

BUSINESS INSIGHTS

What **benefit restoration** can do for key employees—and your business

One of the greatest challenges a successful business owner faces is the recruitment and retention of outstanding talent. A benefit restoration plan, which brings benefit levels up to a more equivalent percentage of salary for key employees, can help.

One of the ways you may be rewarding your most valuable employees is with a generous total compensation package. In most established businesses, this includes a robust combination of employee benefits. In addition to health insurance, they usually offer group life and disability insurance, and a 401(k) plan.

The challenge is that you may not have considered how these employee benefits generally offer more (as a percentage of pay) to your rank-and-file employees than your key employees. The maximum benefits (in the case of group life and disability) or contributions (in the case of a 401(k) plan) may provide limited value to your employees at higher compensation levels. While these benefits are essential to attracting and retaining your broad base of employees, they likely leave a gap for your key employees, who are most valuable to your business.

In a highly competitive job market, it's critical for certain key employees to receive benefits in line with their salary levels.

For example, consider the impact of three kinds of employee benefits—group life insurance, group long-term disability insurance, and a 401(k) plan—to employees at four different salary levels in the following hypothetical scenario.

Employee compensation level (annual)	Maximum group life insurance benefit ¹	How much of their income is replaced by the group long-term disability plan? ²	How much can go into their 401(k) plan? ³
\$75,000	\$150,000 (or 2x compensation)	\$3,750 (60% replaced)	36% of compensation ⁴
\$100,000	\$200,000 (or 2x compensation)	\$5,000 (60% replaced)	28% of compensation
\$200,000	\$200,000 (or 1x compensation)	\$6,000 (36% replaced)	17% of compensation
\$400,000 ⁵	\$200,000 (or ½ x compensation)	\$6,000 (18% replaced)	10% of compensation

In a highly competitive job market, it's critical for certain key employees to receive benefits in line with their salary levels. There are several flexible ways this can be accomplished. Each can be tailored to the exact benefits the employer wants to provide and the employees who'll receive them.

Life insurance benefits

An employer's group life insurance plan replaces a higher percentage of compensation for rank-and-file employees than for higher-earning key employees. In the example on page 1, those earning \$200,000 or more would receive a life insurance death benefit equal to one year's salary or even less—instead of a benefit equal to twice their annual pay. Supplemental guaranteed issue term life insurance can make up this difference, as shown below, for executive groups of 10+ lives. For individuals or groups of less than 10 employees, full underwriting or accelerated underwriting programs are available.

Employee compensation level (annual)	Maximum group life insurance benefit ¹	Supplemental life insurance	Total compensation replaced
\$200,000	\$200,000 (or 1x compensation)	\$200,000	\$400,000 (or 2x compensation)
\$400,000 ⁵	\$200,000 (or ½ x compensation)	\$600,000	\$800,000 (or 2x compensation)

Long-term disability benefits

The benefits provided by the group long-term disability plan shown on page 1 replace up to 60% of the income of rank-and-file employees, but a lower percentage of income is replaced as salary levels grow higher, due to the maximum benefit limits imposed by the plan. However, with employer-paid individual disability income coverage, a supplemental policy can be designed for each affected employee, to protect additional income not protected under the group plan. The employer can choose to provide a policy for each key employee that brings the total coverage level to 60%.

Employee compensation level (annual)	How much of their income is replaced by the group long-term disability plan? ²	Supplemental plan monthly benefit	Total percentage of income replacement
\$200,000	\$6,000 (36% replaced)	\$4,000	60%
\$400,000 ⁵	\$6,000 (18% replaced)	\$14,000	60%

Retirement benefits

Retirement benefits can be enhanced for key employees, with plans designed strictly for them. There are a variety of plan designs you can use. These include bonus plans, loan split dollar arrangements, and deferred compensation plans. Let's look at how a deferred compensation plan can be used to fill the retirement gap. A nonqualified deferred compensation plan can allow certain key employees to make additional salary deferrals, above the 401(k) plan limits. The employer can offer matching, and additional discretionary contributions to some or all key employees, to bring their compensation replacement into alignment with the benefits offered to rank-and-file employees. For top employees, the employer may wish to offer an additional nonqualified benefit funded with employer contributions, promising a future retirement benefit.

In the example on the next chart, let's assume the employer wants to equalize the benefits to the level of the employees earning \$100,000 annually (who can put up to 25% of their compensation into the 401(k) plan). For all employees at or above the \$200,000 level, the employer offers a nonqualified salary deferral plan, with a match comparable to that offered by the 401(k) plan. The deferred comp plan is designed to provide combined contributions of up to an additional 16% of compensation.⁶ For the highest-paid key employees, an employer-funded plan or loan split dollar arrangement could be designed to replace the remaining amount of salary necessary to reach the desired percentage level of 25%.

Employee compensation level (annual)	How much can go into their 401(k) plan? ³	Supplemental plans	Retirement contributions as a percentage of pay
\$200,000	17% of compensation	Salary deferrals with match, up to additional 8% of compensation	25%
\$400,000 ⁵	10% of compensation	Salary deferrals with match, up to an additional 15% of compensation	25%

Next steps

Consider the impact the most essential employee benefits have on employees across all salary ranges. In a highly competitive work environment, employers whose benefit plans fill the gap in coverage to their most essential employees have an advantage over those who don't. The supplemental benefits shown above are flexible and can be designed to meet your goals for each employee or group of employees.

¹ The group life plan is assumed to offer a death benefit of 2x salary, up to \$200,000. The first \$50,000 of employer-provided group life insurance is income tax-free; an imputed tax cost is imposed on amounts exceeding \$50,000.

² The group long-term disability plan replaces 60% of income, with a maximum benefit of \$6,000 monthly.

³ The example assumes a 401(k) plan with matching contribution of 75 cents for each dollar deferred, up to 6% of compensation. The maximum elective deferral for individuals under age 50 is \$22,500 in 2023. Catch-up contributions of up to \$7,500 annually (in 2023) are permitted for participants age 50 or older, but the percentage calculations of how much participants can defer to the plan do not include catch-up contributions.

⁴ Employees are assumed to defer the maximum permitted contribution of \$22,500 and to receive the maximum employer match of 5% of compensation (up to the maximum annual compensation limit of \$330,000 in 2023).

⁵ This employee's compensation exceeds the maximum annual compensation that can be taken into account for qualified plans (\$330,000 in 2023).

⁶ The employees earning \$215,000 or more in these examples are assumed to meet the definition of "top hat" employees.

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Patti Bell specializes in key employee and owner benefit plans, business succession, business protection, and estate planning. She works with business owners and financial professionals to implement comprehensive solutions that help meet employee, business, and personal needs. A Loras College graduate and member of the American Institute of Certified Public Accountants, Patti is a frequent speaker on business planning, executive benefits, estate planning, and related topics.

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