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What is vesting?

Answer:

Vesting occurs when you acquire ownership. Does your employer offer a retirement savings plan such as a 401(k), traditional pension, or profit-sharing plan? Did you receive a stock option grant as a year-end bonus? These employee benefits and others like them are often tied to a timeline known as a vesting schedule. The vesting schedule determines when you acquire full ownership of the benefit.

For example, your employer grants you 10,000 stock options as a thank-you for a job well done, but it may not be time to go mansion shopping just yet. The options may not actually be yours until you're vested. If the options are subject to a vesting schedule, you don't actually own the right to exercise your options until some time in the future. Some stock option plans allow for immediate vesting, while others may delay vesting. Consider these three alternatives for a four-year vesting schedule:

- 25 percent each year
- 50 percent in years two and four
- 100 percent in year four

In addition, there are two permissible vesting schedules for employer contributions to most 401(k) and other defined contribution plans:

- **Cliff vesting:** This provides no vested benefit until the third year. After three years of employment, you reach the "edge of the cliff," or vest 100 percent.
- **Graded vesting:** This provides no vested benefit until year two. For each additional year that you remain with your employer, your benefits vest 20 percent each year. Under this schedule, you'll be 100 percent vested if you remain with your employer for six years.

Keep in mind that if your employer follows the 100 percent in year-three vesting schedule, you'll need to stay with your employer for three years before you are vested. Of course, any personal contributions that you make to your employer's savings plan are automatically fully vested and remain yours no matter how long you stay with the employer.

Defined benefit (traditional pension) plans can have a five year cliff vesting schedule, or a three to seven year graded schedule.

Keep in mind that your employer's plan can provide for faster (earlier) vesting than the law requires. And in some cases, faster vesting is required by law (for example, employer contributions to a SEP, SIMPLE IRA, or SIMPLE 401(k) plan must be immediately vested). To find out about your specific plan's vesting schedule, check with your manager or human resources representative, or read your summary plan description.

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