Nonqualified Deferred Compensation Plans

Presented by:

Michael Roesler
Managing RVP NQ Plans

The Principal Financial Group
The #1 provider of nonqualified plans\textsuperscript{1}

<table>
<thead>
<tr>
<th>Provide administrative services for over 4,200 clients</th>
</tr>
</thead>
<tbody>
<tr>
<td>More than 150 dedicated employees to NQ operations</td>
</tr>
<tr>
<td>Over 20 years dedicated to serving nonqualified clients and their participants</td>
</tr>
<tr>
<td>Serve over 66,000 participants</td>
</tr>
</tbody>
</table>

\textsuperscript{1}Based on the total number of NQDC plans, PLANSponsor Deferred Compensation Plan Buyer’s Guide, December 2015.
# Nonqualified Deferred Compensation Solutions

<table>
<thead>
<tr>
<th>Defined Contribution (DC)</th>
<th>For Profit</th>
<th>LTIP</th>
</tr>
</thead>
<tbody>
<tr>
<td>&quot;EXCESS&quot;</td>
<td></td>
<td>&quot;INCENTIVE BONUS&quot;</td>
</tr>
<tr>
<td>Defined Benefit (DB)</td>
<td>DEFINED BENEFIT</td>
<td></td>
</tr>
</tbody>
</table>

For use with financial professionals only. Not for use in sales situations with the public.
WHAT IS AN “EXCESS” PLAN?

Nonqualified defined contribution plan

Not subject to qualified plan restrictions due to contribution or compensation limits, or to coverage and discrimination testing

An “unfunded” contractual agreement between a Plan Sponsor and a Plan Participant to pay compensation at a future date

A plan not subject to the fiduciary and most reporting requirements of ERISA
ELIGIBILITY

GENERAL “TOP HAT” GUIDELINES

“Highly Compensated” – generally $120,000 or more of total compensation

Key management position(s) that have the ability to “influence plan design”

No more than 10% of employees eligible compared to the entire employee group
COMPENSATION

PARTICIPANTS MAY ELECT TO DEFER COMPENSATION

- Base salary, Bonus, PBC, 1099 Income, etc.
- Restricted stock and stock options (consider earnings period and deferral election timing)
- Board of Directors fees
- Consideration: Employer may impose maximums on participant elected deferrals for each type of compensation
## EARNINGS CREDITING

<table>
<thead>
<tr>
<th>Mutual fund investments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate crediting</td>
</tr>
<tr>
<td>Company stock</td>
</tr>
<tr>
<td><strong>Individual securities?</strong></td>
</tr>
<tr>
<td>Constructive receipt issues</td>
</tr>
<tr>
<td>Can the company buy the asset?</td>
</tr>
</tbody>
</table>
VESTING

WHAT ARE THE COMPANY’S OBJECTIVES?

Vesting not governed by qualified plan rules

Graded vesting tied to 401(k)/profit sharing plan

Graded or cliff vesting tied to corporate objectives

“Rolling” vesting for each annual contribution

Different vesting schedules for different levels

Specific vesting for specific contributions
BENEFIT PAYMENT EVENTS

SECTION 409A PERMITTED EVENTS

- Separation from service (including retirement)
- Specific time and form ("in-service")
- Change in control
- Unforeseeable emergency (very rare)
- Disability
- Death

CONSIDERATIONS

- Plan sponsor may choose which events to permit in plan design
- "Intervening events" may override
BENEFIT PAYMENT OPTIONS

Lump sum and installments

Different elections for different events

Different options before and after a “seniority date”

Change in “time and form” rules

Made 12 months before the distribution begins

Minimum 5 year deferral (except for death, disability, unforeseeable emergency)
PRIMARY USES: 401(k) Repair & Retirement Savings
Employer can offer the plan to those HCE’s capped on qualified plan contributions due to testing restrictions.

- Allows eligible key employees to defer into an NQDC plan
- Any amount restricted by qualified plan non-discrimination testing
- Company contributions follow deferrals as a way to restore a lost match.
Addressing the retirement gap higher earners face

- **Deferral limits can be raised**, or more commonly, eliminated

- **May or may not include** company matching amounts and/or discretionary profit share contributions

- **Employer has the ability to choose which key employees can participate** - discrimination.
  - Plan design may allow ability to create tiers of the Top Hat Group with different deferral limits, employer contributions and vesting schedules
THE RETIREMENT GAP

Your retirement savings gap could be between 40% - 60% of your need.

This information is from the Principal Financial Group® Replacement Ratio Calculator with source information from the Annual Statistical Supplements to the Social Security Bulletin (www.ssa.gov). It is intended to demonstrate the potential impact of Social Security and 401(k) plan benefits at various income levels. For more information on your individual circumstances, please speak with your financial or tax professional. ©2015 Principal Financial Services, Inc.
Q: WHY WOULD YOU WANT TO SAVE ON A PRE-TAX BASIS VS AFTER-TAX?

A: YOU KEEP THE MONEY YOU WOULD HAVE PAID IN TAXES INVESTED, EARNING COMPOUNDED RETURNS.
Your pre-tax deferrals at work

**Pre-tax nets $888K more, a 52% improvement**

**Assumptions:**
35% Marginal Tax Rate

<table>
<thead>
<tr>
<th></th>
<th>Pre-tax NQDC</th>
<th>Taxable Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual deferral amount:</td>
<td>$50,000</td>
<td>$50,000</td>
</tr>
<tr>
<td>Net amount invested:</td>
<td>$50,000</td>
<td>$32,500</td>
</tr>
<tr>
<td>Earnings rate:</td>
<td>8%</td>
<td>8%</td>
</tr>
<tr>
<td>Net investment return:</td>
<td>8%</td>
<td>5.2%</td>
</tr>
<tr>
<td>Account balance after 25 years:</td>
<td>$3.948M</td>
<td>$1.678M</td>
</tr>
<tr>
<td>Net account value after 25 years:</td>
<td>$2.566M</td>
<td>$1.678M</td>
</tr>
</tbody>
</table>

Net amount invested for Taxable Investment based on assumed 35% federal tax bracket. Lower maximum tax rates on capital gains and dividends would make the return of the taxable investment more favorable, thereby reducing the difference in performance between the options shown. Consider your personal investment horizon and income tax bracket, both current and anticipated, when making an investment decision as these may further impact the results of the comparison. Pre-tax NQDC value based on taking lump sum distribution after 25 years at federal tax rate of 35%.

For use with financial professionals only. Not for use in sales situations with the public.
TAXES 101

Marginal Tax Rate
How your last and next dollar of taxable income are taxed.

Effective Tax Rate
Average rate of taxation for all of your dollars.

Total amount of tax dollars ÷ Total taxable income
MARGINAL TAX RATES

- 10%
- 15%
- 25%
- 28%
- 33%
- 35%
- 39.6%

Deferred comp plan
## MARGINAL TAX RATE VS. EFFECTIVE TAX RATE

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Income</td>
<td>$200,000</td>
</tr>
<tr>
<td>Current Deferral</td>
<td>$50,000</td>
</tr>
<tr>
<td>Current Marginal Rate that would have been paid on deferral (Federal)</td>
<td>28%</td>
</tr>
<tr>
<td>Retirement Income/Effective Rate (Federal)</td>
<td>$150,000 / 20%</td>
</tr>
<tr>
<td>Improvement</td>
<td>8%</td>
</tr>
</tbody>
</table>
PRIMARY USES: Taxation Timing
Participants have the ability to coordinate their NQDC distributions with distributions from Social Security or other pre-tax retirement plans such as a 401(k) plan.

- Often participants will fund their retirement with NQDC distributions first, then receive qualified plan distributions later.

Participants can defer distributions while they’re working and their marginal tax rates are potentially high and then take the distribution during retirement when their effective tax rate may be lower.

Income tax payable in the year money is actually received by the key employee.
NONQUALIFIED PLAN ACCOUNTS

**RETIREMENT ACCOUNT**

- Save for retirement/net worth
- Additional vehicle to build net worth
- Payable upon separation from service or other qualifying distribution event
- Payable in lump sum or installments – you decide*

**IN-SERVICE ACCOUNT(S)**

- Save for specific event/purchase
- Save for college education
- Set aside funds with no tax penalties for distributions prior to age 59 ½.
- Payable at predetermined date in lump sum or installments – you decide*

*Subject to specific plan provisions

For use with financial professionals only. Not for use in sales situations with the public.
Key Employee Base Income $250,000  Bonus $100,000

Key Employee elects to defer 15% of base pay and 50% of Bonus

Objectives:
• 2 Kids need College $$
• Planning Second Home
• Secure Retirement

Deferral Amounts:
• Base = $37,500
• Bonus = $50,000
• Total = $87,500

Allocation of Deferral Election

- 10% Mary
- 10% Michael
- 10% Vacation Home
- 25% Retirement 1
- 45% Retirement 2

$8,750 Payable 2018
$8,750 Payable 2021
$8,750 Payable 2025
$21,875 Payable at separation
$39,375 Payable at separation

Conservative Portfolio
Moderate Portfolio
Moderate Portfolio
Aggressive Portfolio
Aggressive Portfolio

For use with financial professionals only. Not for use in sales situations with the public.
PRIMARY USES: Compensation Management
Use discretionary employer contributions based on the particular needs of your organization

**RECRUITMENT**
Attract key performers to the organization via signing bonuses tied to a fixed period of tenure or business objectives.

**RETENTION**
Structure bonuses – sometimes referred to as “golden handcuffs” – with vesting schedules to make it appealing for key employees to stay with the organization.

**REWARDS**
Drive both organizational and personal performance by offering incentive-based contributions to the plan.

**RETIREMENT**
Restore company match benefits disallowed in qualified plans due to ADP/ACP testing and/or compensation limits.
EMPLOYER CONTRIBUTIONS

FULLY DISCRETIONARY CONTRIBUTIONS

Make up for missed contributions in qualified plans due to discrimination testing

Incentive based contributions

Executive “profit sharing”

Phantom stock contributions

Signing and staying bonuses
FINANCING: NONQUALIFIED PLAN OBLIGATIONS
NONQUALIFIED PLAN FINANCING

Corporate Asset
(COLI/Taxable Investments, Securities)

Plan Liability
(Deferred Comp Account)
PLAN FINANCING OPTIONS

A NONQUALIFIED PLAN IS:

An **unfunded** and **unsecured** contractual obligation (liability) to pay a future benefit

3 WAYS TO FINANCE:

- Unfinanced
- Taxable Investments
- Variable COLI

BEST APPROACH DEPENDS ON THE COMPANY’S:

- Income tax bracket
- Long-term cost of money
- Earnings assumptions
- Realized vs. unrealized gains and losses on assets
- Cash flow requirements

For Registered Representative Information only. Not for use with the general public.
Mike Roesler - Managing RVP - NonQualified Plans, (866) 860-3450 (ext. 331)
Email: roesler.mike@principal.com

Chris Fernandez, Sr Consultant - Nonqualified Plans, Phone (866) 860-3450 (ext. 352)
Email: Fernandez.Chris@principal.com

Mark Simser, CFA, Sr Consultant - Nonqualified Plans, Phone (866) 860-3450 (ext. 353)
Email: Simser.mark@principal.com

Tiffany Gardella, Internal Wholesaler - Nonqualified Plans, Phone (800) 654-1491
Email: Gardella.Tiffany@principal.com
The subject matter in this communication is proved with the understanding that The Principal® is not rendering legal, accounting, or tax advice. You should consult with appropriate counsel or other advisors on all matters pertaining to legal, tax, or accounting obligations and requirements.

Insurance products issued by Principal National Life Insurance Co (except in NY) and Principal Life Insurance Co. Plan administrative services offered by Principal Life. Principal Funds, Inc. is distributed by Principal Funds Distributor, Inc. Securities offered through Princor Financial Services Corp., 800-247-1737, Member SIPC and/or independent broker/dealers. Principal National, Principal Life, Principal Funds Distributor, Inc. and Princor® are members of the Principal Financial Group®, Des Moines, IA 50392.