

# Help your organization get the most out of your plan

Strategies for employer contributions

## Employer contributions help with recruiting and retention

As many organizations look to invest in and grow operations, businesses remain concerned about two top issues, especially when they're competing for top talent:

**1 | Finding qualified employees.** Among firms hiring, 93% saw no or few qualified applicants for the positions they're trying to fill.<sup>1</sup>

**2 | Employees leaving for other opportunities.** 45% of SMB customers say the main reason why employees take a new job is for better pay.<sup>1</sup>

The good news is that providing well-designed contributions—either employer contributions only or employer matching contributions—to your nonqualified deferred compensation plan can help address both of these concerns. Once you identify your organization's goals, you can align those goals to the design of your plan to help recruit and retain your key employees.

## Common employer goals

As your organization thinks about discretionary employer contributions, prioritize the organizational needs your deferred comp plan should address. Here are some examples:

- ➔ **Retention.** Making it appealing for key employees to stay with the organization, often beyond the event of a sale, by structuring bonuses (sometimes referred to as “golden handcuffs”) with vesting schedules.
- ➔ **Rewards.** Driving both organizational and personal performance by offering meaningful incentive-based contributions to the plan.
- ➔ **Recruitment.** Attracting key performers to the organization through signing bonuses tied to a fixed tenure period or business objectives.
- ➔ **Retirement.** Supporting retirement readiness by restoring company match benefits not allowed in 401(k) plans due to ADP/ACP testing and/or compensation limits.

# Deferred comp plans and vesting

Because deferred comp plans aren't subject to ERISA coverage, anti-discrimination and vesting requirements, employers have more flexibility in addressing their organizational needs. Plus, plan sponsors have a lot of flexibility in terms of employer contribution formulas and vesting schedules.

## Flexible vesting alternatives

Deferred comp plans use some of the same vesting schedules seen in 401(k) plan arrangements, like vesting based on years of service, age, or a combination of both. Vesting may be applied as graded vesting or cliff vesting. But where deferred comp stands out is other vesting designs not available in 401(k) plans, like rolling vesting and longer-term vesting schedules used in golden handcuff arrangements.

Rolling vesting involves ongoing employer contributions with separate vesting schedules for each contribution. This allows participants to attain vesting milestones more frequently and helps with retention by keeping the participant motivated to achieve that next vesting milestone.

## Employer contributions into the plan



### Primary reasons for employer contributions

- 40% Restore lost 401(k) match
- 39% Retain key employees
- 18% Motivate key employees

Source: 2021 Trends in Nonqualified Deferred Compensation, conducted by Principal.

## Rolling vesting schedule example



Assumptions: Employer makes a \$5,000 contribution each year, which is subject to a 3-year cliff vesting schedule. For illustrative purposes only to help demonstrate how a rolling vesting schedule works.

## Combine coverage options and vesting methods

Employers can have different vesting schedules for different groups of plan participants. There can also be different vesting schedules for different groups of employees or types of employer contributions, and then have a rolling vesting schedule for incentive-based contributions.

The flexibility of combining employer contribution options and vesting methods allows you to offer enhanced benefits for key employees, and have more control over incentive compensation.

Here are some examples of popular vesting schedules our plan sponsors are using now:

<p><b>1</b></p> <p><b>Incentivize/retain high potential key employees:</b></p> <ul style="list-style-type: none"><li>• Class year cliff vesting based on four years of plan participation.</li><li>• Credit of \$10,000 made in year one and vests in year five. The next credit made in year two vests in year six.</li></ul>	<p><b>2</b></p> <p><b>Retirement of senior key employees:</b></p> <ul style="list-style-type: none"><li>• Account graded vesting of 100% in 10 years based on years of service with the company.</li><li>• Credits to account may occur as employee/company meets goals.</li></ul>	<p><b>3</b></p> <p><b>Restore benefits not allowed in 401(k) plans by key employees due to compensation limits:</b></p> <ul style="list-style-type: none"><li>• Account vests on a relatively short schedule that may be similar to a 401(k) plan.</li><li>• May be vesting 100% in three years based on company years of service.</li></ul>	<p><b>4</b></p> <p><b>Retaining key employees following a sale:</b></p> <ul style="list-style-type: none"><li>• Bonus paid at the time of a sale to key employees as incentive to remain with the company through the transition.</li><li>• Cliff vesting over a three- to five-year schedule, based on the date of the sale.</li></ul>
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## Deferred comp plans and existing benefit programs

Employer contributions in deferred comp plans are often an effective alternative to equity-based benefit options, such as stock options or restricted stock. Organizations have better control over costs by having the option—not the obligation—of making contributions if certain results or conditions are met. And, this can result in a neutral balance sheet for the employer.

Check out the table below to see some of the challenges that can come along with existing benefit programs.

Equity benefits	Phantom equity
Common methods include stock options or restricted stock.	Employer determines the value of phantom stock and pays participant benefits in cash with no voting or control rights in most plan designs.
<p><b>Challenges:</b></p> <ul style="list-style-type: none"><li>• Dilution of ownership interests</li><li>• A rigorous valuation process</li><li>• Stock shares that must be sold by participants to translate into value</li></ul>	<p><b>Challenges:</b></p> <ul style="list-style-type: none"><li>• Difficult for employer to explain price fluctuation due to changing market forecast or investments in business expansion</li><li>• Potential balance sheet impact</li><li>• FICA implications for participants</li></ul>

# An industry leader in your corner

Our history speaks for itself. We've been providing deferred comp plans for more than 30 years, and have over 80 years of retirement plan experience. We're the No. 1 provider of deferred comp plans<sup>2</sup> and a leading provider of defined contribution plans<sup>3</sup>.

A member of the FORTUNE 500<sup>®</sup>, our employees are passionate about helping clients of all income and portfolio sizes achieve their goals. You can count on us to offer innovative ideas, investment expertise, and real-life solutions to help make financial progress possible.

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Contact your financial professional or go to [principal.com](https://www.principal.com).

<sup>1</sup> Source: 2022 Principal Sentiment survey of small and midsize employer customers (128), non-customers (128) and employees (128) conducted between May 4 and May 9, 2022.

<sup>2</sup> Based on number of deferred compensation plan participants, 2021 PLANSPONSOR Recordkeeping Survey, July 2021.

<sup>3</sup> Based on number of Section 409A plans, 2021 PLANSPONSOR Defined Contribution Recordkeeping Survey, July 2021.



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