A New Type of 401(k) Picks Up Steam

GM Becomes First Major Employer To Offer Roth 401(k)s; Deciding When to Take the Tax Hit

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General Motors Corp.'s plan to begin offering its employees access to a Roth 401(k) savings account is expected to give a strong boost to the newest retirement-savings product.

GM, which has been cutting employee pension benefits to help restore its profitability, last month said it would begin offering the Roth 401(k) accounts to more than 140,000 eligible workers this summer. Roth 401(k) plans, introduced Jan. 1 by Congress as a way to get workers to save more for retirement, are a version of the popular 401(k) plan that many companies offer employees to allow them to build tax-favored savings for retirement. The main difference: In a traditional 401(k), workers set aside pretax income and then pay taxes when the money is withdrawn after retirement. With a Roth 401(k), contributions are taxed now, but the withdrawals, including all the profits the savings generated, are tax-free.

Few companies have so far added Roth 401(k)s to their retirement-plan options, even though these can provide greater benefits than traditional 401(k)s for some employees, especially younger workers who expect to be in a higher tax bracket after retirement. One complaint: Offering the new plans means additional administrative chores for companies.

Now, GM's planned introduction of the Roth 401(k), as well as adoption of the new product by other high-profile companies such as mutual-fund giant Vanguard Group Inc. and St. Louis brokerage firm A.G. Edwards Inc., could give the Roth 401(k) the legitimacy it needs to gain wider acceptance. Retirement-industry experts say corporate benefits managers have been waiting for a big company to adopt the Roth 401(k) to see what experience it has putting the new plan into place.

"When larger companies start adding features like a Roth, the smaller players feel" they must follow in order to stay competitive, says Chris Bowman, vice president of retirement and investor services at Principal Financial Group, a big administrator of retirement-savings plans.

GM's move comes as the big auto maker, along with other corporate giants such as International Business Machines Corp., are scaling back traditional employee pension plans. This has left a wide range of workers, from highly paid executives to entry-level factory hands, responsible for replacing the retirement income they otherwise would have received.

GM says it began discussing adopting the Roth 401(k) during negotiations with the United Auto Workers union more than two years before the plans were formally introduced. GM's benefits executives analyzed the Roth and concluded that the plan's tax-free savings "would be attractive to both salaried and hourly employees," says Preston Crabill, GM's director of pension and savings plans. He says the company's payroll department hasn't yet run into any significant difficulties in setting up the new plan, which will be administered by Fidelity Investments.

Roth 401(k)s differ from traditional 401(k)s and can benefit certain workers more.
** In a traditional 401(k), workers set aside pre-tax savings and then pay taxes when the money is withdrawn after retirement.* ** Contributions to a Roth 401(k) are taxed now, but the withdrawals, including all the profits, are tax-free.* ** Roth 401(k)s can offer greater benefits to younger workers, and give high-income earners a savings vehicle to accumulate profits tax-free.*

A UAW spokesman said the union wanted the Roth 401(k) as another option for workers to be able to build retirement savings. He said the addition of the Roth 401(k) doesn't affect the traditional pension plans that unionized workers have through GM.

The Roth 401(k) offers advantages to workers who are currently in a low tax bracket but who expect to be in a higher tax bracket after retiring. That's because they're paying taxes on their contributions today at the lower rates, and later will be able to withdraw that money without paying any taxes. Still, because those contributions are after-tax, a worker saving with a Roth 401(k) has lower take-home pay, and that has made it a challenging product to sell, experts say.

Highly paid workers also can benefit from a Roth 401(k) because they're generally locked out of other savings vehicles that accumulate profits tax-free, and the Roth 401(k) allows them to reap the tax-free benefit. While lower-paid workers have access to a Roth IRA, a popular retirement account for accumulating savings tax-free, higher-paid workers generally don't because of income limits that prevent them from contributing to these.

Another benefit: The Roth's tax-free withdrawals can help highly paid workers manage their tax situation in retirement. These workers, who often already have sizable savings in a traditional 401(k) plan, will be able to pull a portion of their retirement income from a Roth 401(k), thereby lowering their overall tax burden.

Employees at other companies also have shown interest in Roth 401(k)s. At A.G. Edwards, employees "called all the way up to our CEO and were calling members of the benefits committee asking for a Roth; their input drove this," says Joe Porter, A.G. Edwards's assistant director of administration. The brokerage firm began offering the Roth 401(k) in January and so far about 5.5% of its roughly 15,500 employees have signed up.

At Vanguard, which also introduced the Roth 401(k) at the beginning of the year, about 15% of the mutual-fund company's work force had enrolled in the new product by the middle of February.

Workers contributing to a Roth 401(k) typically have access to the same mutual funds and other investment options that their companies offer in a traditional 401(k). Companies can choose to match worker contributions, though not all do. A worker's combined contributions to both types of plans can't exceed $15,000 this year, or $20,000 with a catch-up provision for workers over 50 years of age. A Roth 401(k) account must be open at least five years for a tax-free withdrawal, and you must be at least 59½ years old.

For workers whose companies don't offer a Roth 401(k), people can invest on their own in a Roth IRA. However, this only allows a saver to sock away $4,000 annually ($5,000 with the catch-up provision), and there are income limits that prevent some high-income earners from contributing at all.

Despite the advantages of Roth 401(k)s and GM's apparent endorsement, retirement-plan experts say the plans still face hurdles to gain acceptance. Corporate benefits departments question whether employees really want another retirement-savings option when workers are already confronted with a traditional 401(k) plan, money-purchase and cash-balance plans, and a variety of IRAs. And some companies are concerned that after going through the effort of establishing a Roth, the plan could go away since the authorizing law is set to expire at the end of 2010 unless Congress acts to extend it. Even if the law expires, retirement-industry experts expect that money in these accounts will be allowed to continue to grow tax-free.

For those reasons, Hewitt Associates, a human-resources consulting firm, says that only 6% of its large-company 401(k) clients have adopted the Roth option. **And Polycomp, a California-based retirement-consulting firm, says that just 20 of the 1,000 small and medium-size company 401(k)s it administers now offer a Roth.**