

Safe Harbor and Vesting Options: 401(k) matching formulas that could boost participation without breaking the budget



How can you boost plan participation by matching employee contributions without breaking the bank? Here are three options to consider:

1. Safe Harbor 401(k)

About

Employers can allocate 3%-4% of employee compensation via an annual contribution and avoid most compliance tests.¹

Example

If an employee is contributing to the retirement plan, the employer can match with either:

Basic		Enhanced	
Employee Deferral	Employer Match	Employee Deferral	Employer Match
1%	1%	1%	1%
2%	2%	2%	2%
3%	3%	3%	3%
4%	3.5%	4%	4%
5%	4%		

Or, employers can make a 3% non-elective contribution to all eligible employees.

Advantages

- Exempts employers from most annual compliance/ non-discrimination tests.
- Annual contributions to the plan reduce the employer’s taxable income.
- Allows all employees, including those who are highly compensated, to contribute the maximum annual amount to their plan.

Eligibility

Available to any employer with one or more employees, and must be offered to employees 21 or older who have worked at least 1,000 hours in the previous year. (Other restrictions may apply.)

2. Graded Vesting

About

Allows employers to specify a schedule as to how their match contributions become available to employees.

Example

If 20% annual vesting begins after an employee's first year of service, they would be 100% vested in 6 years.

Employment Years and Vesting Schedule					
1 yr	2 yr	3 yr	4 yr	5 yr	6 yr
0%	20%	40%	60%	80%	100%

Advantages

- Enhances employee loyalty by encouraging them to stay with a company to receive the maximum benefit at the end of the period (maximum vesting period is 6 years). The vesting schedule applies only to employer contributions as employee contributions are 100% vested at the time of contribution.
- If an employee quits before becoming fully vested, they will only be entitled to the correlating amount (percentage) of the employer's contribution noted in the vesting schedule.
- Limits employer financial risk by allowing lower amounts to "leave" with an employee if they depart before becoming 100% vested.

Eligibility

Available to any employer with a qualified retirement plan. Cannot be used in conjunction with a Cliff Vesting schedule.

3. Cliff Vesting

About

The employer match does not vest in the initial year(s) of service (usually 1 to 3 years), and then at the stated "cliff" date, the entire contribution by the employer vests.

Example

A cliff schedule might have zero percent vesting after two years of service, but after the third year, 100% of the employer's contribution vests.

Employment Years and Vesting Schedule		
1 yr	2 yr	3 yr
0%	0%	100%

Advantages

- Protects employer's contributions since the employee forfeits those dollars if they leave prior to the stated "cliff" time period. Employee contributions vest at 100% at the time of contribution.
- Enhances employee loyalty by encouraging them to stay with a company to receive the maximum benefit at the end of the vesting period (maximum cliff vesting period is 3 years).²

Eligibility

Available to any employer with a qualified retirement plan. Cannot be used in conjunction with a Graded Vesting schedule.

One of these vesting options may be a good fit for you and your employees. Contact us at hhconsultants.com to learn more.

¹ IRS.gov. "Mid-year Changes to Safe Harbor 401(k) Plans and Notices." Feb 21, 2020.

² IRS.gov. "Issue Snapshot - Vesting Schedules for Matching Contributions." June 19, 2019.