Key employee retention
and retirement

# Discover the right solutions for your business

## Concepts guide

# The right benefits can make all the difference

Do you have the right tools to recruit, reward, retain and retire your key employees? Key employee benefits can play a big role in helping you keep your top talent for the long term.

No one solution is right for everyone. Sometimes it may take implementing multiple plans to meet the unique needs of one organization. And, your benefits package should reflect that. This guide will give you an overview of some of the options available to you, and help you find solutions that may be right for your business.

## Choose the key employee benefit plans for your business

| | | | | | | | |
|---|---|---|---|---|---|---|---|
| Bonus | Bonus (for owners) — S-Owner and LLC | Loan Split Dollar | Deferred Comp — Incentive Bonus | Deferred Comp — Select Reward | Deferred Comp — SERP | Deferred Comp — Defined Contribution | Deferred Comp — Defined Benefit |

# Bonus plans

## Highlights

### Principal® Bonus

A bonus plan for key employees with an emphasis on simplicity and a current business tax deduction.

### Principal® Bonus — S Owner

A bonus plan allowing owners of S corporations to use compensation or K-1 distributions to enhance their personal retirement. This plan can also help provide favorable taxation at distribution.

### Principal® Bonus — LLC Member

A bonus plan allowing members (owners) of limited liability companies (LLCs), taxed as partnerships, to use guaranteed payments or distributions to enhance their personal retirement. This plan can also help provide favorable taxation at distribution.

### Principal® Loan Split Dollar

A plan that uses a loan to allow key employees and the employer to share the cost and benefits of the plan. The arrangement between the key employee and employer results in the purchase of a cash value life insurance policy paid with the loans from the employer.

## Bonus

### Key features

- Participants can choose from a variety of products to tailor an investment strategy to meet changing needs and objectives.
- A business solution that's both administratively and tax efficient.
- Available to all employees — no "Top Hat"[1] requirements.

### Company characteristics

- For employees and owners of C corporations.
- For employees of pass-through entities such as S corporations and LLCs.
- For employees of tax-exempt organizations.
- Companies desiring an immediate tax deduction when funding employee benefits.

### Plan sponsor benefits

- Company may bonus the contributions to the plan and receive a current tax deduction.[2]
- Requires no discrimination testing or Form 5500 filing.
- Simple, but flexible plan design is easy to communicate and maintain.
- Provides plan-level administrative services at no cost.

### Plan participant benefits

- Bonuses may be structured to cover the entire contribution, a portion of it, or provide a "tax-bonus" to reduce or eliminate out-of-pocket tax costs to the participant.
- Depending on the asset selected:
  - Can build assets outside the business, providing tax-deferred growth.
  - May avoid penalties for distribution before age 59½.
  - Provides favorable taxation at distribution.
  - Provides tax diversification.
- Plan participant owns the financial asset.

### Considerations

- Bonus must be reasonable compensation (IRC Section162).
- Each bonus paid reduces company cash flow.
- Since the participant owns the financial product, employers may add a feature to restrict the policy owner's rights in order to add an element of control (i.e., "golden handcuffs") to the plan.
- Restrictive agreement may not be available on all plans, depending on financial asset used.
- Repayment obligation agreement may be available to enhance security.
- Depending on financial asset selected, annual taxation of earnings may apply.
- Limited plan level administrative services available for mutual fund and annuity financed plans.

| Bonus – S Owner | Bonus — LLC Member |
|---|---|
| **Key features** | |
| • Contributions may come from compensation or K-1 distributions.<br>• A business solution that's both administratively and tax efficient for S corporation owners.<br>• Can provide tax diversification and tax leverage similar to Roth IRAs — without income restrictions or contribution limitations. | • Contributions may come from guaranteed payments or LLC distributions.<br>• A business solution that's both administratively and tax efficient for LLC members (owners).<br>• Can provide tax diversification and tax leverage similar to Roth IRAs — without income restrictions or contribution limitations. |
| **Company characteristics** | |
| • For owners of S corporations.<br>• Owners offering nonqualified key employee benefits to non-owners who want to benefit themselves as well.<br>• S corporations with accumulated earnings inside the company. | • For members of LLCs — taxed as partnerships.<br>• Owners offering nonqualified key employee benefits to non-owners who want to benefit themselves as well.<br>• LLCs with previously taxed income inside the company. |
| **Plan sponsor benefits** | |
| • Provides flexibility to choose either compensation or K-1 distributions.<br>• Provides exemption from annual reporting requirements.<br>• Provides plan-level administrative services at no cost. | • Provides flexibility to choose either guaranteed payments or LLC distributions.<br>• Provides exemption from annual reporting requirements.<br>• Provides plan-level administrative services at no cost. |
| **Plan participant benefits** | |
| • Provides liquidity for needs such as retirement income, survivor income and disability protection.<br>• Depending on the asset selected:<br>› Can build assets outside the business, providing tax-deferred growth.<br>› May avoid penalties for distribution before age 59½.<br>› Provides favorable taxation at distribution.<br>› Provides tax diversification.<br>• S corporation owner owns the financial asset. | • Provides liquidity for needs such as retirement income, survivor income and disability protection.<br>• Depending on the asset selected:<br>› Can build assets outside of the business, providing tax-deferred growth.<br>› May avoid penalties for distribution before age 59½.<br>› Provides favorable taxation at distribution.<br>› Provides tax diversification.<br>• LLC member owns the financial asset. |
| **Considerations** | |
| • Owners receive both W-2 compensation and K-1 distributions (which must be based on their percentage of ownership). Wide variances from year to year may be subject to IRS scrutiny.<br>• Ownership percentages must be considered when using K-1 distributions. If there are multiple owners in the S corporation — and dividends are used to fund contributions — distributions from the corporation need to be in proportion to ownership.<br>• Owners pay tax on W-2 compensation, including payroll taxes such as FICA and Medicare.<br>• Owners pay tax on the K-1 distribution (to the extent there's profit) and don't incur payroll taxes.<br>• Depending on the financial asset selected, asset may be subject to the owner's general creditors, and annual taxation of earnings may apply. | • LLC distributions need to be in proportion to ownership and/or in accordance with the LLC Operating Agreement.<br>• If the contribution is paid out as part of the LLC distribution, profits may be reduced for purposes of distributions made to all members.<br>• Accounting implications may be different depending on whether the LLC uses cash basis or accrual basis accounting, making the client's professional advisor involvement important.<br>• Depending on the financial asset selected, asset may be subject to the owner's general creditors, and annual taxation of earnings may apply. |

## Loan Split Dollar

### Key features

- Company can design benefit to recruit, reward, retain and retire key employees.
- Available to all employees, no "Top Hat"[1] requirement.
- A portion of the cash value and death benefit equal to the loan is assigned to the employer. At retirement or death, the loan is paid off or forgiven and the assignment is terminated.
- Provides enhanced retirement and survivor benefits with minimum employee cash outlay.
- Provides cost recovery for employer.

### Company characteristics

- For employees and owners of C corporations.
- For employees of pass-through entities such as S corporations and LLCs.
- For employees of tax-exempt organizations.
- Companies with employees interested in supplementing income for retirement and providing for family in the event of death.

### Plan sponsor benefits

- Easier to administer requiring no discrimination testing or Form 5500 filing.
- Bonuses to pay the participant's tax on the loan interest are deductible (IRC Section 162(a)1).
- Any forgiven loan is tax-deductible (IRC Section 162(a)).
- Company has collateral assignment on the policy to secure the loan.
- Provides plan-level and participant-level administrative services at no cost.

### Plan participant benefits

- Employee owns the policy with minimal income tax impact from premiums paid.
- Bonuses may be structured to reduce or eliminate out-of-pocket tax costs to the participant.
- No required minimum distribution at age 70½.
- Cash values in the plan accumulate tax-deferred and can be accessed on a tax-advantaged basis.
- Death benefits are received income-tax free by beneficiaries.

### Considerations

- Loaned premium isn't deductible.
- Interest paid by key employees on loans is taxable as income.
- Forgiven loans are taxable to the participant.
- Life insurance application requires evidence of insurability.
- Not available for top executives of public companies.
- An exit strategy, defined at plan implementation, is encouraged.

# Nonqualified deferred compensation plans

## Highlights

### Principal® Deferred Comp — Incentive Bonus

A long-term incentive plan that gives employers a retention and reward strategy that allows them to provide additional compensation to the select key employees they choose. The company can choose to informally finance the future obligation or pay through company cash flow.

### Principal® Deferred Comp — Select Reward

This is a deferred comp defined benefit plan. Enables employers to promise a lump-sum benefit to select key employees payable at the end of a predetermined service period.

### Principal® Deferred Comp — SERP

A selective executive retirement plan (SERP) is a deferred comp defined contribution plan to benefit one to five select key employees. Accepts employer contributions only and allows multiple vesting and payout options.

### Principal® Deferred Comp — Defined Contribution

A plan allowing select key employees to defer compensation above qualified plan limits — potentially up to 100%.[3] The employer can also provide contributions to help retain employees and meet organizational goals. The company can choose to informally finance the future obligation or pay through company cash flows.

### Principal® Deferred Comp — Defined Benefit

A plan providing select key employees a supplemental retirement benefit beyond qualified plan limits. The company can choose to informally finance the future obligation or pay through company cash flow.

## Deferred Comp — Incentive Bonus

#### Key features

- Both "Top Hat"[1] and "non-Top Hat" employees are eligible to participate in the plan.
- Company can design discretionary incentive benefits to reward and retain selected key employees.

#### Company characteristics

- C corporations (or pass-through tax entity for non-owners).
- Have a substantial business continuity plan in place.
- Companies with strong financial integrity: profitable, good cash flow and good financial history.

#### Plan sponsor benefits

- Easier to administer with no discrimination testing, minimum participation or Form 5500 filing, if set up properly.
- Use discretionary company contributions with vesting schedules to help achieve corporate goals.
- Flexible plan design to meet the needs of specific key employees.
- Assets accumulated to informally finance the plan remain an asset on the company's balance sheet.

#### Plan participant benefits

- Pre-tax employer contributions, tax-deferred growth and compounded earnings.
- Design a personalized investment strategy.
- Flexibility to delay plan benefits and the taxation of them if they choose.

#### Considerations

- The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.[4]
- Distributions to plan participants must be paid within 10 years of the original date of each employer grant.
- To qualify as a bonus plan not subject to ERISA, the plan cannot be designed to "systematically" provide benefits to participants after separation from service. This determination must be made by the plan sponsor.
- Plan benefits aren't protected in the event of company bankruptcy.
- The decision to defer payout of benefits must be made the year prior to when the employer initially contributes to the plan.

<table>
<tr><th>Deferred Comp — Select Reward</th><th>Deferred Comp — SERP</th></tr>
<tr><th colspan="2">Key features</th></tr>
<tr><td>• Creates strong “golden handcuffs” that can tie employees to the business.<br>• Subject to Section 409A, but design is intended to qualify for the short-term deferral exception to the definition of deferred comp.</td><td>• Creates strong “golden handcuffs” that can tie key employees to the business.<br>• Company can make discretionary incentive contributions to recruit, reward, retain and retire selected key employees.</td></tr>
<tr><th colspan="2">Company characteristics</th></tr>
<tr><td colspan="2">• C corporations (or pass-through tax entity for non-owners).<br>• For employees of tax-exempt organizations.<br>• Have a substantial business continuity plan in place.<br>• Companies with strong financial integrity: profitable, good cash flow and good financial history.<br>• Generally, participants must meet “Top Hat”[1] definition.</td></tr>
<tr><th colspan="2">Plan sponsor benefits</th></tr>
<tr><td>• Easier to administer with no discrimination testing, minimum participation or Form 5500 filing, if set up properly.<br>• Informal financing options include fixed, indexed or variable universal life insurance policies from Principal®.<br>• Earnings from company-owned life insurance (COLI) policies accumulate tax-deferred.<br>• Company receives a tax deduction (as compensation) if/when the lump-sum benefit is paid.<br>• Assets accumulated to informally finance the plan remain an asset on the company’s balance sheet.<br>• Provides plan-level administrative services at no cost.</td><td>• Easier to administer with no discrimination testing, minimum participation or Form 5500 filing, if set up properly.<br>• Informal financing options include fixed, indexed or variable universal life insurance policies from Principal.<br>• Earnings from COLI policies accumulate tax-deferred.<br>• Company receives a tax deduction (as compensation) if/when the benefit is paid out.<br>• Vesting schedules and payout options allow plan to meet multiple retention goals.<br>• Provides plan-level administrative services at no cost.<br>• Life insurance policies used to informally finance the plan remain an asset on the company’s balance sheet.</td></tr>
<tr><th colspan="2">Plan participant benefits</th></tr>
<tr><td>• Simple and easy-to-understand plan design.<br>• No current income taxation on the promised lump-sum benefit.<br>• No required minimum distribution at age 70½ or 10% IRS early withdrawal penalty.</td><td>• Simple and easy-to-understand plan design.<br>• Contributions and earnings accumulate tax-deferred.<br>• Opportunity to accumulate retirement income in excess of qualified plan limits.<br>• No required minimum distribution at age 70½ or 10% IRS early withdrawal penalty.</td></tr>
<tr><th colspan="2">Considerations</th></tr>
<tr><td>• Participant risks losing the bonus if the service requirement isn’t met.<br>• Participant must pay economic benefit cost on any death benefit endorsed to him/her during the service period.<br>• Employee must pay income tax on entire lump-sum benefit at payout — no option is available to take an income stream or defer payment of the lump sum benefit.<br>• Per our sample agreement, the promised benefit must be paid within 30 days of the participant meeting the service requirement. Failure to do so within 2½ months of the end of the tax year in which the employee meets the service requirement may result in a 20% excise penalty.<br>• Not an appropriate benefit for owners or members of the owner’s immediate family.</td><td>• No loan provisions or rollover provisions into an IRA, qualified plan or nonqualified plan.<br>• Limited ERISA protection — assets are owned by the company and subject to company creditors.<br>• Participants must provide evidence of insurability to qualify for the life insurance policy used to informally finance the plan.<br>• Limited to one to five “Top Hat”[1] employees.<br>• Annual plan contributions of $25,000 - $150,000.<br>• The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.[5]</td></tr>
</table>

| Deferred Comp — Defined Contribution | Deferred Comp — Defined Benefit |
| --- | --- |
| **Key features** | |
| • Company can make discretionary incentive contributions to recruit, reward, retain and retire selected key employees.<br>• With proper design, may be cost neutral over time or even financially beneficial to the company.<br>• Flexible plan design to meet the needs of specific key employees. | • Company can design discretionary incentive benefits to recruit, reward, retain and retire selected key employees.<br>• Flexible plan design to meet the needs of specific key employees. |
| **Company characteristics** | |
| • C corporations (or pass-through tax entity for non-owners).<br>• Have a substantial business continuity plan in place.<br>• Companies with strong financial integrity: profitable, good cash flow and good financial history.<br>• Have key employees falling short of savings goals due to qualified plan limits and testing issues.<br>• Participants must meet "Top Hat" definition.[1] | |
| **Plan sponsor benefits** | |
| • Easier to administer with no discrimination testing, minimum participation or Form 5500 filing, if set up properly.<br>• Make optional company contributions to meet organizational goals.<br>• Restore 401(k) plan contributions limited by IRS testing.<br>• Company receives a tax deduction (as compensation) if/when the benefit is paid.<br>• Assets accumulated to informally finance the plan remain an asset on the company's balance sheet. | • Easier to administer with no discrimination testing, minimum participation or Form 5500 filing, if set up properly.<br>• Increase morale with top employees by offering a benefit they value, which helps keep them loyal and motivated.<br>• Leverage incentives to structure a benefit to recruit, reward and retain your top employees.<br>• Assets accumulated to informally finance the plan remain an asset on the company's balance sheet. |
| **Plan participant benefits** | |
| • Pre-tax deferrals, tax-deferred growth and compounded earnings.[6]<br>• Defer up to 100%[3] of compensation to meet savings goals.<br>• Design a personalized investment strategy.<br>• Flexibility to take payouts from the plan without the same age restrictions as 401(k) plans. | • Receive an additional benefit paid entirely by the employer without any investment risk by the employee.<br>• Receive benefits beyond 401(k) or 403(b) plan limits.<br>• Design a personalized investment strategy.<br>• Flexibility to take payouts from the plan without the same age restrictions as 401(k) plans. |
| **Considerations** | |
| • Plan benefits aren't protected in the event of company bankruptcy.<br>• There are no rollovers or loans like qualified retirement plans.<br>• The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.[4]<br>• The decision to defer compensation must be made the year ahead of earning the income.<br>• There's a potential charge to earnings on assets purchased to finance the plan. | • Plan benefits aren't protected in the event of company bankruptcy.<br>• If the company doesn't comply with IRS rules, participants could face taxes and penalties.<br>• The corporate tax deduction is deferred until benefits are paid, rather than a current deduction.[4]<br>• There are fees for plan administrative services and could be a potential charge to earnings on assets purchased to finance the plan.<br>• The company takes an investment risk by promising to pay a defined benefit to the employee. |

# We're here to help

There's a lot to think about when you're designing and implementing a benefits package. And while the plan is a core part of your key employee benefits solution, there's so much more to consider. Think about the entire package — **solutions**, **expertise** and **service**.

### Solutions

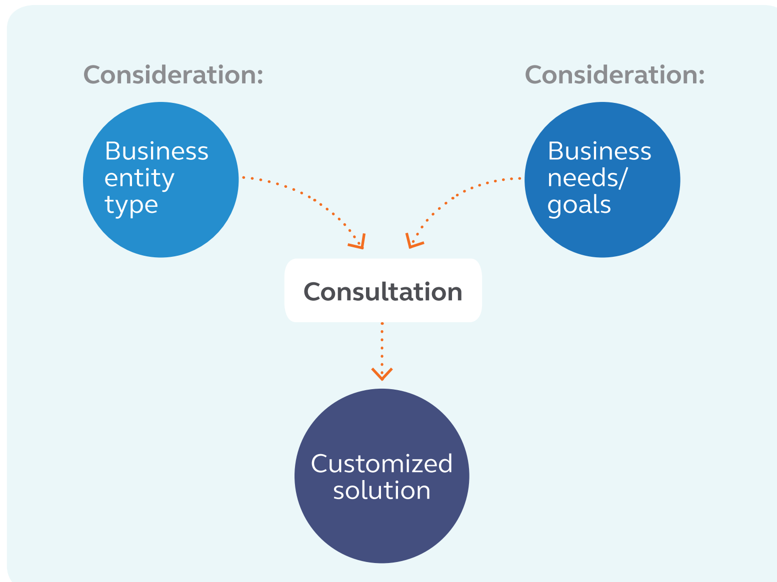
You'll want a benefits package that fits your business type and overall goals. Principal offers multiple, unique solutions for all types of businesses.

### Expertise

When implementing a new plan, it's helpful to work with a provider that has the expertise and experience to understand how to turn your objectives into a successful benefits package. Our team of business solutions experts will consult with you and your financial professional to determine the right solution for your organization.

### Service

We know you need to spend your time focusing on your business. That's why we focus on the details so you don't have to. Our plan administrative services staff assist you with the day-to-day aspects of your plan.




# What Principal means for you

- We currently provide administrative services for nonqualified key employee benefit plans that serve more than 4,500 employers, representing over 71,000 plan participants.[7]
- A member of the FORTUNE 500®, we have $673.8 billion in assets under management[8] 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.[9]
- No. 1 provider of deferred comp plans.[10]
- Our innovative business solutions include more than 30 plan types and serve over 18,000 plan customers.[11]

[1] "Top Hat" employees are a select group of management or highly compensated employees that meet Department of Labor guidelines.

[2] Depending on the plan type and options selected, the tax-deductible amount will differ.

[3] Employees can defer up to 100% of compensation, but plan sponsors typically permit deferrals of less than 100% due to other payroll deductions, such as FICA taxes and health insurance.

[4] For taxable corporations.

[5] Contributions to the plan are subject to FICA when benefits vest. Distributions are taxable to plan participants upon receipt.

[6] Contributions to the plan are subject to FICA when benefits vest. Plan participant deferrals may not be deductible in all states. Distributions are taxable to plan participant upon receipt.

[7] As of December 31, 2017.

[8] As of March 31, 2018.

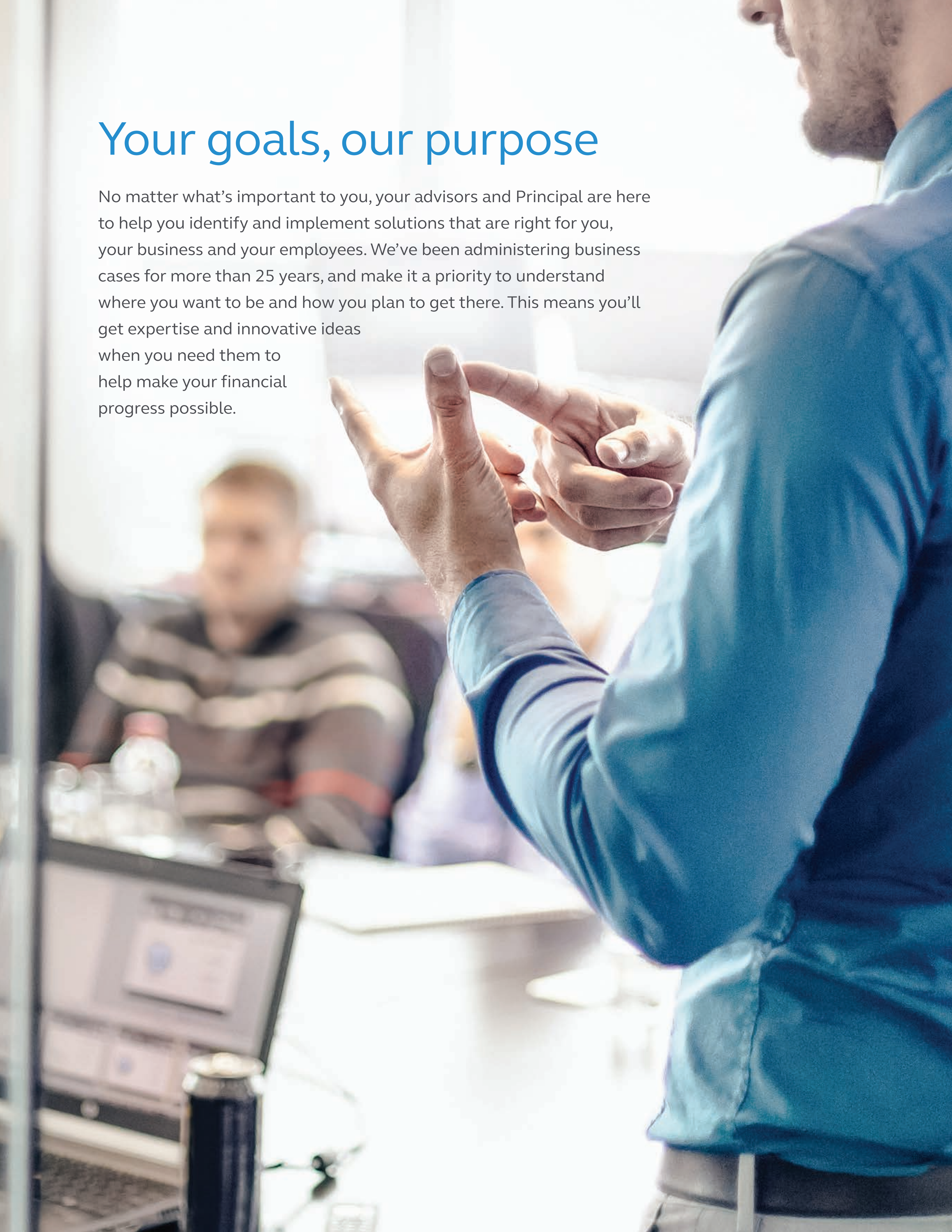
[9] Third-party ratings relate only to Principal Life Insurance Company, the largest member company of the Principal Financial Group, and Principal National Life Insurance Company, and do not reflect any ratings actions or notices relating to the US life insurance sector generally. A high rating by a particular firm does not constitute an endorsement of the rated insurer by the ratings firm.

[10] Based on total number of Section 409A plans and non-governmental 457 plans, PLANSPONSOR 2017 Recordkeeping Survey, June 2017.

[11] As of December 2017.

# Your goals, our purpose

No matter what's important to you, your advisors and Principal are here to help you identify and implement solutions that are right for you, your business and your employees. We've been administering business cases for more than 25 years, and make 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.



Let's connect

What are you waiting for? Contact your financial professional today to find the solutions that are right for you, your business and your key employees.

Principal®

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