Principal® Death Benefit Only Plan

Peace of mind for your key employees can make all the difference.

Presented to:

Sample Company

Presented by:

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Proprietary and confidential

We appreciate the opportunity to prepare and present this death benefit only plan.

The information contained in this proposal has been developed based on our years of knowledge and experience in the key employee benefits industry. Rest assured that the information contained in this proposal will be kept strictly confidential.

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Key employee benefits can be your key to success.

We understand that you have select key employees who play important roles in your company. Would your business be as successful without them?

Having the right benefits in place to recruit, reward, retain, and retire those key employees can have a significant impact on the success of your business. Key employee benefits can play a big role in helping you by helping them. When you offer a death benefit only (DBO) plan, you provide your key employees with peace of mind—knowing that extra financial protection would be provided to their beneficiary(ies) in the event of their death. The result? An effective and economical recruiting and retention tool that creates more engaged and loyal employees.

Multiple benefits in one solution

A DBO plan could have a positive impact on your business by helping you retain key employees and providing peace of mind for them at a minimal cost. Specifically, it's designed to help you:

Recruit. Attract top talent as part of a competitive benefits package.

Reward. Provide key employees a benefit as a reward for long-term service.

Retain. Encourage loyalty by helping to secure financial futures.

Retire. Provide death benefit protection to the key employee's beneficiary(ies) during the employee's working years.

WHAT TO EXPECT

Let's walk through the flexibility of this plan and how it can be tailored to fit your specific needs. You're in control of key decisions and determining next steps. So, this proposal will help you do that by covering the following areas:

Design. Choose the plan design that can help you accomplish your goals.

Financing. Decide which permanent life insurance product best meets your plan objectives and budget.

Support. Understand the valuable support services available to maintain this plan.

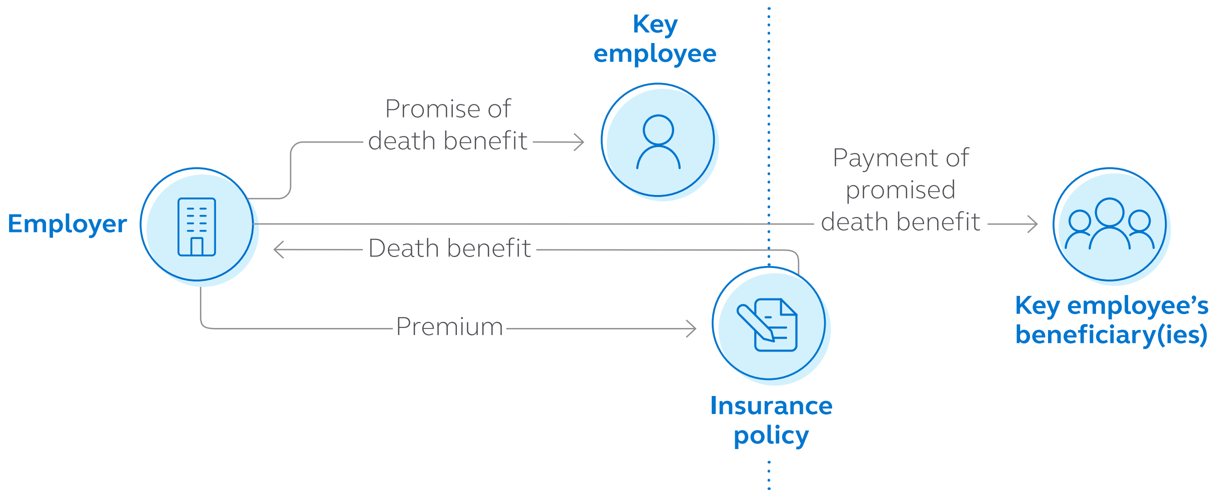
Next steps. Review how to implement your plan.

Before we dive into the details of the design elements, let's take a quick look at how the plan works and its benefits and considerations.

Here's how it works

When you establish a death benefit only plan for your key employees, you promise them that in the event of their death while covered by the plan, their named beneficiary will receive the death benefit specified under the plan. You choose the manner of payment and the amount of the death benefit you'll offer. The plan can be in effect during employment only, or can continue if the employee separates from service due to a disability.

To help informally fund your liability, your company could purchase a life insurance policy on the key employee. If the life insurance death benefit exceeds your business' obligation, any excess coverage could be used as key person protection or to recover the cost of premiums paid for the policy. Alternatively, you could cancel the plan and transfer the policy ownership to the key employee in the future as part of an executive bonus plan.



BENEFITS AND CONSIDERATIONS

For you

Lower cost, convertible option. Term life insurance may be used to informally fund the plan. In future years, this term policy can be converted to a permanent life policy as your goals change.

Be selective. Plan participation can be offered on a selective basis; no need to provide the same benefit to all participants.

Receive a tax deduction. When you pay the death benefit to the key employee's beneficiary(ies), your company generally receives an income tax deduction.

Communicate easily. The simple and flexible plan design is easy to communicate and maintain.

Recover premium cost. If the death benefit purchased is higher than the amount you promise to your key employee(s), you can retain the difference to provide key person protection or cost recovery for the premiums you paid.

For your key employee

Peace of mind. Knowing their named beneficiary(ies) will receive a death benefit can help provide comfort to your key employees that their loved ones have some financial protection in the event of their death.

No current tax impact. Your employees don't report any benefit amount as income during their lifetime.

Must qualify. The key employee must be healthy enough to qualify for the life insurance policy. To simplify the application process, a Guaranteed Issue option may be available if you have 10 or more plan participants.

Tax impact to beneficiaries. The payment of the death benefit will be treated as taxable income to the beneficiary(ies). Part of the death benefit they receive could be used to pay the tax.

Build a path for loyalty with key employees.

You're in control of making this plan yours, based on your company's budget, goals, and your key employees' needs. Together with your financial professional, we'll walk you through the necessary plan design decisions that make sense for your business. Consider the following as you tailor your plan.

Who's eligible to participate in the plan?

You can select any key employee or group of key employees to participate. This plan isn't limited to a select group of management or highly compensated employees who qualify for the "top hat" exemption. But, employers with more than 100 participants may limit their exposure to certain ERISA requirements if they choose to limit it to top hat employees. (Refer to the ERISA section on page 12 for further details.)

If you want to limit eligibility to top hat employees, consider these guidelines:

- Less than 10% of total employees.
- Earned $120,000+ in wages in the preceding year.
- Average compensation that's three times greater than the average compensation of the employees not considered top hat.
- The ability (by virtue of the position or compensation level) to influence the design and operation of the plan.

How long will the key employee be eligible for participation?

Selected key employees will be eligible during their working years. Your plan can also specify whether eligibility continues in the event that employment is terminated due to a disability.

What amount will you contribute for life insurance premiums?

The plan is flexible and can be tailored to meet the specific needs and budget of your organization. The actual amount is up to you, based on the amount of death benefit you want to provide and the type of life insurance you may wish to purchase.

How and when are benefits paid to the key employee's beneficiary(ies)?

A death benefit is paid to the key employee's beneficiary(ies) upon the key employee's death.

- You can design this plan to pay benefits either as a lump sum or for a period of years.
- You could choose to terminate the plan in the future, and transfer the policy to the key employee as part of an executive bonus program.

Example: ABC Health Clinic established a death benefit only plan for Will, one of its key employees. The plan is designed to pay Will's wife a specified benefit of $500,000, payable as a lump sum. In the future, ABC Health Clinic may decide to transfer the policy to Will as an executive bonus.

What financing options are available?

Several types of life insurance products are available—or the benefit could be paid with other business assets. When selecting a life insurance product, it's important to consider the design features of your plan. If the benefit will be promised only for a limited period of years (e.g., until normal retirement age), term life insurance could be used. Alternatively, a cash value life insurance policy may be more effective if the policy will be retained or transferred as an executive bonus in the future. You can choose a fixed, indexed, or variable life insurance product. To simplify the application process, a Guaranteed Issue option may be available.

What factors might influence product design decisions?

The age of the key employee, as well as your business objectives, could influence product choice. Term life insurance has limited flexibility at older ages. Also, if you choose to purchase a policy to address this liability, as well as key person coverage and/or cost recovery, a permanent (cash value) life insurance product may be beneficial.

What control do you have over the plan?

Participation. You select the key employees you want to include in the plan, and whether you want each employee's eligibility to only be during their working years or to continue in the event that employment terminates due to disability.

Contributions. You decide how much you want to contribute, per key employee, if you acquire life insurance to finance the death benefit.

Retention.You determine the death benefit payment options that meet your business needs and budget, while tying key employees more closely to your organization.

What are the tax implications of this plan?

For you

- Premium payments are not deductible.
- Life insurance cash values accumulate tax deferred.
- You generally receive the life insurance death proceeds income tax free.[1]
- You may deduct the benefits paid to the key employee's beneficiary(ies) following the key employee's death.

For the key employee

- There are no income tax implications to the key employee during his or her lifetime.
- See page 10 in the Appendix for more information.

For the key employee's beneficiary

- Life insurance death benefits paid by you to the employee's beneficiary(ies) are taxable as "income in respect of a decedent," but aren't subject to FICA or FUTA tax.
- See page 10 in the Appendix for more information on the income tax implications.

[1] Additional tax details are available in the Appendix.

Focused on your plan's details—today and tomorrow

It takes a lot of work to run your business. We understand that you may not have time to think about the details associated with administering a benefit plan like this one. That's why we're here. We have the expertise and services to help you with implementation today and administration throughout the life of your plan.

The Business Market Administration team at Principal provides dedicated, ongoing support for your employer-owned and employer-sponsored plans funded with life insurance. And as your needs change, or regulations change, we'll help you keep up with both.

Supporting you every step of the way

Beginning at plan implementation, we understand what you need and what needs to be done. You and your key employees will benefit from the complimentary administrative services offered by Principal.

Dedicated administrator. Personally assists you with enrollments, policy adjustments, service requests, policy illustrations, and more.

Plan-level reporting. Makes participant communications and any needed tax reporting easier. Consolidated reports show a census of covered key employees and basic information about the policies covering those key employees.

List billing. Delivers consolidated payment reminders covering all policies under your plan.

Economic benefit information (if applicable). Makes reporting on key employees' income simpler by providing amounts reflecting the value of the insurance coverage provided under any endorsement split dollar agreement that may be in place.

Online access. Allows you to view all policies associated with your plan.

Walking you through a successful implementation

Helping you tailor a plan to your specific needs and goals is a top priority. Once you're comfortable with the plan design and the financing to support it, attention will shift to you and your financial professional putting the plan in place using the Principal platform.

As everyone works together to successfully implement your plan within your desired timing, our goal is to deliver a positive experience for everyone involved. Here's what you can expect:

Next steps

1 Strategy development

- Finalize designated documents[1]
- Confirm funding levels

2 Application process

- Educate owners on the funding program
- Collect applications and signatures, if applicable

3 Administrative set-up

- Finalize underwriting, if applicable
- Enter plan information into recordkeeping systems

4 Implementation

- Begin premium payments
- Issue new insurance policies, if applicable

[1] Step 1 for this plan is particularly important since many of the plan benefit details need to be documented in agreements. Principal offers sample documents that your attorney can use.

An industry leader in your corner

You know the importance of a valued and affordable benefits package for your business and key employees. And you know a key employee benefits plan can be a strategic part of that. Equally important is the company you work with to implement and provide funding solutions and reporting services for these plans.

Everything you need in one place

Once you decide this plan is right for you, we'll bring our expertise and resources to the table to help you put the plan in place. Everything you need to successfully implement and maintain your plan is available at Principal:

- Innovative plan design
- Life insurance financing options
- Efficient plan implementation
- Dedicated plan administrative services

You can trust our expertise and leadership[1]

We've been providing administrative services for business solutions for more than 30 years, making it a priority to understand where you want to be and how you plan to get there. This means you'll get expertise and innovative ideas when you need them to help make your financial progress possible.

- A member of the *FORTUNE* 500®, we have $714 billion in total assets under management[1] and serve clients worldwide of all income and portfolio sizes.
- Year after year, we receive strong financial ratings from the four major rating agencies—A.M. Best Company, Moody's Investor Services, Standard & Poor's, and Fitch Ratings.[2]
- No. 1 provider of nonqualified deferred compensation plans.[3]
- We're the leader in the small-case business life insurance market.[4]

[1] Principal® 2022 Company Profile, December 31, 2021. For the latest and additional information, visit www.principal.com.

[2] Third-party ratings relate only to Principal Life Insurance Company, the largest member company of the Principal Financial Group, and Principal National Life Insurance Company, and do not reflect any ratings actions or notices relating to the US life insurance sector generally. While ratings can be objective indicators of an insurance company's financial strength and can provide a relative measure to help select among insurance companies, they are not guarantees of the future financial strength and/or claims-paying ability of a company and do not apply to any underlying variable investment options. The broker/dealer a life insurance policy is purchased from, the insurance agency and any affiliates of those entities make no representations regarding the quality of the analysis conducted by the rating agencies. The above mentioned entities are not affiliated with any rating agency nor are they involved in any rating agency's analysis of the insurance companies.

[3] Based on total number of Section 409A plans, PLANSPONSOR Recordkeeping Survey, July 2021.

[4] July 2021 COLI/CSIO survey of participating life insurance carriers, IBIS Associates, Hamilton, VA.

Accounting

The accounting principles that apply to this death benefit only (DBO) plan are outlined below. With a DBO plan, the financial asset is owned by the employer. As such, it will appear on the employer's balance sheet.

Based on the plan design, the actual payment of the benefit requires the key employee to remain employed. A number of factors, such as termination or death, may impact whether the participant receives the benefit payment. Under normal accounting contingency rules, the contingency must be probable and reasonably estimated before a liability is booked. Another consideration for your professional advisors would be whether the promised benefit is material to the company's financial statements. Decisions regarding the booking of the liability and the proper amount should be reviewed with your corporate financial officers and your professional advisors.

If you're a for-profit employer, and you and your professional advisors choose to book the liability, the accounting for this DBO plan is made up of two separate categories of entries:

- The first set of entries is to account for the promised death benefit as a compensation expense and to record it as a liability.
- The second set of entries is to account for the informal financing of the DBO plan using life insurance policies.

Consult with your professional advisors to determine the accounting treatment that will be used for financial reporting for your particular plan.

GAAP guidelines

The Financial Accounting Standards Board (FASB) is responsible for establishing non-governmental U.S. Generally Accepted Accounting Principles (GAAP). Effective for accounting periods ending after September 15, 2009, the FASB Accounting Standards Codification (ASC Codification) is the single source of authoritative U.S. GAAP. For convenience, these accounting guidelines include both pre- and post-codification references to GAAP.

Expense and liability

GAAP provides two methods to calculate the liability associated with promising a benefit.

- ASC 715-30 (FAS 87 and FAS 158)—This applies to any arrangement that's similar in substance to a qualified defined benefit plan. Whether a deferred comp plan is similar to a qualified defined benefit plan is a facts-and-circumstance type decision and may be based on to whom and how the benefits are offered on an ongoing basis. This approach would recognize the liability over the working life of the key employee without regard to vesting.
- ASC 710-10-25 (APB 12)—When the deferred comp benefit is, in substance, an individual deferred comp contract, the liability is calculated following a systematic and rational method. When the benefit is a fixed amount, such as with this plan, a simple present value calculation could be reported as the liability.

Income taxes (SFAS 109)

If your professional advisor does record a liability, the corresponding tax impact should also be recorded based on ASC 740-10-25 (SFAS 109). The company would record a deferred tax asset to reflect the future deduction of the plan benefit. However, you should consult with your professional advisors on best practices in this regard.

Life insurance

In this plan, you promise a pre-retirement death benefit for the key employee. Under this type of arrangement, you own the contract, pay the premium, and record the policy as a corporate-owned asset according to ASC 325-30-35 (TB 85-4).

Journal transaction example:

In this hypothetical example, the company promises a future death benefit to a key person. This results in a future liability, often funded with life insurance. The company may purchase a higher amount of life insurance than the promised death benefit for cost recovery and key person coverage.

1. The company pays a $20,000 life insurance premium out of cash flow.
2. The future payment promised under the DBO plan is accounted for as a liability.
3. The cash surrender value (CSV) is accounted for as an asset and offsets the life insurance premium expense.
4. In the year of death, the death benefit to the company is shown as income and the portion promised as a death benefit is a deductible expense. Any additional death benefit is retained by the company.

Expense and liability entries

		Balance sheet		Income statement	
		Debit	Credit	Debit	Credit
1	**Life insurance premium expense**			$20,000	
	Cash		$20,000		
2	**Deferred comp expense**			$1 million	
	DBO promised benefit (liability)		$1 million		
3	**Cash surrender value of life insurance contract**	$17,000			
	Life insurance premium expense				$17,000
4	**In year of death: life insurance death benefit received**	$1.5 million			
	In year of death: payment of death benefit to beneficiary		$1 million		
	In year of death: part of death benefit retained as key person coverage				$500k

Tax considerations

There are some tax considerations to keep in mind with a DBO plan, for your organization, your key employees participating in the plan, and their beneficiaries.

For you

- Your receipt of the death benefit is generally not subject to income tax, provided that:
  - Your key employee must sign a Notice and Consent form if you purchase life insurance on their life. (IRC Sec. 101(j)),
  - No transfer for value of the policy has occurred (or that any such transfer satisfies an exception under IRC Sec. 101(a)(2)), and
  - No reportable policy sale has been made under IRC Sec. 101(a)(3).
- There's no deduction for premiums paid (IRC Section 264(a)(1)).
- Your payment of a death benefit is income tax-deductible, assuming the compensation package to the employee is reasonable (IRC Section 162).

For the key employee

- When a DBO plan is used, there's no income tax due during the key employee's lifetime.
- A standalone DBO plan is not subject to IRC Sec. 409A (Treas. Reg. §1.409A-1(a)(5)).
- The plan promises a death benefit to the key employee's beneficiary(ies), should the employee's death occur while covered under the plan.
- Any life insurance death benefit that may be paid to the key employee's beneficiary will be included in the key employee's gross estate for estate tax purposes.

For the key employee's beneficiary

- The death benefit payment is subject to income tax.
- No FICA or FUTA tax applies to the payment of the death benefit.

ERISA

- A DBO plan will generally be considered a welfare benefit plan under the Employee Retirement Income Security Act (ERISA), in that it provides benefits in the event of the death of a plan participant.
- As a welfare benefit plan, the DBO plan must meet ERISA requirements, including a written plan document, explanation of benefits and eligibility, designation of a named fiduciary, explanation of the plan funding policy, allocation of fiduciary responsibility, plan amendment and termination procedures, and claims procedures. Principal has a sample document designed to meet these requirements for review by the client's attorney.
- Welfare benefit plans are generally subject to substantial reporting and disclosure requirements. However, small welfare benefit plans (under 100 participants) whose benefits are paid from the employer's general assets are generally exempt from most reporting and disclosure requirements, but are required to provide plan participants with a Summary Plan Description document that tells participants, in plain language, what the plan provides and how it operates.
- Reporting and disclosure requirements may also be limited by offering this benefit only to a select group of management or highly compensated employees that qualify for the top hat exemption. For specific guidelines about top hat eligibility, see page 5.

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Variable life insurance has annual fees and expenses and has both life insurance-related charges and investment management fees. See the variable life insurance prospectus for complete details on fees and expenses.

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