How do you prepare for retirement?

Financial experts predict you will need roughly 70%-80% of your current income to maintain your standard of living upon retirement. Many new business owners are hesitant to invest their profits anywhere but back into their business. Once small business owners are able to consider retirement, often the window of opportunity for funding has become very short. This results in the need for large contributions in order to meet retirement income replacement goals. Qualified retirement plans, such as 401(k) plans, generally have limitations that may prevent business owners from reaching income replacement goals when the need is imminent.

WHAT CHALLENGES DO YOU FACE?

The government imposes limits on the amounts that can be contributed to qualified retirement plans and IRAs. In addition, some plans are subject to minimum coverage, participation and discrimination testing. Here are the amounts for 2003:

Defined Contribution Plans (401(k), Profit Sharing, etc.)

- $200,000 maximum eligible compensation limit
- $12,000 maximum deferral ($14,000 if age 50 or older in 2003 [catch-up provision])
- Total annual contributions limited to $40,000 per participant ($42,000 if age 50 or older in 2003)

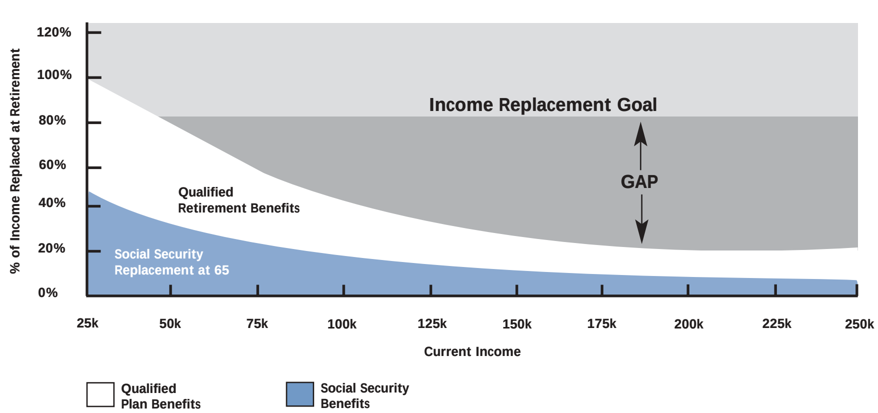
Standard Defined Benefit Pension Plan

- $200,000 maximum eligible compensation limit
- $160,000 maximum annual benefit payout

Individual Retirement Accounts (IRAs)

- $3,000 maximum contribution ($3,500 if age 50 or older in 2003)
- Deductible contributions limited if income exceeds $70,000 (married) or $50,000 (single) if participating in a qualified plan (2003)

LIMITS CAN CREATE A RETIREMENT INCOME GAP



ASSUMPTIONS FOR CHART ON PREVIOUS PAGE

1. Beginning at age 45, 401(k) contributions are maximized (up to 15%) with up to 4% employer match, but are limited by maximum compensation limits (currently $200,000) and highly compensated employee elective deferrals capped at 8%.
2. 4% annual salary increases until retirement age 62.
3. Assets earn 9% during pre-retirement and 7% during retirement distributions.
4. Retirement income paid to age 75. 401(k) benefits adjust annually at 4%; Social Security benefits adjust annually at 2%.
5. Assets are fully depleted over income period.

This information is from the Executive Benefit Services, Inc., Replacement Ratio Calculator (http://www.ebsnq.com) with source information from the Annual Statistical Supplements to the Social Security Bulletin (http://www.ssa.gov/SSA_Home.html).

Not all qualified plans are created equal

Although there are contribution and benefit limits placed on qualified plans, there are plan designs that can overcome some of these challenges. There are specific plans that may allow you to focus the contribution or benefit on older, more highly-compensated employees, allowing you to target their benefits.

There are defined contribution plan allocation formulas that can skew the contribution to the older, more highly compensated employees, but the maximum contribution allowed annually for any participant remains $40,000 ($42,000 if age 50 or older).

401(k) Safe Harbor Plan

- Maximum deferral – $12,000 (2003)
- Maximum deferral if over 50 – $14,000 (catch-up provision) (2003)
- Maximum total annual contribution per participant – $40,000 (2003)

New Comparability Profit Sharing Plan

- Requires cross-tested classification
- Benefits older, highly-compensated employees
- Salary deferrals allowed
- Maximum total annual contribution per participant – still $40,000 ($42,000 if age 50 or older)

Defined benefit plan designs, on the other hand, are extremely efficient at allowing older, more highly compensated participants to accumulate a desired retirement income in a short period of time. The contributions to these plans are not restricted by annual contribution limits – rather, these plans allow contributions necessary to fund the maximum benefit allowed. For 2003, that maximum benefit is $13,333 monthly, or $160,000 annually for the life of the participant. Here are the maximum contributions for 2003:

Age	Traditional Defined Benefit Annual Contribution	412(i) Defined Benefit Annual Contribution (100% Annuity Financing)	412(i) Defined Benefit Annual Contribution (split financed with Life Ins./Annuities)
45	$46,892	$95,395	$118,828
50	$71,907	$137,820	$176,737
55	$121,499	$223,598	$299,888
60	$154,344	$241,404	$357,154

Assumptions:
- Compensation = $200,000 for each participant
- No employees
- Interest rate assumption for traditional defined benefit plan = 5.5%.
- Minimum guaranteed rate for 412(i) plan = 3%.

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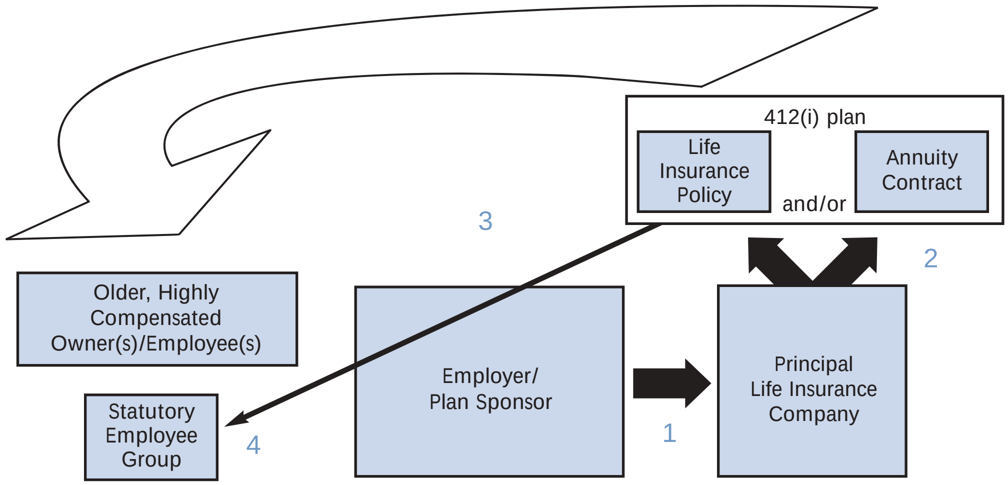
Traditional Defined Benefit Plan

- Now allows for normal retirement age of 62 without penalty
- Requires actuarial valuations and increased reporting
- Maximum annual benefit – $160,000 per participant

412(i) Defined Benefit Plan

- Benefits focused on older, highly-compensated participant
- Fully insured defined benefit plan, with guaranteed benefits
- Benefit is guaranteed by the claims-paying ability of insurance carrier providing the product which eliminates risk in a down market, assuming scheduled premiums are paid by the employer
- May provide the largest tax-deductible qualified plan contribution allowed with proper funding
- Maximum annual benefit – $160,000 per participant or 100% of the average of the highest three consecutive years of compensation as a plan participant

How does a 412(i) plan work?



STEP 1

Employer/plan sponsor determines that a 412(i) Qualified Defined Benefit plan is the right retirement benefit for their business. The employer determines the best plan design based on his or her needs and the level of required annual contribution. The employer sends required annual contributions to Principal Life Insurance Company.

STEP 2

Principal Life Insurance Company deposits the contributions received by the employer into special life insurance and/or annuity products with guaranteed minimum rates which are used to finance the 412(i) Qualified Defined Benefit plan.

STEP 3

At normal retirement date, death, disability or plan termination – as determined by the 412(i) Qualified Defined Benefit plan – the plan sponsor or trust will distribute a large benefit to the owner/highly compensated participant in the form of a lump sum payment or a annual benefit based on the participant's life expectancy – or the benefit may be rolled over to another qualified plan or Individual Retirement Account (IRA).

STEP 4

At normal retirement date, death, disability or plan termination – as determined by the 412(i) Qualified Defined Benefit plan, the plan sponsor or trust will distribute the required benefit as dictated by the plan to the remaining participating employee base. This benefit is generally substantially smaller than those benefits provided to the owners and highly compensated employees.

Meet your retirement needs

A QUALIFIED 412(i) DEFINED BENEFIT PLAN CAN MEET YOUR RETIREMENT NEEDS

Benefits for Participants

- The employer/plan sponsor funds the qualified plan benefit.
- Benefits grow tax-deferred; participants are not taxed until distribution.
- Plans benefit older, highly compensated employees, generally owners and key employees.
- Retirement benefits are guaranteed, eliminating uncertainties of a down market.
- Benefits are protected by ERISA from both business and personal creditors.
- If life insurance is used as part of the funding, the plan guarantees employees' heirs will receive a retirement benefit should death occur prior to retirement.

Benefits for the Company

- 412(i) Qualified Defined Benefit plans solve a problem for small business owners who delay putting a qualified plan in place.
- Annual contributions generally result in a larger tax-deductible contribution than allowed under any other qualified retirement plan (with proper funding).
- Higher tax-deducible contributions can reduce retained earnings or net income.
- Plan offers substantially lower costs than regular defined benefit plans. It is based on product guarantees, so no actuarial valuations are required.
- Benefits are guaranteed by the claims-paying ability of the insurance carrier providing the products to finance the plan assuming scheduled premiums are paid by the employer, shifting market risk from the plan sponsor to the insurance carrier.
- Allows for an element of flexibility should your business situation change; amendments can be made to alter the promised benefit, the plan design or the plan may be terminated and the assets rolled into another qualified plan or IRA.

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How does the 412(i) plan benefit growing businesses?

The 412(i) Defined Benefit plan is a uniquely positioned benefit for owners and key employees of growing businesses, generally with fewer than 10 employees. However, larger businesses can also benefit from a 412(i) plan if a carve-out approach is used. This plan is specifically designed to let you:

- Create a guaranteed retirement benefit, allowing the employer/plan sponsor to make large tax-deductible contributions – especially in the early years of the plan.
- Target the majority of the benefit to those employees who are older and more highly paid – generally the owner(s) and key employees.

WHAT IS A 412(i) DEFINED BENEFIT PLAN?

A 412(i) Defined Benefit plan is a fully insured qualified defined benefit pension plan. As a plan established under IRC 412(i), it is exempt from many IRS and Department of Labor (DOL) regulations that apply to other types of pension plans.

WHO PARTICIPATES IN THE 412(i) PLAN?

- Since it is a qualified defined benefit pension plan, all employees meeting certain eligibility requirements must benefit under the plan (generally at least age 21 with at least 1,000 hours of service annually and not participating in a union plan). Non resident aliens may be excluded.
- These plans are particularly well suited to independent contractors with few or no employees.
- It is designed to maximize the annual contribution deduction for older, business owners.

HOW ARE CONTRIBUTIONS MADE TO A 412(i) PLAN?

- The employer/plan sponsor makes all contributions to the plan. Elective deferral contributions are not allowed under a 412(i) plan. However, a 401(k) plan can be established allowing salary deferral contributions only.
- Contribution amount depends on the amount of desired retirement income benefit (not to exceed the lesser of $160,000 or 100% of the highest three consecutive years of compensation while a plan participant) and the time remaining until each participant reaches retirement age as specified under the plan.

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ARE ALL OF MY CONTRIBUTIONS CURRENTLY TAX-DEDUCTIBLE? WHAT ABOUT EARNINGS?

- Yes. All employer contributions required to fund the benefits of a 412(i) Defined Benefit plan are currently tax-deductible to the business sponsoring the plan – and non-taxable until distribution, to participants of the plan – as are all plans qualified under Internal Revenue Code Section 401(a).
- All earnings are also tax-deferred. If life insurance is used to fund any part of the benefit, a relatively small amount of income must be realized each year by each covered participant. This amount is known as the economic benefit cost.

WHAT ARE THE IRS REQUIREMENTS FOR A 412(i) PLAN?

- Plan benefits must be provided exclusively by insurance products – special life insurance policies and/or annuity contracts.
- These products must provide all benefits stated in the plan using guaranteed values at normal retirement age.
- Insurance products must provide required level annual premiums payable to normal retirement age as determined by the plan document.
- Dividends and/or excess interest (above the guarantees) must be used to reduce future contributions (dividends are not guaranteed).
- Forfeited benefits must also be used to reduce contributions.

WHAT FINANCING VEHICLES CAN BE USED TO FUND A 412(i) PLAN?

- 412(i) Qualified Defined Benefit plans can invest in any insurance product that meets Internal Revenue Service (IRS) guidelines with guaranteed interest and annuity purchase rates. This includes fixed cash value life insurance and/or fixed deferred annuities filed and approved as being of the same series.

WHAT DISTRIBUTION OPTIONS ARE AVAILABLE UNDER A 412(i) PLAN?

- Benefit payment events may include retirement, termination of employment (if vested), death and disability, or plan termination.
- Benefits may be distributed in a lump sum, monthly or annual income stream and/or rolled over to another qualified retirement plan or IRA.

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What are the disadvantages of a 412(i) plan?

For the Company

- The company must expect to have relatively consistent profits/earnings to enable them to make the required annual plan contribution.
- A prototype plan doesn't generally perform well for companies with more than 10 employees.
- Forfeitures, dividends and/or excess earnings over guarantees may reduce the annual deduction for plan contributions.

For Owners/Participants

- There are no loan provisions.
- No employee deferrals are allowed.
- Owners must include all eligible employees.
- Some employees may be uninsurable.

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This document is believed to provide accurate and authoritative information in regard to the subject matter covered. The accuracy of the material is not guaranteed, and is provided with the understanding that Principal Life is not rendering legal, accounting or tax advice. In specific cases, clients should consult their legal, accounting or tax advisor.

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