

How to Open the Door to the Roth 401(k) Savings Opportunity

For many employees, Roth 401(k) contributions are a smart move toward strengthening retirement readiness, yet they remain markedly underused. Employers should consider providing the option, educating employees on its value and providing a good modeling tool to help plan participants make the Roth decision. Doing so could both increase overall 401(k) participation and lead employees to save more for retirement—which would help the enterprise meet organizational goals by maintaining high employee engagement and productivity levels and reducing talent-related risk.

by **Jamie Knopping** | *Towers Watson*

More than ever, U.S. employers are worried about what can happen when employees delay retirement because they can't afford to stop working. Knowledge transfer, engagement and productivity can all take a hit—as can the bottom line, due to the labor costs often associated with long-tenured workers. And as younger employees' career progression is blocked, employers risk losing critical talent, potential leaders and new skill sets. So employers are boosting their efforts to help employees prepare for retirement.

With more robust education tools and an emerging focus on considering overall financial wellness, valuable drivers to improve an employee's retirement outlook can get lost. One such driver that is markedly underused is Roth 401(k) contributions.

For many employees, contributing to a Roth 401(k) can be a smart move. Employees can designate all or part of their

401(k) contributions as Roth contributions. For those they designate as Roth, employees pay into the fund with after-tax dollars, and the money they contribute, including earnings, comes out tax-free in retirement.

So why aren't more employees taking advantage of the Roth 401(k) opportunity? Probably because many don't know about it or understand how it works or because they are in the plan due to automatic enrollment, which is usually a pretax deferral.

Plan sponsors need to educate the workforce and help employees determine whether Roth 401(k) contributions make sense for them.

Roth 401(k) Contributions: Making the Underused Useful

The percentage of U.S. employers that offer the Roth savings opportunity has increased in recent years, but it's still

only 54%, according to Towers Watson's most recent *Defined Contribution Plan Sponsor Survey*. And most that offer autoenrollment for savings plans do so only for traditional 401(k) plans. The same study confirmed that when a Roth is offered, few employees take advantage of it: only 8% of highly compensated employees and 11% of other workers.

Some employees might confuse a Roth 401(k) with a Roth individual retirement account (IRA)—even though a Roth contribution is just a simple type of contribution offered in a 401(k) plan. Many might not know that their employer can match their Roth contributions or might not understand how withdrawals are taxed.

Employees also might not understand that Roth 401(k) contributions provide flexibility in how they use their savings after retirement. For example, they can pass the account to their heirs, and they can withdraw the funds without penalty if they retire early.

Particularly for young workers in low tax brackets and older workers seeking to minimize their tax bill after retirement, saving in a Roth 401(k) account can make good sense. And for workers at all career stages, it can strengthen retirement readiness.

If you haven't yet shared the Roth 401(k) secret with your workforce, it's time you did.

Plan Sponsors: Open the Door

First, create a process to continually monitor employees' financial well-being. Via plan-level analyses, predict when employees will be able to retire

comfortably and revise these projections periodically. Be sure employees know about and understand the various savings methods available. If you don't already offer a Roth feature in your 401(k) plan, consider doing so, and allow participants to convert their pretax 401(k) balances to a Roth plan.

Next, craft a plan to increase employee use of your Roth provision. Explain to employees that a Roth 401(k) isn't the same as a Roth IRA. Educate them about the potential benefits, particularly for those in early career stages and high earners who aren't eligible to make Roth IRA contributions. The burden of choosing the Roth option is on employees, and they must consider many variables, so help them make the decision.

Here's what it takes: Employees need a thoughtful, well-planned communication program that includes step-by-step guidance for decision making and provides effective modeling tools.

Strengthen Your Employee Education Program

An effective education program will help employees understand the factors they should consider when they evaluate the Roth option, the value of accumulating more tax-favored funds for retirement, the benefit of having more flexibility in taking distributions and more. The primary question they'll need to answer is: Is it better for me to pay income taxes on contributions while I'm working or to pay taxes when I withdraw funds in retirement?

To answer that question, employees must consider the stage of their career, their wage level and tax rate, their expected income and tax rate in retirement, and their desire to leave retirement savings to their heirs. Along with understanding the risks of Roth saving, they'll need to know how much value they can derive from Roth contributions. Without effective modeling tools, it's a daunting task.

That's where you, representing the plan sponsor, can make a big difference: Make a comprehensive modeling tool available to employees and encourage them to use it.

What the Right Modeling Tool Can Do

A good modeling tool can help employees determine whether Roth contributions make sense for them.

The ideal modeler should factor in the employee's:

- Total estimated retirement income
- Expected pay growth rate
- Inflation rates and how they'll affect future tax brackets
- Marital status and how it will affect future tax brackets
- Projected Social Security income and how it's phased in as taxable income.

With this information, the tool helps users determine whether pretax contributions may be more beneficial than Roth contributions and whether it would be wise to convert their pretax 401(k) balances to a Roth plan. It also helps them decide how much to diversify their portfolio, as it may be valuable to have both Roth and pretax resources available in their retirement.

Communication Is Essential

Educating employees about the Roth opportunity—and helping them with decision making—will be effective only if you deliver easy-to-digest information via thoughtful communications that align with employees' preferences and needs.

Segment the workforce according to employees' career stages and roles, and then use the appropriate media mix to deliver customized information to each segment. For example, workers who can't easily access a computer might want to receive printed information, and young workers might need more general information about the power of saving than older workers need.

More tips:

- Use interactive approaches. In addition to traditional retirement education vehicles—such as newsletters, account statements and webcasts—consider using mobile apps and digital technology to engage employees.
- Communicate clearly and frequently.
- Keep messages short, personal and action-oriented.
- Provide interactive channels for feedback and questions.

You can do plenty to help employees save for retirement, whether via an after-tax Roth option, a traditional 401(k) plan or a combination of both. If they decide to make Roth contributions, they potentially can save more for retirement

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over time. Also, the organization can realize tax savings of between 0.25% and 0.75%. It's not a dramatic percentage, but it's enough to make the effort worth your while.

You're probably already working on improving employees' retirement readiness. But if you aren't making the Roth option available to them, you can strengthen those efforts by providing the option, educating employees on its value and providing a good modeling tool to help them make the Roth decision. That could both increase overall 401(k) participation and lead employees to save more for retirement—which would help the enterprise meet organizational goals by maintaining high employee engagement and productivity levels and reducing talent-related risk. 

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