Washington Watch

Too Good to be True.

PSCA reacts to the SAFE Plan.

By Ed Ferrigno

"A worker with a SAFE Plan would have to contribute only half as much of their paycheck as a worker saving in a typical [401(k] plan to have the same likelihood of maintaining their standard of living upon retirement."

"Employers would not be faced with administrative or fiduciary obligations."

"The plan would be far less risky for workers and retirees than a 401(k), with a higher likelihood of achieving target benefit levels."

Eureka! Double returns and less risk! And just 25 points! And an indexed annuity plus "bonus checks!" Sign me up today. Why did it take so long to figure this out?

The uber-liberal Center for American Progress (CAP), in its recently released paper, *American Retirement Savings Could be Much Better,* makes these promises, and more, about its Secure, Accessible, Flexible, and Efficient Retirement Plan. I expect that Senator Tom Harkin's long-awaited USA Retirement Funds proposal will closely follow the CAP proposal.

What's under the hood?

The SAFE plan claims to be a "collective defined contribution plan." However, at the end of the day the mandatory annuity payout will probably result in it being classified as a new form of defined benefit plan. It will likely operate as a multiple-employer plan with special relief from the DOL's strict commonality standard. "Independent boards" will assume fiduciary responsibility from employers. Risk is managed by using a "collaring" strategy in which losses are limited by purchasing put options. The puts are partially financed by the sale of call options, which limit upside potential. Interestingly, in the SAFE plan it appears that the plan owns the call options, raising questions about how the puts are financed.

Investopedia explains "Collar"

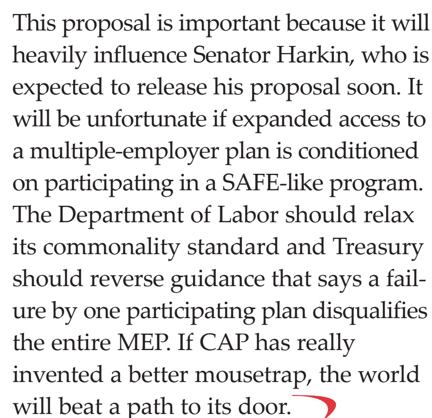
1. The purchase of an out-of-the-money put option is what protects the underlying shares from a large downward move and locks in the profit. The price paid to buy the puts is lowered by amount of premium that is collect by selling the out-of-the-money call. The ultimate goal of this position is that the underlying stock continues to rise until the written strike is reached.
2. An example is a circuit breaker which is meant to prevent extreme losses (or gains) once an index reaches a certain level.

Collars can protect you against massive losses, but they also prevent massive gains.

Collared investments are readily available today, including in a mutual fund format. They are just one of many hedging strategies available, including insured products. No doubt, retirement plans exist today that use collars to manage risk. Of course, but omitted in the CAP paper, hedging is not free.

CAP confuses investment management fees with plan costs when it claims the SAFE plan will cost 25 bps. Presumably, the compliance, nondiscrimination, and reporting rules, applied at the employer level, will apply. If they don't, we are talking about $51,000 IRAs, plus catch-up. It's safe to say that is not what CAP has in mind. Unfortunately, there's no evidence that the SAFE plan will address the high non-investment costs for small plans beyond the advantages of a regular multiple employer plan.

Outlook



This proposal is important because it will heavily influence Senator Harkin, who is expected to release his proposal soon. It will be unfortunate if expanded access to a multiple-employer plan is conditioned on participating in a SAFE-like program. The Department of Labor should relax its commonality standard and Treasury should reverse guidance that says a failure by one participating plan disqualifies the entire MEP. If CAP has really invented a better mousetrap, the world will beat a path to its door.

Ed Ferrigno is PSCA's Vice President, Washington Affairs.