

**Is a Schwab
Personal Defined Benefit Plan
right for you?**

Questions and answers
to help employers decide.

Here are answers to some questions you may have about a Schwab Personal Defined Benefit (DB) Plan. Please carefully consider the following questions related to your business situation. The answers to these questions are important in determining if a personal defined benefit plan is right for your business. We recommend that you also consult with your tax advisor before establishing your company retirement plan.

Qualifications

The type of retirement plan your business should sponsor depends on a number of factors, including how many persons you employ in addition to yourself, your income level, your age and when you would like to retire.

Do I have the steady annual income needed to cover required annual DB plan contributions?

The IRS has strict required minimum contribution rules. Should investment losses occur, your required contributions may increase as well. It is important to have steady income to meet these needs. Remember, a DB plan is not like a profit-sharing plan, in which a sponsor can suspend contributions in certain years. If the sponsor contributes less than required, the IRS will impose excise taxes, possibly disqualify the plan and possibly disallow past tax deductions.

Must I have a net income of \$250,000 or more per year?

Annual funding contributions are generally substantial amounts. This means you will need significant future earned income so that you can make contributions and still have sufficient funds for other purposes. We estimate that earnings, before considering the DB plan contribution, need to be \$250,000 or more per year to make the cost of running the plan low relative to the tax savings.

High earnings are also important because IRS benefit limits are based on the highest three consecutive years of net earnings. High earnings ensure that a high target benefit can be established for the plan, which leads to higher contribution levels.

What qualifies as compensation for the purposes of a DB plan calculation?

Compensation must be earned income from active employment in the business sponsoring the plan. Generally, this is all income that is subject to FICA taxation. For a sole proprietor, compensation would equal net earned income from the business after deducting employer FICA taxation and qualified retirement plan contributions. This can also be W-2 earnings if the business files as a corporation. Passive income such as rental income or shareholder income does not qualify.

Must I be 50 years or older at the time the plan starts?

Contributions to the plan are spread over the period from plan startup to the expected retirement date. The shorter this period, the more each annual contribution needs to be to accumulate assets to pay the target benefit. Longer periods would result in low contribution levels. Starting the plan before age 50 would generally result in a very long savings period, and therefore annual contributions would be too low to justify using a DB plan.

Must I be under age 65 at the time the plan starts?

Persons starting a plan over age 65 will need to start withdrawing benefits at age 70½, which means a very short tax-deferral period, and so the tax benefits may not outweigh the costs of running the plan.

Do I need to run the plan for a minimum number of years?

The IRS expects a plan to be maintained for the purpose of accumulating retirement assets. Clients seeking short-term tax relief who do not expect to run the plan to the stated date they anticipate retiring from their company run the risk of the IRS disqualifying the plan as a tax shelter rather than a valid retirement plan.

Do I need to cover all of my employees?

This plan requires that all employees meeting eligibility requirements participate in the plan. The Schwab Personal DB Plan must cover all employees who work over 1,000 hours per year. Therefore, all current employees (and all future new hires) working 1,000+ hours would earn benefits under the plan and significantly increase plan costs.

What if I own other businesses?**Or if my spouse owns a business?**

Businesses under common ownership could be considered a single business for DB plan participation and benefit coverage rules. For example, if you own or partially own two or more businesses (or your spouse also owns a business and you have a child under age 21), then ALL of the employees of all commonly controlled businesses could be required to be covered under your DB plan.

This could cause you to cover employees beyond your immediate business, and thereby significantly increase the contributions to the plan. You should work with your attorney and accountant to make this determination.

What if I have sponsored a DB plan in past?

The benefits you earned under a previous plan could reduce the amount of benefits you might earn under any new DB plans. Therefore, if you earned a high benefit in a past DB plan your business (or past business) sponsored, the amount you can target in a new plan would be reduced.

Contributions

When your plan is set up, your expected annual contribution level will be based on your desired level of annual savings until retirement and must conform to IRS rules. To apply the IRS rules correctly, you must choose an anticipated retirement age and also provide an estimate of future pay for yourself and your employees. This information is required because IRS limits for each participant's benefits are adjusted for age at retirement, the number of years a person participates in the plan, and pay earned while participating in the plan. Schwab uses this information to create a customized benefit formula for the plan.

How do I choose my anticipated retirement age?

This should be your best estimate of when you expect to stop working and retire. When you stop working, you will terminate the plan and have the benefits distributed to you (and your employees, if applicable).

For most plans, the age you select will become the Normal Retirement Age (NRA) under the plan. IRS rules specify that the NRA must be a reasonable estimate of actual retirement. It could be challenged later by the IRS if you ultimately retire at a different age.

Is there a specific dollar contribution limit each year?

No. However, IRS limits do apply to the ultimate annual lifetime benefit you can receive at retirement, and these limits could affect your contributions. For example, if your projected benefit payout goes above the limits, your desired annual contribution level will be reduced. The IRS also has rules for how the maximum annual benefit level is translated into a maximum lump sum available at retirement. The maximum lump sum is calculated based on legislated interest rate and mortality assumptions.

How much do I need to contribute for my employees?

The benefits earned each year in the Schwab DB Plan must be the same percentage of compensation for all employees, so an employer must consider the impact of “sharing the wealth” with all employees regardless of age or income. For example: If a 55-year-old owner has one employee aged 35, the contribution will be about \$144,000 for the owner and approximately \$21,000 for the employee.

What is the due date for my contribution?

For a plan that has a January 1 to December 31 plan year, the contribution has to be made before you file your business’ tax return for that calendar year, but not later than September 15 of the following year. If the plan is underfunded according to IRS rules, you will be required to make about 25% of the contribution on a quarterly basis (on April 15, July 15 and October 15 of the plan year, and on January 15 of the following year).

When will I know my contribution amount for a particular plan year?

This is generally calculated and communicated in the fourth quarter of a particular plan year. However, Schwab can provide this earlier, if desired. For some plans it will be necessary to wait until the end of a plan year, when actual pay levels for each participant are known. In that situation, the contribution will be determined after the end of the plan year, but before taxes need to be filed.

Can the contribution fluctuate each year?

Each year we will communicate the IRS minimum required contribution and the IRS maximum allowed tax-deductible contribution. You have to contribute at least the minimum, and no more than the maximum, or face excise tax penalties (10% per year) and possible disqualification of the plan.

The contribution amount will be adjusted every year, taking into consideration the value of assets in the plan. If past investment returns have been better than expected, this will decrease contribution amounts, and the inverse is also true. Before you start your plan, you need to be comfortable with the fact that contribution requirements can move up or down depending on asset performance. Also see “What happens if my asset returns are more or less than the expected long-term asset return selected for the plan?” on page 6 for more information.

What if my income decreases and I can’t make required contributions?

Your plan may need to be amended to reduce the projected benefit payable at your expected retirement age. Note: amending your plan will result in added fees for the work needed to design a new benefit formula and draft documents for signing.

If your income were severely reduced such that the continuance of your business was in question, it might be appropriate to terminate your plan.

Is there a deadline for amending contribution levels for the plan for the current plan year?

For a January 1 to December 31 plan year, the deadline is March 15 of the following year. To allow time for meeting that deadline, you need to let Schwab know of your situation by the preceding December 31.

Why is a benefit formula needed if I’m just going to take a lump sum at retirement?

IRS rules require that the plan document define a lifetime annual benefit payable at retirement, and specify how it will be earned over a participant’s career. A formula is designed so that the desired level of savings (limited by IRS rules) is expected to result in sufficient assets to pay the benefit at retirement.

May I make my DB plan contributions from a source other than business income of the entity sponsoring the DB plan?

Yes. However, the contribution made is a tax deduction only on the tax return of the entity sponsoring the plan. Therefore, you may borrow from another source to meet a particular year's contribution, but the deduction can only be applied against the business income of the sponsoring entity.

What if I already made employer contributions to my defined contribution (DC) plan this year?

In some instances, making both DB and DC contributions will cause an employer to exceed the IRS limit on annual employer contributions to all employer plans. Under new Pension Protection Act legislation, your business can make employer contributions to a DC plan up to 6% of

compensation (with each employee's compensation capped at the IRS limit). Therefore, if you exceeded the 6% limit, it would not be possible to set up a DB plan for the current year (unless your DC plan allowed for a return of employer contributions to the employer under certain circumstances).

The 6% limit referred to above applies for 2006. In 2007 and beyond, the limit may increase for your plan.

What if I already made employee deferrals (i.e., 401(k) deferrals) to my DC plan this year?

Each employee is allowed to make 401(k) salary deferrals (up to IRS limits) each year. These do not count toward the IRS limit on annual employer contributions to all plans of the employer.

Unexpected Events

The IRS requires that a DB plan be used as a tool to provide for retirement income and not solely as a tax shelter. Under normal circumstances, you would maintain the DB plan as long as you run your company and are able to make required contributions to the plan.

What if I do not work until my anticipated retirement age, and I retire earlier?

Your contributions each year depend on a particular length of time until retirement. If you decide to change your anticipated retirement age, or have a need to retire suddenly, there could be a mismatch between the amount of assets needed at termination and the amount actually in the plan. Therefore, it is extremely important that you alert Schwab about changing retirement dates. This should allow enough time to change contribution levels over the remaining life of the plan so that all benefits can be paid.

May I terminate a DB plan whenever I want?

You must have a "valid business reason" to terminate the plan. Your retirement from employment would constitute a valid reason. Retirement is when you stop working and stop earning income from your company. At retirement, you generally will terminate the DB plan and distribute benefits to all employees.

Another reason might be the inability to generate enough business income to make required contributions to the plan. You should consult with your attorney on this matter for an opinion about whether specific situations would meet IRS requirements.

Are there any penalties for terminating a DB plan earlier than expected?

The IRS may audit any plan that was terminated. If a “valid business reason” is not found for terminating the plan, penalties may be imposed, including disallowing prior tax deductions. This risk may be increased in situations where the business continued in operation following the plan termination.

When I wish to retire and terminate the plan, what will happen if I have more assets in the plan than are needed to pay benefits?

The benefits paid to participants may not exceed IRS limits. At termination, it might be possible to amend the plan to expand benefits up to the IRS limits, and use up some of the excess assets. But if benefits are already at the IRS limits, then the plan will have excess assets at termination. Unfortunately, these assets cannot be simply returned to the sponsor (see below). That is why careful estimates of your retirement age are so important in designing the plan, and why any change in the anticipated retirement age needs to be disclosed to Schwab immediately.

Technically, you may withdraw excess assets from the plan, but only after paying a 50% excise tax, and then income taxes, on the amount taken out of the plan. In effect, this results in paying 85% of the excess to the IRS.

If I decide to continue working past my original anticipated retirement age, how are my contributions affected?

If you continue to work past your expected retirement age, your benefit under the formula designed for the plan will generally continue to grow, allowing for continuing contributions. It may be necessary to amend the plan to change the benefit formula to result in a higher benefit or to allow service counted under the formula to exceed a limit written into the formula. Amending your plan will result in added fees for the work needed to design a new benefit formula and draft documents for signing.

Note that an altered anticipated retirement age will likely reduce contribution levels from prior levels unless the plan can be amended. Also, if you have reached the IRS limit on benefits at the time you decide to change your anticipated retirement age, it may not be possible to make any additional contributions to the plan.

What if I am self-employed and become an employee of another entity?

Your employment with the other entity, and the related pay, cannot be included for your DB plan. You will continue to only include your self-employment income for the purposes of your DB plan. Contribution levels will need to be recalculated and the plan may need to be amended to reflect lower self-employment income.

If your self-employment income decreases significantly, it might be considered a valid business reason for terminating your DB plan.

What happens to the plan’s assets in the event of my death?

Assets will be paid out to your designated beneficiary. Since the death benefit is based on the plan’s benefit formula, the situation described above regarding the possible mismatch between actual assets and those needed to pay the death benefit is relevant.

Assets

If I start a DB plan, do I have to roll over the assets in my current retirement plans sponsored by my business?

While it might make sense to terminate your current plan(s) and move the money to another investment vehicle in certain situations, you will not be allowed to roll over assets in your current plan(s) to the Schwab Personal DB Plan. Therefore, you will need to roll money over to another type of account such as an IRA.

Note that, due to IRS employer contribution limits, there are limits on employer-based contributions to any other plan except the DB plan. Please refer to “What if I already made employer contributions to my defined contribution (DC) plan this year?” on page 4. However, you could continue to make 401(k) employee deferrals and catch-up contributions to the old plan(s). These might be reasons to keep a prior plan active, rather than closing it and rolling funds to an IRA.

Are the contributions held in a designated account for each employee?

No. Contributions and accumulated assets are held in a single Schwab Personal Defined Benefit Investment Account, which is a brokerage account that is specifically designed to hold assets of qualified plans. There are no individual participant accounts set up.

How do I invest assets for my account?

All assets for funding the plan must be held in a Schwab Personal Defined Benefit Investment Account. You may select from a wide range of investments, including stocks, bonds and mutual funds.

Who “owns” the money in the plan?

The plan will be established and sponsored by your business entity (corporation, company, partnership, sole proprietorship, etc.). The assets are “owned” by the plan, and are used solely to pay participant benefits. The business entity sponsoring the plan will be responsible for making the contributions needed for paying retirement benefits. After the contributions are submitted to the plan, they may only be used to pay plan benefits. There are severe penalties for using the assets for any other purpose.

What happens if my asset returns are more or less than the expected long-term asset return selected for the plan (generally 6%)?

An annual return of less than 6% will increase your future contributions, since the shortfall in the return would need to be made up in the future by increased contributions to meet the projected target plan benefit. Similarly, a return of greater than 6% will decrease your future contributions. The impact of investment performance—higher or lower than expected—increases over time as your assets grow and you get closer to retirement. Therefore, it is very important to take asset performance volatility into account when selecting suitable investments.

Plans Sponsored by a Partnership

Can the partners maintain separate accounts for their DB plan contributions?

No. The DB plan will maintain only one account for all the plan assets. However, for the purpose of the annual contribution, assets per partner will be tracked, and the amount of the annual contribution per partner will be provided to the partnership for deductibility purposes. When a partner retires, all the assets in the plan may be used to pay that partner's benefit. Because assets are pooled to pay all benefits under the plan, partners need to agree on the investment policy before they decide to open a DB plan.

Can my partner opt out of a DB plan?

Schwab's prototype plan document does not allow for excluding partners from participating in a DB plan.

Distributions

When can I take distributions from the plan?

Participants may not take ANY distribution until termination of employment. You will receive a distribution only after you terminate employment, or at the end of the plan termination process, if later. But there is one exception, as explained below.

What are the options for taking benefits from the plan?

The DB plan allows you to roll over the total value of your retirement benefits to an IRA after you retire. The money then becomes subject to IRA withdrawal rules. You could also take a full cash payment rather than a rollover (subject to mandatory 20% withholding taxes). Alternatively, you could draw a monthly benefit (but this requires you to maintain the plan, which requires continuing administrative fees), or you could purchase an annuity.

When must I start withdrawing benefits from the plan?

When the owners of the business reach age 70½, they must begin withdrawing annual payments from the plan. These annual payments are taxable as income and may not be rolled over to an IRA.

May I take hardship withdrawals from my plan?

No. Participants may not make a withdrawal from the plan in an emergency—not even hardship.

May I take loans from my plan?

No. The Schwab DB plan does not allow loans from the plan, or rollovers into the plan.

Fees and Services

Are the annual fees for administration of the DB plan deductible?

Yes. They are a deductible business expense in the year they are paid. Please refer to the Schwab DB information sheet for additional information.

May I pay fees from my DB plan's asset account?

You should not pay plan fees out of the DB plan account. Contribution calculations do not factor in the payment of expenses from the plan. Fees should be paid from the general assets of your business.

Are there fees for terminating the plan?

Yes. Fees for terminating the plan currently range between \$2,500 and \$4,500, depending on how many participants your plan covers and the extent of IRS inquiry.

What is involved in a plan termination?

Termination services include all government forms required for terminating the plan and filing for qualification with the IRS. Services also include interaction with the IRS to provide historical information and answer questions related to the plan. The termination process can take up to a year or more due to IRS timing rules and approval and/or processing of certain documents.

If I have an existing DB plan, can I transition all services to Schwab?

No. Schwab is not able to administer a plan document that has already been established by another provider. Schwab can handle the remaining actuarial and administration work, and provide an investment account for plan assets. However, you would need to retain legal counsel to continue to administer the plan document.

I already have a plan held through a Third-Party Administrator (TPA). I would like to keep services at that TPA, but I am looking for a place to custody the assets. What solutions are available to me?

You may hold assets for your plan in a Schwab Company Retirement Account (CRA), where you can benefit from a wide range of investment choices, including stocks, fixed income investments and mutual funds. Please call 1-800-435-4000, or contact a Schwab Investment Professional to receive information or set up an account.

Does my plan need to be administered on a calendar-year basis to be eligible?

At this time, Schwab only administers plans with a January 1 to December 31 plan year. If your business has a non-calendar fiscal year, you will need to work with your accountant to determine how to allocate the DB plan tax deductions to each fiscal year.

Statutory Requirements

Does this plan require state approval?

No. It does not require any state's approval.

Does Schwab provide the annual IRS Form 5500?

Schwab fees include providing the Form 5500 for your DB plan each year.

Do the IRS limits on benefits ever change?

Yes. The maximum amounts increase each year by cost-of-living adjustments. If your benefit is affected by the IRS limits, then your contributions would increase a little each year due to increases in the IRS limits.

Will this plan be exempt from creditors?

In some instances, benefits earned under a qualified DB plan are protected from creditors. You will need to consult your attorney and/or tax advisor to determine how you would be affected.

Will I need to pay Pension Benefit Guaranty Corporation premiums?

You will need to pay PBGC premiums only if your plan becomes a "covered plan" under PBGC rules. A plan is generally covered unless it only provides benefits to owners/partners or to owners/partners and their spouses. Also, a DB plan is not covered by the PBGC if it is established and maintained by a professional service employer and has fewer than 25 active participants.

A law firm or medical practice is an example of a professional service employer. Contact your accountant and/or tax advisor for the PBGC's definition of a professional service employer.

Do I need to insure my DB plan with fiduciary insurance or be bonded in some way?

Law requires that the plan sponsor and other plan fiduciaries who have responsibility to direct and control plan assets be bonded by a Fidelity Bond. Plans that only cover the owner or the owner and spouse are not subject to this rule. The Fidelity Bond provides protection to the plan against loss by reason of acts of fraud or dishonesty on the part of the plan official. The amount of bond required is based on the amount of plan assets.

