Roth accounts mystify most participants: Cerulli

By Editorial Staff *Thu, Sep 7, 2017*

Partial 'Rothification' of the 401(k) system might be on the Republican tax reform agenda this fall. If passed, it could lead to lower contribution levels, analysts at the global research firm said.

Two-thirds of savers have no understanding or a misunderstanding of Roth contributions, according to new research from Cerulli Associates, the global research and consulting firm. Cerulli pointed to the relevance of this finding given the potential "Rothification" of the defined contribution (DC) market through tax reform.

In a survey this year, Cerulli asked approximately 1,000 DC plan participants to select the data that best described Roth contributions. Only one-third of participants knew that Roth contributions are after-tax, that money in a Roth account grows tax-free, and that withdrawals at retirement are tax-free.

"The current tax code allows taxpayers to deduct retirement savings and delay paying taxes on traditional accounts—as opposed to Roth–until the savings are withdrawn, thereby encouraging individuals to build a nest egg to fund their retirement," said Jessica Sclafani, associate director at Cerulli, in a release. "This incentive would no longer exist if tax reform succeeds in Rothifying the DC market and could dramatically change Americans' retirement savings behavior."

Given the lack of understanding of Roth contributions, the behavioral challenges associated with taxable contributions and the loss of the immediate tax benefit, or incentive, Rothification could cause some individuals to reduce or cease their contributions to an employer-sponsored retirement savings plan, Sclafani said.

"Cerulli believes that there are some counterinitiatives that recordkeepers and consultants can consider to get in front of tax reform and the potential threats it poses in terms of reducing DC plan contributions," she added. These included:

- Implementing the switch to a Roth system on a non-elective basis for participants
- Emphasizing the power of an employer matching contribution within the context of a Roth system
- Framing a tax break as a salary raise and an opportunity to increase retirement plan deferrals.

The third quarter 2017 issue of The Cerulli Edge – U.S. Retirement Edition explores assisting age 50+ workers in preparing for retirement, and the potential consequences of Rothifying traditional retirement accounts through tax reform.