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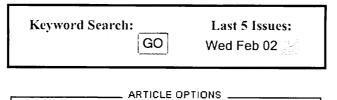
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Article published on February 02, 2005

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By Chris Frankie

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While the devil will be in the details of the President's Social Security reform proposal, it is becoming increasingly clear that the push for privatization will look more like government-sponsored Thrift Savings Plans.

If that proves to be true, according to industry and Capitol Hill observers, it would make it less likely that the proposal would provide the oncehoped-for boon to the financial services and mutual fund industries. Such a plan would instead benefit the few firms that are chosen to run the program.

Barclays currently runs the government's Thrift Savings Plan (TSP), and any firm chosen to run the new program could reap a significant windfall, some observers have noted.

"There is definitely a thrust to put very significant restrictions on the president's proposal. I have been hearing that the program will be modeled after the TSP and will have a limited number of options," says Niels Holch, executive director of the Mutual Fund

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Currently, investors in the TSP have five investment options, a mixture of stock and bond funds.

The default setting in Bush's proposal would likely be a life-cycle-fund-type selection where the investment options in the plan would be restricted as the account holder grows closer to retirement age. This would help limit the risk exposure of investors and attempt to provide some level of security with the plan. "It's privatizing without privatizing," Holch says

However, circumstances can change by the time the final proposal is drafted. "A lot is going on behind the scenes." Holch says. "Bush spent the weekend at a Republican members' retreat in West Virginia and heard a lot of feedback on a lot of the proposals. Nothing is set in stone and clearly the concepts are changing hourly [as Bush's Wednesday address approaches]."

Pressure from both Democrats and Republicans has forced Bush to retool his pitch for privatization and abandon some of the more controversial, and what critics call more risky, parts of the plan

"The whole idea is putting together a package that can be passed," says Don Cassidy, senior analyst with **Lipper**.

Cassidy says the TSP model is "known and simple and something Congress has approved once before." Congress previously approved the TSP program, which was set up for government employees but was not nearly as large or politically sensitive an issue, he says.

There are also a number of proposals on the Hill that would include a second tier of investment options for accounts with more than \$5,000. While this option would allow investors greater

flexibility and potentially provide the oncehoped-for boon the investment management and mutual fund industries have been looking for, it appears to be a long shot in this current environment, according to observers.

"The proposal won't be a matter of investors just turning over their nest eggs to Wall Street firms," Holch says. "The administration appears to be moving away from handing Wall Street, as a whole, control of this potential opportunity."

John Benvenuto, the director of research for mutual funds at **Financial Research Corp.**, says the biggest challenge for personal accounts is figuring out how to minimize the risk someone can take. While life-cycle accounts would be one option, he says there is no way the government is going to allow individuals anywhere near market-level risk in their privatized retirement accounts that could potentially be offered in some of the second-tier proposals.

"Ideally, for the investment management industry as a whole, it would be a very good thing to open up those larger accounts," Benvenuto says. "That's something the industry would want to see."

However, it would be a challenge to get it done, as the new accounts would still be under a government program. Benvenuto says he has a hard time thinking this part of the program would be included in the final proposal.

Cassidy says that the second-tier options could be a "casualty" of the president's cutting back of the plan in order to get it approved. "They may want to open the door to that option now, but may have to negotiate it away to get it passed."

He says the subject could be brought again to the forefront five years down the road and potentially adopted at a later date once the initial phase of the program is approved and on its way

to becoming a reality.

Click here to contact Chris Frankie.

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