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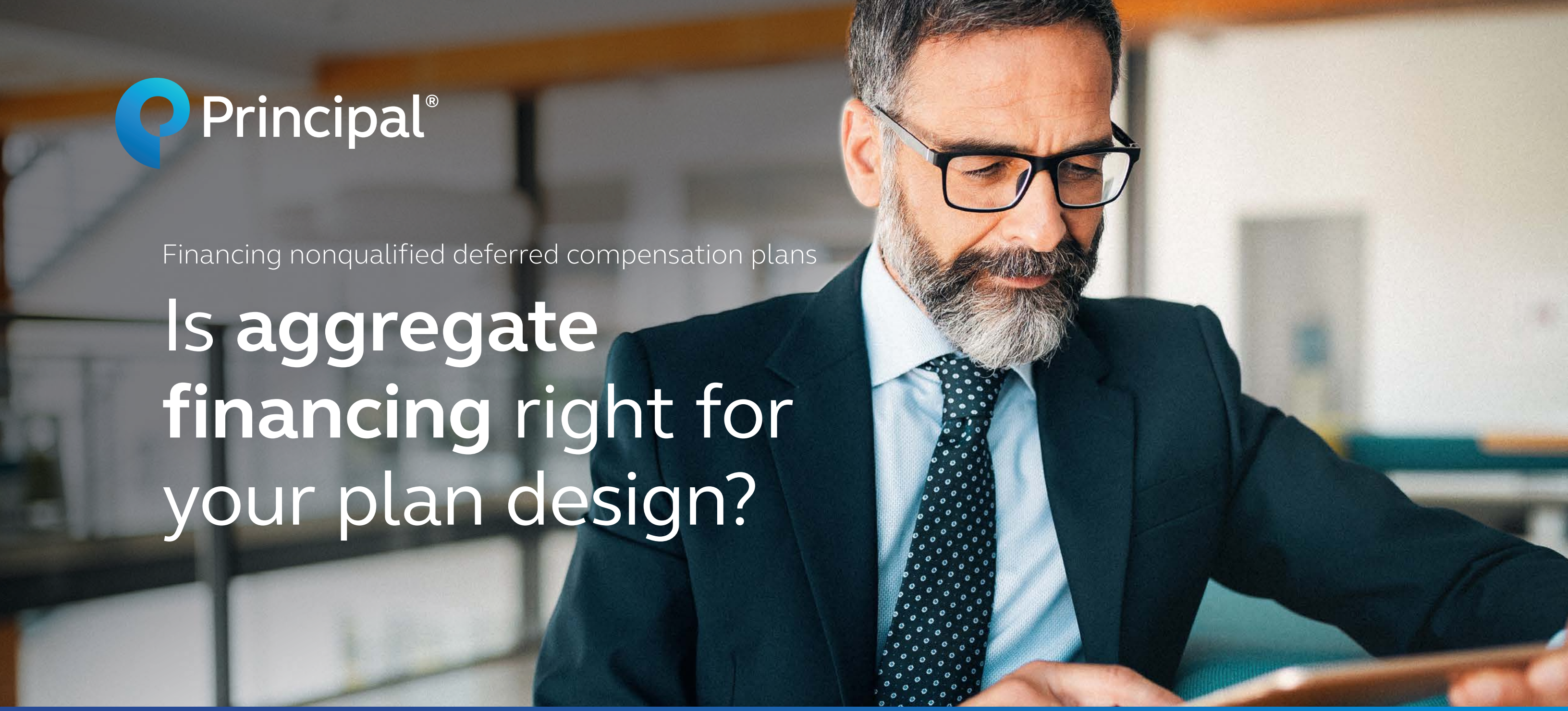

Financing nonqualified deferred compensation plans

Is **aggregate financing** right for your plan design?

Many organizations implement nonqualified deferred compensation (NQDC) plans as a way to help retain their top talent. Corporate-owned life insurance (COLI) is commonly used to informally finance these plans. It provides protection in the event of the death of an insured, along with tax-friendly features such as tax-deferred build-up of cash value and tax-advantaged withdrawals.

Deferred compensation plan financing options.

Employer contributions can be applied to COLI policies as premiums to fund the future plan benefit for the employees selected to participate. Principal® offers two financing options. Either option can help you achieve your plan objectives. But there may be benefits to one or the other in certain situations.

Individual financing is when a policy is purchased on each eligible plan participant to informally fund their future benefit. Premiums are applied to each policy based on the planned contribution level of the participant/insured.

Aggregate financing is when a subset of individuals from the participant group, or business owners, are insureds on policies purchased to informally fund future benefits for the entire group. Premiums can be allocated to the policies in any manner you choose.

When is aggregate financing appropriate?

This type of financing can be helpful when asset growth for future plan benefit funding is important. You're able to select individuals from your participant group that may be younger and healthier to be insureds. This can help minimize the cost of your insurance, so more of your premium payment can go to accumulating cash value. You may also choose to insure individuals for whom key person coverage is needed.

From a financial standpoint, the future deferred compensation benefits are carried on your books as a liability, while COLI cash values are carried as an asset. So, the greater growth potential aggregate financing offers may give an extra boost to your balance sheet and could deliver more value when the benefit is paid.

You might also enjoy the following benefits:

- Easier plan recordkeeping because fewer policies are involved.
- Easier premium payment administration since premiums can be applied as needed to each policy.

Some additional things to consider.

- Multiple life insurance underwriting options are available. The options differ in the amount of medical information required. Generally, the more information we have about applicants, the more accurate risk assessment we can make, which can result in a better rate and, potentially, greater cash value to fund the benefit.
- Sufficient policies need to be issued to accommodate the plan contributions you intend to make. There are limits to how much premium you can pay to a policy, relative to the death benefit amount, and maintain the life insurance tax benefits.
- If a participant who isn't one of the insureds dies, you would need to pay the plan benefit from another source of funds.

Let's look at a hypothetical example.

ABC Company is a growing business that plans to implement a deferred compensation plan for five of its key employees.

- The two business owners are ages 40 and 42, and healthy, so their financial professional recommends the business purchase a COLI policy on each of them.
- The two policies will be used to informally finance the plan benefits each of the five participants will begin receiving at age 60.
- When it's time to make a benefit payment, the company will have the flexibility to either use company cash flow or withdrawals from one or both insurance policies.
- In addition to offering a potential source of future benefit funding, the two policies also provide key person protection for the business.

Learn more | Talk with your financial professional about what deferred compensation financing option might be best for your situation.

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