



The New Roth Rules: Are Your Clients Converting? Survey Results – April/May 2010

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We're almost two quarters into 2010 and the new Roth conversion rules that took effect this year. Many fund companies are reporting high levels of Roth conversion activity, but to date there have been only anecdotal reports as to what investment advisors and wealth managers are experiencing with their clients and prospects. Looking to dig deeper, [Advisors Trusted Advisor](#) and Advisor Perspectives co-sponsored a twelve-question survey of 242 investment advisory firms to understand the impact of the new rules on both their current clients and their prospects. We found that while the majority of clients and prospects are showing little interest in Roth conversions, advisors may be partially to blame, as only a small percentage of them are publicizing the new rules or educating clients about their potential benefits.

Survey demographics

As the media paid increasing attention to Roths over the last months of 2009, we wanted to learn what level of interest advisors were experiencing from prospects and clients as the new rules took hold. To capture any prospects in the "pipeline," we asked prospect-related questions about the period from October 1, 2009 through March 31, 2010; for current clients, we asked for advisors' experience during the first quarter of 2010. Respondents completed this survey during the last two months of April and first week of May.

The average firm size (assets under management, in millions), number of clients, number of prospects over the past six months, and size of clients' non-Roth retirement accounts were as follows:

Average AUM (millions)	Average # of clients	Average # of prospects (past 6 months)	Avg. non-Roth retirement accounts
317.1	296.3	19.4	\$382,842

We asked about the size of a firm's average non-Roth retirement accounts in order to gauge clients' conversion potential and the opportunity advisors have to discuss this important topic with them. With non-Roth retirement accounts averaging \$382,842, there appears to be a strong incentive for advisors to assess the impact of a full or partial conversion.



Muted interest in Roths, despite opportunities for advisors

Despite all the “buzz” about Roth conversions, we found that clients and prospects were generally not seeking counsel about this, nor were advisors being proactive in providing advice. To the question “Since January 1, 2010 how many clients have proactively sought your counsel about Roth conversions?” the response was 4%. To see how assertive advisors are being in making clients aware of the rule changes, we asked, “For the same time frame, with how many clients has your firm *initiated* Roth conversion discussions or analysis?” Thus far in 2010, advisors have initiated discussion or analysis with 14.2% of their clients.

Roth conversions are creating more new business opportunities for advisors than are current clients. We asked “What proportion of the past six months’ prospects have either proactively expressed interest in a Roth conversion, or determined that this was important after the opportunity was discussed?” Nearly 1 in 5 prospects (18.9%) were interested in a Roth conversion.

Percentage of clients expressing interest in Roth	Percentage of clients with whom firm has initiated Roth analysis	Percentage of interested prospects
4.0%	14.2%	18.9%

The major benefits of the new rules, however, accrue to those who earn more than \$100,000 in modified adjusted gross income (MAGI), as prior to 2010 these people could not convert to Roth IRAs. We asked “What percentage of your client base earns more than \$100,000 in modified adjusted gross income (MAGI) annually?” The responses show a normal distribution, from 0 to 100%, across the 242 responses. Our 242 advisors reported that, on average, 58% of their clients earned above this threshold.

These data are more interesting when filtered by the proportion of an advisor’s client base that earns more than \$100,000 in MAGI. We expected (especially given an advisor’s fiduciary responsibility) that advisors with a higher incidence of high-earners would be more proactive in communicating the new Roth rules to clients, and to doing an analysis. We compared the extremes of client income averages per advisor by filtering responses by advisors with less than 30% of their clients earning more than \$100,000 and those with greater than 70% earning this amount. The summary statistics for these two groups are as follows:



	Average AUM (millions)	Average # of clients	Average # of prospects (past 6 months)	Avg. non-Roth retirement accounts (thousands)
Less than 30% of clients earning > \$100K MAGI	\$170.4	317.9	15.8	\$203.176
Greater than 70% of clients earning > \$100K MAGI	\$549.2	243.6	18.4	\$634.602

On one side of the MAGI spectrum, unsurprisingly, the higher-earning clients are expressing more interest to their advisors than the lower-earning group (6.3% vs. 3.5%). What *is* surprising, however, is that more than double the number of prospects of the lower average-earning group expressed interest in Roths (24.6% vs. 10.8%) and that more advisors with the lower-earning clients are *initiating* conversion discussions (24.2% vs. 14.3%).

	Average number of clients expressing interest in Roth	Average number of clients firm has initiated Roth analysis	Average number of interested prospects
Less than 30% of clients earning > \$100K MAGI	3.5%	24.2%	24.6%
Greater than 70% of clients earning > \$100K MAGI	6.3%	14.3%	10.8%

Some of the comments we received on the survey help explain these counterintuitive disparities between the two groups:

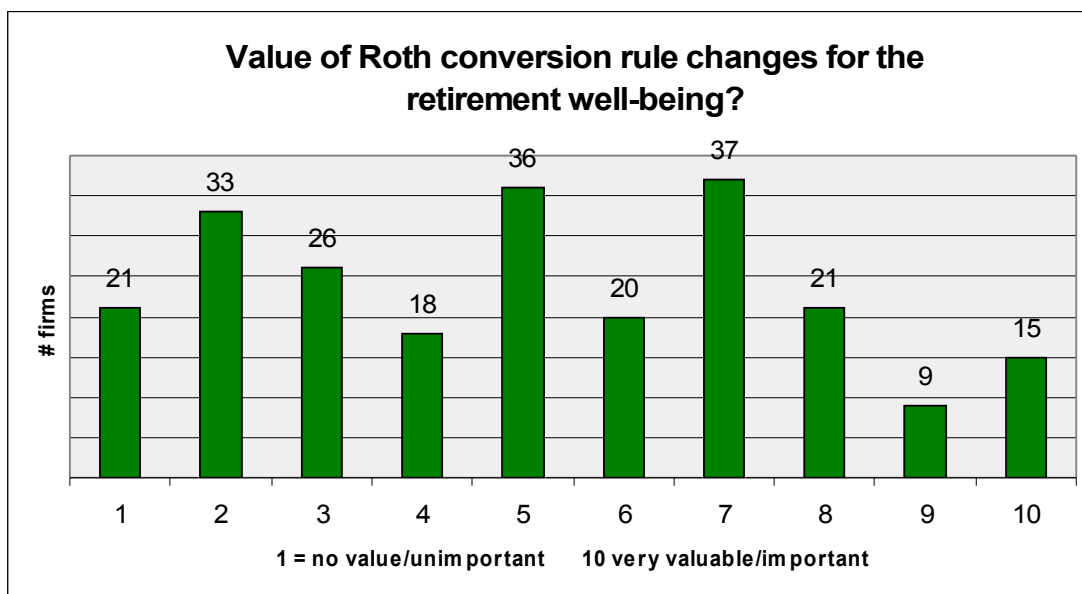
- Advisors of higher earners believe the analysis is too complicated or the arguments for conversion aren't compelling enough
- Advisors of higher earners – even if they see compelling reasons – do not want to tell clients they need to pay conversion taxes now or are being told by clients that they won't do it
- Advisors of lower earners are looking for every opportunity possible to grow their firm – and see the conversion discussion as mutually beneficial to client and firm
- Advisors of lower earners believe that “the \$60,000 earner today will be the \$120,000 earner tomorrow” – and they want this client to stay with them as they grow and become conversion-eligible



- Lower-earning prospects, who are typically younger, are open to listening to longer-term retirement options, but the need to pay conversion taxes diminishes the interest of higher-earning prospects.

Advisors with a lower-earning clientele were “more aggressive” on Roths than the more well-to-do group. Cory Fauchaux, a Louisiana-based advisor whose firm falls in the smaller group, commented on his survey: “We have opened the discussion to most of [our] clients, whether we felt it was in their best interests or not. The reason? We wanted to be the person they heard the strategy from first. We didn’t want clients that we had good relationships with to come to us and say, ‘Hey, did you know about this?’”

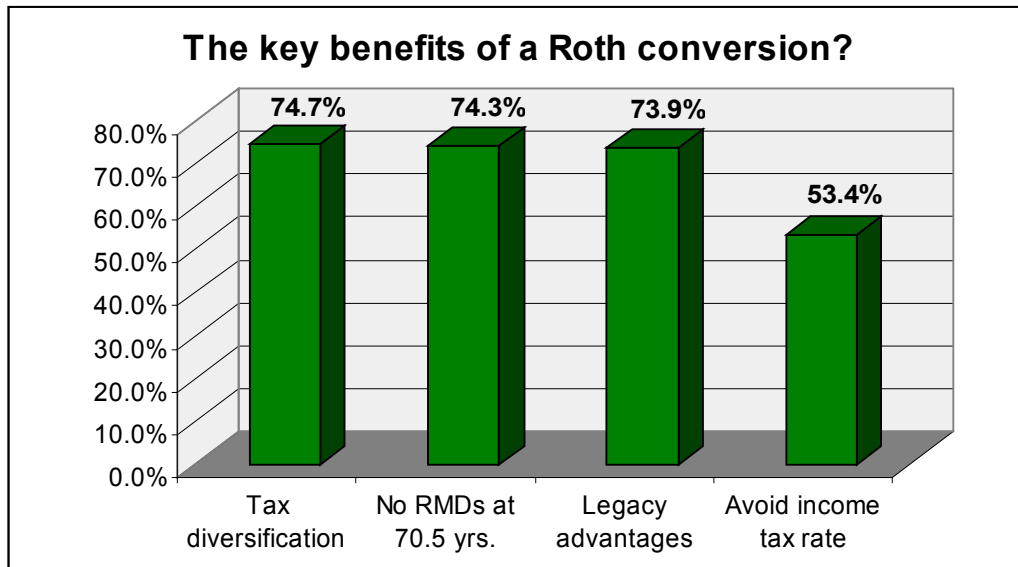
Why have advisors with a preponderance of high earners initiated Roth conversion discussions or analysis with only 1 in 7 clients (this percentage rises to 35%, 1 in 3, for firms with greater than 90% MAGI clients)? We asked, “On a scale of 1 to 10, how valuable are the Roth conversion rule changes for the retirement well-being of your clients and prospects?”



The dispersion of responses for all respondents is quite wide, with a slight skew toward “unimportant.” Reasons for the indifference vary, with many citing resistance to paying taxes now (“They [clients] universally don’t want to pay the higher taxes now...”), being overwhelmed by the apparent complexity of the analysis (“...a Roth conversion is not a clear-cut win for most of my clients. Even my own accountant is not very interested in helping figure this out!”), or generally wanting to take a “wait and see” approach.



To learn more about what advisors saw as the main advantages and disadvantages of Roth conversions, we first asked what they believe to be the key benefits.



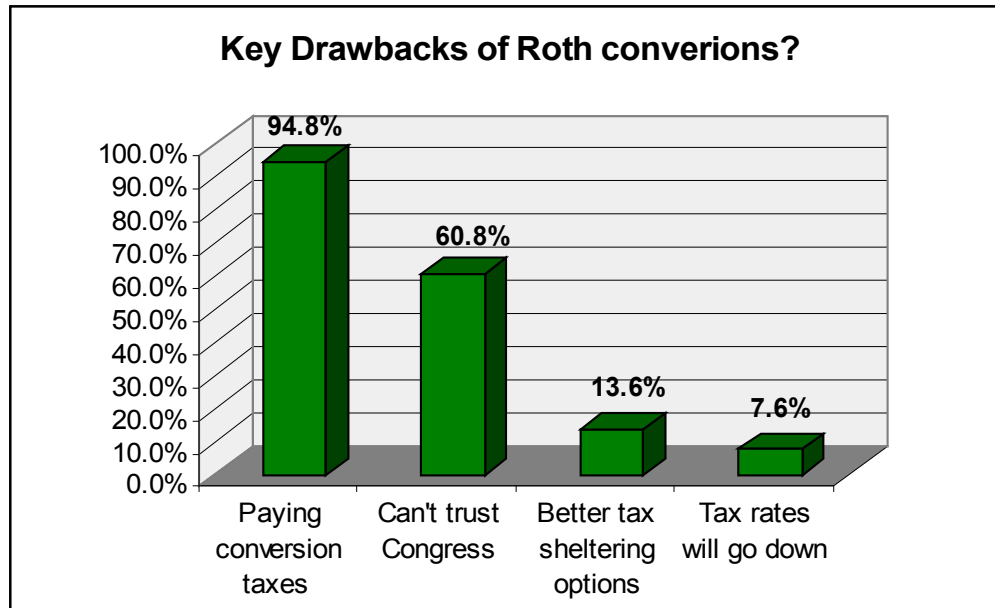
The top three benefits they identified were:

1. Tax diversification – the ability to withdraw tax-free assets in retirement
2. No required minimum distribution at 70 1/2 years old
3. Legacy advantages – the ability to pass tax-free assets on to heirs

The last choice, “Inevitable income tax rate increases can be avoided,” was a distant fourth, reflecting many comments that income tax rate hikes are far from a certainty. Generally, advisors are generally quite clear about the benefits of Roth conversions. That said, the top three reasons are all empirically true, and the fact that over 25% of respondents didn’t see *all three* of these facts as benefits indicates some confusion or ignorance about the reasons a client might convert.

The key drawback of a Roth conversion that respondents cited was paying conversion taxes now. This reflects many comments indicating that this is a hard sell to clients and that the old axiom “never pay taxes before you must” doesn’t lose its force in the face of analytical evidence. In order, the other three choices were:

1. Can’t trust Congress – they’ll likely revoke or change Roth’s tax-free status
2. There are better vehicles for tax sheltering to address legacy concerns
3. Tax rates will likely go down during my clients’ lives



Unlike the “Roth benefits” question, the comments on this question reflected a marked amount of confusion or ignorance about the new rules or the analytical components that must be considered. This was evident in many blanket comments, such as:

- “...most conversions are not worth it unless you have no or little current income (unemployed or in an industry like real estate and not making any sales.)”
- “...the affluent middle class cannot really use them effectively.”
- “...we estimate the recovery period for a Roth conversion to be 10-12 years, i.e. the time it takes to recover the opportunity cost of the added taxes paid.”
- “Dangerous paying taxes while employed when most folks will be in a lower bracket in retirement!”
- “Conversion only makes sense if [someone] can pay taxes out of other funds. Effect is equivalent to putting into the Roth the amount of taxes paid from other funds, since the assets grow same as if in traditional, but not taxed when withdrawn.”

Enthusiasts, deliberators and skeptics

We grouped respondents into three categories, based on a qualitative grouping of their comments.

Many advisors (the *Enthusiasts*) see clear benefits to Roth conversions, are educating themselves on the nuances and recognize that this is not an “all or nothing” decision. They see that clients and prospects need to at least hear about the new rules. They also see this as an exciting opportunity for making contact with previously unreachable or uninterested prospects.



The *Deliberators* have investigated Roths but respond that clients refuse to pay taxes now or believe it's too hard to convince them. They also believe there are few if any software tools that offer sound advice. They remain mostly on the sideline but continue to evaluate.

The *Skeptics* don't trust the government and worry that it will dramatically change the rules in the future, making current "converters" the losers. The cynicism about government also extends to Wall Street, and that may be serving as an excuse to do nothing. Citing heavy promotion by fund companies, the response seems to be "Because someone is over-hyping this, I'm going to ignore the whole thing!"

The Deliberators and Skeptics have fair concerns, but these survey data indicate that far too many of them are choosing to *not* dive into the details or even broach the subject with clients – leaving many currently eligible "converttees" without critical retirement and legacy planning information.

This report, information about Roth conversion analytical, educational and marketing tools; and other practice management resources are available from Advisors Trusted Advisor by [clicking here](#).

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