of Pension and Welfare Plan Administration.¹¹⁶

To increase support for the bill, Javits called on allies in organized labor to pressure their legislators, and Williams turned to the media, and through them, the people. One of the Senators’ initial opponents turned out to be a valuable ally in the fight to pass the bill. Javits described Senator Lloyd Bentsen (D-TX), a key member of the Finance Committee, as “business-oriented,” but also cognizant of “the public-interest aspects of pension reform.”¹¹⁷

¹¹⁵Williams, in *ERISA History*, 90; “With this tremendous background of evidence derived from years of painstaking inquiry, the Retirement Income Security for Employees Act of 1972 was introduced by Senator Javits and myself, on May 11, 1972; we were ultimately joined by 46 cosponsors. The Subcommittee on Labor and the Committee on Labor and Public Welfare unanimously approved it, and S. 3598 was reported to the Senate on September 15, 1972. My colleagues will recall that, due to the urgency of other matters pending, and the proximity of national elections, that bill was not brought to the floor for a vote. However, although it was not voted upon, many Senators expressed a desire for the bill to be brought up in the next session of the Congress as soon as possible.” (91)

¹¹⁶ *ERISA History*, 190.

¹¹⁷ Javits, *Autobiography of a Public Man*, 382-384.

After the Finance Committee eviscerated S.2 by removing its untenable financial stipulations, Bentsen, along with Committee Chair Carl Curtis (R-NE) went to work crafting the Finance Committee version of pension reform, which became S.1179, “a bill to strengthen and improve the private retirement system by establishing minimum standards for participation in and vesting of benefits under pension and profit-sharing retirement plans; by establishing minimum funding standards; by requiring termination insurance; and by allowing Federal income tax credits to individuals for personal retirement savings.”¹¹⁸

One of the biggest fears of pension and insurance industry insiders who opposed federal legislation was the possibility of a government takeover of the private system, and the evolution of some sort of ‘super Social Security.’ They feared both the growth of federal bureaucracy and the potential loss of control by the private sector.¹¹⁹ In his introductory remarks on S.1179, Senator Bentsen argued against these objections, saying “Some individuals will argue that enactment of this legislation would result in excessive Federal interference with the private retirement system. I strongly disagree. ... I strongly oppose efforts toward a Federal takeover of the private pension system.”¹²⁰ The primary goals of the Finance bill included vesting and funding provisions similar to the Williams-Javits Bill, but emphasized that the main idea was to change the Internal Revenue Code in such a way that more people would be encouraged to save for their own retirement.¹²¹ The promotional rhetoric surrounding S.1179 assuaged conservative

¹¹⁸ ERISA History, 211.

¹¹⁹ “Washington Letters,” *Pension and Welfare News*.

¹²⁰ ERISA History, 215.

¹²¹ ERISA History, 211-214.

fears, by affirming that the purpose of reform was to help the free enterprise system operate more efficiently and effectively.¹²²

Bentsen put forth a number of reasons why the Finance bill was superior to that proposed by the Labor Committee, chiefly that vesting and funding provisions would be better administered by the Internal Revenue Service than by the Labor Department. One other point as well, though, the Finance plan actually proposed better protections for workers, by including both smaller plans (the Williams-Javits bill exempted plans covering 25 or fewer employees) and union-administered plans financed solely by member contributions. Bentsen called for both earlier vesting (after five years instead of eight) and tax credits for employee contributions. In another move to limit bureaucratic expansion, the Finance bill proposed that the termination insurance program be operated by a federally-chartered nonprofit corporation.¹²³

In April of 1973, Senators Carl Curtis (R-NE), Clifford Hansen (R-WY), known as a far-right Republican, Wallace Bennett (R-UT), former president of the National Association of Manufacturers, Peter Dominick (R-CO), a Yale law graduate born in Stamford, CT, and Paul Fannin (R-AZ), a former petroleum distributor and Governor of Arizona, collectively introduced the Nixon administration's version of pension reform legislation.¹²⁴ The administration bill, S.1631, titled the Individual Retirement Benefits Act of 1973, was a

“bill to strengthen and improve the private retirement system by establishing minimum standards for participation in and for vesting of benefits under pension and profit-sharing retirement plans, by allowing deductions to individuals for their contributions to retirement plans, by increasing contribution limitations for self-employed individuals and shareholder-employees of electing small business

¹²² ERISA History, 215.

¹²³ ERISA History, 217-219.

¹²⁴ See the Biographical Directory of the United States Congress, at bioguide.congress.gov

corporations, by imposing an excise tax on prohibited transactions, and for other purposes.”¹²⁵

The decidedly conservative administration proposal intended to rectify the problems of private pensions primarily through changes to the tax code, and through relaxed limitations on the methods individuals could use to set aside money for retirement. One of the main features of the plan, which was amended into the Finance bill and ultimately into ERISA, was an increase to the amounts individuals could set aside in Keogh plans, which were self-funded retirement accounts available to the self-employed. The bill outlined the creation of a similar investment vehicle with more widespread availability, called the Individual Retirement Account, which workers could use to supplement private pension plans.¹²⁶

The Senators of the Labor and Finance Committees spent the summer months debating various portions of the reform bills and combining them into a new version of S.4. Every bill the Senate considered that had anything at all to do with retirement or the welfare of the elderly provided an opportunity for one of the supporters of the bill to state the case for reform. Harrison Williams took every opportunity to repeat the stories from the pension hearings held by the Labor Subcommittee, in language that would become the vocabulary among pension researchers. Williams’ impassioned speeches, with reference to loyal service, broken promises, and American tragedies, set the stage for retirement debates for decades to come.¹²⁷

¹²⁵ ERISA History, 325.

¹²⁶ Ibid.

¹²⁷ HAW Collection, Speeches; *Pensions: The Broken Promise; The Promise of Private Pensions; Broken Promises*, etc.

Speaking before the Senate Finance Committee's Subcommittee on Pensions, Williams made the case for Labor to retain control of pension reform efforts, painting the problem of retirement more as a matter of protecting worker's rights than one of financial oversight.

Mr. Chairman, I will say that from a personal point of view, these hearing were often most disturbing. It was most painful to come face to face with the tragic, true stories of men and women denied the retirement security they had been relying on. Time and again, we heard from worker who had given a lifetime of loyal service to their employers, counting on the promise of future pension benefits. But in case after case, the promises proved empty, and the dreams of economic security in retirement simply evaporated. While the causes of these broken promises varied, the results were personal economic catastrophes. And we also found that most of these tragedies could have been prevented. They could have been prevented by adoption of comprehensive, nationwide, and vigorously-administered guidelines for private pension systems. Accordingly, the Committee's judgment was that administration of pension plan regulation ought to rest with the agency which has as its primary mission, safeguarding the rights of working people - the Department of Labor.¹²⁸

Official debate and proposal of amendments to S.4 started in September of 1973. Robert C. Byrd proposed a time limit of one hour to debate any single amendment, "with the exception of an amendment by the distinguished Senator from South Carolina (Mr. Thurmond), which will be limited to 2 hours."¹²⁹ The bill under consideration was the new version of S.4, a combination of the Williams-Javits Bill (the original S.4) and the Finance Bill S.1179. It was 227 pages, and many Senators complained at the hurried nature of debate and the length of the bill, provided at such short notice.¹³⁰

¹²⁸ HAW Collection Box 1215: 6/12/73 testimony before Subcommittee on pensions of senate finance comm.

¹²⁹ ERISA History, 1225.

¹³⁰ ERISA History, 1579-1584.

Senator Gaylord Nelson (D-WI), an ally of reform on the Finance Committee, though not part of the conservative faction, sponsored S.4 for debate. He took the lead in defending the bill against its most persistent critic, Senator Vance Hartke (D-IN). Ironically, Hartke was one of the original proponents of retirement reform; he sponsored the Federal Reinsurance of Private Pensions Act in 1964. A response to the Studebaker crisis in his home state, the bill was not successful except that it brought to light the many issues surrounding the creation of pension plan termination insurance.¹³¹ The fact that Senator Hartke, a staunch advocate of pension reform, was the most critical opponent of the S.4 reveals much about the confusing compromise that became ERISA. The majority of Hartke's objections centered on points where he thought the law was not far-reaching enough. His opinion was that if the Congress could not do the right thing, it was better to wait, and to keep pushing, until the true goals could be achieved. After their previous failures, though, both Javits and Williams realized that something was better than nothing, and that new retirement regulations could only pass if they included provisions acceptable to the conservative side of Congress.

At least twenty random amendments and amendments to amendments, regarding broader measures for equality and beneficiary protections for women and minorities, part time and domestic workers, and many others, did pass during debate. These were sponsored by many Senators, including from Senators Mondale, Taft, Jackson, Buckley, Thurmond, Tunney, and others. However, none of Senator Hartke's amendments was passed.

Hartke's critique of S.4 began with complaints over the lack of transparency of the compromise process. He admitted that the presentation of a compromise bill in lieu of an

¹³¹ Wooten, *ERISA*, 78.

original was legal, but insisted that it was “not good legislative practice.”¹³² Finance proposed the new S.4 as an amendment in substitution, to be considered as original text and therefore open to two degrees of amendment. Many Senators were displeased they lacked the chance to understand the new bill before debate began, but Hartke was the most vocal in his objections, complaining that “to do this in this fashion without having a chance to understand what is in the bill – the original legislation was bad enough – I do not know what this does – I tried until 6 o’clock last night to get a copy of the bill.” “There is no report,” declared Hartke, “what is being attempted by the Senator from Wisconsin (Nelson) is to substitute one bill for two other bills.”¹³³

Regardless of the complaints, Senator Javits was proud of the bill and the cooperation that brought it to the floor, telling the Senate that, “I have never seen in all my time here –almost 18 years—a more effective effort to coordinate probably as complex a piece of legislation as we have had to consider in years.”¹³⁴ Javits passed on much of the credit where credit was due, to the various committee staffers who actually researched and wrote the bill: “As everyone knows, we do not do these things ourselves; it is our staffs who are the heroes in this case.”¹³⁵ Those Javits singled out for praise included Mike Gordon, the minority counsel of the Committee on Labor and Public Welfare in respect to pension and welfare, Mario Noto, special counsel to Labor, Noto’s replacement Bob Nagle, as well as Larry Woodworth from the Joint Committee on

¹³² ERISA History, 1594.

¹³³ ERISA History, 1593.

¹³⁴ ERISA History, 1606.

¹³⁵ ERISA History, 1607.

Taxation and the staff of the Finance Committee, who brought “a true understanding of what is meant by the people’s capitalism.”¹³⁶

For his part of the introduction of the new S.4, Senator Nelson described the differences between the original Williams-Javits bill and the new version. The compromise took the fee structure from the Finance Bill, which assessed a more straightforward cost per participant for termination insurance, and added a nominal fee per participant to help cover IRS administration costs. Mr. Bentsen rose to again support the idea that the new bill was intended to supplement the existing system, not to take over it. He reiterated, "I strongly oppose efforts toward a Federal takeover of the private pension system. I believe that the free enterprise system can work effectively in this area but only if a proper balance is reached between the interests of employers and employees."¹³⁷ The Finance Committee Republicans argued less about the protection of the rights of workers, and more about achieving equity between the tax treatment of businesses and individuals with regard to money intended for pensions.¹³⁸

Before Senator Nelson could explain the extent of the changes proposed by the Finance version, Senator Hartke interjected to say that there was nothing in the bill that would have helped the workers at Studebaker. Both Nelson and Javits immediately responded that term insurance would have provided protection for Studebaker workers.¹³⁹ Javits went on to describe how the funding requirements could have ensured that the money was available to pay pensions,

¹³⁶ Ibid; 1609: Javits said, “For over the last half-century, public policy has been concerned with relieving oppressive work conditions and enhancing work opportunities. It is but a natural extension of that policy to obtain protection of workers against deprivations of their private pensions.”

¹³⁷ ERISA History, 1637.

¹³⁸ ERISA History, 1621-1632.

¹³⁹ ERISA History, 1639.

and that Studebaker would not have been able to lay off younger workers without violating the bill's nondiscrimination clause.¹⁴⁰

Once he regained the floor, Nelson went on to explain the major amendments proposed by the Finance Committee. In addition to co-opting the administration's plans to increase the deductible amounts for Keogh plans and creating new individual retirement accounts, the Finance plan set limits on benefits, that they be no greater than 100 percent of the employee's average compensation, as measured over his three highest-earning years. The plan also called for an equalizing of contribution amounts across the range of employees, in order to prevent corporate executives from being able to take excessive deductions, especially when they already controlled the operation of the pension plans. In a response to well-directed industry lobbying, Finance insisted that restrictions on investing by 403(b) plans be eased, to allow them to invest directly in mutual funds.¹⁴¹

Senator Nelson had serious objections himself about the bill's lack of limitations on executive level pension compensation. He first proposed an amendment to limit the amount of tax deductibility available to high-paid executives, commenting that it was unfair to offer such high tax breaks to those who possessed the means to provide for their own retirement. With support from Hartke, Nelson proposed limiting the maximum possible pension benefit to forty-five thousand dollars per year.¹⁴² Bentsen and Curtis were quick to object that it was not the government's job to decide what people's retirement should be. In addition, adopting a ceiling at \$45K would make executive pensions lower than those of some public officials. For example,

¹⁴⁰ ERISA History, 1641.

¹⁴¹ ERISA History, 1655-1664.

¹⁴² ERISA History, 1711-1731.

the annual retirement pension for some Supreme Court justices was already fixed at sixty thousand dollars. It would look bad, the Senators said, if we kept pensions for ourselves in public office but limited them in the private sector.¹⁴³ Senator Long offered a more practical objection to Nelson's amendment; he did not think it would do any good. As Finance chair, Long approached the matter from a taxation viewpoint. If the purpose of Nelson's proposal was to raise money from those who could afford it in order to relieve the burden on others, said Long, then it made no real difference whether it was adopted or not, since "we are not going to raise enough money to wad a shotgun."¹⁴⁴ If the amendment would not achieve anything concrete, Long reasoned, there was no reason to support it. In the end the amendment was defeated by a vote of 59 against to 32 in favor.¹⁴⁵

Only somewhat daunted, Nelson soldiered on, proclaiming, "now that the Senate has done its duty and taken care of the rich and affluent with the defeat of the last amendment, let us adopt this amendment that at least says you cannot raid the Treasury for any more money than it takes to pay a \$75,000 a year pension."¹⁴⁶ Under the Finance revisions to S.4, a limit to annual pension amounts of an average of the greatest three years of compensation *or* \$100,000, whichever was highest, applied only to professional and closely held corporations. Nelson wanted to lower the limit to \$75,000, and apply it more broadly - to all corporations. Again, the argument was dominated by Finance's conservative Republicans and Democrats. Russell Long questioned why the Congress should limit the potential of those who are helping others earn

¹⁴³ ERISA History, 1735.

¹⁴⁴ ERISA History, 1741.

¹⁴⁵ ERISA History, 1748.

¹⁴⁶ ERISA History, 1749.

more by managing such corporations as GM or IBM.¹⁴⁷ Hartke broke in to object yet again, that the plan was not broad enough and that all these details were not addressing the elephant in the Congressional chamber; "the fatal defect" was that the majority of Americans were not covered by a pension at all.¹⁴⁸

Senator Thurmond took the floor to propose an amendment to one of Mr. Nelson's defeated amendments, in order to erase distinctions in the treatment of small and large corporations. This led to further discussion on the authority of Congress to determine amounts of compensation. Senator Jesse Helms (R-NC) objected vigorously to any idea of limiting the pension potential of high earners, on the grounds that "this is wrong and contrary to out American philosophy that a person is entitled to enjoy the fruits of his labor."¹⁴⁹ Ultimately, the amendment was worded in language of equality between businessmen, and passed by an overwhelming 89 votes to 2.¹⁵⁰ Other critiques were put forth, including another from Mr. Hartke, calling for more liberal vesting and funding, but Javits deflected these arguments by explaining their impracticalities. As Javits put it, "How much is a man going to vest if he has 1 year's service? How much will he get out of his pension? By the time you get through keeping all those records and certifying them to the Secretary of Labor and the Social Security Administration, and paying them out as \$1.89 checks, you will wish you had never heard of pension plans, and every employer knows that, just as I have stated."¹⁵¹ One set of proposed

¹⁴⁷ ERISA History, 1749.

¹⁴⁸ ERISA History, 1759.

¹⁴⁹ ERISA History, 1783.

¹⁵⁰ ERISA History, 1783.

¹⁵¹ ERISA History, 1800-1801.

amendments that did pass was for clarity and improved portability.¹⁵²

Senators Kennedy and Pell told a few pension stories of their own, drawing on examples from the UAW hearings, to reiterate their support and urge passage of the bill, which at this point was in actuality a minor house bill H.R.4200, with S. 4 amended to it. The Senate passed the bill by a vote of 93 in favor and none opposed.¹⁵³ The next step in the process was a joint House and Senate conference, to iron out the differences between the Senate's new H.R.4200, and the House's H.R. 2. The Senate's delegates were Senators Long, Williams, Randolph, Nelson, Bentsen, Javits, Schweiker, Bennett, and Curtis.¹⁵⁴ The House finally appointed conferees in April of 1974, and after a series of reconciliations, which did little to alter the substance of the Senate's bill, H.R. 2 was finalized in August, 1974, with only two dissenting votes in the House, and signed as Public Law 93-406, ERISA, by President Ford on Labor Day, September 2, 1974.

In another time, the lag between the Senate's approval of ERISA and the House's final consideration could have signaled the bill's ultimate demise. The legislative record of the history of ERISA shows no actions taken between October, 1973, and February, 1974. The fact of the matter is that Congress had bigger fish to fry, and impeachment hearings took precedence over retirement reform. ERISA needed to be passed or tabled, and it had enough people fighting for it to keep it alive. Pension scholar Fran Hawthorne has conjectured that the Watergate scandal, and the lack of normalcy of 1974, was what saved ERISA.¹⁵⁵

ERISA first and foremost called for stringent standards of fiduciary responsibility,

¹⁵² ERISA History, 1828.

¹⁵³ ERISA History, 1881.

¹⁵⁴ ERISA History, 2179.

¹⁵⁵ Hawthorne, *Pension Dumping*, 45.

applicable to both pension fund management and to the businesses sponsoring plans. The legislation called for vesting standards, so that employees would legally own their own pensions, and for portability rules, so workers could take their pensions with them if they moved jobs. Under ERISA, all plans would have to meet minimum funding requirements, and pay for plan insurance through a new agency, the Pension Benefit Guaranty Corporation. In addition, ERISA created a way for individuals to assume direct control over retirement funding with a new investment vehicle called an Individual Retirement Account. ERISA changed the emphasis of federal pension legislation from maintaining plan assets to protecting the rights of individual employees. Senator Williams thought public policy should legitimize pensions “for what they really are – deferred wages, part of the employee’s just compensation, and payable at retirement.”¹⁵⁶

“We think that it is time to give much more attention to the question of the desirability of creating pension systems that will not only provide adequate minimum old-age incomes but also provide the elderly with pensions that permit them to maintain or more closely approach their preretirement living standard in retirement and, perhaps, even improve upon it.”¹⁵⁷

While ERISA was built on practical political and economic considerations, it marked an important populist moment. ERISA could succeed because its proponents moved the pension away from the realm of labor relations and turned it into a social and consumer issue. As

¹⁵⁶ Dan M. McGill, *Preservation of Pension Benefit Rights* (Homewood, IL: Irwin, Inc., 1972) 39-40; and Sass, *Promise*; much more legislation was required before the IRA reached its current form; Press release 72-103, Box #1620, HAW Collection

¹⁵⁷ James Schulz, Guy Carrin, Hans Krupp, Manfred Peshke, Elliott Sclar, and J. Van Steenberge. *Providing Adequate Retirement Income: Pension Reform in the United States and Abroad* (Hanover, New Hampshire Published for Brandeis UP by the UP of New England, 1974), 22.

consumers, older Americans held economic and political power.¹⁵⁸ And pension failures that left the nation's grandparents cold and hungry garnered much more attention than did suspected mismanagement of union benefit plans.

In his memorandum detailing the creation of Social Security, Edwin Witte, executive director of the Committee on Economic Security, did not use the word "retirement."¹⁵⁹ The focus of both government and reformers in the 1930s was on "security," which is a very different thing. The challenge facing ERISA's policy-makers was that the American public increasingly thought of old age security and retirement as one and the same, which led to increased demands on both Social Security and the private pension system.

Social Security was created to provide financial support for workers whose employers deemed them mentally or physically unfit to work, but the concept of retirement later evolved to include the idea of earning enough money so that work was no longer required if one so desired. Retirement further evolved into the idea that everyone should have the option to stop working at a certain point in life.

Social Security created the expectation of a period of life not defined by work, but left questions as to the greater purpose of life after employment.¹⁶⁰ The modern concept of retirement was invented in the postwar period, when unions promised a period of leisure following a lifetime of work, and groups like the American Association of Retired Persons (founded 1955) promoted retirement as a change in lifestyle. Retirement "was not to be a

¹⁵⁸ Gary Cross, *An All-Consuming Century: why commercialism won in modern America* (New York: Columbia University Press, 2000), 187.

¹⁵⁹ See Witte.

¹⁶⁰ Carole Haber and Brian Gratton, *Old Age and the Search for Security: an American social history* (Bloomington: Indiana University Press, 1994), 168.

relatively brief period of inactivity before death, but a new life stage of fulfillment and compensation for work, unfettered by geographical or time constraints.”¹⁶¹

Society was changing on a broad level. While Americans continued to define their place in society through employment, more and more began to define the quality of their lives based on what they did outside the workplace. This increasing emphasis on leisure made the new idea of retirement almost a necessity. The expectation of security before death changed into an entitlement to enjoy life after decades of work.¹⁶² Work itself evolved into the broader, life-goal encompassing idea of the career. The expected parting gift of a pension from a grateful employer became the right to deferred wages specifically set aside for retirement.

The evolving idea of retirement is further complicated as older Americans gained economic and political power through their growing role as consumers. That power only grew as life expectancies increased. Gary Cross argues that business promoted the idea of retirement in order to spur consumer demand among the elderly.¹⁶³ Economic growth had long before created a corresponding consumer ideology, in which workers claimed the right to an “American standard of living,” which included “low prices, high wages, and better-quality products.”¹⁶⁴ The right to an enjoyable retirement became a natural extension of this ideology. Driven by consumerism and promises of the good life, the public concept of security for the aged became synonymous with the private ideology of retirement.

¹⁶¹ Cross, *All-Consuming Century*, 187.

¹⁶² W. Andrew Achenbaum, *Shades of Gray: Old Age, American Values, and Federal Policies since 1920*. (Boston and Toronto: Little, Brown and Company, 1983),59; 130.

¹⁶³ Cross, *All-Consuming Century*, 187.

¹⁶⁴ Meg Jacobs, *Pocketbook Politics*, 5;8. Postwar Americans fully absorbed the Keynesian idea that thrift was no longer a virtue. See Robert Collins, *The Business Response to Keynes, 1929-1964* (New York: Columbia University Press, 1982).

ERISA was the law that nobody wanted. Business saw nothing redeeming in it, and organized labor was skeptical of its usefulness. Presidents Johnson and Nixon may have supported its stated aims, but could not give their full support to its passage. How then did ERISA pass?

Those who supported reform, within Congress and certain unions, did their best to mobilize public support for ERISA. They took advantage of the social changes that were taking place in America; this was not a period of excitement or optimism in America, but a time of pessimism and malaise, overlaid with boredom. As American workers questioned, *is this it*, the proponents of the new kind of retirement were ready to supply the answer. Consumer ideology and the pension promise held out hope for something better following a lifetime of work. In an economy on the edge of transition away from industry, a secure retirement became something that individual Americans were willing to fight for. This pushed ERISA from Javits' impossible dream to reality.

All regulation produces unintended consequences; the particular question to ask with regard to retirement reform, though, is how regulation created a system so remarkably different from the stated intention. The idea that Williams and Javits sought to affirm was that retirement is a right, and not a privilege. Their intention was to create a private pension system that guaranteed individual retirement security. "The day is here (or not far away) for many Americans when *financial planning for retirement will no longer be a major problem*. Social security together with private pensions will reduce dramatically or *eliminate for many Americans the need to save individually* for their retirement."¹⁶⁵ This is not the situation that ERISA created. A law intended to protect individuals instead reinforced the power of institutions and

¹⁶⁵ Schulz, et al, 46. My emphasis.

the role of the New York Stock Exchange in the American economy. On a broader level, an examination of retirement regulation prompts historians to reassess our evolving characterization of twentieth century American capitalism.¹⁶⁶

¹⁶⁶ Likely the same problem as during the Depression – pensions just weren't evolving quickly enough. In this case the precipitating event was less drastic or cataclysmic but equally far-reaching, especially if we take a long view of the 1970s as a period of fundamental social change. This really is the slow end of the New Deal and the beginning of the Conservative Ascendancy: the rise of technology and the start of widespread computer use; social upheaval with greater individualization generally; the deregulation movement and finding a new role for government in social policy; especially the transition from an industrial economy to a service/technology economy

CHAPTER V

Implementation and Aftermath

No one anticipated a decade earlier that two major issues confronted by Congress in the early 1970s would be inextricably intertwined: reforming the nation's private retirement system and creation new regulations for the national securities market. Each problem represented a huge and fundamental change in its own right. Refashioning the nation's private pension system was a distinctly-conceptualized task, as was reformatting the operations of the New York Stock Exchange. Both the Employee Retirement Income Security Act (ERISA) and the Securities Acts Amendments of 1975 marked ending points for very long processes of political change. Crafting separate solutions appeared logical but the process did not take into account the deepening connections between private pensions and the nation's capital markets. By the early '70s, retirement pensions provided a huge portion of the nation's investment capital, trading more common stock than even other institutional investors, such as life or property and liability insurance companies.¹ By the end of 1971, the assets of private pension funds topped \$140 billion.²

That connection was significant. An increase in the amount of trading done by institutions, such as pension trusts, spurred the need for new securities regulations. Institutions chafed at paying commissions according to the fixed rate schedule that applied to individual investors. Because the size of the typical institutional trade was so much larger than the average

¹ "Pension Funds Top Net Purchase of Common Stock," *Pensions & Investments*, August, 1972, 6; see also, Arthur S. Fefferman, "Private Pension Plans: A 1968 Prospectus," *The Journal of Risk and Insurance*, Vol. 36, No. 4 (Sept., 1969) 433-436.

² Theodore Schuchat, "Washington Letter," *Pensions & Investments*, October, 1971.

individual transaction, many institutions thought their trades should receive a discount. At the same time, many individuals thought that stockbrokers neglected them in favor of providing better services to the larger, more profitable, institutions.

Policymakers neglected to draw a specific connection between the complaints of institutions, the problems of the individual investors, and the fact that institutions were investing on behalf of the retirement of individuals. What Congress did not foresee was how new regulation of retirement and changes to investment methodology would, in combination, drive employers and stockbrokers to promote retirement planning as an individual, rather than a corporate, responsibility.

Implementing ERISA presented pension fund managers with many challenges, but chief among these was the problem of administration. The one thing all of ERISA's provisions had in common was the increased complexity and supervision they required of pension management. ERISA's new standards of fiduciary responsibility increased the importance of investment research services.³ In theory, this provided a larger market for brokerage firms; however, brokers were ill-equipped to take advantage of the opportunity. When the Securities and Exchange Commission and Congress both demanded that Wall Street move from fixed to negotiated commission rates, stockbrokers faced a fundamental problem: they needed to increase trade volume in order to maintain income levels.⁴ As a result, brokerages reduced the amount of research they provided in favor of maintaining their active sales forces. Following commission

³ "practically every plan will have to be revised to meet the standards;" Skolnik, Alfred M., "Private Pension Plans, 1950-74," Social Security Bulletin 39-6 (June 1976) 3-17, 5; Most of the new standards required by ERISA went into effect January 1, 1976.

⁴ "American Brokers: Mayday on May Day?" *The Economist* 26 Apr. 1975: 118

deregulation, the New York Stock Exchange (NYSE) approached the goal of increasing the number of individual investors with a renewed vigor.

Many of ERISA's provisions also had the effect of increasing the time and effort necessary to run a private pension, prompting pension managers to alter or terminate their plans in favor of more individualized pension arrangements, such as defined-contribution pension plans, the best-known of which is the 401(k). The combination of increased fiduciary responsibility on the part of pension managers and greater attention to and opportunity for individual investment helped companies shift the burden of investing for retirement away from the corporation and toward the individual employee. Deregulation and ERISA combined to provide encouragement and opportunity for individual retirement investment.

The most senior Congressperson involved with both retirement and securities reforms was Senator Harrison Williams. Williams co-authored ERISA with Senator Jacob Javits, while at the same time serving as Chairman of the Senate Subcommittee on Securities. From a financial standpoint, pensions and securities were connected directly through the issue of institutional membership on stock exchanges. Williams acknowledged this problem, but approached it from a different point of view than those on Wall Street.

Large institutions, often those charged with investing pension fund monies, attempted to use stock exchange memberships to circumvent increasingly onerous commission fees. By the late 1960s pension fund management companies were looking for a way to avoid the high fixed commissions incurred by their large trades. One solution was to apply for membership on an exchange, cutting out both the third-party broker and his commission. The problems of fixed commission rates and spiraling equity investment by pensions combined to produce an environment on Wall Street which, as Williams recognized, was hostile to the individual

investor.⁵ By the time Williams was fighting to pass ERISA, the shrinking body of individual investors was a well-recognized phenomenon and “an alarmingly long-run trend.”⁶

To Williams, the problem with Wall Street was not the cost burden it imposed on institutions, but rather that the preponderance of institutional investors made active investment more difficult for individuals. Institutions wanted commissions to be negotiated so that they could save money, and those on Wall Street who supported reforming the rate structure did so with the goal of maintaining their existing institutional customer base. Such a radical change as the unfixing of commission rates was a hugely contentious issue for Wall Street. As a so-called self-regulatory body, the NYSE was in a position to moderate Congressional demands.⁷ The misalignment of the reformers’ goals – making room for individuals versus making life easier for institutions – made adapting to change a fluid and unpredictable process. The lack of a unified, concentered objective for securities reform gave the NYSE leeway in accommodating competitive rates.

⁵ Harrison Williams, Remarks Before the Harvard Business Club of Minnesota at the Sheraton-Ritz Hotel, Minneapolis, MN, June 14, 1974, Box 1398, HAW Collection; Press Release #74-84, Box 1619, HAW Collection; Press Release #73-122, Box 364, HAW Collection.

⁶ James P. Roscow, “Bulls in the Insurance Shop: 1973 + Separate Accounts = Optimism,” *Pensions & Investments*, June, 1974, 30-35, 30. The flight of individuals was less distressing to insurance companies than to market analysts because of the creation of what were called Separate Accounts. These provided a way for insurance companies to divide their assets into specialized accounts which could then trade in common stocks under fewer regulations. Traditional insurers feared a drastic loss of business if they remained constrained by the limitations most states placed on common stock trading by insurance companies. They welcomed the creation of a way for them to enter the booming market of institutional trading of common stocks. See also George D. Bjurman, “Are You Getting 12%?” *Pension and Welfare News*, June, 1969, 39-40, 42-43.

⁷ An explanation of how the NYSE operated as an entity both subject to and apart from federal regulation can be found in Chapter 3.

Senator Williams was passionate about pension reform on behalf of non-executive employees, who were the ones most often hurt by plan termination or underfunding.⁸ Harrison Williams had made a good career by positioning himself as a champion of the people. His public remarks about preserving the rights of the working people were carefully calculated to maintain that image.⁹ Such a reputation was a useful tool in the political arena. Standing on the side of the little guy brought Williams access to two powerful strategies. As a defender of the American people, Williams was a difficult man to oppose. His efforts on behalf of the average worker gave him the ability to rally and manipulate public opinion, something increasingly powerful in the era of rapidly expanding communications technology.¹⁰ As Chairman of the Senate Committee on Labor and Public Welfare, Williams was a powerful senator and a valuable ally. More idealistic than Williams, Senator Jack Javits insisted on fairness and equal protections, which ultimately gave ERISA some of its most burdensome provisions. Javits really did have altruistic motives, but his policies were challenging to implement because they included no potential reward structure for employers. ERISA, as originally envisioned by Javits, was all stick and no carrot. Williams understood that certain compromises were necessary. Javits himself was frank about the fact that his proposed retirement reforms made no substantial progress until Williams joined the campaign.

⁸ Harrison Williams, Speech Before the Detroit Chapter of the Financial Executives Institute, September 24, 1973, Box 1215, HAW Collection: As head of the Senate Labor Subcommittee Study of Private Pensions, which ran from 1970-73, Williams reviewed approximately 20,000 letters from individuals hurt by inadequate, mismanaged, or terminated pension plans.

⁹ Williams's second wife, Jeannette, helped him cut down on his drinking, and polished his political aspirations – she was much more active on the DC social circuit; at one point he considered the presidency, but that was all lost with the ABSCAM scandal.

¹⁰ See Richard R. John, *Network Nation: Inventing American Telecommunications* (Cambridge, MA: Harvard University Press, 2010).

It would be a mistake to characterize Harrison Williams solely by his well-crafted public image. The man was a shrewd operator, and no fool. In fact, Williams understood the larger threat posed by the growth of institutional investment. While the growth of institutions could indeed force individuals out of the markets, this was the smaller threat when compared to the potential result of institutions choosing to trade outside the bounds of established market systems. The so-called Third Market was a thorn in the side of Wall Street and was becoming problematic on a national level. As opposed to trades on the NYSE, where exchange-listed stocks traded in a central marketplace, or a forum where trades of unlisted stocks occurred over distance, between members of the National Association of Securities Dealers (NASD), the Third Market consisted of trades of exchange-listed stocks performed outside the floor of the exchange, and not subject to regulation by either the NYSE or the NASD.

Unhappy with high commissions, some institutions turned to the Third Market to arrange trades of listed stock at a lower transaction cost. Others purchased seats on local or regional exchanges, effectively becoming their own brokers. In either case, the actual trades were negotiated behind closed doors, away from open national market that was the floor of the NYSE. And this was what Williams correctly judged to be most dangerous to the American economy. As institutional holdings continued to increase at an exponential rate, more and more of the nation's capital was changing hands out of view of the public eye and out of view of the SEC as well. Net purchases of common stock by private pensions jumped from \$4.6 billion in 1970 to \$8.9 billion in 1971. The Senate Labor Subcommittee's Interim Report of Activities of the Private Welfare and Pension Plan Study remarked regarding this kind of purchasing power, that "Lacking governmental guidance and supervision, it can lead to incalculable risks to assets

which are held or invested for the trust of workers.”¹¹ This was too much money moving around outside the boundaries of federal control.

When speaking before financial professionals, Williams made clear that his understanding of the situation on Wall Street went beyond the public plight of individual investors or the internal power struggles between different categories of brokers. As institutions increased their seat ownership at regional exchanges, the stock market was closing in on itself. In essence, by acting as their own brokers, institutions were removing a step from the investment process – the step where a purchase or sale is made in an open and competitive environment. By arranging their own trades behind the scenes, and directing them to preferred exchanges, institutional investors were slowly and steadily eroding the structure of America’s capital markets, compromising not only the investment abilities of individuals but also the flow of investment capital to the national economy.

At the same time, the burgeoning growth of pension funds meant that institutions were directing the investment of increasingly huge sums of money.¹² Williams was cognizant of the massive implications of this change, which management theorist Peter Drucker would later characterize as “one of the most startling power shifts in economic history.”¹³ The issue of pension security was both a personal and a corporate problem, and although Williams was fully

¹¹ Shirley Scheibla, “The Business Front: Not-So-Private Pensions: Congress is Weighing Various Proposals to Regulate Them,” *Barron’s National Business and Financial Weekly*, June 19, 1972, (51,25), 11.

¹² Conrad W. Thomas, “Sure as Death and Taxes: Corporate Pension Costs Continue to Mount at an Alarming Rate,” *Barron’s National Business and Financial Weekly*, August, 1972 (52, 35) 3. The cost value (less than market value, presumably) of GM’s pension assets was \$3.15 billion, for example.

¹³ Peter F. Drucker, “The Governance of Corporations,” in *A Functioning Society: Selections from Sixty-Five Years of Writing on Community, Society, and Polity*, ed. Drucker (New Brunswick and London: Transaction Publishers, 2003), 129. “The rise of pension funds as dominant owners and lenders represents one of the most startling power shifts in economic history.”

aware of the extent of the problem, his priority was to ensure that the nation's capital markets continued to function smoothly. Williams' commitment to his constituents, and to solving the problem of old age impoverishment, was genuine, but the issue of reforming the private pension system included the fundamental problem of preserving the nation's open capital markets.

And yet, because of the nature of the American political process, the easiest way for Congress to pass reforms was through an appeal couched in the rhetoric of preserving and defending individual rights. In fact, journalist and author Shirley Schiebla referred to the situation as a "politician's dream of giving the voter something without taking it away from the taxpayer."¹⁴ In the same vein, new regulations for the NYSE were better presented to the public as an improvement to individual market access, rather than the resolution of institutions' complaints that their costs were too high. The Exchange's public position on reform was constantly challenged by internal differences of opinion between those who welcomed the change and those who resisted it. The challenge of interpreting the Exchange's position was that the distinction between reality and good public relations was murky on Wall Street. Supporters of negotiated rates and those opposed both argued that their choice would best preserve the market system and help the NYSE fulfill its vital role in the national economy.¹⁵

The publicity surrounding pension reform made it a personal, individual problem in need of redress. However, Congressional action was necessary because of a fundamental economic problem – the nation's pensions were major players now in the capital markets. Beyond questions of ownership or control, the success or failure of private pensions could affect the

¹⁴ Shirley Scheibla, "The Business Front: Not-So-Private Pensions: Congress is Weighing Various Proposals to Regulate Them," *Barron's National Business and Financial Weekly*, June 19, 1972, (51,25), 11

¹⁵ See Chapter 3

growth of the national economy. The assets of pension funds were growing at a higher rate than either company assets or stockholders' equity.¹⁶ Individuals were the face of the problem, but institutions were the cause and substance of it. The relationship between pensions at an individual level and the institutions which managed them is most transparent in the ways ERISA and securities regulations mutually discouraged the growth and expansion of traditional defined benefit pension plans.

While the strength of public opinion helped reforms pass Congress, it also provided a way for the business community to change its behaviors in ways that outwardly appeased public demands but actually perpetuated traditional profit-seeking behaviors. By refashioning retirement as an individual right, corporations could justify changing their plans from defined benefit to defined contribution, moving the burden of funding from the company to individual employees.

America of the early 1970s was undergoing massive change, reaching well beyond the more visible social movements of the times, such as those for civil rights, the equality of women, or the end to war in Vietnam. A quieter revolution occurred within the halls of American business, as traditional institutional hierarchies were reconfigured, responding to advances in technology and communication, and to new manifestations of populism. The end of the Bretton Woods monetary system marked the end of the gold standard in 1971, but also serves as a signifier of a new conception of money. Americans' ways of measuring value came to embrace a greater range of attributes than sheer monetary worth. The concept of value became increasing fluid as consumers began to consider whether a purchase or investment was safe, family-

¹⁶ Conrad W. Thomas, "Sure as Death and Taxes: Corporate Pension Costs Continue to Mount at an Alarming Rate," *Barron's National Business and Financial Weekly*, August, 1972 (52, 35) 3.

friendly, fairly traded, or environmentally-conscious.¹⁷ Money was no longer only meant to be spent or saved, invested or donated. Money became something to be managed, and it was the job of the managers of new and powerful institutions to make money work.¹⁸

Technological change catapulted management, especially executive management, to a new level of organizational importance. As processes became automated and systematized, regular workers became both plentiful and expendable. The corporate ideology of loyalty no longer needed to emphasize the relationship between the worker and the company. The executives, who kept the system running and who managed the money, were the employees corporations wanted to keep. Loyalty, reinforced through salary, benefits, and perquisites, correlated with education and financial knowledge in the evolving economy. Business turned its collective attention away from the average worker, easily replaced or outsourced, and directed its efforts to retaining managerial expertise.¹⁹

Employers who sponsored, or were considering sponsoring, pension plans, reacted to the 1974 passage of ERISA with extreme caution. The economy was still reeling from the 1973 oil crisis and the effects of stagflation, and the stock market's poor performance reflected the general malaise. The rate of inflation for 1973 was 8.8%, and pension obligations were growing at twice the average rate of earnings.²⁰ ERISA was poised to influence every aspect of pension

¹⁷ e.g. creation of the EPA, OSHA, etc. Other reforms accomplished through Ralph Nader's lobbying efforts.

¹⁸ John K. Kittredge, "Group Insurance and Pensions in 1975," *Pension and Welfare News*, December, 1968, 36. "Economists quite confidently predict an increasing level of affluence for the American public during the '70s."

¹⁹ See work of Jefferson Cowie and Nelson Lichtenstein.

²⁰ Dana L. Thomas, "Escalating Pensions: They're a Mounting Threat to Corporate Finances," *Barron's National Business and Financial Weekly*, March 18, 1974, (54, 11) 3.

management and operation, but the specifics were still uncertain. Initially, many sponsors took a watch and wait approach, moving their funds into conservative portfolios while the IRS and Labor Department hammered out the regulatory details. Although ERISA was signed into law in September of 1974, most of its provisions did not go into effect until 1976. The stated purpose of the delay was to give companies time to bring their plans into compliance.²¹ In reality, many of ERISA's provisions needed clearer explanation before they could be implemented. The delay also gave employers time to investigate alternative pension arrangements that did not merit the same degree of government oversight.

One thing was clear, that pension managers could no longer pursue high risk equities to the exclusion of more stable investments. Instead of relying on investment gains to fund pensions, sponsors discovered that larger direct contributions would be required, lowering corporate profits. A study of private pensions by Merrill Lynch found a decrease in the proportion of funds in equities, from 70% in 1972, to less than 59% in 1975.²²

ERISA was problematic well before it went into effect. One of the problems Congress faced in passing the legislation was the question of appropriate oversight. Both the Labor Department and the Internal Revenue Service claimed to be primarily responsible for matters involving pensions, so Congress decided to split oversight between the two. While the Labor Department might seem the more appropriate agency to deal with employee retirement security, treatment of retirement plans in America was historically within the purview of the tax system, giving the IRS an equally valid claim.

²¹ See *Pensions & Investments*.

²² "Wall Street Goes Slow." *Business Week* 11 Oct. 1976: 100.

The IRS took the frontline, and claimed primary responsibility for issues regarding vesting and questions of ownership, adequate funding, and equitable participation. This left Labor in charge of regulating fiduciary standards and operating the new Pension Benefit Guaranty Corporation, the agency created by ERISA with the purpose of providing pension plan termination insurance.²³ Still, any regulations developed by the IRS had to be approved by the Treasury Department, and then approved and adopted by the Labor Department. Roughly three hundred additional pages of regulation, covering minimum standards and issued at the end of 1976, did not resolve all the jurisdictional questions.²⁴ The American Bankers Association lobbied Congress to streamline the process by allowing the Labor Department to assume full administrative control, but in the meantime employers were left confused on the basic issue of where to direct their questions.²⁵

The amount of paperwork and the general administrative costs incurred by pension plans skyrocketed under ERISA. As a result of Congress's decision to solve the question of oversight by splitting responsibility between departments, the appropriate forms had to be filed with numerous agencies, leading to "monumental recordkeeping problems."²⁶ The annual reports required by the IRS alone necessitated the production of hundreds of pages of documentation. The projected administrative costs of bringing plans into regulatory compliance were enough to

²³ Michael J. Clowes, *The Money Flood: how pension funds revolutionized investing* (New York: Wiley, 2000), 94.

²⁴ *Pensions & Investments*: Paul R. Merrion "Minimum Standards Clear Way for Big Year in New ERISA Regulations," Jan. 3, 1977, 14.

²⁵ *Pensions & Investments* – see the ABA articles

²⁶ Linda Moskowitz, "Reactions Vary On Minimum Standards," *Pensions & Investments*, Jan. 17, 1977, 1, 26.

force many small plans to terminate even before ERISA took effect.²⁷ ERISA made basic operation of a pension plan an expensive proposition; the Department of Labor later estimated that ERISA increased costs for small plans by 72%.²⁸ Pension costs were already growing at an average annual rate of 20% in the years immediately preceding ERISA, and, unlike other business expenses, did not vary with economic conditions.²⁹

In addition to regular filings with the IRS and Labor, the Social Security Administration had to be kept informed, and, even more daunting to corporate plan sponsors, so did their employees.³⁰ ERISA required that everything to do with pension plans be thoroughly documented and summarized in language accessible to the average plan beneficiary. One of Senator Williams' key talking points in Labor Subcommittee hearings had been that "many employees have little or no understanding of their rights and obligations under their plans," and "many pension plan participants never receive the benefits they are led to expect."³¹ This, too, had been one of the requirements Ralph Nader lobbied hard to achieve, that all the details of the

²⁷ Yohalem, Martha Remy, "Employee Benefit Plans, 1975," *Social Security Bulletin* 40-11 (Nov 1977) 19-28, 25; Martin Neil Baily and Jacob Funk Kirkegaard, *US Pension Reform: Lessons from Other Countries* (Washington, DC: Peterson Institute for International Economics, 2009), 386.

²⁸ Sylvester J. Schieber and John B. Shoven. "The Economics of US Retirement Policy: Current Status and Future Directions." In *Public Policy toward Pensions*, edited by Sylvester J. Schieber and John B. Shoven, 1-39. London and Cambridge, MA: MIT Press, 1997), 7.

²⁹ Conrad W. Thomas, "Sure as Death and Taxes: Corporate Pension Costs Continue to Mount at an Alarming Rate," *Barron's National Business and Financial Weekly*, August, 1972 (52, 35) 3.

³⁰ Dan M. McGill, *Preservation of Pension Benefit Rights* (Homewood, IL: Irwin, Inc., 1972), 41-48.

³¹ HAW collection, Box 1215: 2/15/73 Open statement at hearings by Labor Subcommittee on S. 4 (the version of the law in 1973 that would become ERISA, identical to S. 3598, sponsored by Williams and Javits

plan be communicated, in comprehensible language, to all participants.³² What exactly constituted comprehensible language remained unclear, since the regulations issued by the Labor Department were so dense and jargon-filled themselves. Pension analysts had been calling for improved communications throughout the sixties, albeit for different reasons. While acknowledging employees' need for information, analysts encouraged executives to pay more attention to their pensions from a business point of view, not only for improved employee relations, but because the cost of benefit programs averaged 26% of payroll. This was too great an investment to be left to the free standardized flyers provided by insurance companies.³³

The problem employers predicted, and indeed faced, was lawsuits. Chicago attorney Peter Kelly, who taught pension law at Loyola University, complained that the detail required by beneficiary documents went so far beyond informing employees of their rights that employees were actually being encouraged to sue. Disclosure became, in his opinion, "a road map for litigation."³⁴ And ERISA's first year did generate a "surge of private litigation," as employees received and questioned their plan descriptions. The only potential saving grace (for employers) was that employees near retirement could not afford to wait several years for lawsuits to be resolved.³⁵

³² "Ralph Nader Looks at Private Pension Plans," *Pensions & Investments*, September, 1971, 25-30. A report of Nader's speech at the legislative conference of the Association of Private Pension and Welfare Plans. See also, Ralph Nader and Kate Blackwell, *You and Your Pension*.

³³ William R. Wood, "Are You Getting Your Money's Worth from Employee Benefits?" *Pension and Welfare News*, November, 1967, 26-29.

³⁴ "Plan Booklets Need to State Participants' Rights (in addition to summary of provisions and benefits)," *Pensions & Investments*, March 28, 1977, 4-5.

³⁵ "Several suits could alter legal environment," *Pensions & Investments*, September 12, 1977, 44-46.

Paperwork annoyed plan managers, and the threat of employee litigation constantly loomed in the background, but ERISA's liability requirements really scared pension plan sponsors. In the event of a plan termination, ERISA held companies liable for up to thirty percent of their net worth. All of a sudden, the commonplace deficit in pension funding posed a serious threat to corporate credit. Pension costs were commonly acknowledged, but seldom treated with specifics in corporate financial reporting. Companies reported how many retirees their plans covered, or the percentage increase in asset growth, but were loath to admit actual figures.³⁶ But now, unfunded pension liabilities were required to be reported on the corporate balance sheet as senior level debt.³⁷ However, plan assets were to be kept strictly separate from other corporate assets. Even in the event of excess funds left after a plan termination, ERISA stipulated that those funds could be turned over to the employer only if the excess was caused by "erroneous actuarial computation," but not if caused by investment gains.³⁸ The investment portfolios of pensions could not be viewed as an asset to corporations, as they had been in the past, but any money owed to a pension fund gained new prominence as corporate debt. This encouraged pension plan sponsors to meet their minimum funding requirements, but to disregard the performance of previously committed pension investments.

ERISA created its own unique entity for pension oversight, a nonprofit insurance corporation called the Pension Benefit Guaranty Corporation (PBGC).³⁹ All qualified plans

³⁶ Dana L. Thomas, "Escalating Pensions: They're a Mounting Threat to Corporate Finances," *Barron's National Business and Financial Weekly*, March 18, 1974, (54, 11) 3.

³⁷ E. Philip Davis, *Pension Funds: Retirement-Income Security, and Capital Markets, an international perspective* (Oxford: Clarendon Press, 1995) 100.

³⁸ McGill, *Preservation*, 42, 53, 57.

³⁹ See PBGC website, www.pbgc.gov

were required to pay annual premiums to the PBGC for plan termination insurance, creating yet another set of paperwork for pension officers, all subject to review by the Labor Department.⁴⁰ Under ERISA, pension plans held little financial benefit but huge administrative expense for employers. One analyst compared ERISA requirements to medical malpractice insurance, questioning whether the safety of termination insurance came at too great a cost, since the threat of contingent liability in the form of thirty percent of corporate net worth could impair the credit access of an otherwise healthy company.⁴¹ Pension liabilities represented a sizeable portion of a company's liability already, and the threat of even greater liability could be seriously damaging to a corporation's long term viability.⁴²

Beyond termination insurance, plan sponsors could purchase insurance to protect their plan assets, and themselves, in the event of fiduciary breaches of conduct, at an additional expense.⁴³ ERISA's expanded definition of fiduciary responsibility extended liability to anyone with any measure of authority or control over any part of the pension itself or any decisions relating to it.⁴⁴ This definition meant that virtually any person involved in pension management decisions might face litigation in response to a loss suffered by the pension, if that loss could be

⁴⁰ Alfred M. Skolnik, "Pension Reform Legislation of 1974" *Social Security Bulletin* 37-12 (Dec 1974) 35-42, 38; 42.

⁴¹ Joseph M. LaMotta, "ERISA is having a bad effect on traditional investment practices," *Pensions & Investments*, July 4, 1977, 19.

⁴² Dana L. Thomas, "Escalating Pensions: They're a Mounting Threat to Corporate Finances," *Barron's National Business and Financial Weekly*, March 18, 1974, (54, 11) 3.

⁴³ Les Stern, "Fiduciary liability insurance – A corporate headache," *Pensions & Investments*, July 18, 1977, 1, 15.

⁴⁴ McGill, *Preservation*, 49; James A Wooten, *The Employee Retirement Income Security Act of 1974: a political history* (Berkeley and Los Angeles: University of California Press, 2004), 257.

traced to a failure to uphold fiduciary standards.⁴⁵ The executives of a corporation which sponsored a qualified pension plan, then, were to be held to the same standard of responsibility as those individuals within the company whose specific role was pension management. Through this regulation, ERISA encouraged corporate executives to pay much more attention to the operation of company pensions.⁴⁶ The sometimes contradictory or confusing requirements made following ERISA an exercise in balancing. On the one hand, the plans needed only to meet the minimum amount of required funding because further attention to plan performance brought minimal, if any, financial benefit to the corporations. At the same time, though, the plan had to perform well enough that any losses could be explained by market movements instead of being blamed on managerial malfeasance or negligence.

Trustees, administrators, and executives alike worried about the extent to which they could be held personally liable for pension losses. ERISA was long and convoluted. The legislation was so unclear that the Executive Director of the Association of Private Pension and Welfare Plans, Joseph Leary, remarked that “except for a handful” no one in Congress understood what they had just done. Many plans had difficulty finding people willing to serve as trustees in the months following ERISA’s passage; no one wanted the job until Congress clarified the responsibilities and potential penalties associated with it.⁴⁷

⁴⁵ William M. O'Barr, John M. Conley, and Carolyn Kay Brancato, *Fortune and Folly: The Wealth and Power of Institutional Investing* (Homewood, Ill.: Business One Irwin, 1992), 99.

⁴⁶ Many of the past abuses of pension funds had actually been caused by the plan’s sponsors, rather than its investment agents. The corporate plan sponsors “could direct the trustees to buy company securities or invest in Las Vegas casinos, with the presumption that their interest and those of the beneficiaries coincided.” Sass, *Promise*, 205

⁴⁷ “Editorially Speaking: Finding replacement isn’t trustee’s job,” *Pensions & Investments*, March 14, 1977, 12.

Pension professionals agreed that fiduciary responsibility was a good idea, but waited for a clearer definition of that responsibility.⁴⁸ If investment on behalf of a pension was to be in accordance with the so-called prudent man rule—and no one objected to the idea of prudent investing—then how should prudence be determined? Assistant Secretary of Labor Thomas Donahue declared in 1968 that prudence did not necessarily require investment diversification.⁴⁹ Such a statement would have come as welcome news to many trustees, who felt most confident directing their plans to invest a majority of their assets in blue chip and growth stocks.⁵⁰ In its final deliberations, Congress agreed to adopt the version of the prudent man rule put forth by the House of Representatives, which decreed that all financial decisions relating to pension plan management should be made “with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in conducting an enterprise of like character and with like aims.”⁵¹ The unique phrase in this definition was “familiar with such matters.” Historically, the prudent man rule indicated only that the care required be that of a sensible person, exercising “sound discretion.”⁵² But the idea of familiarity “with such matters” indicated a necessary level of skill

⁴⁸ Substitute “healthcare for all” for “fiduciary responsibility” and the parallels between ERISA and the Affordable Care Act begin to become evident; even the current reactions by pundits are eerily similar – conservative fears of a government controlled healthcare system echo the fears that because of ERISA, the government would end up absorbing private pensions as a supplement to the Social Security program. See Dana Thomas, “Escalating:” “the private pension system will have to be dumped in Uncle Sam’s lap,” and chapter 4.

⁴⁹ Theodore Schuchat, “Washington Letter,” *Pension and Welfare News*, May, 1968, 23.

⁵⁰ Noel Arnold Levin, “Policy Making: The Duty of the Fund Trustee,” *Pension and Welfare News*, January, 1968, 28-34.

⁵¹ McGill 54-55, quoting from ERISA; a variation of the standard set forth in 1830 by the Supreme Judicial Court of Massachusetts in *Harvard College v. Amory*

⁵² See statement of Justice Samuel Putnam, *Harvard College v. Amory*: “All that can be required of a trustee to invest, is that he shall conduct himself faithfully and exercise a sound discretion. He is to

belonging to someone more akin to an investment professional than just an educated businessperson.⁵³

Beyond the concept of prudence, ERISA defined responsible pension management as maintaining the actuarial soundness of the plan. For the first time in private pension regulation, the IRS was put in the position of determining whether or not pensions had the ability to meet their expected benefit obligations. Under previous tax laws, the IRS pressured pension plans to avoid overfunding, but ERISA's emphasis was on creating the proper investment mix of plan funds in order to prevent underfunding.⁵⁴ Pension management became more an issue of avoiding failure than of achieving success.⁵⁵

Specific provisions were included to prevent any financial dealings that were not arm's length, including limits on self-dealing. When a trustee or other fiduciary makes decisions regarding the pension that are for his own benefit over the concerns of the pension fund, this constitutes self-dealing, and was the cause of many pension losses before ERISA.⁵⁶ In return for directing a pension fund's investments to a particular broker or brokerage, some managers were rewarded by the brokerage with a percentage of the commission payment. In addition, because

observe how men of prudence, discretion, and intelligence manage their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income as well as the probably safety of the capital to be invested." Quoted in John D. Wilson, "Quality Essential in Employee Benefit Planning," *Pension and Welfare News*, August, 1968, 32.

⁵³ See Michael J. Clowes, *The Money Flood: how pension funds revolutionized investing* (New York: Wiley, 2000).

⁵⁴ McGill, *Preservation*, 32; 39.

⁵⁵ The result of this policy was an overfunding of pensions, which led to pension raiding in the late 1990s and early 2000s; see Hawthorne, *Pension Dumping*.

⁵⁶ Alfred M. Skolnik, "Pension Reform Legislation of 1974," *Social Security Bulletin* 37-12 (Dec 1974) 35-42, 41

of the size of the commissions, many managers were not required to pay for research information – this was provided as a perk of doing business with a particular broker. The new rules made illegal the kickbacks of money or research services that were prevalent in Wall Street’s dealings with pension fund institutions in the late 1960s. If fiduciaries had any personal gain through the abuse or mismanagement of their position, under ERISA that money must be returned to the pension, in addition to which the fiduciaries are held personally liable for the fund’s losses.⁵⁷

The purpose of ERISA’s fiduciary standards was not only to protect employees from theft or waste of plan assets by administrators; a fiduciary needed to do everything possible to be able to provide full benefits to the employees covered by the plan.⁵⁸ In an attempt to provide a better guarantee of those benefits, ERISA stipulated diversification of plan assets. The general requirements for diversification included type of investment, geographic location and industrial classification of investments, and differing dates of maturity.⁵⁹ Pension managers could no longer pursue high risk equities to the exclusion of more stable investments.⁶⁰ Instead of relying on investment gain to maintain the amount of principal in the fund, corporations discovered that larger amounts of their pensions would have to be funded directly out of the company’s own profits.⁶¹

⁵⁷ McGill, *Preservation*, 56-7.

⁵⁸ Wooten, *ERISA*, 5, 257.

⁵⁹ McGill, *Preservation*, 55.

⁶⁰ A study of private pensions by Merrill Lynch found a decrease in the proportion of funds in equities, from 70% in 1972, to less than 59% in 1975. “Wall Street Goes Slow,” *Business Week*, 11 Oct. 1976: 100

⁶¹ “Wall Street Goes Slow,” *Business Week*, 11 Oct. 1976: 100.

The problem facing pension managers was achieving a level of diversification that would both maximize expected returns and fulfill fiduciary obligations without unnecessary exposure to risk. The task was made all the more difficult because of the changing nature of investment in the late 1960s and early '70s. Investment vehicles and methodologies were rapidly diversifying themselves during this period; for example, through the widespread acceptance and use of options after the publication of the Black-Scholes option pricing model in 1973. Finance evolved rapidly following a series of advances that collectively formed the basis for Modern Portfolio Theory. Harry Markowitz developed mean-variance analysis, which accounts for the tradeoff between risk and return of individual securities in creating a portfolio. This provided managers with a method to 'balance' a portfolio, using different categories of assets. William Sharpe developed the Capital Asset Pricing Model in 1964, which quantified Beta as a measure of the volatility of the price of a stock relative to the volatility of the market. The Beta of the market is one, and stocks with Beta greater than one are more risky than the overall market, and stocks with Beta less than one are less risky. Investment managers could use Beta calculations to assemble a portfolio which, although it could contain some very risky stocks, could still have an overall Beta at or near the same risk level as the market.⁶² James Lorie and Lawrence Fisher calculated the long run average return of the stock market at close to ten percent, and, after Eugene Fama proposed the Efficient Markets Hypothesis, matching a portfolio to market performance seemed like a good investment strategy.⁶³

⁶² Clowes, *Money Flood*, 37-40.

⁶³ Clowes, *Money Flood*, 40-41. Markets process information efficiently; in other words, prices reflect all available information in a timely manner, making it a difficult—nearly impossible—proposition to find a deal or beat the market.

With Modern Portfolio Theory, risky investments could be combined to produce a less risky portfolio, and it seemed to some pension professionals that the risk of a particular investment was less important than the risk level of the fund investments as a whole. A risky investment could be acceptable, if it fit with pension plan objectives. However, ERISA did not draw a specific distinction, leaving managers in doubt as to whether individually risky investments were permitted under fiduciary requirements. The Labor Department took until 1989, well over ten years, to clearly explain investment policy in such a way that pension fund managers were finally willing to permit higher risk level components within their portfolios.⁶⁴

ERISA did offer a way to divert some fiduciary responsibility. If a named fiduciary of a plan, or its trustees, could prove to have chosen and retained an investment manager in a prudent manner, then neither the named fiduciary nor the trustees could be held responsible for the manager's actions or omissions.⁶⁵ Pension funds needed to develop a statement of plan objectives and investment policy, but once that step was completed managers were "largely off the hook" if they delegated further decision making to investment professionals.⁶⁶ If they retained direct control, fiduciaries faced a number of prohibited transactions in addition to their personal liability assumption.⁶⁷ Additionally, not all pension fund managers had the professional training necessary to fulfill their investment responsibilities, and many found themselves in great need of professional investment advisors.

⁶⁴ Clowes, *Money Flood*, 95-97.

⁶⁵ McGill, *Preservation*, 51.

⁶⁶ Joseph M. LaMotta, "ERISA is having a bad effect on traditional investment practices," *Pensions & Investments*, July 4, 1977, 19.

⁶⁷ Joseph M. LaMotta, "ERISA is having a bad effect on traditional investment practices," *Pensions & Investments*, July 4, 1977, 19; Clowes, 97.

ERISA's ambiguous language, coupled with harsh penalties for breaches of fiduciary conduct, caused an immediate reaction among pension fund managers. They moved their investments overwhelmingly toward more secure fixed income instruments. Ambitious investment strategies brought only risk, now that regulation removed much of the potential for reward, so managers scaled down their investment objectives to a more "realistic" level.⁶⁸ As a result, many funds shifted strongly into bonds and out of equity. Bonds were safer and more dependable than stocks, but the price of their reliability was lower returns. Another new favorite among pension investments was the type of mutual fund known as the index fund.⁶⁹ Index funds track market performance by imitating the holdings of the particular index they follow. The long run average annual return of the fund can be expected to parallel the index's long run return, and managers expected funds mimicking the Dow Jones Industrial Average and S&P 500 indexes to maintain returns between nine and ten percent.

One unique investment vehicle that gained popularity because of ERISA was the guaranteed income contract, or GIC. The GIC was offered by insurance companies as a variation on a traditional annuity. It guaranteed both payment at a specified interest rate over a preset term, and the return of the full principal at the end of that period. The transaction was backed by the assets of the issuing insurance company. A GIC was basically the same as a bond,

⁶⁸ "Study cites Social Security and ERISA, IRAs as threats to pension system," *Pensions & Investments*, Mar. 28, 1977, (14); Michael Clowes, "Fixed-income managers get the business in 1976," *Pensions & Investments*, Jan. 3, 1977, 9, 25; Michael Clowes, "Sponsors get active in asset allocation decisions," *Pensions & Investments*, May 9, 1977, 34.

⁶⁹ Michael Clowes, "Fixed-income managers get the business in 1976," *Pensions & Investments*, Jan. 3, 1977, 9, 25; Joseph M. LaMotta, executive Vice President, Centennial Capital Corp., NY, "A Deadly Duo: ERISA and the Tax Reform Act of 1976," *Pensions & Investments*, June 20, 1977, 21.

but with one very important difference. Unlike a bond, a GIC has no market value; it is a private contract and not subject to market fluctuation.⁷⁰

In a landmark example, San Francisco company Crown Zellerbach, Inc., a forest products company, in 1976 moved two-thirds of its \$225 million pension fund into GICs. The company dismissed four major financial management firms, and hired two new money managers to oversee the remainder of its equity portfolio. The named fiduciaries of the Crown Zellerbach pension plan were the members of the company's board of directors. Their decision "was prompted by concerns about ERISA's prudence and fiduciary liability standards."⁷¹ The interest rates on Crown's GICs varied between 8.75% and 9.5%, which was near or a little lower than the long run average return on equity, but much lower than some of the returns achieved not long before by star money managers.⁷² GICs offered safety, but also diminished the amount of direct control pension funds had over their investments by shifting the primary investment function from pensions themselves to investment companies.

The aftermath of ERISA was a scramble for safety amidst regulatory confusion. From the standpoint of the corporate sponsor, costs increased just as potential income was eliminated. (This was the creation of one of the most reviewed and amended pieces of legislation in American history, one which is still very much in force today.) In 1977, one befuddled administrator described accommodating ERISA through the metaphor of driving, leaving his audience to decide for themselves whether ERISA is better conceptualized as a freight hauler or as a clown car:

⁷⁰ Clowes, *Money Flood*, 104.

⁷¹ Clowes, *Money Flood*, 105. "No wonder the board members wanted to invest conservatively."

⁷² *Ibid.*

The plan administrator is trying to steer the vehicle. The minimum funding requirement, controlled by the Department of Labor, controls the gas pedal. The maximum deductible contribution requirement, controlled by the Treasury Department, from time to time trips the emergency brake. The highway is a yet uncharted route constructed from a highly ambiguous law written by various committees, many of whose members have had no experience whatever in either the pension or the tax field. The actuary is shouting directions from the back seat based on what he sees by looking out the rear window. Over your CB comes conflicting instructions from your trustees and attorneys who are almost as confused as you are. While following closely behind are the Department of Labor and the Internal Revenue Service, seeking to enforce an impossible time schedule and to determine if the plan sponsor has broken any of their as yet unissued regulations.⁷³

Although pension managers were now required by ERISA to pay for the research they were accustomed to receiving as a bonus from Wall Street brokers, deregulation simultaneously forced many brokerages to cut back on the overall amount of research produced and to increase research fees. Negotiated commission rates forced the brokerage community into a sense of desperation. Unusually high volume prevented an initial shock when Mayday arrived, causing some to dub it a “non-event,” but brokers knew they had to prepare for the end to the bullish market.⁷⁴ NYSE Chairman James Needham had cautioned that even a steady volume of trades would not accurately reflect the losses caused by negotiated commissions. Already by early 1973, the first volume discounts for institutional investors had reduced NYSE member firm revenues by \$80 million.⁷⁵ SEC economist Bernard H. Garil determined that those firms who

⁷³ “Driving Through ERISA” *Pensions & Investments* June 20, 1977 (21)

⁷⁴ John Carson-Parker, “Wall Street’s Great Non-Event of 1975.” *Business Week* 21 Apr. 1975: 114

⁷⁵ “Jim Needham: What’s Wrong with Wall Street,” *Business Week*, April 14, 1973, 72-3.

did business primarily with institutions were two to three times as profitable as those who dealt mainly with individuals.⁷⁶

Firms could be forced out of business entirely if volume fell too low, and, with ERISA forcing pensions out of strong equity positions, brokers could not rely on institutional traders.⁷⁷ Pension managers were willing to pay for research, but these fees could not cover the income deficit caused by deregulation. Stockbrokers were forced, first, to expand the market for research services, and second, to vigorously court individual clients.⁷⁸ The choice for the future was between high quality offerings at high prices or high quantity offerings at low prices. “The only way to recoup the discounts on institutional commissions is to increase market share,” said Peter T. Buchanan, executive vice-president at First Boston Corp. “To do that, you’ve got to have a very strong research and execution capability.”⁷⁹ The research provided by the Street was intended for institutions rather than individuals, though, and was very expensive to produce. Without the income provided by fixed commissions, many brokerages could not afford to maintain their level of research services; “the availability of research we have been getting more or less for free is diminishing,” said Charles W. Brady, president of Citizens & Southern Investment Counseling, Inc. of Atlanta, in an interview with *Business Week* in late 1976.⁸⁰ Even

⁷⁶ Theodore Schuchat, “Washington Letter,” *Pension and Welfare News*, February, 1969. Garil determined that the average income of a partner at a firm dealing with the general public was \$133,000 in 1967, and opposed to \$337,000 for partners at firms dealing mainly with institutions.

⁷⁷ “American Brokers: Mayday on May Day?” *The Economist* 26 Apr. 1975: 118

⁷⁸ Walter, *Deregulating*, 10; “The Bulls Trample May Day Worries.” *Business Week* 10 May 1976: 88

⁷⁹ “Research Specialists Scramble to Survive,” *Business Week*, August 18, 1975.

⁸⁰ “Wall Street Goes Slow.” *Business Week* 11 Oct. 1976: 100

with “modern portfolio management techniques,” investment research was still both valuable and necessary.⁸¹

Although some brokers tried to offer research services for sale, purchasing research was still not a widespread option in the aftermath of deregulation. When brokerages were first hit by negotiated rates, many had to drastically cut costs just to stay afloat. The stockbrokers themselves were needed to try to build sales volume, so back office researchers and staff economists were fired in huge numbers.⁸² This was problematic for pension funds, because analysts had vigorously encouraged active equity trading for pensions since the mid-1960s. If pensions were to achieve the same returns as the star fund managers of the late ‘60s, they needed to be getting similar 9-15% returns, which was not easy to achieve without research.⁸³

The only viable method of business after Mayday was through increasing trading volume, but the New York Stock Exchange needed to find a way to both restore the research capabilities institutions expected and boost overall volume.⁸⁴ Brokers were forced to expand the market for research services by offering to share information, and the costs to produce it, with individual investors, who previously lacked access to the sort of technical information required for the most successful investing.⁸⁵

⁸¹ *Pensions & Investments* Nov. 21, 1977 “Conference told of need for research” 23.

⁸² Carson-Parker, John. “The Clouds Over a Brokers’ Gala.” *Business Week* 26 May 1975: 66; “Research Specialists Scramble to Survive.” *Business Week* 18 Aug. 1975: 90.

⁸³ Derrik C. Hoitsma, “Aggressive Pension Fund Investing – the Place of Risk Taking,” *Pension and Welfare News*, June, 1969. Hoitsma argued strongly against any buy and hold strategies.

⁸⁴ Burk, 119; Walter, 1; *Business Week* May 26, 1975 and August 18, 1975.

⁸⁵ John Carson-Parker, “Wall Street’s Great Non-Event of 1975,” *Business Week*, April 21, 1975, 114. “American Brokers: Mayday on May Day?” *The Economist*, April 26, 1975, 118; “The Bulls Trample May Day Worries,” *Business Week*, May 10, 1976, 88. Press Release May 14, 1973, Box 1254, HAW Collection, Rutgers Special Collections; Ronald C. Lease, Wilbur G. Llewellyn, and Gary G. Schlarbaum, “The Individual Investor: Attributes and Attitudes,” *The Journal of Finance* 29.2 (1974): 413-433.

By spring of 1976, volume was maintaining the revenues of larger brokerages, but “the swing to negotiated rates (was) making life hell for many medium-sized brokerage houses that are finding it hard to get their volume high enough to offset the lower commissions.”⁸⁶ With regular but flat commissions secured from institutional investors, the Exchange increased its attention to pre-existing programs to sponsor individual investment. The challenge of increasing individual participation on the Street was compounded by the fact that brokers were accustomed to dealing with a very particular kind of individual, the affluent, older man who had money to play the market. A 17% drop in the Dow Jones Average over the first half of 1973 did not help encourage public investing.⁸⁷ Wall Street was known for its reputation as the center of a boom and bust culture, likened to a “classic manic-depressive.”⁸⁸ The NYSE’s commoditization of value, the buying and selling of shares, was a necessary component of a growing economy, but it led brokers to adopt a cavalier attitude toward gains and losses that did not resonate with the general public.

ERISA, however, was a boon to the NYSE. It put retirement front and center in the public consciousness, and the numerous Congressional hearings about pension plan failures and the need for reform encouraged individuals to re-evaluate their own pension situations. ERISA liberalized Keogh plans, which functioned as retirement savings accounts for the self-employed. Even more importantly, ERISA created the Individual Retirement Account, or IRA, giving

⁸⁶ “The Bulls Trample May Day Worries,” *Business Week*, May 10, 1976, 88; William Wolman, “Interest Rates Signal a Rise in Confidence,” *Business Week*, March 1, 1976.

⁸⁷ James P. Roscow, “Two-Tier Market: Are Pension Funds Culprit or Victim?” *Pension and Welfare News*, September, 1973, 10-12, 70.

⁸⁸ James P. Roscow, “Two-Tier Market: Are Pension Funds Culprit or Victim?” *Pension and Welfare News*, September, 1973, 10-12, 70.

stockbrokers the perfect vehicle with which to promote individual investment.⁸⁹ Also, corporate pension plans were undergoing a reformation of their own, one which would ultimately work to the advantage of both Wall Street and institutional investors.

From Defined Benefit to Defined Contribution

Although ERISA's provisions increased the cost of operating a pension plan, most of them applied only to defined benefit plans. The majority of employer-sponsored pensions were noncontributory, defined benefit plans in the late 1960s. Informing employees of a pre-determined expected benefit amount was more straightforward than attempting to adjust the benefit calculation based on individual employee contributions. Refusing employee contributions gave employers greater control over the form and operation of pensions. Industry experts had predicted in the 1960s that the vast majority of plans would be noncontributory within twenty years.⁹⁰ As late as December, 1968, insurance analyst John Kittredge predicted that most plans would be noncontributory by 1975. He thought this a very logical move, in keeping with the treatment of pensions as part of employee compensation. Also, the increasing use of computer technology, he predicted, would enable plan sponsors to offer an even greater range of benefit choices.⁹¹ Following the trend, ERISA's authors devoted the bulk of their attention to defined benefit pension plans, to which employees did not contribute, as opposed to

⁸⁹ McGill, *Preservation*, 39-40.

⁹⁰ Howard M. Koster, "Current Trends in Retirement Plans," *Pension and Welfare News*, May, 1968, 26-28; Carolyn S. Winkler and Charles E. Selinske, "The 1970 Study of Industrial Retirement Plans," *Pensions & Investments*, March, 1971, 29-34,54.

⁹¹ John K. Kittredge, "Group Insurance and Pensions in 1975," *Pension and Welfare News*, December, 1968, 37.

defined contribution plans, in which the amount of individual and company contribution was defined rather than the expected benefit amount.

ERISA made operation of a defined benefit pension plan incredibly bothersome. Administrative costs increased. Companies derived no profit from operating pension plans, but increased their liability and risked damaging their corporate creditworthiness. Extended fiduciary responsibility and personal liability measures put both administrators and executives under pressure to ensure sound investment performance, at a time when the economy was stagnant and Wall Street was in a state of upheaval.⁹² However, a new trend was underway by the early seventies. Pension experts began predicting a shift to more profit-sharing type plans. The growth of mergers and acquisitions left many without pension coverage, just at a time when social attitudes toward pensions were changing, from expectation of a reward for service to a guaranteed right as part of compensation. Defined contribution plans were more flexible and better suited to worker mobility, something recognized as the new normal.⁹³ And defined contribution plans gave employers a way to subvert ERISA.

Initially, ERISA put stress on defined benefit plans by making their everyday operations more expensive. The potential increase in administration costs prompted many small plans to terminate rather than attempt compliance.⁹⁴ The fears of the insurance industry, and Congressional Republicans, appeared to be coming true: instead of strict requirements protecting

⁹² James P. Roscow, "Two-Tier Market: Are Pension Funds Culprit or Victim?" *Pension and Welfare News*, September, 1973, 10-12, 70.

⁹³ "The Push for Pension Reform" *Business Week*, 3-17-73, 46-58.

⁹⁴ Martha Remy Yohalem, "Employee Benefit Plans, 1975," *Social Security Bulletin* 40-11 (Nov., 1977): 19-28; see Scheiber and Shoven, "The Economics of US Retirement Policy." Also McGill. The paperwork was immense, in part because Congress could not resolve the question of which agency should have oversight over the private pension plan system, and split the responsibility over a range of agencies.

pensions, they were leading pensions to close, and discouraging the creation of new plans.⁹⁵ In addition to increased administrative expenses, the new Pension Benefit Guaranty Corporation required payment of regular premiums for plan termination insurance.

The new law required pension plan assets to be kept on a separate set of books from other company assets. This meant that any capital gains from pension investments remained attached to the pension instead of being realized as corporate income. Since managers could no longer rely on gains from high risk equity investments to maintain the principal of their funds, pension funding would need to come directly out of corporate profits instead. At the same time, however, the corporate balance sheet revealed total unfunded pension liabilities as senior level debt.⁹⁶

The decrease in potential gain from pension operations resulted in decreased attention to corporate pension planning. Historically, plan sponsors “tended toward rather passive relationships with investment managers and actuaries.”⁹⁷ With much less to gain from an active role in plan selection, executives began to delegate plan decisions once controlled by corporate finance divisions to lower level personnel departments.⁹⁸ The new pension managers quickly

⁹⁵ Verne Arends, Assistant Secretary, Northwestern Mutual Life, “Will Higher Costs Stimulate Growth of Private Pensions?” *Pension and Welfare News*, October, 1967, 31; “Interview: Pension Legislation is Premature Says Rep. John N. Erlenborn (R-IL), ranking Republican on the General Subcommittee on Labor of the House of Representatives,” *Pension and Welfare News*, December, 1971, 35-6: “I fear blanket legislation to regulate private pension plans would result in certain inequities and, additionally, would retard their growth,” said Erlenborn.

⁹⁶Wooten, *ERISA*, McGill, *Preservation*, 53; A study of private pensions by Merrill Lynch found a decrease in the proportion of funds in equities, from 70% in 1972, to less than 59% in 1975. “Wall Street Goes Slow,” *Business Week* (11 Oct. 1976): 100; E. Philip Davis, *Pension Funds: Retirement-Income Security, and Capital Markets, an international perspective* (Oxford, 1995).

⁹⁷ William A. Dreher, “Options for Pension Plan Sponsors,” *Pension and Welfare News*, January, 1973, 29-34, 52, 30.

⁹⁸ Wooten, *ERISA*, 279.

found themselves in a difficult position. They often lacked education or training in financial management, but they were still responsible for the fiscal soundness and positive returns of plans. Replacing defined benefit plans with a form of profit-sharing simplified administration, removed part of the burden of liability from managers, and did not necessitate termination insurance payments.⁹⁹

One of ERISA's often overlooked requirements was for pension plan portability. In order to address the problem of employees changing employers and losing their accumulated pension credits, Congress mandated that employees be able to effectively take their pensions with them. This posed an immediate challenge to defined benefit plans. Administrators could arrange a transfer of funds in such a situation, but the money in their pension funds was not individually earmarked, which made for challenging calculations.¹⁰⁰ The other option was to standardize plans between companies, so that employees could transfer credits, but that would still involve a monetary transfer at some point, and left managers scratching their heads as to how widespread that standardization would need to be, whether within an industry or beyond. Defined contribution plans avoided the issue entirely since it was an easy matter for employees to transfer their own individual accounts. Additionally, the burden was on the employee to ensure that such transfers took place, making hiring or terminating an even more streamlined process for employers.¹⁰¹

⁹⁹Michael Clowes, "Is ERISA Just an Excuse Plans use to Terminate?" *Pensions and Investment*, Sept. 12, 1977, 19-20.

¹⁰⁰ "A Straitjacket for Pensions?" *Nation's Business*, September, 1973 (61, 9), 74.

¹⁰¹ William A. Dreher, "Deadline for Private Pensions," *Pension and Welfare News*, September, 1971, 16-24.

The Pension Benefit Guaranty Corporation did not insure defined contribution plans. Such plans also demanded no contingent liability of employers. While ERISA did not prompt a widespread cancellation of existing defined benefit plans, new plans overwhelmingly avoided the defined benefit model. In the ten years prior to ERISA, the ratio of new defined benefit plans to plan terminations was 14.4 to 1. For 1976, that ratio dropped to 1.2 plans created for every 1 plan terminated. Analysts blamed the new legislation, claiming that “if ERISA were a drug or food additive the Food and Drug Administration would have banned it by now.”¹⁰²

Defined-contribution plans were attractive because they mitigated ERISA’s insistence on prudence. In the late sixties, some pension experts had questioned whether the idea of the prudent man rule was unnecessarily restrictive, even before Congress tightened the rule, calling for portfolios to commit as much as 60%, or more, of their assets to equities.¹⁰³ ERISA did allow an exception to its prudence requirements in cases where employees made personal decisions about how to allocate individual pension investments. This meant that management was not liable for poor investment of funds in defined contribution plans.¹⁰⁴ Under ERISA, defined benefit plans were subject to both overall corporate liability and the personal liability of plan managers and company executives. As one journalist put it, “No longer will the role (of the

¹⁰² “Editorially Speaking: ERISA is good, but still can be made better,” *Pensions and Investments*, April 25, 1977, 8.

¹⁰³ Edmund A. Mennis, “Investment Policy for a Growing Pension Fund,” *Pension and Welfare News*, May, 1968, 43-48, 58.

¹⁰⁴ McGill, *Preservation*, 51, 56; Today the most common defined-contribution plan is the 401k, which was created as part of the Internal Revenue Code in 1978.

board of trustees) end with the automatic, simple selection of a manager to live with in friendly bliss forever after.”¹⁰⁵

While executives had little to gain from a well-run pension plan, now stripped of the ability to realize capital gains from pension investments, they had much to lose from a poorly-run plan under the fiduciary responsibility regulations, which held them personally responsible for plan performance. ERISA mandated a new level of responsibility not only from those individuals with direct control over pensions, but also from all executives at companies sponsoring qualified plans. Those executives not involved in the day to day management of a pension were subject to the threat of fines and even incarceration, should plan managers be found guilty of wrongdoing. As a result, many plans incurred an additional expense for insurance against fiduciary infringements.¹⁰⁶

Nor could executives receive any kickbacks from Wall Street under the new negotiated commission rate system. Huge transactions under the fixed rate system generated excessive commissions. These commissions provided bountiful cash which could be used for a variety of ‘services,’ including everything from entertaining clients to paying them under the table.¹⁰⁷ Commission deregulation abruptly curtailed cash flow, and brokerages scrambled just to keep afloat. Brokers could not devote the time and attention toward hand-holding of pension managers, not with their new focus of increasing the number of transactions. Without expert

¹⁰⁵ Stephen Rogers, “How Pension Funds will be Managed Tomorrow,” *Pension and Welfare News*, December, 1971, 53-60, 54.

¹⁰⁶ Alfred M. Skolnik, “Pension Reform Legislation of 1974,” *Social Security Bulletin* 37-12 (Dec., 1974): 35-42; Theodore Schuchat, “Washington Letter,” *Pension and Welfare News*, November 1968, 13.

¹⁰⁷ McGill, *Fundamentals of Private Pensions*, 54-55, ERISA’s prudent man rule was defined as a variation of the standard set forth in 1830 by the Supreme Judicial Court of Massachusetts in *Harvard College v. Amory*; Wooten, *ERISA*; Sass, *The Promise of Private Pensions*, 205; Skolnik, “Pension Reform,” 41.

guidance, high risk-high return equity investment became a more dangerous game for pension plan managers.

ERISA's clear distinction between defined contribution and defined benefit plans gave defined benefit plan sponsors a clear avenue away from increased costs and liabilities, but it posed a huge question for unions. The question was whether a multiemployer union plan was more properly defined as a defined benefit plan or a defined contribution plan. In a defined benefit plan the benefit payments are pre-determined, the amounts to be paid to retirees. In a defined contribution plan, the amounts the employer contributes to the plan are contractually defined. The unique nature of multiemployer plans was a situation in which both benefits and contributions were defined through collective bargaining. To what extent were union pensions subject to ERISA regulation?

The question was brought to court in *Connolly v. Pension Benefit Guaranty Corporation*. John Connolly and the other trustees of the Operating Engineers Pension Trust wanted their plan to be legally recognized as defined contribution, in which case it would be exempt from the termination insurance coverage ERISA mandated for all defined benefit plans.¹⁰⁸ The PBGC disagreed, classing the plan as defined benefit. The Supreme Court finally resolved the case in 1986, although Congress was forced to pass the Multiemployer Pension Plan Amendments Act of 1980 in the meantime, effectively rendering the question moot, and adding another layer of regulation.¹⁰⁹ The House of Representatives passed legislation allowing the PBGC to postpone the mandatory insurance coverage for multiemployer plans while it debated that Amendments

¹⁰⁸ *Pension & Investments* 2-14-77.

¹⁰⁹ <http://supreme.justia.com/cases/federal/us/475/211/>

Act, “thus averting what was predicted to be a rash of foldings among poorly funded plans and a disruption of the Pension Benefit Guaranty Corporation’s services.”¹¹⁰

One of ERISA’s more insidious influences was its effect on the executive attitude toward company pension plans. Under defined-benefit plans, executives could easily adjust their level of expected benefit. With the new regulations, while benefits could still be greater for executives than for workers, these benefits had to be proportional. That is, the ratio of pension benefit to other compensation had to be constant for all those covered by the plan.¹¹¹ Under previous plans, benefit levels were generally determined by employees’ average salary over the final few years of work. This got very expensive, since large payments were required to catch up the pension fund to employees’ new, retroactive, pension levels. But the formula was very advantageous for executives because they generally have steep compensation increases late in their careers.¹¹² ERISA put an upper limit on the amount of benefits that qualified plans were permitted to provide.¹¹³

By restricting benefit levels, ERISA encouraged executives to do more of their own retirement investing outside the company. As a result, business increased for specialized

¹¹⁰ *Pensions & Investments* Dec. 19, 1977 (1) “PBGC gets extension from House legislation”

¹¹¹ McGill, *Fundamentals of Private Pensions*, 42-3; The IRS requirements related to plan design and equitability created yet more paperwork and administrative expense.

¹¹² Edward E. Burrows, “Salaried Pension Plans Revisited,” *Pension and Welfare News*, August, 1973, 56-64; “What the Funds are Doing,” *Pension and Welfare News*, September, 1970, 4; Conrad W. Thomas, “Sure as Death and Taxes: Corporate Pension Costs Continue to Mount at an Alarming Rate,” *Barron’s National Business and Financial Weekly*, August, 1972 (52, 35) 3: Executive habit was to keep very quiet about the details of salaried employees’ pensions, fearing “the whole subject is ... much like Pandora’s box – i.e., that lifting the lid would release untold horrors.”

¹¹³ Wooten, *ERISA*, 278; 279: “The decline of qualified defined-benefit plans likely owes something to the fact that the corporate officers who select compensation programs do not stand to gain much from such a plan.” Schieber, *Surprise*, 148: previously, DB lesser of 75K or average highest 3 years salary; DC lesser of 25K or 25% earnings

research and investment firms known as boutiques. At the time, there were three prominent investment research boutiques: Donaldson, Lufkin & Jenrette; Faulkner, Dawkins & Sullivan; and Auerbach, Pollack, and Richardson. As the larger firms dropped internal research services, opportunities arose for these and similar firms. Analysts left out by the system made their own employment. Some of the larger firms were able to spin off investment counseling services, including Bear Stearns Capital Management, Smith Barney Advisers, Inc., and Lionel D. Edie & Co. (from Merrill Lynch).¹¹⁴ A lack of good research coverage meant opportunities could be created by inefficiencies or knowledge gaps, and this gave the markets a chance to regain the ability to boom. Ironically, the strength of personal relationships between investors and brokers became even more important in such a market. Boutique firms were one way in which Wall Street adapted to negotiated commissions, and also worked well to take advantage of the situation of executives dissatisfied with their traditional pensions.

Executives could bypass ERISA regulation by converting their defined-benefit plans into defined-contribution plans, to which most of ERISA's standards did not apply. Alternatively, companies could easily add a defined contribution plan to existing benefit packages, increasing benefits without much additional expense. Instead of a defined benefit as expected deferred compensation, employees could contribute to the pension plan from their own earnings. The amounts and frequency of this contribution were not standardized. Employees also had a greater degree of control in the direction of the investment of their pension contributions, which benefitted those executives with investment knowledge and experience, but left uninformed

¹¹⁴ <http://www.forbes.com/2009/06/16/kaman-sidoti-gamco-personal-finance-financial-advisor-network-wedbush-morgan.html>; Clowes 57.

lower-wage employees exposed to market risk.¹¹⁵ In its quest to regain commissions, though, Wall Street left no market unexplored, and those who could not afford the services of a research boutique could instead turn to the bare bones services offered by a new type of firm, the discount brokerage.

Put simply, the increased burden of pension management under ERISA, combined with Wall Street's new inability to cater primarily to the needs of institutional investors, made traditional pensions too much trouble and expense to operate. Every little requirement hampered both employers' ability to be flexible and unions' ability to negotiate. Pensions had long been a balancing act, between doing the right thing for employees, and doing the best thing for shareholders – any excess investment in pensions was a penalty to current earnings, so employers tended to restrain pension funding, until the boom of the late 1960s encouraged excessive equity investing.¹¹⁶ With ERISA, Congress was forcing the business community to change its ideas of what a pension was meant to be. Retired actuarial consultant John Dyer had reminded pension managers, as late as 1968, that “the original and still primary objective of a pension plan is a business objective – to serve as an effective instrument of employee relations.”¹¹⁷ Such an opinion was no longer valid after ERISA, which recognized the pension as the employees' right to deferred compensation.

¹¹⁵ Wooten, *ERISA*, 271-2; 280. This was the situation at Enron; employees invested too much of their retirement in their own company, which would have been prohibited in a defined-benefit plan regulated by ERISA. McGill, *Fundamentals of Private Pensions*; The IRS requirements related to plan design and equitability created yet more paperwork and administrative expense; also, the amounts and frequency of contributions were not standardized for defined-contribution plans. Today the most common defined-contribution plan is the 401k, which was created as part of the Internal Revenue Code in 1978.

¹¹⁶ A.M. King, “Funding Salaried Plans? Be Fair to Stockholders!” *Pension and Welfare News*, January, 1973, 22-26.

¹¹⁷ John K. Dyer, Jr., “Private Pension Legislation – Existing, Pending, and Proposed,” *Pension and Welfare News*, April, 1968, 24-27, 27.

The consequences of ERISA and deregulation produced a fundamental change in the nature of retirement planning for individual American workers. Retirement was both an issue of private and individual circumstances, which provided the public impetus for reform, as well as a very public problem consisting of hundreds of billions of dollars, amounts capable of directing the national economy under the control of a relatively small number of executives who did not answer to public demand in the same way as their Congressional counterparts. Although Congress forced the business community to change its behaviors in order to meet the public call for reform, the responses to both ERISA and Mayday deregulation perpetuated traditional profit-seeking behaviors. The inventiveness and resilience of the system was such that executives of pension-sponsoring companies and their brokers found ways to circumvent the new regulations. To gain volume, the NYSE sought the individual investor's retirement savings, and, to alleviate the greater burden of regulatory compliance, corporate pension sponsors looked for ways to shift more responsibility for retirement to individual employees.

When the Government Accounting Office in 1977 surveyed businesses that had terminated their defined benefit plans within the past several years, over 85% of the respondents agreed that ERISA was either partly or fully the cause of that decision.¹¹⁸ Philip J. Canfield, the manager of employee benefits at Xerox Corp., remarked, "The social problem to me is that half of the working population isn't covered. How does Congress solve that problem by making it more expensive to set up and run a private pension plan? They should be doing something to encourage new ones."¹¹⁹ Ironically, Congress was encouraging the growth of pensions, just in a form that no one could predict in 1973, the now ubiquitous 401(k).

¹¹⁸ Martin Neil Baily and Jacob Funk Kirkegaard, *US Pension Reform: Lessons from Other Countries* (Washington, DC: Peterson Institute for International Economics, 2009), 386.

¹¹⁹ "A Straitjacket for Pensions?" *Nation's Business*, September, 1973 (61, 9), 74.

ERISA created a new kind of retirement device called the Individual Retirement Account. Why would any company, especially a small one, consider starting a defined benefit plan? Individuals had a new option for retirement investing, although ERISA's creation of the Individual Retirement Account (IRA) was of greater ideological than practical significance. The Securities Acts Amendments symbolically supported individual rights, since negotiated commissions gave the appearance of democratizing the stock market. Pension managers began to realize that lower commission rates not only made investing more affordable for individuals, but that the consequences of that change, chiefly greater access to information and to investment options like IRAs and mutual funds, meant that corporations could justify shifting more retirement responsibility to employees.¹²⁰

The best way for brokers to overcome the challenge posed by negotiated commissions was to restructure their way of doing business by increasing attention to individual investors. By altering its own behaviors and by taking advantage of new federal laws, the NYSE recovered from Mayday by transforming itself into the primary institution for individual retirement investment. The simultaneous enforcement of new regulations under the Employee Retirement Income Security Act of 1974 helped propel retirement from a corporate to a personal responsibility, and confirmed the centrality of the NYSE to the American economy. The Exchange adapted to reform by using the concept of retirement security both to entice individual investors into the market and to reaffirm its institutional relationships. The events of the 1970s

¹²⁰ The NYSE was certainly not "democratized;" just as one example, odd lot trading not yet approved, so investing was still well out of reach for many, if not most, Americans. Walter, *Deregulating Wall Street*; William G. Shepherd, "Swinging with the New IRA Plans," *Business Week* (30 June 1975): 92; "The Bulls Trample May Day Worries," *Business Week* (10 May 1976): 88.

increased the pervasiveness of the stock market in American life and made permanent Wall Street's economic dominance.

CONCLUSIONS

President Gerald Ford signed ERISA into law on Sept. 2, 1974, Labor Day. The first call to the Pension Benefit Guaranty Corporation about a company terminating its pension plan came on Sept. 4, 1974. This was only the beginning.¹ The Treasury Department had predicted a rash of terminations as a direct result of ERISA, but the number was roughly five times what they expected.² When the magazine *Pensions & Investments* interviewed pension plan sponsors about what they would change about ERISA, the responses ran the gamut from “simplify reporting,” to eliminating the Labor Department.³ ERISA was causing plans to terminate, and was drastically slowing the development of new defined benefit plans, too.⁴

Everyone was waiting for Javits and Williams to admit that ERISA did not produce its intended results, and by the fall of 1977 even the Senators could not deny the problems. Javits announced on the Senate floor that “mistakes are clearly and unmistakably indicated.”⁵ A survey conducted by the PBGC put the number of plan terminations caused by ERISA at 17,000. An IRS survey returned a much higher number, 150,000, which accounted for roughly one-third of existing pensions. Even Javits had to admit that the simplest way for a plan sponsor to avoid fiduciary liability was to terminate the plan. The massive increase in paperwork prompted the

¹ Fran Hawthorne, *Pension Dumping: the reasons; the wreckage; the stakes for Wall Street* (NY: Bloomberg Press, 2008), 37-38.

² Clowes, *Money Flood*, 115: The government downplayed ERISA’s role in pension terminations and blamed the economy.

³ “Advisers, too, have ideas on revising Act,” *Pensions & Investments*, Sept. 12, 1977, (36).

⁴ Joseph M. LaMotta, executive VP, Centennial Capital Corp., NY, “A Deadly Duo: ERISA and the Tax Reform Act of 1976,” *Pensions & Investments*, June 20, 1977, 21. Hawthorne, *Pension Dumping*, 38.

⁵ Paul Merrion, “Javits calls for improvements in ERISA” *Pensions & Investments*, Aug. 15, 1977.

same result. A study by the House Small Business Committee concluded that the burden of operating a pension caused many small businesses to terminate their plans. Williams was unhappy with the division of administration between the IRS and the Labor Department (and the PBGC), calling it “inefficient, costly, time-consuming and confusing.”⁶ The contradictions and overlapping policies of ERISA and the tax code have since caused ERISA to be amended constantly, resulting in a mesh of laws so complicated that legal scholar James Wooten readily admits they are “too complicated for even experts to understand.”⁷

Defined benefit pensions did not disappear entirely; many were able to weather the initial blow of ERISA. These plans only succeeded in postponing the difficulty, though. Since unfunded pension liability was reported on the balance sheet as senior level debt, companies poured money into their pensions, to avoid harming their credit. Instead of underfunding, traditional pensions became overfunded, which led to the pension raiding of the early 2000’s, as Fran Hawthorne describes in *Pension Dumping*.⁸

What ERISA’s creators had forgotten was that private pensions are voluntary; employers do not have to offer a pension at all. To escape from the increased regulation and cost of defined

⁶ “Editorially speaking: shocking estimate point to need for relief,” *Pensions & Investments*, August 15, 1977, 26; *Pensions & Investments*, October 24, 1977, 44: “Study shows ERISA caused terminations”; *Pensions & Investments*, October 24, 1977, 25: “Williams wants one ERISA unit”

⁷ James A Wooten, *The Employee Retirement Income Security Act of 1974: a political history* (Berkeley and Los Angeles: University of California Press, 2004), 277. I can attest to the complexity of ERISA from personal experience. While completing this dissertation, I worked in the Benefits department of a Fortune 500 company headquartered in Nashville. Our Director preferred to work with a hard copy of ERISA; it is *the* document governing the administration of welfare and benefit plans. It took up six five-inch binders, printed on the tissue paper familiar to anyone who works with government documents. And every month a fat envelope arrived in my inbox, with the new pages to add and instructions on which to discard. When we had a question, we referred to ERISA, but no one had time to read and digest tens of thousands of pages, certainly not in between phone calls and meetings.

⁸ Davis, E. Philip, *Pension Funds: Retirement Income Security, and Capital Markets, An International Perspective* (Oxford: Clarendon Press, 1995) 100 .

benefit plans, many employers converted their plans to defined contribution. Such plans were not a new creation, but they were much less common than defined benefit. With a defined contribution plan, employers could not promise a definite future payment amount, which many workers regarded as vitally important. After all, what good was promising a pension if there was no indication how much that pension would be.⁹

Indeed, defined contributions plans are more correctly characterized as forced savings plans; they do not come with a guarantee, and they are often available as a source of hardship loans.¹⁰ The most dramatic increase in defined contribution plans came a bit later, as the result of the addition of subsection (k) to section 401 of the Internal Revenue Code, which allowed pre-tax employee contributions.¹¹ The first so-called 401(k) plan was created in 1981.¹² Such plans were easy to create by modifying existing plans to include salary deferral. The percentage of workers covered by defined contribution plans doubled from 1975 to 1984.¹³

Business journalist Chris Welles titled his book on the Exchange of the 1970s *The Last Days of the Club*. He describes the death throes of the old way of doing things in the face of

⁹ Nancy Altman and Ted Marmor, “Social security from the Great society to 1980: Further expansion and rekindled Controversy” in *Conservatism and American Political Development*, edited by Brian K. Glenn and Steven Michael Teles, Oxford: Oxford University Press, 2009) 154-187, 177; Clowes, *Money Flood*, 122.

¹⁰ Thomas J. Mackell, Jr., xxi; Altman and Marmor, 176; Wooten, *ERISA*, 2.

¹¹ Altman & Marmor, 177; Sylvester J. Schieber, *The Predictable Surprise: the unraveling of the U.S. retirement system* (Oxford: Oxford University Press, 2012), 161.

¹² Richard A. Ippolito, *Pension Plans and Employee Performance: evidence, analysis, and policy* (Chicago: University of Chicago Press, 1997), 5. (Check)

¹³ Schieber, *Surprise*, 148

Mayday, but Wall Street is nothing if not inventive and adaptable.¹⁴ The Club, as Welles had known it, did end, but was merely replaced with a newer version of itself. Welles saw the future of a new Club, directed by behemoth banks and dominated by the growing power of NASDAQ. Some might argue that he turned out to be correct. The NYSE reasserted its internal machinations almost immediately after fixed rates ended. Soft money payments resumed with a vengeance to take advantage of the new system. James Needham was maneuvered out of his position by the Board of Governors in 1976, much the way Bob Haack had been. ““It just goes to show that the private club still runs the Exchange,” says a Congressional staffer who helped draft the 1975 Securities Acts amendments;” the club that was had been supplanted by the club that is.¹⁵ ERISA was a boon to the Exchange; in 1975 pension funds accounted for 69% of trading on the NYSE, as defined benefit plan sponsors boosted their investments, and the new defined contributions began to arrive.¹⁶

One of the groups that benefited most from the passage of ERISA was the mutual fund industry. Mutual fund representatives were the only lobbyists really concerned with defined contribution plans while ERISA was being developed. Their attention was on securing changes that would expand their market, and they succeeded in all their aims. The creation of the IRA and increased contribution limits for self-employed plans were among the mutual funds’ goals.

¹⁴ Kynaston, *The City*, “Clubs, like families, are capable of renewing themselves; but they still remain clubs” 8.

¹⁵ “Rushing to Shape a Central Market,” *Business Week*, October 18, 1976; Benn, 140; “Behind the Maneuvering to Oust Needham,” *Business Week*, May 10, 1976; John Carson-Parker, “The Shadows Deepen for the Exchange,” *Business Week*, November 10, 1975. James Needham had replaced Haack as president. The Martin report recommended, and the Board approved, a reconfiguring of the Exchange’s corporate governance, with a CEO to take on a new role replacing both president and chairman in daily operations. Needham was the first CEO, so he really replaced both Haack and Lasker, though too late to present a united front on the commission issue.

¹⁶ Clowes, *Money Flood*, 122.

A key change they lobbied for, and got, was permission for 403(b) plans to invest in mutual funds in addition to insurance annuities. Mutual funds were granted specific exemption from fiduciary rules, on the rationale that they were already regulated by the Investment Company Act of 1940. By their nature, the funds achieved a level of diversification adequate to meet ERISA requirements, and fund companies already produced documentation extensive and informative enough to meet disclosure requirements. Mutual funds seemed ready-made to take advantage of the new retirement investing conditions. On top of everything else, they had an appearance of trustworthiness and stability that appealed to individuals now faced with the task of directing their own retirement planning.¹⁷

The IRA was not intended to be an escape route for companies to shrug off their pension responsibilities, although some used it in just that way. Congress did recognize that Social Security was inadequate for those retirees who had no company pension; the IRA was meant to supplement the retirement incomes of people in that situation. Participation in employer sponsored pension plans stabilized in the 1970s, and then decreased; personal retirement accounts have become the dominant choice of American workers since 1980.¹⁸

The combination of deregulation and the IRA drew individuals into retirement investing.¹⁹ Simultaneously, ERISA and the side effects of deregulation led companies to push

¹⁷ Ralph Nader had proposed the creation of federally-chartered investment companies to which employees could send their retirement contributions to be managed. Then chairman of the House Banking Committee, Rep. Wright Patman (D-TX) was interested in how this idea could come to fruition. But the move to negotiated commission rates resolved the question, by opening the door to explosive growth for a relatively new player on Wall Street, the discount brokerage. Theodore Schuchat, "Washington Letter," *Pensions & Investments*, April 1973.

¹⁸ Scheiber and Shoven, "Economics," 12; 18; Davis, *Pension Funds*, 100.

¹⁹ "the Popularity of IRAs and Keoghs" *Pensions & Investments*, Jan. 3, 1977, 35.

retirement out of the corporate sphere and onto the shoulders of individual employees.²⁰ The IRA gave all the advantages of employer-sponsored plans, plus immediate full vesting and easy portability.²¹ In 1975 one and a quarter million people adopted IRAs, which had an initial contribution limit of \$1,500.²² IRA growth began slowly, going from \$3 billion invested in 1975 to \$20 billion by 1980, but took off during the early 1990s and now total over \$7 trillion, with just under half of that amount invested in mutual funds.²³

ERISA was most important in its ideological implications. By implementing vesting and portability requirements, ERISA changed the emphasis of pension regulation from maintaining plan assets to upholding the rights of individual employees.²⁴ Harrison Williams identified this change in 1972, when he explained that, “When private pension plans were in their infancy, they were customarily thought of as a gift from the employer to the loyal, retiring employee – like the traditional gold watch. More recently, pensions have come to be recognized more for what they really are – deferred wages, part of the employee’s just compensation, and payable at retirement.”²⁵

²⁰ Sass, *Promise*, 228-29; Sass views ERISA as the high-water mark for private pensions in America; declining participation in employer sponsored plans may have multiple causes, but Sass admits that ERISA was at fault, at least, in hurrying the end of private pensions: “The law’s regulatory burdens, hyper-rational standard of fiduciary conduct, and rising PBGC) premiums clearly sped the contraction.”

²¹ Ture, 9, 95. study by Norman B. Ture and Barbara A. Fields, *The Future of Private Pension Plans* (American Enterprise Institute for Public Policy Research)

²² Yohalem, Martha Remy, “Employee Benefit Plans, 1975,” *Social Security Bulletin* 40-11 (Nov 1977) 19-28, 25.

²³ <http://www.ici.org/research/stats/retirement> At its introduction, the IRA was perhaps more important as a concept than as an actual financial tool. Initially proposed by the Nixon administration, the IRA gave government sanction to self-directed, self-controlled retirement planning. The IRA portion of the administration’s plan was left in the law through many revisions; I think nobody thought it would ever be used, so why bother if it makes the administration happy to include it.

²⁴ McGill, *Preservation*, 40; 33. (Check)

²⁵ Press Release 72-103, Box #1620, HAW Collection

Since ERISA passed, though, the American economy has experienced radical change. In the modern service-based technological economy, the traditional pension has lost much of its original function. Hazardous conditions still exist in some industries, of course, but safety regulations have drastically reduced the number of incidents. No longer are workers expected to remain at one or two employers throughout their careers. In fact, the opposite is now the expectation. Workers are supposed to move around, and keep looking for the best fit for themselves. Companies have become more like collaborations, a fluid environment where people of similar ideas, skills, and interests pool their talents. The boundary that pensions set between workers and management, and between companies, no longer exists and is no longer needed. Defined contribution plans suit the modern economy better, because they are just as mobile as the workers who own them.²⁶

The challenge is deciding the purpose of the retirement pension. If the pension is indeed a consumer product, then the responsibility falls to the consumer to influence positive changes in its evolution. The idea of the pension as security is gone; if companies do not expect worker loyalty then it is no surprise if they are unwilling to provide security. But defined contribution plans are in limbo, stuck between different owners. Although the investment decision is made by the employee, the choices for that investment are delimited by the terms of the company's plan. If the public decides that security is most important, then perhaps control should go back to the companies. But if the possibility of higher returns is worth the risk, then why not go ahead and give individuals full control of their funds?²⁷ If the pension is, as Senator Williams said,

²⁶ Nancy Altman and Ted Marmor. "Social Security from the Great Society to 1980: further expansion and rekindled controversy." In *Conservatism and American Political Development*, edited by Brian K. Glenn and Steven Michael Teles, 154-187 (Oxford: Oxford University Press 2009), 177.

²⁷ Wooten, *ERISA*, 271-272.

part of an employee's just compensation, are companies legally obligated to see that a certain minimum amount is delivered at retirement, regardless of the employee's investment decisions? Is ERISA meant to guarantee a retirement fund, or the opportunity to have a retirement fund?

These are important questions, because research continues to show that Americans are woefully underprepared for retirement. Defined contribution plans suffer not only from market risk, but can be drained when employees need hardship loans. Such plans are voluntary for employees, and many people delay signing up for the company 401(k), or have no idea how much of their salary to contribute and so contribute too little. Overall participation in retirement plans decreased through the end of the twentieth century.²⁸ A 1998 study, "based on many optimistic assumptions," determined that the average baby boomer was saving roughly one third of the amount that would be necessary to maintain the same standard of living in retirement as when working.²⁹ One third is not very much.

As troubling as that is, evidence is beginning to suggest that the Affordable Care Act is following the same pattern with healthcare as ERISA did with pensions. Defined contribution health plans are growing more popular with employers.³⁰ Such plans are eerily similar to retirement plans, in that they offer employees greater freedom of choice, but do not necessarily provide the tools to make an informed decision. In July, 2015, Walgreens reported that their first two years of using a healthcare exchange worked well, but that lower-wage workers seemed to

²⁸ Sass, *Promise*, 228-9.

²⁹ B. Douglas Bernheim, "Financial Illiteracy, Education, and Retirement Saving" in *Living with Defined Contribution Pensions: Remaking Responsibility for Retirement*. Edited by Olivia S. Mitchell and Sylvester J. Schieber. (Philadelphia: Pension Research Council, Wharton, University of Pennsylvania Press, 1998), 38.

³⁰ Employee Benefit Research Institute, Issue Brief no.373, July, 2012; available online at https://www.ebri.org/pdf/briefspdf/EBRI_IB_07-2012_No373_Exchgs2.pdf

be most concerned about the price of the plans, choosing bronze or silver level plans instead of gold or platinum.³¹ This begs the question, does America want to guarantee healthcare, or the opportunity to have healthcare? The Society for Human Resource Management reported a study conducted by Accenture, predicting a growth in private healthcare exchange enrollment from 6 million people in 2015, to 40 million in 2018.³² Some of these exchanges are operated by traditional healthcare companies, such as Blue Cross Blue Shield, but many exchanges have been created by human resources consulting firms with less familiar names, such as Aon, Mercer, and Willis Towers Watson. These might be good stocks to have in your IRA.

³¹ Bob Herman, “Employers Warming Up to Private Exchanges,” Modern Healthcare, July 24, 2015. Available online at <http://www.modernhealthcare.com/article/20150724/NEWS/150729892>

³² Stephen Miller, “Private Health Exchange Enrollments Doubled in 2015” April 9, 2015. Available online at: <http://www.shrm.org/hrdisciplines/benefits/articles/pages/private-exchange-enrollments.aspx#sthash.UXCyzI7J.dpuf>

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