

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended June 30, 2008

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

1-16725

(Commission file number)

**PRINCIPAL FINANCIAL GROUP, INC.**

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

42-1520346

(I.R.S. Employer Identification Number)

711 High Street, Des Moines, Iowa 50392

(Address of principal executive offices)

(515) 247-5111

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

The total number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of July 31, 2008 was 259,158,218.

**PRINCIPAL FINANCIAL GROUP, INC.**

**TABLE OF CONTENTS**

**Part I - FINANCIAL INFORMATION**

	<u>Page</u>
<u>Item 1. Financial Statements</u>	3
<u>Consolidated Statements of Financial Position at June 30, 2008 (Unaudited) and December 31, 2007</u>	3
<u>Unaudited Consolidated Statements of Operations for the three and six months ended June 30, 2008 and 2007</u>	4

<a href="#">Unaudited Consolidated Statements of Stockholders' Equity for the six months ended June 30, 2008 and 2007</a>	5
<a href="#">Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2008 and 2007</a>	6
<a href="#">Notes to Unaudited Consolidated Financial Statements — June 30, 2008</a>	8
<a href="#">Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</a>	38
<a href="#">Item 3. Quantitative and Qualitative Disclosures about Market Risk</a>	81
<a href="#">Item 4. Controls and Procedures</a>	87
<b>Part II — OTHER INFORMATION</b>	
<a href="#">Item 1. Legal Proceedings</a>	88
<a href="#">Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</a>	88
<a href="#">Item 4. Submission of Matters to a Vote of Security Holders</a>	89
<a href="#">Item 6. Exhibits</a>	89
<a href="#">Signature</a>	90

## PART I — FINANCIAL INFORMATION

### Item 1. Financial Statements

#### Principal Financial Group, Inc. Consolidated Statements of Financial Position

	June 30, 2008 (Unaudited)	December 31, 2007
	(in millions)	
<b>Assets</b>		
Fixed maturities, available-for-sale	\$ 46,860.9	\$ 46,738.9
Fixed maturities, trading	907.4	529.3
Equity securities, available-for-sale	261.6	316.4
Equity securities, trading	265.5	269.8
Mortgage loans	12,773.1	12,659.6
Real estate	888.7	862.5
Policy loans	875.6	869.9
Other investments	2,296.1	2,118.6
Total investments	65,128.9	64,365.0
Cash and cash equivalents	1,524.5	1,344.4
Accrued investment income	744.0	774.1
Premiums due and other receivables	892.1	951.2
Deferred policy acquisition costs	3,344.1	2,810.1
Property and equipment	490.9	469.0
Goodwill	385.1	374.7
Other intangibles	995.7	1,006.9
Separate account assets	75,527.3	80,486.8
Other assets	2,494.3	1,938.0
Total assets	\$ 151,526.9	\$ 154,520.2
<b>Liabilities</b>		
Contractholder funds	\$ 42,942.1	\$ 40,288.9
Future policy benefits and claims	18,690.5	18,454.7
Other policyholder funds	546.9	540.5
Short-term debt	215.1	290.8
Long-term debt	1,384.0	1,398.8
Income taxes currently payable	52.8	41.6
Deferred income taxes	165.0	576.3
Separate account liabilities	75,527.3	80,486.8
Other liabilities	5,383.3	5,020.1
Total liabilities	144,907.0	147,098.5
<b>Stockholders' equity</b>		
Series A preferred stock, par value \$.01 per share with liquidation preference of \$100 per share - 3.0 million shares authorized, issued and outstanding in 2008 and 2007	—	—
Series B preferred stock, par value \$.01 per share with liquidation preference of \$25 per share - 10.0 million shares authorized, issued and outstanding in 2008 and 2007	0.1	0.1
Common stock, par value \$.01 per share - 2,500.0 million shares authorized, 386.7 million and 385.8 million shares issued, and 259.0 million and 259.1 million shares outstanding in 2008 and 2007, respectively	3.9	3.9

Additional paid-in capital	8,350.4	8,295.4
Retained earnings	3,757.7	3,414.3
Accumulated other comprehensive income (loss)	(773.9)	420.2
Treasury stock, at cost (127.7 million and 126.7 million shares in 2008 and 2007, respectively)	(4,718.3)	(4,712.2)
Total stockholders' equity	6,619.9	7,421.7
Total liabilities and stockholders' equity	\$ 151,526.9	\$ 154,520.2

See accompanying notes.

3

**Principal Financial Group, Inc.**  
**Consolidated Statements of Operations**  
**(Unaudited)**

	For the three months ended		For the six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
(in millions, except per share data)				
<b>Revenues</b>				
Premiums and other considerations	\$ 1,156.2	\$ 1,176.9	\$ 2,209.2	\$ 2,284.6
Fees and other revenues	622.5	622.9	1,235.9	1,215.4
Net investment income	991.0	976.6	1,951.3	1,899.8
Net realized/unrealized capital gains (losses)	(111.5)	55.4	(237.5)	93.0
Total revenues	<u>2,658.2</u>	<u>2,831.8</u>	<u>5,158.9</u>	<u>5,492.8</u>
<b>Expenses</b>				
Benefits, claims and settlement expenses	1,634.0	1,584.7	3,106.0	3,082.7
Dividends to policyholders	69.0	74.0	139.8	148.0
Operating expenses	749.2	760.4	1,495.1	1,515.1
Total expenses	<u>2,452.2</u>	<u>2,419.1</u>	<u>4,740.9</u>	<u>4,745.8</u>
Income from continuing operations before income taxes	206.0	412.7	418.0	747.0
Income taxes	29.4	100.4	59.0	169.4
Income from continuing operations, net of related income taxes	176.6	312.3	359.0	577.6
Loss from discontinued operations, net of related income taxes	—	(0.2)	—	(0.2)
Net income	176.6	312.1	359.0	577.4
Preferred stock dividends	8.3	8.3	16.5	16.5
Net income available to common stockholders	<u>\$ 168.3</u>	<u>\$ 303.8</u>	<u>\$ 342.5</u>	<u>\$ 560.9</u>
<b>Earnings per common share</b>				
Basic earnings per common share:				
Income from continuing operations, net of related income taxes	\$ 0.65	\$ 1.14	\$ 1.32	\$ 2.09
Loss from discontinued operations, net of related income taxes	—	—	¾	¾
Net income	<u>\$ 0.65</u>	<u>\$ 1.14</u>	<u>\$ 1.32</u>	<u>\$ 2.09</u>
Diluted earnings per common share:				
Income from continuing operations, net of related income taxes	\$ 0.64	\$ 1.12	\$ 1.31	\$ 2.07
Loss from discontinued operations, net of related income taxes	—	—	¾	¾
Net income	<u>\$ 0.64</u>	<u>\$ 1.12</u>	<u>\$ 1.31</u>	<u>\$ 2.07</u>

See accompanying notes.

4

**Principal Financial Group, Inc.**  
**Consolidated Statements of Stockholders' Equity**  
**(Unaudited)**

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total stockholders' equity
(in millions)								
<b>Balances at January 1, 2007</b>	\$ —	\$ 0.1	\$ 3.8	\$ 8,141.8	\$ 2,824.1	\$ 846.9	\$ (3,955.9)	\$ 7,860.8
Common stock issued	—	—	—	38.5	—	—	—	38.5
Capital transactions of equity method investee, net of related income taxes	—	—	—	0.2	—	—	—	0.2
Stock-based compensation and additional related tax benefits	—	—	—	43.2	—	—	—	43.2
Treasury stock acquired, common	—	—	—	—	—	—	(224.0)	(224.0)
Dividends to preferred stockholders	—	—	—	—	(16.5)	—	—	(16.5)
<b>Comprehensive income:</b>								
Net income	—	—	—	—	577.4	—	—	577.4
Net unrealized losses, net	—	—	—	—	—	(328.5)	—	(328.5)
Foreign currency translation adjustment, net of related income taxes	—	—	—	—	—	36.5	—	36.5
Unrecognized post-retirement benefit obligation, net of related income taxes	—	—	—	—	—	—	—	(0.9)
Comprehensive income	—	—	—	—	—	(0.9)	—	284.5
<b>Balances at June 30, 2007</b>	<u>\$ —</u>	<u>\$ 0.1</u>	<u>\$ 3.8</u>	<u>\$ 8,223.7</u>	<u>\$ 3,385.0</u>	<u>\$ 554.0</u>	<u>\$ (4,179.9)</u>	<u>\$ 7,986.7</u>

<b>Balances at January 1, 2008</b>	\$	—	\$	0.1	\$	3.9	\$	8,295.4	\$	3,414.3	\$	420.2	\$	(4,712.2)	\$	7,421.7
Common stock issued		—		—		—		23.6		—		—		—		23.6
Capital transactions of equity method investee, net of related income taxes		—		—		—		0.2		—		—		—		0.2
Stock-based compensation and additional related tax benefits		—		—		—		31.2		—		—		—		31.2
Treasury stock acquired, common		—		—		—		—		—		—		(6.1)		(6.1)
Dividends to preferred stockholders		—		—		—		—		(16.5)		—		—		(16.5)
Effects of changing post-retirement benefit plan measurement date, net of related income taxes		—		—		—		—		0.9		(2.0)		—		(1.1)
Comprehensive loss:																
Net income		—		—		—		—		359.0		—		—		359.0
Net unrealized losses, net		—		—		—		—		—		(1,220.9)		—		(1,220.9)
Foreign currency translation adjustment, net of related income taxes		—		—		—		—		—		32.8		—		32.8
Unrecognized post-retirement benefit obligation, net of related income taxes		—		—		—		—		—		(4.0)		—		(4.0)
Comprehensive loss		—		—		—		—		—		—		—		(833.1)
<b>Balances at June 30, 2008</b>	\$	<u>—</u>	\$	<u>0.1</u>	\$	<u>3.9</u>	\$	<u>8,350.4</u>	\$	<u>3,757.7</u>	\$	<u>(773.9)</u>	\$	<u>(4,718.3)</u>	\$	<u>6,619.9</u>

See accompanying notes.

5

**Principal Financial Group, Inc.**  
**Consolidated Statements of Cash Flows**  
(Unaudited)

	For the six months ended June 30,	
	2008	2007
(in millions)		
<b>Operating activities</b>		
Net income	\$ 359.0	\$ 577.4
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations, net of related income taxes	—	0.2
Amortization of deferred policy acquisition costs	126.4	150.5
Additions to deferred policy acquisition costs	(373.8)	(252.8)
Accrued investment income	30.1	21.3
Net cash flows from trading securities	(409.8)	(157.8)
Premiums due and other receivables	23.0	186.6
Contractholder and policyholder liabilities and dividends	1,083.9	983.7
Current and deferred income taxes	(20.1)	26.7
Net realized/unrealized capital (gains) losses	237.5	(93.0)
Depreciation and amortization expense	69.8	65.4
Mortgage loans held for sale, acquired or originated	(27.4)	(52.5)
Mortgage loans held for sale, sold or repaid, net of gain	28.8	128.4
Real estate acquired through operating activities	(29.9)	(28.2)
Real estate sold through operating activities	7.2	46.8
Stock-based compensation	26.4	37.3
Other	(58.0)	280.5
Net adjustments	714.1	1,343.1
Net cash provided by operating activities	1,073.1	1,920.5
<b>Investing activities</b>		
Available-for-sale securities:		
Purchases	(4,360.4)	(5,067.2)
Sales	434.2	2,265.5
Maturities	1,799.4	2,356.7
Mortgage loans acquired or originated	(753.4)	(1,336.8)
Mortgage loans sold or repaid	613.8	862.4
Real estate acquired	(11.2)	(60.8)
Real estate sold	46.0	5.7
Net purchases of property and equipment	(49.5)	(46.1)
Purchases of interest in subsidiaries, net of cash acquired	(20.3)	—
Net change in other investments	(25.3)	(16.9)
Net cash used in investing activities	\$ (2,326.7)	\$ (1,037.5)

6

**Principal Financial Group, Inc.**  
**Consolidated Statements of Cash Flows (continued)**  
(Unaudited)

	For the six months ended, June 30,	
	2008	2007
(in millions)		
<b>Financing activities</b>		

Issuance of common stock	\$	23.6	\$	38.5
Acquisition of treasury stock		(6.1)		(224.0)
Proceeds from financing element derivatives		83.3		76.2
Payments for financing element derivatives		(61.1)		(69.1)
Excess tax benefits from share-based payment arrangements		2.8		6.1
Dividends to preferred stockholders		(16.5)		(16.5)
Issuance of long-term debt		3.1		8.3
Principal repayments of long-term debt		(12.7)		(22.3)
Net repayments of short-term borrowings		(72.7)		(26.1)
Investment contract deposits		6,792.5		4,015.3
Investment contract withdrawals		(5,531.7)		(4,510.4)
Net increase in banking operation deposits		232.3		108.2
Other		(3.1)		—
Net cash provided by (used in) financing activities		1,433.7		(615.8)
<b>Discontinued operations</b>				
Net cash provided by operating activities		—		1.4
Net cash used in investing activities		—		(1.1)
Net cash used in financing activities		—		(0.3)
Net cash provided by discontinued operations		—		—
Net increase in cash and cash equivalents		180.1		267.2
Cash and cash equivalents at beginning of period		1,344.4		1,590.8
Cash and cash equivalents at end of period	\$	1,524.5	\$	1,858.0
<b>Cash and cash equivalents of discontinued operations included above</b>				
At beginning of period	\$	—	\$	(0.7)
At end of period	\$	—	\$	(0.7)

See accompanying notes.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**June 30, 2008**  
**(Unaudited)**

**1. Nature of Operations and Significant Accounting Policies**

**Basis of Presentation**

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (“PFG”), its majority-owned subsidiaries and its consolidated variable interest entities (“VIEs”), have been prepared in conformity with accounting principles generally accepted in the U.S. (“U.S. GAAP”) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2008, are not necessarily indicative of the results that may be expected for the year ended December 31, 2008. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2007, included in our Form 10-K for the year ended December 31, 2007, filed with the United States Securities and Exchange Commission (“SEC”). The accompanying consolidated statement of financial position as of December 31, 2007, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Reclassifications have been made to the June 30, 2007, financial statements to conform to the June 30, 2008, presentation.

**Recent Accounting Pronouncements**

On March 19, 2008, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* (“SFAS 161”). This Statement requires (1) qualitative disclosures about objectives and strategies for using derivatives, (2) quantitative disclosures about fair value amounts of gains and losses on derivative instruments and related hedged items and (3) disclosures about credit-risk-related contingent features in derivative instruments. The disclosures are intended to provide users of financial statements with an enhanced understanding of how and why derivative instruments are used, how they are accounted for and the financial statement impacts. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact this guidance will have on our disclosures.

On February 15, 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* (“SFAS 159”). SFAS 159 permits entities to choose, at specified election dates, to measure eligible financial instruments and certain other items at fair value that are not currently required to be reported at fair value. Unrealized gains and losses on items for which the fair value option is elected shall be reported in net income. The decision about whether to elect the fair value option (1) is applied instrument by instrument, with certain exceptions; (2) is irrevocable and (3) is applied to an entire instrument and not only to specified risks, specific cash flows or portions of that instrument. SFAS 159 also requires additional disclosures that are intended to facilitate comparisons between entities that choose different measurement attributes for similar assets and liabilities and between assets and liabilities in the financial statements of an entity that selects different measurement attributes for similar assets and liabilities. At the effective date, the fair value option may be elected for eligible items that exist at that date and the effect of the first remeasurement to fair value for those items should be reported as a cumulative effect adjustment to retained earnings. We adopted SFAS 159 on January 1, 2008, and the cumulative effect of the change in accounting principle as a result of adopting SFAS 159 was immaterial. Therefore, the pre-tax cumulative effect of the change in accounting principle is reflected in net realized/unrealized capital gains (losses). Election of this option upon acquisition or assumption of eligible items could introduce period to period volatility in net income.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**1. Nature of Operations and Significant Accounting Policies (continued)**

On September 29, 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132R* ("SFAS 158"). The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements were effective for fiscal years ending after December 15, 2006, and did not have a material impact on our consolidated financial statements. Effective for fiscal years ending after December 15, 2008, SFAS 158 also eliminates the ability to choose a measurement date, by requiring that plan assets and benefit obligations be measured as of the annual balance sheet date. For 2007, we used a measurement date of October 1 for the measurement of plan assets and benefit obligations. Two transition methods are available when implementing the change in measurement date for 2008. We chose the alternative that allowed us to use the October 1, 2007, measurement date as a basis for determining the 2008 expense and transition adjustment. The effect of changing the measurement date resulted in a \$0.9 million increase to retained earnings and a \$2.0 million decrease to accumulated other comprehensive income in the first quarter of 2008.

On September 15, 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ("SFAS 157"). This standard, which provides guidance for using fair value to measure assets and liabilities, applies whenever other standards require or permit assets or liabilities to be measured at fair value, but does not expand the use of fair value in any new circumstances. SFAS 157 establishes a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, and requires fair value measurements to be separately disclosed by level within the hierarchy. On February 12, 2008, the FASB issued FASB Staff Position ("FSP") FAS 157-2, *Effective Date of Statement No. 157*, to defer the effective date of the standard for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. On February 14, 2008, the FASB issued FSP FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13*, which amends SFAS 157 to exclude instruments covered by SFAS No. 13, *Accounting for Leases*, and its related interpretive guidance from the scope of SFAS 157. Our adoption of SFAS 157 on January 1, 2008, did not have a material impact on our consolidated financial statements. See Note 6, Fair Value Measurement, for further details.

**Separate Accounts**

As of June 30, 2008, and December 31, 2007, the separate accounts include a separate account valued at \$418.4 million and \$748.5 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. The separate account shares are recorded at fair value and are reported as separate account assets and separate account liabilities in the consolidated statements of financial position. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

**2. Federal Income Taxes**

The effective income tax rates for the three and six months ended June 30, 2008, were lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and additional U.S. foreign tax credits resulting from the enactment of legislation to increase the Brazilian tax rate in the second quarter of 2008. As we apply the equity method of accounting to our Brazilian operations, the net increase in deferred tax liabilities associated with the newly enacted rate is reflected in net investment income. The effective income tax rate for the six months ended June 30, 2008, is also lower than the prevailing corporate federal income tax rate due to the release of state deferred income tax liabilities associated with a reorganization of certain subsidiaries. The effective income tax rates for the three and six months ended June 30, 2007, were lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income. The effective income tax rate for the six months ended June 30, 2007, is also lower than the prevailing corporate federal income tax rate due to tax credits received on our investment in a synthetic fuel production facility.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**2. Federal Income Taxes (continued)**

The Internal Revenue Service is currently auditing our federal income tax returns for the years 2004 and 2005. We do not expect the results of these audits or developments in other tax areas to significantly increase or decrease the total amount of unrecognized tax benefits in the next twelve months, but the outcome of tax reviews is uncertain and unforeseen results can occur.

**3. Employee and Agent Benefits**

**Components of net periodic benefit cost (income):**

Pension benefits		Other postretirement benefits	
For the three months ended June 30,		For the three months ended June 30,	
2008	2007	2008	2007

	(in millions)			
Service cost	\$ 12.4	\$ 11.8	\$ 2.1	\$ 2.0
Interest cost	24.9	22.4	4.2	3.9
Expected return on plan assets	(32.6)	(28.6)	(9.4)	(8.4)
Amortization of prior service benefit	(1.9)	(2.1)	(0.6)	(0.7)
Recognized net actuarial loss (gain)	0.3	2.5	(0.8)	(0.5)
Net periodic benefit cost (income)	<u>\$ 3.1</u>	<u>\$ 6.0</u>	<u>\$ (4.5)</u>	<u>\$ (3.7)</u>

	Pension benefits		Other postretirement benefits	
	For the six months ended		For the six months ended	
	June 30,		June 30,	
	2008	2007	2008	2007
	(in millions)			
Service cost	\$ 24.8	\$ 23.5	\$ 4.2	\$ 4.0
Interest cost	49.8	44.8	8.4	7.7
Expected return on plan assets	(65.2)	(57.1)	(18.8)	(16.8)
Amortization of prior service benefit	(3.8)	(4.2)	(1.2)	(1.3)
Recognized net actuarial loss (gain)	0.6	5.0	(1.6)	(0.9)
Net periodic benefit cost (income)	<u>\$ 6.2</u>	<u>\$ 12.0</u>	<u>\$ (9.0)</u>	<u>\$ (7.3)</u>

## Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act ("ERISA") and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2008 will be zero so we will not be required to fund our qualified pension plan during 2008. However, it is possible that we may fund the qualified and nonqualified pension plans in 2008 in the range of \$20.0 million to \$50.0 million. During the three and six months ended June 30, 2008, no contributions were made to these plans.

10

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

## 4. Contingencies, Guarantees and Indemnifications

### Litigation and Regulatory Contingencies

We are regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services, life, health and disability insurance. Some of the lawsuits are class actions, or purport to be, and some include claims for punitive damages. In addition, regulatory bodies, such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers. We receive requests from regulators and other governmental authorities relating to other industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life Insurance Company ("Principal Life"). Principal Life's Motion to Transfer Venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleges, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives "revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans" and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleges that these acts constitute prohibited transactions under ERISA. Plaintiff seeks to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained "revenue sharing" fees from mutual funds. Plaintiff seeks declaratory, injunctive and monetary relief. Principal Life is aggressively defending the lawsuit.

On August 28, 2007, two plaintiffs filed two putative class action lawsuits in the United States District Court for the Southern District of Iowa against Principal Life and Princor Financial Services Corporation (the "Principal Defendants"). One of the lawsuits alleges that the Principal Defendants breached alleged fiduciary duties to participants in employer-sponsored 401(k) plans who were retiring or leaving their respective plans, including providing misleading information and failing to act solely in the interests of the participants, resulting in alleged violations of ERISA. The Plaintiffs dismissed the second suit, which was based upon the same facts and alleged violations of the Securities Exchange Act of 1934 and the Securities Act of 1933. The Principal Defendants are aggressively defending the first lawsuit.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any pending litigation or regulatory matter will have a material adverse effect on our business or financial position. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could materially affect net income in a particular quarter or annual period.

### Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary, joint ventures and industrial revenue bonds. These agreements generally expire through 2019. The maximum exposure under these agreements as of June 30, 2008, was approximately \$206.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the

sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. It is possible that performance under these guarantees could materially affect net income in a particular quarter or annual period.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**4. Contingencies, Guarantees and Indemnifications (continued)**

We are also subject to various other indemnification obligations issued in conjunction with certain transactions, primarily the sale of Principal Residential Mortgage, Inc. and other divestitures, acquisitions and financing transactions whose terms range in duration and often are not explicitly defined. Certain portions of these indemnifications may be capped, while other portions are not subject to such limitations; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. At inception, the fair value of such indemnifications was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe that performance under these indemnifications would not result in a material adverse effect on our business or financial position. It is possible that performance under these indemnifications could materially affect net income in a particular quarter or annual period.

**Securities Posted as Collateral**

We posted \$865.0 million in fixed maturities, available-for-sale securities at June 30, 2008, to satisfy collateral requirements primarily associated with our derivatives credit support annex agreements and a reinsurance arrangement. In addition, we posted \$295.2 million in commercial and residential mortgage-backed securities as of June 30, 2008, to satisfy collateral requirements associated with our obligation under a funding agreement with the Federal Home Loan Bank of Des Moines ("FHLB of Des Moines").

**5. Stockholders' Equity**

**Reconciliation of Outstanding Shares**

	Series A preferred stock	Series B preferred stock (in millions)	Common stock
Outstanding shares at January 1, 2007	3.0	10.0	268.4
Shares issued	—	—	1.3
Treasury stock acquired	—	—	(3.7)
Outstanding shares at June 30, 2007	<u>3.0</u>	<u>10.0</u>	<u>266.0</u>
Outstanding shares at January 1, 2008	3.0	10.0	259.1
Shares issued	—	—	0.9
Treasury stock acquired	—	—	(1.0)
Outstanding shares at June 30, 2008	<u>3.0</u>	<u>10.0</u>	<u>259.0</u>

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**5. Stockholders' Equity (continued)**

Comprehensive income (loss) is as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Net income	\$ 176.6	\$ 312.1	\$ 359.0	\$ 577.4
Net change in unrealized losses on fixed maturities, available-for-sale	(716.8)	(756.8)	(2,172.0)	(713.6)
Net change in unrealized gains (losses) on equity securities, available-for-sale	6.6	(4.9)	(2.3)	(5.4)
Net change in unrealized gains on equity method subsidiaries and minority interest adjustments	5.5	83.5	6.1	96.6
Adjustments for assumed changes in amortization patterns	122.7	113.1	293.7	118.5
Adjustment for assumed changes in liability for policyholder benefits and claims	(3.7)	—	(11.4)	—
Net change in unrealized gains on derivative instruments	48.6	21.9	11.9	28.8



Change in net foreign currency translation adjustment	(29.3)	38.8	41.1	38.3
Change in unrecognized post-retirement benefit obligation	(3.0)	(0.7)	(6.1)	(1.4)
Provision for deferred income tax benefits	154.6	161.4	646.9	145.3
Comprehensive income (loss)	<u>\$ (238.2)</u>	<u>\$ (31.6)</u>	<u>\$ (833.1)</u>	<u>\$ 284.5</u>

## 6. Fair Value Measurement

### Valuation hierarchy

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). For disclosures, SFAS 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels.

- **Level 1** – Unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities primarily include exchange traded equity securities, mutual funds and highly liquid U.S. Treasury bonds.
- **Level 2** – Inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. Our Level 2 assets and liabilities primarily include fixed maturity securities (including public and private bonds), equity securities, over-the-counter derivatives and other investments for which public quotations are not available but that are priced by third-party pricing services or internal models using observable inputs.
- **Level 3** – Unobservable inputs for the asset or liability. Our Level 3 assets and liabilities include fixed maturity securities (including private, structured transactions), private equity securities, complex derivatives and embedded derivatives that must be priced using broker quotes or other valuation methods that utilize substantial unobservable inputs.

### Determination of fair value

The following discussion describes the valuation methodologies used for assets and liabilities measured at fair value. The techniques utilized in estimating the fair values of financial instruments are reliant on the assumptions used, including discount rates and estimates of the amount and timing of future cash flows. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

### 6. Fair Value Measurement (continued)

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument, including estimates of timing, amount of expected future cash flows and the credit standing of the issuer. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In some cases, the fair value estimates cannot be substantiated by comparison to independent markets. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument.

#### *Fixed Maturities and Equity Securities*

Fair values of equity securities are determined using public quotations, when available. Fair values of public bonds and those private securities that are actively traded in the secondary market have been determined through the use of third-party pricing services using market observable inputs. Private placement securities and other corporate fixed maturities where we do not receive a public quotation are valued by discounting the expected cash flows. Market rates used are applicable to the yield, credit quality and average maturity of each security. Private equity securities may also utilize internal valuation methodologies appropriate for the specific asset. Fair values might also be determined using broker quotes or through the use of internal models or analysis.

#### *Derivatives*

Fair values of derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The valuation models consider projected discounted cash flows, relevant swap curves and appropriate implied volatilities.

#### *Other Investments*

Other investments reported at fair value primarily include seed money investments, for which the fair value is determined using the net asset value of the fund.

#### *Cash Equivalents*

Because of the nature of these assets, carrying amounts approximate fair values. Fair values of cash equivalents may be determined using public quotations, when available.

#### *Separate Account Assets*

Separate account assets include public equity, public and private debt securities and derivative instruments, for which fair values are determined as previously described. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of the loans. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. In addition, each property is appraised annually by an independent appraiser.

Certain annuity contracts and other investment-type insurance contracts include embedded derivatives that have been bifurcated from the host contract. The fair value of embedded derivatives is calculated based on actuarial and capital market assumptions, including non-performance risk, reflecting the projected cash flows over the life of the contract, incorporating expected policyholder behavior.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**6. Fair Value Measurement (continued)****Assets and liabilities measured at fair value on a recurring basis**

Assets and liabilities measured at fair value on a recurring basis are summarized below.

Assets / liabilities measured at fair value	As of June 30, 2008			
	Fair value hierarchy level			Level 3
	Level 1	Level 2	Level 3	
(in millions)				
<b>Assets</b>				
Fixed maturities, available-for-sale	\$ 46,860.9	\$ 147.2	\$ 44,862.2	\$ 1,851.5
Fixed maturities, trading	907.4	—	842.0	65.4
Equity securities, available-for-sale	261.6	206.4	2.0	53.2
Equity securities, trading	265.5	127.2	138.3	—
Net derivative assets and liabilities (1)	486.6	—	522.4	(35.8)
Other investments (2)	125.6	16.7	108.9	—
Cash equivalents (3)	1,419.4	693.3	726.1	—
Sub-total excluding separate account assets	<u>50,327.0</u>	<u>1,190.8</u>	<u>47,201.9</u>	<u>1,934.3</u>
Separate account assets	<u>75,527.3</u>	<u>49,216.4</u>	<u>19,213.8</u>	<u>7,097.1</u>
<b>Total assets</b>	<b>\$ <u>125,854.3</u></b>	<b>\$ <u>50,407.2</u></b>	<b>\$ <u>66,415.7</u></b>	<b>\$ <u>9,031.4</u></b>
<b>Liabilities</b>				
Investment-type insurance contracts (4)	\$ (2.4)	\$ —	\$ —	\$ (2.4)
<b>Total liabilities</b>	<b>\$ <u>(2.4)</u></b>	<b>\$ <u>—</u></b>	<b>\$ <u>—</u></b>	<b>\$ <u>(2.4)</u></b>

- (1) The fair value of our derivative instruments classified as assets and liabilities at June 30, 2008, was \$1,227.0 million and \$740.4 million, respectively. Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities.
- (2) Primarily includes seed money investments reported at fair value.
- (3) Includes short-term investments with a maturity date of three months or less when purchased.
- (4) Includes bifurcated embedded derivatives that are reported at fair value.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**6. Fair Value Measurement (continued)****Changes in Level 3 fair value measurements**

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three and six months ended June 30, 2008, is as follows:

	For the three months ended June 30, 2008					Ending balance as of June 30, 2008	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning balance as of March 31, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements	Transfers in (out) of Level 3		
		Included in net income (1)	Included in other comprehensive income				
(in millions)							
<b>Assets</b>							
Fixed maturities, available-for-sale	\$ 1,810.8	\$ (8.6)	\$ (13.3)	\$ 4.0	\$ 58.6	\$ 1,851.5	\$ (9.4)

Fixed maturities, trading	106.5	(1.0)	—	(30.0)	(10.1)	65.4	(1.0)
Equity securities, available-for-sale	38.9	(11.0)	10.3	—	15.0	53.2	(11.0)
Net derivative assets and liabilities	(48.1)	10.0	1.8	0.5	—	(35.8)	8.0
Separate account assets	7,388.2	(301.2)	—	8.7	1.4	7,097.1	(289.7)

#### Liabilities

Investment-type insurance contracts	(4.0)	(1.4)	—	3.0	—	(2.4)	1.3
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	For the six months ended June 30, 2008						Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	Beginning balance as of January 1, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements	Transfers in (out) of Level 3	Ending balance as of June 30, 2008	
		Included in net income (1)	Included in other comprehensive income				

#### Assets

Fixed maturities, available-for-sale	\$ 2,201.3	\$ (50.4)	\$ (362.2)	\$ (74.8)	\$ 137.6	\$ 1,851.5	\$ (49.0)
Fixed maturities, trading	92.3	(1.6)	—	(15.2)	(10.1)	65.4	(1.6)
Equity securities, available-for-sale	51.1	(34.3)	0.2	(1.8)	38.0	53.2	(34.7)
Net derivative assets and liabilities	(8.0)	(35.9)	7.0	1.1	—	(35.8)	(37.3)
Separate account assets	7,313.2	(283.8)	—	140.1	(72.4)	7,097.1	(272.7)

#### Liabilities

Investment-type insurance contracts	(49.3)	7.3	—	39.6	—	(2.4)	7.6
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- (1) Both realized and unrealized gains and losses for the three and six months ended June 30, 2008, are generally reported in net realized/unrealized capital gains (losses) within the consolidated statements of operations. Gains and losses for separate account assets are not reflected in the consolidated statements of operations.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

#### 6. Fair Value Measurement (continued)

##### Assets and liabilities measured at fair value on a nonrecurring basis

Certain assets are measured at fair value on a nonrecurring basis. During the first quarter of 2008, mortgage servicing rights with an aggregate cost of \$9.0 million had been written down to fair value of \$7.9 million, resulting in a charge of \$1.1 million that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans.

##### Transition

In connection with our adoption of SFAS 157 on January 1, 2008, we recorded a \$13.0 million pre-tax gain in net realized/unrealized capital gains (losses) resulting from the incorporation of our own creditworthiness and additional risk margins in the valuation of certain embedded derivatives recorded at fair value.

#### 7. Segment Information

We provide financial products and services through the following segments: U.S. Asset Accumulation, Global Asset Management, International Asset Management and Accumulation and Life and Health Insurance. In addition, there is a Corporate and Other segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

Prior to December 31, 2007, amounts now reported in the U.S. Asset Accumulation segment and the Global Asset Management segment were reported together in the U.S. Asset Management and Accumulation segment. This change was made due to continued growth in our Global Asset Management business and has no impact on our consolidated financial statements for any period presented. Our segment results for the three and six months ended June 30, 2007, have been restated to conform to the current segment presentation.

The U.S. Asset Accumulation segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals.

The Global Asset Management segment provides asset management services to our asset accumulation businesses, our life and health insurance operations, the Corporate and Other segment and third-party clients.

The International Asset Management and Accumulation segment consists of Principal International, which has operations in Brazil, Chile, China, Hong Kong, India, Malaysia and Mexico. We focus on countries with favorable demographics and growing long-term savings and defined contribution markets. We entered these countries through acquisitions, start-up operations and joint ventures.

The Life and Health Insurance segment provides individual life insurance, group health insurance and specialty benefits, which consists of group dental and vision insurance, individual and group disability insurance and group life insurance, within the United States.

The Corporate and Other segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate and Other segment primarily reflect our financing activities (including interest expense), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**7. Segment Information (continued)**

Management uses segment operating earnings in goal setting, as a basis for determining employee compensation and in evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income available to common stockholders for net realized/unrealized capital gains and losses, as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized/unrealized capital gains and losses, as adjusted, are net of income taxes, related changes in the amortization pattern of deferred policy acquisition costs ("DPAC") and sales inducements, recognition of deferred front-end fee revenues for sales charges on retirement products and services, net realized capital gains and losses distributed, minority interest capital gains and losses and certain market value adjustments to fee revenues. Net realized/unrealized capital gains (losses), as adjusted, exclude periodic settlements and accruals on non-hedge derivative instruments. Segment operating revenues exclude net realized/unrealized capital gains (except periodic settlements and accruals on non-hedge derivatives) and their impact on recognition of front-end fee revenues and certain market value adjustments to fee revenues and include operating revenues from real estate properties that qualify for discontinued operations. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

The accounting policies of the segments are consistent with the accounting policies for the consolidated financial statements, with the exception of income tax allocation. The Corporate and Other segment functions to absorb the risk inherent in interpreting and applying tax law. The segments are allocated tax adjustments consistent with the positions we took on tax returns. The Corporate and Other segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

The following tables summarize selected financial information by segment and reconcile segment totals to those reported in the consolidated financial statements:

	June 30, 2008	December 31, 2007
	(in millions)	
<b>Assets:</b>		
U.S. Asset Accumulation	\$ 123,028.0	\$ 126,131.1
Global Asset Management	1,343.3	1,438.9
International Asset Management and Accumulation	9,571.1	9,350.5
Life and Health Insurance	14,949.8	14,816.6
Corporate and Other	2,634.7	2,783.1
Total consolidated assets	<u>\$ 151,526.9</u>	<u>\$ 154,520.2</u>

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**7. Segment Information (continued)**

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
<b>Operating revenues by segment:</b>				
U.S. Asset Accumulation	\$ 1,255.7	\$ 1,265.9	\$ 2,460.4	\$ 2,445.0
Global Asset Management	146.1	154.5	264.4	289.3
International Asset Management and Accumulation	251.2	175.0	434.9	316.3
Life and Health Insurance	1,180.6	1,211.5	2,368.2	2,423.9
Corporate and Other	(44.5)	(21.4)	(99.8)	(65.3)
Total segment operating revenues	<u>2,789.1</u>	<u>2,785.5</u>	<u>5,428.1</u>	<u>5,409.2</u>
<b>Add:</b>				
Net realized/unrealized capital gains (losses) (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	(130.9)	46.1	(269.2)	83.3

Subtract:

Operating revenues from a discontinued real estate investment	—	(0.2)	—	(0.3)
Total revenues per consolidated statements of operations	<u>\$ 2,658.2</u>	<u>\$ 2,831.8</u>	<u>\$ 5,158.9</u>	<u>\$ 5,492.8</u>
<b>Operating earnings (loss) by segment, net of related income taxes:</b>				
U.S. Asset Accumulation	\$ 152.9	\$ 164.5	\$ 292.0	\$ 319.2
Global Asset Management	23.7	32.2	26.4	55.9
International Asset Management and Accumulation	31.8	26.7	63.5	46.0
Life and Health Insurance	66.7	60.1	145.9	105.6
Corporate and Other	(21.4)	(0.6)	(32.8)	(7.0)
Total segment operating earnings, net of related income taxes	<u>253.7</u>	<u>282.9</u>	<u>495.0</u>	<u>519.7</u>
Net realized/unrealized capital gains (losses), as adjusted (1)	(85.4)	20.9	(160.1)	41.2
Other after-tax adjustments (2)	—	—	7.6	—
Net income available to common stockholders per consolidated statements of operations	<u>\$ 168.3</u>	<u>\$ 303.8</u>	<u>\$ 342.5</u>	<u>\$ 560.9</u>

19

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**7. Segment Information (continued)**

(1) Net realized/unrealized capital gains (losses), as adjusted, is derived as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Net realized/unrealized capital gains (losses)	\$ (111.5)	\$ 55.4	\$ (237.5)	\$ 93.0
Periodic settlements and accruals on non-hedge derivatives	(19.4)	(9.5)	(28.2)	(9.5)
Certain market value adjustments to fee revenues	—	(0.2)	(3.5)	(1.0)
Recognition of front-end fee revenues	—	0.4	—	0.8
Net realized/unrealized capital gains (losses), net of related revenue adjustments	(130.9)	46.1	(269.2)	83.3
Amortization of deferred policy acquisition and sales inducement costs	16.4	1.8	29.9	1.1
Capital (gains) losses distributed	(6.9)	(8.6)	2.4	(10.6)
Certain market value adjustments of embedded derivatives	(3.2)	—	(3.2)	—
Minority interest capital (gains) losses	(3.0)	(5.6)	3.7	(6.9)
Income tax effect	42.2	(12.8)	76.3	(25.7)
Net realized/unrealized capital gains (losses), as adjusted	<u>\$ (85.4)</u>	<u>\$ 20.9</u>	<u>\$ (160.1)</u>	<u>\$ 41.2</u>

(2) For the six months ended June 30, 2008, other after-tax adjustments included the positive effect of \$7.6 million, resulting from a change in estimated loss related to a prior year legal contingency.

20

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**7. Segment Information (continued)**

The following table summarizes operating revenues for our products and services:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
U.S. Asset Accumulation:				
Full service accumulation	\$ 368.1	\$ 370.4	\$ 730.8	\$ 736.9
Principal Funds	168.8	179.0	342.1	336.4
Individual annuities	271.9	187.7	491.8	334.7
Bank and trust services	16.6	14.7	36.7	29.6
Eliminations	(44.9)	(43.5)	(94.2)	(72.2)
Total Accumulation	<u>780.5</u>	<u>708.3</u>	<u>1,507.2</u>	<u>1,365.4</u>
Investment only	274.4	295.5	562.1	577.9
Full service payout	200.8	262.1	391.1	501.7
Total Guaranteed	<u>475.2</u>	<u>557.6</u>	<u>953.2</u>	<u>1,079.6</u>

Total U.S. Asset Accumulation	1,255.7	1,265.9	2,460.4	2,445.0
Global Asset Management (1)	146.1	154.5	264.4	289.3
International Asset Management and Accumulation	251.2	175.0	434.9	316.3
Life and Health Insurance:				
Individual life insurance	350.7	337.4	699.7	675.2
Health insurance	452.0	510.8	917.4	1,030.0
Specialty benefits insurance	378.4	363.9	752.2	720.0
Eliminations	(0.5)	(0.6)	(1.1)	(1.3)
Total Life and Health Insurance	1,180.6	1,211.5	2,368.2	2,423.9
Corporate and Other	(44.5)	(21.4)	(99.8)	(65.3)
Total operating revenues	\$ 2,789.1	\$ 2,785.5	\$ 5,428.1	\$ 5,409.2
Total operating revenues	\$ 2,789.1	\$ 2,785.5	\$ 5,428.1	\$ 5,409.2
Net realized/unrealized capital gains (losses) (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues				
	(130.9)	46.1	(269.2)	83.3
Operating revenues from a discontinued real estate investment	—	0.2	—	0.3
Total revenues per consolidated statements of operations	\$ 2,658.2	\$ 2,831.8	\$ 5,158.9	\$ 5,492.8

(1) Reflects inter-segment revenues of \$59.1 million and \$57.1 million and \$117.9 million and \$111.9 million for the three and six months ended June 30, 2008 and 2007, respectively. These revenues are eliminated within the Corporate and Other segment.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**8. Stock-Based Compensation Plans**

As of June 30, 2008, we have the 2005 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan, the Directors Stock Plan and the Long-Term Performance Plan (“Stock-Based Compensation Plans”). As of May 17, 2005, no new grants will be made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan.

As of June 30, 2008, the maximum number of new shares of common stock that were available for grant under the 2005 Stock Incentive Plan and the 2005 Directors Stock Plan was 16.5 million.

The compensation cost that was charged against income for the Stock-Based Compensation Plans is as follows:

	For the six months ended June 30,	
	2008	2007
	(in millions)	
Compensation cost	\$ 27.4	\$ 34.0
Related income tax benefit	9.0	11.0
Capitalized as part of an asset	2.6	2.1

**Nonqualified Stock Options**

Nonqualified stock options were granted to certain employees under the 2005 Stock Incentive Plan. Total options granted were 1.6 million for the six months ended June 30, 2008. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 1.5 percent, a weighted-average expected volatility of 25.3 percent, a weighted-average risk-free interest rate of 3.1 percent and a weighted-average expected term of 6 years. The weighted-average estimated fair value of stock options granted during the six months ended June 30, 2008, was \$15.47 per share.

As of June 30, 2008, there were \$21.6 million of total unrecognized compensation costs related to nonvested stock options. The costs are expected to be recognized over a weighted-average service period of approximately 2.0 years.

**Performance Share Awards**

Performance share awards were granted to certain employees under the 2005 Stock Incentive Plan. Total performance share awards granted were 0.3 million for the six months ended June 30, 2008. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance objectives to be determined at the end of the respective performance period. The actual number of shares to be awarded at the end of each performance period will range between 0% and 200% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was \$59.99 per common share.

As of June 30, 2008, there were \$9.2 million of total unrecognized compensation costs related to nonvested performance share awards granted. The costs are expected to be recognized over a weighted-average service period of approximately 1.2 years.

**Restricted Stock Units**

Restricted stock units were issued to certain employees and agents pursuant to the 2005 Stock Incentive Plan. Total restricted stock units granted were 0.8 million for the six months ended June 30, 2008. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was \$59.79 per common share.

As of June 30, 2008, there were \$41.9 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted. The costs are expected to be recognized over a weighted-average period of approximately 2.4 years.

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**8. Stock-Based Compensation Plans (continued)**

**Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan, employees purchased 0.4 million shares for the six months ended June 30, 2008. The weighted-average fair value of the discount on the stock purchased was \$7.42 per share.

The maximum number of shares of common stock that we may issue under the Employee Stock Purchase Plan is 2% of the number of shares outstanding immediately following the completion of the Initial Public Offering. As of June 30, 2008, a total of 2.3 million of new shares are available to be made issuable by us for this plan.

**9. Earnings Per Common Share**

The computations of the basic and diluted per share amounts for our continuing operations were as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions, except per share data)			
Income from continuing operations, net of related income taxes	\$ 176.6	\$ 312.3	\$ 359.0	\$ 577.6
Subtract:				
Preferred stock dividends	8.3	8.3	16.5	16.5
Income from continuing operations available to common stockholders, net of related income taxes	\$ 168.3	\$ 304.0	\$ 342.5	\$ 561.1
Weighted-average shares outstanding				
Basic	259.1	267.7	259.2	267.9
Dilutive effects:				
Stock options	1.8	2.3	1.7	2.3
Restricted stock units	0.3	0.3	0.3	0.4
Diluted	261.2	270.3	261.2	270.6
Income from continuing operations per common share:				
Basic	\$ 0.65	\$ 1.14	\$ 1.32	\$ 2.09
Diluted	\$ 0.64	\$ 1.12	\$ 1.31	\$ 2.07

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information**

Principal Life has established special purpose entities to issue secured medium-term notes. Under the program, the payment obligations of principal and interest on the notes are secured by funding agreements issued by Principal Life. Principal Life's payment obligations on the funding agreements are fully and unconditionally guaranteed by PFG. All of the outstanding stock of Principal Life is indirectly owned by PFG and PFG is the only guarantor of the payment obligations of the funding agreements.

The following tables set forth condensed consolidating financial information of Principal Life and PFG as of June 30, 2008, and December 31, 2007, and for the six months ended June 30, 2008 and 2007.

10. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position  
June 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$ —	\$ 42,133.2	\$ 5,347.1	\$ (619.4)	\$ 46,860.9
Fixed maturities, trading	—	730.9	176.5	¾	907.4
Equity securities, available-for-sale	—	255.4	6.2	¾	261.6
Equity securities, trading	—	—	265.5	¾	265.5
Mortgage loans	—	10,443.9	2,662.4	(333.2)	12,773.1
Real estate	—	20.0	868.7	—	888.7
Policy loans	—	859.2	16.4	—	875.6
Investment in unconsolidated entities	7,238.7	928.0	2,867.8	(10,522.2)	512.3
Other investments	—	3,672.7	609.8	(2,498.7)	1,783.8
Cash and cash equivalents	(22.1)	976.4	576.5	(6.3)	1,524.5
Accrued investment income	—	692.1	58.1	(6.2)	744.0
Premiums due and other receivables	¾	727.6	172.1	(7.6)	892.1
Deferred policy acquisition costs	—	3,128.9	215.2	—	3,344.1
Property and equipment	—	430.6	60.3	—	490.9
Goodwill	—	96.7	288.4	—	385.1
Other intangibles	—	37.0	958.7	—	995.7
Separate account assets	—	70,533.4	4,993.9	—	75,527.3
Other assets	7.0	1,621.0	431.9	434.4	2,494.3
Total assets	\$ 7,223.6	\$ 137,287.0	\$ 20,575.5	\$ (13,559.2)	\$ 151,526.9
<b>Liabilities</b>					
Contractholder funds	\$ —	\$ 43,147.3	\$ 22.8	\$ (228.0)	\$ 42,942.1
Future policy benefits and claims	—	15,794.0	2,904.1	(7.6)	18,690.5
Other policyholder funds	—	528.2	18.7	—	546.9
Short-term debt	—	—	215.1	—	215.1
Long-term debt	601.8	99.5	1,291.4	(608.7)	1,384.0
Income taxes currently payable (receivable)	(9.5)	(371.3)	43.2	390.4	52.8
Deferred income taxes	(7.8)	(272.4)	310.5	134.7	165.0
Separate account liabilities	—	70,533.4	4,993.9	¾	75,527.3
Other liabilities	19.2	2,111.6	3,537.1	(284.6)	5,383.3
Total liabilities	603.7	131,570.3	13,336.8	(603.8)	144,907.0
<b>Stockholders' equity</b>					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.9	2.5	—	(2.5)	3.9
Additional paid-in capital	8,350.4	5,616.4	7,785.4	(13,401.8)	8,350.4
Retained earnings	3,757.7	1,078.6	218.1	(1,296.7)	3,757.7
Accumulated other comprehensive loss	(773.9)	(980.8)	(764.8)	1,745.6	(773.9)
Treasury stock, at cost	(4,718.3)	—	—	—	(4,718.3)
Total stockholders' equity	6,619.9	5,716.7	7,238.7	(12,955.4)	6,619.9
Total liabilities and stockholders' equity	\$ 7,223.6	\$ 137,287.0	\$ 20,575.5	\$ (13,559.2)	\$ 151,526.9

Principal Financial Group, Inc.  
Notes to Consolidated Financial Statements (continued)  
June 30, 2008  
(Unaudited)

10. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position  
December 31, 2007

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$ —	\$ 42,178.6	\$ 5,288.6	\$ (728.3)	\$ 46,738.9
Fixed maturities, trading	—	267.4	261.9	—	529.3
Equity securities, available-for-sale	—	305.0	11.4	—	316.4



Equity securities, trading	—	—	269.8	—	269.8
Mortgage loans	—	10,284.2	2,693.1	(317.7)	12,659.6
Real estate	—	10.9	851.6	—	862.5
Policy loans	—	853.7	16.2	—	869.9
Investment in unconsolidated entities	8,031.2	703.1	3,861.1	(12,104.7)	490.7
Other investments	—	3,559.5	464.7	(2,396.3)	1,627.9
Cash and cash equivalents	(3.2)	927.8	536.4	(116.6)	1,344.4
Accrued investment income	—	722.9	59.2	(8.0)	774.1
Premiums due and other receivables	0.9	696.8	267.2	(13.7)	951.2
Deferred policy acquisition costs	—	2,626.7	183.4	—	2,810.1
Property and equipment	—	421.6	47.4	—	469.0
Goodwill	—	94.6	280.1	—	374.7
Other intangibles	—	38.3	968.6	—	1,006.9
Separate account assets	—	75,743.3	4,743.5	—	80,486.8
Other assets	6.3	1,371.2	395.3	165.2	1,938.0
Total assets	\$ 8,035.2	\$ 140,805.6	\$ 21,199.5	\$ (15,520.1)	\$ 154,520.2
<b>Liabilities</b>					
Contractholder funds	\$ —	\$ 40,511.7	\$ 21.4	\$ (244.2)	\$ 40,288.9
Future policy benefits and claims	—	15,626.4	2,834.2	(5.9)	18,454.7
Other policyholder funds	—	526.0	14.5	—	540.5
Short-term debt	—	—	371.9	(81.1)	290.8
Long-term debt	601.8	99.5	1,320.8	(623.3)	1,398.8
Income taxes currently payable (receivable)	(7.0)	(255.0)	38.9	264.7	41.6
Deferred income taxes	(6.2)	253.1	340.3	(10.9)	576.3
Separate account liabilities	—	75,743.3	4,743.5	—	80,486.8
Other liabilities	24.9	1,823.9	3,482.8	(311.5)	5,020.1
Total liabilities	613.5	134,328.9	13,168.3	(1,012.2)	147,098.5
<b>Stockholders' equity</b>					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.9	2.5	—	(2.5)	3.9
Additional paid-in capital	8,295.4	5,595.9	7,760.7	(13,356.6)	8,295.4
Retained earnings (deficit)	3,414.3	760.8	(156.7)	(604.1)	3,414.3
Accumulated other comprehensive income	420.2	117.5	427.2	(544.7)	420.2
Treasury stock, at cost	(4,712.2)	—	—	—	(4,712.2)
Total stockholders' equity	7,421.7	6,476.7	8,031.2	(14,507.9)	7,421.7
Total liabilities and stockholders' equity	\$ 8,035.2	\$ 140,805.6	\$ 21,199.5	\$ (15,520.1)	\$ 154,520.2

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2008**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$ —	\$ 2,014.5	\$ 194.7	\$ —	\$ 2,209.2
Fees and other revenues	—	743.0	717.9	(225.0)	1,235.9
Net investment income (loss)	(0.1)	1,621.3	323.5	6.6	1,951.3
Net realized/unrealized capital gains (losses)	—	(293.9)	24.5	31.9	(237.5)
Total revenues	(0.1)	4,084.9	1,260.6	(186.5)	5,158.9
<b>Expenses</b>					
Benefits, claims and settlement expenses	—	2,804.2	309.8	(8.0)	3,106.0
Dividends to policyholders	—	139.8	—	—	139.8
Operating expenses	25.9	991.1	673.3	(195.2)	1,495.1
Total expenses	25.9	3,935.1	983.1	(203.2)	4,740.9
Income (loss) from continuing operations before income taxes	(26.0)	149.8	277.5	16.7	418.0
Income taxes (benefits)	(11.1)	14.4	58.2	(2.5)	59.0
Equity in the net income of subsidiaries	373.9	181.5	154.6	(710.0)	—

Net income	359.0	316.9	373.9	(690.8)	359.0
Preferred stock dividends	16.5	—	—	—	16.5
Net income available to common stockholders	<u>\$ 342.5</u>	<u>\$ 316.9</u>	<u>\$ 373.9</u>	<u>\$ (690.8)</u>	<u>\$ 342.5</u>

27

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2007**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$ —	\$ 2,168.4	\$ 116.2	\$ —	\$ 2,284.6
Fees and other revenues	—	722.2	688.9	(195.7)	1,215.4
Net investment income	4.5	1,627.0	251.6	16.7	1,899.8
Net realized/unrealized capital gains	—	21.7	69.1	2.2	93.0
Total revenues	4.5	4,539.3	1,125.8	(176.8)	5,492.8
<b>Expenses</b>					
Benefits, claims and settlement expenses	—	2,888.9	201.5	(7.7)	3,082.7
Dividends to policyholders	—	148.0	—	—	148.0
Operating expenses	24.9	1,014.9	647.7	(172.4)	1,515.1
Total expenses	24.9	4,051.8	849.2	(180.1)	4,745.8
Income (loss) from continuing operations before income taxes	(20.4)	487.5	276.6	3.3	747.0
Income taxes (benefits)	(8.2)	117.3	60.2	0.1	169.4
Equity in the net income of subsidiaries, excluding discontinued operations	589.8	157.0	373.3	(1,120.1)	—
Income from continuing operations, net of related income taxes	577.6	527.2	589.7	(1,116.9)	577.6
Loss from discontinued operations, net of related income taxes	(0.2)	—	(0.1)	0.1	(0.2)
Net income	577.4	527.2	589.6	(1,116.8)	577.4
Preferred stock dividends	16.5	—	—	—	16.5
Net income available to common stockholders	<u>\$ 560.9</u>	<u>\$ 527.2</u>	<u>\$ 589.6</u>	<u>\$ (1,116.8)</u>	<u>\$ 560.9</u>

28

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Cash Flows**  
**For the six months ended June 30, 2008**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (25.9)	\$ 856.4	\$ 149.3	\$ 93.3	\$ 1,073.1
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases	—	(3,837.0)	(475.7)	(47.7)	(4,360.4)
Sales	—	317.7	116.5	—	434.2
Maturities	—	1,665.1	134.3	—	1,799.4

Mortgage loans acquired or originated	—	(708.3)	(110.2)	65.1	(753.4)
Mortgage loans sold or repaid	—	533.9	129.4	(49.5)	613.8
Real estate acquired	—	(0.2)	(11.0)	—	(11.2)
Real estate sold	—	—	46.0	—	46.0
Net purchases of property and equipment	(0.1)	(39.9)	(9.5)	—	(49.5)
Purchases of interests in subsidiaries, net of cash acquired	—	—	(20.3)	—	(20.3)
Dividends received from unconsolidated entities	6.1	40.3	7.3	(53.7)	—
Net change in other investments	$\frac{3}{4}$	(53.2)	(5.3)	33.2	(25.3)
Net cash provided by (used in) investing activities	6.0	(2,081.6)	(198.5)	(52.6)	(2,326.7)
<b>Financing activities</b>					
Issuance of common stock	23.6	—	—	—	23.6
Acquisition of treasury stock	(6.1)	—	—	—	(6.1)
Proceeds from financing element derivatives	—	83.3	—	—	83.3
Payments for financing element derivatives	—	(61.1)	—	—	(61.1)
Excess tax benefits from share-based payment arrangements	—	1.2	1.6	—	2.8
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	—	15.7	(12.6)	3.1
Principal repayments of long-term debt	—	—	(39.8)	27.1	(12.7)
Net repayments of short-term borrowings	—	—	(74.1)	1.4	(72.7)
Dividends paid to parent	—	(7.3)	(46.4)	53.7	—
Investment contract deposits	—	6,792.5	—	—	6,792.5
Investment contract withdrawals	—	(5,531.7)	—	—	(5,531.7)
Net increase in banking operation deposits	—	—	232.3	—	232.3
Other	—	(3.1)	—	—	(3.1)
Net cash provided by financing activities	1.0	1,273.8	89.3	69.6	1,433.7
Net increase (decrease) in cash and cash equivalents	(18.9)	48.6	40.1	110.3	180.1
Cash and cash equivalents at beginning of period	(3.2)	927.8	536.4	(116.6)	1,344.4
Cash and cash equivalents at end of period	<u><u>\$ (22.1)</u></u>	<u><u>\$ 976.4</u></u>	<u><u>\$ 576.5</u></u>	<u><u>\$ (6.3)</u></u>	<u><u>\$ 1,524.5</u></u>

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Cash Flows**  
**For the six months ended June 30, 2007**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (16.8)	\$ 1,479.9	\$ 684.6	\$ (227.2)	\$ 1,920.5
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases	—	(4,601.8)	(512.8)	47.4	(5,067.2)
Sales	—	2,144.7	120.8	—	2,265.5
Maturities	—	2,179.9	176.8	—	2,356.7
Mortgage loans acquired or originated	—	(1,167.0)	(214.5)	44.7	(1,336.8)
Mortgage loans sold or repaid	—	779.1	105.8	(22.5)	862.4
Real estate acquired	—	(48.6)	(12.2)	—	(60.8)
Real estate sold	—	4.5	1.2	—	5.7
Net purchases of property and equipment	—	(26.3)	(19.8)	—	(46.1)
Dividends received from (contributions to) unconsolidated entities	256.3	(70.9)	456.3	(641.7)	—
Net change in other investments	$\frac{3}{4}$	(82.1)	(71.9)	137.1	(16.9)
Net cash provided by (used in) investing activities	256.3	(888.5)	29.7	(435.0)	(1,037.5)
<b>Financing activities</b>					
Issuance of common stock	38.5	—	—	—	38.5
Acquisition of treasury stock	(224.0)	—	—	—	(224.0)
Proceeds from financing element derivatives	—	76.2	—	—	76.2
Payments for financing element derivatives	—	(69.1)	—	—	(69.1)
Excess tax benefits from share-based payment	—	4.2	1.9	—	6.1

arrangements					
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	14.6	90.7	(97.0)	8.3
Principal repayments of long-term debt	—	—	(30.3)	8.0	(22.3)
Net repayments of short-term borrowings	—	—	(57.9)	31.8	(26.1)
Dividends paid to parent	—	(456.3)	(185.4)	641.7	—
Investment contract deposits	—	4,015.3	—	—	4,015.3
Investment contract withdrawals	—	(4,510.4)	—	—	(4,510.4)
Net increase in banking operation deposits	—	—	108.2	—	108.2
Net cash used in financing activities	(202.0)	(925.5)	(72.8)	584.5	(615.8)
<b>Discontinued operations</b>					
Net cash provided by operating activities	—	—	1.2	0.2	1.4
Net cash used in investing activities	—	—	(1.1)	—	(1.1)
Net cash used in financing activities	¾	¾	(0.3)	—	(0.3)
Net cash provided by (used in) discontinued operations	—	—	(0.2)	0.2	—
Net increase (decrease) in cash and cash equivalents	37.5	(334.1)	641.3	(77.5)	267.2
Cash and cash equivalents at beginning of period	30.9	1,399.8	261.1	(101.0)	1,590.8
Cash and cash equivalents at end of period	\$ 68.4	\$ 1,065.7	\$ 902.4	\$ (178.5)	\$ 1,858.0
<b>Cash and cash equivalents of discontinued operations included above</b>					
At beginning of period	\$ —	\$ —	\$ (0.7)	\$ —	\$ (0.7)
At end of period	\$ —	\$ —	\$ (0.7)	\$ —	\$ (0.7)

30

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

On June 11, 2008, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2004, as it was scheduled to expire in the fourth quarter of 2008. Under our current shelf registration, we have the ability to issue unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration statement.

The following tables set forth condensed consolidating financial information of PFS and PFG as of June 30, 2008, and December 31, 2007, and for the six months ended June 30, 2008, and 2007.

**Condensed Consolidating Statements of Financial Position**  
**June 30, 2008**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$ —	\$ —	\$ 46,860.9	\$ —	\$ 46,860.9
Fixed maturities, trading	—	—	907.4	—	907.4
Equity securities, available-for-sale	—	—	261.6	—	261.6
Equity securities, trading	—	—	265.5	—	265.5
Mortgage loans	—	—	12,773.1	—	12,773.1
Real estate	—	—	888.7	—	888.7
Policy loans	—	—	875.6	—	875.6
Investment in unconsolidated entities	7,238.7	7,858.7	512.1	(15,097.2)	512.3
Other investments	—	41.3	1,751.9	(9.4)	1,783.8
Cash and cash equivalents	(22.1)	290.9	1,827.1	(571.4)	1,524.5
Accrued investment income	—	—	744.0	—	744.0
Premiums due and other receivables	¾	1.7	903.6	(13.2)	892.1
Deferred policy acquisition costs	—	—	3,344.1	—	3,344.1
Property and equipment	—	—	490.9	—	490.9
Goodwill	—	—	385.1	—	385.1
Other intangibles	—	—	995.7	—	995.7
Separate account assets	—	—	75,527.3	—	75,527.3
Other assets	7.0	9.9	2,438.6	38.8	2,494.3
Total assets	\$ 7,223.6	\$ 8,202.5	\$ 151,753.2	\$ (15,652.4)	\$ 151,526.9

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Financial Position (continued)**  
**June 30, 2008**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Liabilities</b>					
Contractholder funds	\$ —	\$ —	\$ 42,942.1	\$ —	\$ 42,942.1
Future policy benefits and claims	—	—	18,690.5	—	18,690.5
Other policyholder funds	—	—	546.9	—	546.9
Short-term debt	—	159.9	336.3	(281.1)	215.1
Long-term debt	601.8	454.8	327.4	—	1,384.0
Income taxes currently payable (receivable)	(9.5)	(5.9)	16.8	51.4	52.8
Deferred income taxes	(7.8)	4.9	177.4	(9.5)	165.0
Separate account liabilities	—	—	75,527.3	—	75,527.3
Other liabilities	19.2	350.1	5,329.8	(315.8)	5,383.3
Total liabilities	<u>603.7</u>	<u>963.8</u>	<u>143,894.5</u>	<u>(555.0)</u>	<u>144,907.0</u>
<b>Stockholders' equity</b>					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.9	—	17.8	(17.8)	3.9
Additional paid-in capital	8,350.4	7,785.4	7,153.6	(14,939.0)	8,350.4
Retained earnings	3,757.7	218.1	1,438.3	(1,656.4)	3,757.7
Accumulated other comprehensive loss	(773.9)	(764.8)	(749.0)	1,513.8	(773.9)
Treasury stock, at cost	(4,718.3)	—	(2.0)	2.0	(4,718.3)
Total stockholders' equity	<u>6,619.9</u>	<u>7,238.7</u>	<u>7,858.7</u>	<u>(15,097.4)</u>	<u>6,619.9</u>
Total liabilities and stockholders' equity	<u>\$ 7,223.6</u>	<u>\$ 8,202.5</u>	<u>\$ 151,753.2</u>	<u>\$ (15,652.4)</u>	<u>\$ 151,526.9</u>

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Financial Position**  
**December 31, 2007**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$ —	\$ —	\$ 46,738.9	\$ —	\$ 46,738.9
Fixed maturities, trading	—	—	529.3	—	529.3
Equity securities, available-for-sale	—	—	316.4	—	316.4
Equity securities, trading	—	—	269.8	—	269.8
Mortgage loans	—	—	12,659.6	—	12,659.6
Real estate	—	—	862.5	—	862.5
Policy loans	—	—	869.9	—	869.9
Investment in unconsolidated entities	8,031.2	8,713.7	490.7	(16,744.9)	490.7
Other investments	—	41.9	1,595.1	(9.1)	1,627.9
Cash and cash equivalents	(3.2)	349.1	1,665.1	(666.6)	1,344.4
Accrued investment income	—	—	774.1	—	774.1
Premiums due and other receivables	0.9	7.7	951.8	(9.2)	951.2
Deferred policy acquisition costs	—	—	2,810.1	—	2,810.1

Property and equipment	—	—	469.0	—	469.0
Goodwill	—	—	374.7	—	374.7
Other intangibles	—	—	1,006.9	—	1,006.9
Separate account assets	—	—	80,486.8	—	80,486.8
Other assets	6.3	9.0	1,897.5	25.2	1,938.0
Total assets	<u>\$ 8,035.2</u>	<u>\$ 9,121.4</u>	<u>\$ 154,768.2</u>	<u>\$ (17,404.6)</u>	<u>\$ 154,520.2</u>
<b>Liabilities</b>					
Contractholder funds	\$ —	\$ —	\$ 40,288.9	\$ —	\$ 40,288.9
Future policy benefits and claims	—	—	18,454.7	—	18,454.7
Other policyholder funds	—	—	540.5	—	540.5
Short-term debt	—	233.2	402.1	(344.5)	290.8
Long-term debt	601.8	454.7	342.3	—	1,398.8
Income taxes currently payable (receivable)	(7.0)	(2.4)	12.2	38.8	41.6
Deferred income taxes	(6.2)	17.0	576.3	(10.8)	576.3
Separate account liabilities	—	—	80,486.8	—	80,486.8
Other liabilities	24.9	387.7	4,950.7	(343.2)	5,020.1
Total liabilities	<u>613.5</u>	<u>1,090.2</u>	<u>146,054.5</u>	<u>(659.7)</u>	<u>147,098.5</u>
<b>Stockholders' equity</b>					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.9	—	17.8	(17.8)	3.9
Additional paid-in capital	8,295.4	7,760.7	7,125.6	(14,886.3)	8,295.4
Retained earnings (deficit)	3,414.3	(156.7)	1,135.0	(978.3)	3,414.3
Accumulated other comprehensive income	420.2	427.2	437.3	(864.5)	420.2
Treasury stock, at cost	(4,712.2)	—	(2.0)	2.0	(4,712.2)
Total stockholders' equity	<u>7,421.7</u>	<u>8,031.2</u>	<u>8,713.7</u>	<u>(16,744.9)</u>	<u>7,421.7</u>
Total liabilities and stockholders' equity	<u>\$ 8,035.2</u>	<u>\$ 9,121.4</u>	<u>\$ 154,768.2</u>	<u>\$ (17,404.6)</u>	<u>\$ 154,520.2</u>

33

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Operations**  
**For the six months ended June 30, 2008**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$ —	\$ —	\$ 2,209.2	\$ —	\$ 2,209.2
Fees and other revenues	—	0.1	1,243.1	(7.3)	1,235.9
Net investment income (loss)	(0.1)	(2.0)	1,953.4	—	1,951.3
Net realized/unrealized capital losses	—	(0.5)	(236.9)	(0.1)	(237.5)
Total revenues	<u>(0.1)</u>	<u>(2.4)</u>	<u>5,168.8</u>	<u>(7.4)</u>	<u>5,158.9</u>
<b>Expenses</b>					
Benefits, claims and settlement expenses	—	—	3,106.0	—	3,106.0
Dividends to policyholders	—	—	139.8	—	139.8
Operating expenses	25.9	21.9	1,454.7	(7.4)	1,495.1
Total expenses	<u>25.9</u>	<u>21.9</u>	<u>4,700.5</u>	<u>(7.4)</u>	<u>4,740.9</u>
Income (loss) from continuing operations before income taxes	(26.0)	(24.3)	468.3	—	418.0
Income taxes (benefits)	(11.1)	(23.7)	93.8	—	59.0
Equity in the net income of subsidiaries	373.9	374.5	—	(748.4)	—
Net income	<u>359.0</u>	<u>373.9</u>	<u>374.5</u>	<u>(748.4)</u>	<u>359.0</u>
Preferred stock dividends	16.5	—	—	—	16.5
Net income available to common stockholders	<u>\$ 342.5</u>	<u>\$ 373.9</u>	<u>\$ 374.5</u>	<u>\$ (748.4)</u>	<u>\$ 342.5</u>

34

10. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations  
For the six months ended June 30, 2007

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$ —	\$ —	\$ 2,284.6	\$ —	\$ 2,284.6
Fees and other revenues	—	—	1,221.0	(5.6)	1,215.4
Net investment income (loss)	4.5	(0.4)	1,895.5	0.2	1,899.8
Net realized/unrealized capital gains	—	1.8	91.2	—	93.0
Total revenues	4.5	1.4	5,492.3	(5.4)	5,492.8
<b>Expenses</b>					
Benefits, claims and settlement expenses	—	—	3,082.7	—	3,082.7
Dividends to policyholders	—	—	148.0	—	148.0
Operating expenses	24.9	19.9	1,475.7	(5.4)	1,515.1
Total expenses	24.9	19.9	4,706.4	(5.4)	4,745.8
Income (loss) from continuing operations before income taxes	(20.4)	(18.5)	785.9	—	747.0
Income taxes (benefits)	(8.2)	(5.7)	183.3	—	169.4
Equity in the net income of subsidiaries, excluding discontinued operations	589.8	602.6	—	(1,192.4)	—
Income from continuing operations, net of related income taxes	577.6	589.8	602.6	(1,192.4)	577.6
Loss from discontinued operations, net of related income taxes	(0.2)	(0.2)	(0.2)	0.4	(0.2)
Net income	577.4	589.6	602.4	(1,192.0)	577.4
Preferred stock dividends	16.5	—	—	—	16.5
Net income available to common stockholders	\$ 560.9	\$ 589.6	\$ 602.4	\$ (1,192.0)	\$ 560.9

Principal Financial Group, Inc.  
Notes to Consolidated Financial Statements (continued)  
June 30, 2008  
(Unaudited)

10. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows  
For the six months ended June 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (25.9)	\$ (51.0)	\$ 1,097.8	\$ 52.2	\$ 1,073.1
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases	—	—	(4,360.4)	—	(4,360.4)
Sales	—	—	434.2	—	434.2
Maturities	—	—	1,799.4	—	1,799.4
Mortgage loans acquired or originated	—	—	(753.4)	—	(753.4)
Mortgage loans sold or repaid	—	—	613.8	—	613.8
Real estate acquired	—	—	(11.2)	—	(11.2)
Real estate sold	—	—	46.0	—	46.0
Net purchases of property and equipment	(0.1)	—	(49.4)	—	(49.5)
Purchases of interests in subsidiaries, net of cash acquired	—	(2.3)	(18.0)	—	(20.3)
Dividends received from unconsolidated entities	6.1	54.1	—	(60.2)	—
Net change in other investments	¾	20.7	(25.6)	(20.4)	(25.3)
Net cash provided by (used in) investing activities	6.0	72.5	(2,324.6)	(80.6)	(2,326.7)

<b>Financing activities</b>					
Issuance of common stock	23.6	—	—	—	23.6
Acquisition of treasury stock	(6.1)	—	—	—	(6.1)
Proceeds from financing element derivatives	—	—	83.3	—	83.3
Payments for financing element derivatives	—	—	(61.1)	—	(61.1)
Excess tax benefits from share-based payment arrangements	—	—	2.8	—	2.8
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	—	3.1	—	3.1
Principal repayments of long-term debt	—	—	(12.7)	—	(12.7)
Net repayments of short-term borrowings	—	(73.6)	(62.5)	63.4	(72.7)
Dividends paid to parent	—	(6.1)	(54.1)	60.2	—
Investment contract deposits	—	—	6,792.5	—	6,792.5
Investment contract withdrawals	—	—	(5,531.7)	—	(5,531.7)
Net increase in banking operation deposits	—	—	232.3	—	232.3
Other	—	—	(3.1)	—	(3.1)
Net cash provided by (used in) financing activities	<u>1.0</u>	<u>(79.7)</u>	<u>1,388.8</u>	<u>123.6</u>	<u>1,433.7</u>
Net increase (decrease) in cash and cash equivalents	(18.9)	(58.2)	162.0	95.2	180.1
Cash and cash equivalents at beginning of period	(3.2)	349.1	1,665.1	(666.6)	1,344.4
Cash and cash equivalents at end of period	<u>\$ (22.1)</u>	<u>\$ 290.9</u>	<u>\$ 1,827.1</u>	<u>\$ (571.4)</u>	<u>\$ 1,524.5</u>

36

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements (continued)**  
**June 30, 2008**  
**(Unaudited)**

**10. Condensed Consolidating Financial Information (continued)**

**Condensed Consolidating Statements of Cash Flows**  
**For the six months ended June 30, 2007**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (16.8)	\$ 544.4	\$ 1,612.4	\$ (219.5)	\$ 1,920.5
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases	—	(0.2)	(5,067.0)	—	(5,067.2)
Sales	—	13.4	2,252.1	—	2,265.5
Maturities	—	—	2,356.7	—	2,356.7
Mortgage loans acquired or originated	—	—	(1,336.8)	—	(1,336.8)
Mortgage loans sold or repaid	—	—	862.4	—	862.4
Real estate acquired	—	—	(60.8)	—	(60.8)
Real estate sold	—	—	5.7	—	5.7
Net purchases of property and equipment	—	—	(46.1)	—	(46.1)
Dividends received from unconsolidated entities	256.3	407.0	—	(663.3)	—
Net change in other investments	<sup>¾</sup>	(1.8)	(3.2)	(11.9)	(16.9)
Net cash provided by (used in) investing activities	<u>256.3</u>	<u>418.4</u>	<u>(1,037.0)</u>	<u>(675.2)</u>	<u>(1,037.5)</u>
<b>Financing activities</b>					
Issuance of common stock	38.5	—	—	—	38.5
Acquisition of treasury stock	(224.0)	—	—	—	(224.0)
Proceeds from financing element derivatives	—	—	76.2	—	76.2
Payments for financing element derivatives	—	—	(69.1)	—	(69.1)
Excess tax benefits from share-based payment arrangements	—	—	6.1	—	6.1
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	—	8.3	—	8.3
Principal repayments of long-term debt	—	—	(22.3)	—	(22.3)
Net repayments of short-term borrowings	—	—	(18.4)	(7.7)	(26.1)
Dividends paid to parent	—	(256.3)	(407.0)	663.3	—
Investment contract deposits	—	—	4,015.3	—	4,015.3
Investment contract withdrawals	—	—	(4,510.4)	—	(4,510.4)
Net increase in banking operation deposits	—	—	108.2	—	108.2
Net cash used in financing activities	<u>(202.0)</u>	<u>(256.3)</u>	<u>(813.1)</u>	<u>655.6</u>	<u>(615.8)</u>
<b>Discontinued operations</b>					
Net cash provided by operating activities	—	—	1.4	—	1.4



Net cash used in investing activities	—	—	(1.1)	—	(1.1)
Net cash used in financing activities	—	—	(0.3)	—	(0.3)
Net cash provided by discontinued operations	—	—	—	—	—
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>37.5</b>	<b>706.5</b>	<b>(237.7)</b>	<b>(239.1)</b>	<b>267.2</b>
Cash and cash equivalents at beginning of period	30.9	129.2	2,031.3	(600.6)	1,590.8
Cash and cash equivalents at end of period	\$ 68.4	\$ 835.7	\$ 1,793.6	\$ (839.7)	\$ 1,858.0
<b>Cash and cash equivalents of discontinued operations included above</b>					
At beginning of period	\$ —	\$ —	\$ (0.7)	\$ —	\$ (0.7)
At end of period	\$ —	\$ —	\$ (0.7)	\$ —	\$ (0.7)

37

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of June 30, 2008, compared with December 31, 2007, and our consolidated results of operations for the three and six months ended June 30, 2008 and 2007, prepared in conformity with U.S. GAAP. The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2007, filed with the SEC and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

### Forward-Looking Information

Our narrative analysis below contains forward-looking statements intended to enhance the reader's ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as "anticipate," "believe," "plan," "estimate," "expect," "intend" and similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties including, but not limited to the following: (1) declining or increasing volatility in the securities markets could result in investors withdrawing from the markets or decreasing their rates of investment, either of which could reduce our net income, revenues and assets under management ("AUM"); (2) our investment portfolio is subject to several risks which may diminish the value of our invested assets and the investment returns credited to customers, which could reduce our sales, revenues, AUM and net income; (3) competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability; (4) a downgrade in our financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors, impact existing liabilities and increase our cost of capital, any of which could adversely affect our profitability and financial condition; (5) unforeseen increases in cash outflows may negatively impact our liquidity; (6) our efforts to reduce the impact of interest rate changes on our profitability and retained earnings may not be effective; (7) if we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced; (8) our international businesses face political, legal and other risks that could reduce our profitability in those businesses; (9) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (10) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life; (11) the pattern of amortizing our DPAC and other actuarial balances on our investment contract, participating life insurance and universal life-type products may change, impacting both the level of the asset and the timing of our net income; (12) we may need to fund deficiencies in our closed block assets; (13) a pandemic, terrorist attack or other catastrophic event could adversely affect our net income; (14) our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and profitability; (15) we face risks arising from acquisitions of businesses; (16) changes in laws, regulations or accounting standards may reduce our profitability; (17) a computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our earnings; (18) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (19) fluctuations in foreign currency exchange rates could reduce our profitability; (20) applicable laws and our stockholder rights plan, certificate of incorporation and by-laws may discourage takeovers and business combinations that our stockholders might consider in their best interests and (21) our financial results may be adversely impacted by global climate changes.

### Overview

We provide financial products and services through the following reportable segments:

- U.S. Asset Accumulation, which consists of our asset accumulation operations that provide retirement and related financial products and services. We provide a comprehensive portfolio of asset accumulation products and services to businesses and individuals in the U.S., with a concentration on small and medium-sized businesses. We offer to businesses products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, non-qualified executive benefit plans and employee stock ownership plan consulting services. We also offer annuities, mutual funds and bank products and services to the employees of our business customers and other individuals.

38

- Global Asset Management, which consists of our asset management operations conducted through Principal Global Investors and its affiliates. Global Asset Management offers an extensive range of equity, fixed income and real estate investments as well as specialized overlay and advisory services to institutional investors.

- International Asset Management and Accumulation, which consists of Principal International, offers retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products through operations in Brazil, Chile, China, Hong Kong, India, Malaysia and Mexico.
- Life and Health Insurance, which provides individual life insurance, group health insurance as well as specialty benefits in the U.S. Our individual life insurance products include universal and variable universal life insurance and traditional life insurance. Our health insurance products include group medical insurance and fee-for-service claims administration and wellness services. Our specialty benefits products include group dental and vision insurance, individual and group disability insurance and group life insurance.
- Corporate and Other, which manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate and Other segment primarily reflect our financing activities (including interest expense), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

## Transactions Affecting Comparability of Results of Operations

### Acquisitions

We acquired the following businesses, among others, during 2008 and 2007:

**Morley Financial Services, Inc.** On August 31, 2007, we acquired Morley Financial Services, Inc. (“Morley Financial Services”) from Nationwide Mutual Insurance Company, for \$75.0 million in cash. Morley Financial Services is a stable value asset manager with approximately \$14.0 billion in institutional AUM as of August 31, 2007. The operations of Morley Financial Services are reported and consolidated in our Global Asset Management segment.

### Dispositions

We entered into disposition agreements or disposed of the following business, among others, during 2008 and 2007:

**Real Estate Investments.** In 2007, we sold a certain real estate property previously held for investment purposes. This property qualified for discontinued operations treatment. Therefore, the loss from the discontinued operations has been removed from our results of continuing operations for all periods presented. We have separately disclosed the operating, investing and financing portions of the cash flows attributable to the discontinued operations in our consolidated statements of cash flows.

Selected financial information for the discontinued operations is as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Total revenues	\$ —	\$ (0.2)	\$ —	\$ (0.3)
Loss from discontinued operations:				
Loss before income taxes	\$ —	\$ (0.2)	\$ —	\$ (0.3)
Income taxes	—	—	—	(0.1)
Net loss	\$ —	\$ (0.2)	\$ —	\$ (0.2)

### Other

**SBB Mutual Berhad and SBB Asset Management Sdn Bhd.** On February 5, 2007, we invested approximately U.S. \$55.1 million to retain our 40% ownership interest in CIMB-Principal, our joint venture company in Malaysia, as a result of its decision to purchase the mutual fund and asset management companies of the former Southern Bank Bhd (“SBB”) Mutual

Berhad and SBB Asset Management Sdn Bhd. The results of our SBB acquisition are reported in our International Asset Management and Accumulation segment.

## Fluctuations in Foreign Currency to U.S. Dollar Exchange Rates

Fluctuations in foreign currency to U.S. dollar exchange rates for countries in which we have operations can affect reported financial results. In years when foreign currencies weaken against the U.S. dollar, translating foreign currencies into U.S. dollars results in fewer U.S. dollars to be reported. When foreign currencies strengthen, translating foreign currencies into U.S. dollars results in more U.S. dollars to be reported.

Foreign currency exchange rate fluctuations create variances in our financial statement line items but have not had a material impact on our consolidated net income. Our consolidated net income was positively impacted by \$0.4 million and \$1.3 million for the three months ended June 30, 2008 and 2007, respectively, and positively impacted \$6.2 million and \$1.4 million for the six months ended June 30, 2008 and 2007, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. “Quantitative and Qualitative Disclosures About Market Risk.”

## Stock-Based Compensation Plans

For information related to our Stock-Based Compensation Plans, see Item 1. “Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Stock-Based Compensation Plans.”

## Defined Benefit Pension Expense

The 2008 annual pension benefit expense for substantially all of our employees and certain agents is expected to be \$12.3 million pre-tax, which is an \$11.7 million decrease from the 2007 pre-tax pension expense of \$24.0 million. This decrease is primarily due to the increase in discount rate and greater than estimated returns on plan assets. The expected long-term return on plan assets assumption remained at 8.25%. Approximately \$3.1 million and \$6.2 million of pre-tax pension expense were reflected in the determination of net income for the three and six months ended June 30, 2008, respectively. In addition, approximately \$3.1 million of pre-tax pension expense will be reflected in each of the following two quarters for 2008. The discount rate used to develop the 2008 expense was raised to 6.3%, up from the 6.15% discount rate used to develop the 2007 expense.

## Recent Accounting Pronouncements

For recent accounting changes, see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies."

40

## Results of Operations

The following table presents summary consolidated financial information for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
(in millions)						
<b>Revenues:</b>						
Premiums and other considerations	\$ 1,156.2	\$ 1,176.9	\$ (20.7)	\$ 2,209.2	\$ 2,284.6	\$ (75.4)
Fees and other revenues	622.5	622.9	(0.4)	1,235.9	1,215.4	20.5
Net investment income	991.0	976.6	14.4	1,951.3	1,899.8	51.5
Net realized/unrealized capital gains (losses)	(111.5)	55.4	(166.9)	(237.5)	93.0	(330.5)
Total revenues	2,658.2	2,831.8	(173.6)	5,158.9	5,492.8	(333.9)
<b>Expenses:</b>						
Benefits, claims and settlement expenses	1,634.0	1,584.7	49.3	3,106.0	3,082.7	23.3
Dividends to policyholders	69.0	74.0	(5.0)	139.8	148.0	(8.2)
Operating expenses	749.2	760.4	(11.2)	1,495.1	1,515.1	(20.0)
Total expenses	2,452.2	2,419.1	33.1	4,740.9	4,745.8	(4.9)
Income from continuing operations before income taxes	206.0	412.7	(206.7)	418.0	747.0	(329.0)
Income taxes	29.4	100.4	(71.0)	59.0	169.4	(110.4)
Income from continuing operations, net of related income taxes	176.6	312.3	(135.7)	359.0	577.6	(218.6)
Loss from discontinued operations, net of related income taxes	—	(0.2)	0.2	—	(0.2)	0.2
Net income	176.6	312.1	(135.5)	359.0	577.4	(218.4)
Preferred stock dividends	8.3	8.3	—	16.5	16.5	—
Net income available to common stockholders	\$ 168.3	\$ 303.8	\$ (135.5)	\$ 342.5	\$ 560.9	\$ (218.4)

### Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

#### Net Income Available to Common Stockholders

Net income available to common stockholders decreased primarily due to a \$105.4 million after-tax change in net realized/unrealized capital gains (losses). The change in net realized/unrealized capital gains (losses) was primarily driven by net losses in 2008 versus gains in 2007 for derivatives not in a hedge accounting relationship and higher other than temporary impairments of fixed maturity and equity securities.

#### Total Revenues

Premiums and other considerations decreased \$45.0 million for the Life and Health Insurance segment primarily due to a decline in covered medical members in our health insurance business. In addition, premiums decreased \$17.8 million for the U.S. Asset Accumulation segment, primarily resulting from a decrease in sales of full service payout annuities with life contingencies, which was partially offset by an increase in sales of individual payout annuities with life contingencies from certain distribution channels. Partially offsetting these decreases was a \$42.0 million increase from the International Asset Management and Accumulation segment, which was primarily due to higher sales of single premium annuities with life contingencies in Chile and a strengthening of the Chilean peso against the U.S. dollar.

Fees for the U.S. Asset Accumulation segment decreased primarily due to a decline in Principal Funds distribution and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets. This decrease was offset by an increase in fees for the Life and Health Insurance segment, which was primarily due to growth in the individual universal life and variable universal life insurance lines of business.

41

Net investment income increased primarily due to a \$3,613.5 million increase in average invested assets and cash. This increase was partially offset by a decrease in the average annualized yield on invested assets and cash. The average annualized yield on invested assets and cash was 6.0% for the three months ended June 30, 2008, compared to 6.2% for the three months ended June 30, 2007.

Net realized/unrealized capital gains (losses) can be volatile due to mark to market adjustments of certain invested assets, other than temporary impairments of invested assets and our decision to sell appreciated invested assets. Net realized/unrealized capital losses increased primarily due to mark to market losses on derivatives not in a hedge accounting relationship. For additional information, see "Investments — Investment Results."

### **Total Expenses**

Benefits, claims and settlement expenses increased \$82.7 million for the International Asset Management and Accumulation segment, primarily due to a higher change in reserves associated with increased sales of single premium annuities with life contingencies in Chile and the strengthening of the Chilean peso against the U.S. dollar. Partially offsetting this increase was a \$35.6 million decrease from the Life and Health Insurance segment, as a decrease in average covered medical members was partially offset by higher claim costs per member in our health insurance business.

Operating expenses decreased \$11.1 million for the U.S. Asset Accumulation segment primarily due to lower fees paid to advisors resulting from a decrease in average account values within Principal Funds. In addition, DPAC amortization expense decreased within our full service accumulation business primarily due to a change in DPAC assumptions reflected in late 2007.

### **Income Taxes**

The effective income tax rates were 14% and 24% for the three months ended June 30, 2008 and 2007, respectively. The effective income tax rate for the three months ended June 30, 2008, was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate and interest exclusion from taxable income. The effective income tax rate for the three months ended June 30, 2007, was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income. The effective income tax rate decreased to 14% from 24% for the three months ended June 30, 2008 and 2007, respectively, primarily due to additional U.S. foreign tax credits resulting from the aforementioned Brazilian tax rate increase. As we apply the equity method of accounting to our Brazilian operations, the increase in net deferred tax liabilities associated with the newly enacted rate is reflected in net investment income.

### ***Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007***

#### **Net Income Available to Common Stockholders**

Net income available to common stockholders decreased primarily due to a \$211.4 million after-tax change in net realized/unrealized capital gains (losses). The change in net realized/unrealized capital gains (losses) was primarily driven by net losses in 2008 versus gains in 2007 for derivatives not in a hedge accounting relationship and higher other than temporary impairments of fixed maturity and equity securities.

#### **Total Revenues**

Premiums and other considerations decreased \$82.4 million for the Life and Health Insurance segment primarily due to a decline in covered medical members in our health insurance business. In addition, premiums decreased \$29.7 million for the U.S. Asset Accumulation segment primarily due to a decrease in sales of full service payout annuities with life contingencies, which was partially offset by an increase in sales of individual payout annuities with life contingencies from certain distribution channels. Partially offsetting these decreases was a \$36.6 million increase from the International Asset Management and Accumulation segment primarily due to higher sales of single premium annuities with life contingencies in Chile and a strengthening of the Chilean peso against the U.S. dollar.

Fees for the Life and Health Insurance segment increased \$23.8 million primarily due to growth in the individual universal life and variable universal life insurance lines of business partially offset by a reclassification of the reimbursement of certain expenses from fee revenues to operating expenses for our health insurance business. In addition, Global Asset Management fees increased \$12.5 million resulting from growth in AUM in our fee mandate business offset by a decrease in fees from our spread and securitization business related to lower loan volumes in 2008 compared to 2007. Partially offsetting these increases was a \$15.7 million decrease from the U.S. Asset Accumulation segment primarily due to a decline in Principal Funds distribution and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets.

Net investment income increased primarily due to a \$3,807.7 million increase in average invested assets and cash. This increase was partially offset by a decrease in the average annualized yield on invested assets and cash. The average annualized yield on invested assets and cash was 5.9% for the six months ended June 30, 2008, compared to 6.1% for the six months ended June 30, 2007.

Net realized/unrealized capital gains (losses) can be volatile due to mark to market adjustments of certain invested assets, other than temporary impairments of invested assets and our decision to sell appreciated invested assets. Net realized/unrealized capital losses increased primarily due to mark to market losses on derivatives not in a hedge accounting relationship and higher other than temporary impairments, net of recoveries from sales, on fixed maturity and equity securities. For additional information, see "Investments — Investment Results."

### **Total Expenses**

Benefits, claims and settlement expenses increased \$108.5 million for the International Asset Management and Accumulation segment, primarily as a result of higher interest crediting rates to customers in Chile, a higher change in reserves due to increased sales of single premium annuities with life contingencies in Chile and the strengthening of the Chilean peso against the U.S. dollar. In addition, benefit expense for the U.S. Asset Accumulation segment increased \$27.1 million, primarily due to an increase in the change in reserves in our individual annuities business resulting from higher sales of our payout annuities with life contingencies and, to a lesser extent, an increase in cost of interest credited resulting from a growing block of fixed deferred annuities. Partially offsetting the increase in our U.S. Asset Accumulation segment was a decrease in the change in reserves in our full service payout business resulting from lower sales of payout annuities with life contingencies. The overall increase in benefit expense was also offset by a \$111.9 million decrease

from the Life and Health Insurance segment primarily due to a decrease in average covered medical members and favorable prior period claim development relative to the same period a year ago in our health insurance business.

Operating expenses decreased \$19.3 million for the Corporate and Other segment in part due to a decline in amounts credited to employee accounts in a nonqualified defined contribution plan, which was offset by a corresponding reduction in net realized capital gains related to the assets backing this nonqualified plan. The decline in operating expenses for the Corporate and Other segment was also due to a change in the estimated loss related to a prior year legal contingency. In addition, operating expenses decreased \$9.9 million for the U.S. Asset Accumulation segment primarily as a result of lower fees paid to advisors stemming from a decrease in average account values. Partially offsetting these decreases was a \$10.3 million increase in the Global Asset Management segment due to continued growth in staff and staff related costs resulting from continued growth in AUM and the acquisition of Morley Financial Services.

## Income Taxes

The effective income tax rates were 14% and 23% for the six months ended June 30, 2008 and 2007, respectively. The effective income tax rate for the six months ended June 30, 2008, was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate and the release of state deferred income tax liabilities associated with a reorganization of certain subsidiaries. The effective income tax rate for the six months ended June 30, 2007, was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and tax credits received on our investment in a synthetic fuel production facility. The effective income tax rate decreased to 14% from 23% for the six months ended June 30, 2008 and 2007, respectively, primarily due to additional U.S. foreign tax credits resulting from the aforementioned Brazilian tax rate increase and the release of state deferred income tax liabilities associated with a reorganization of certain subsidiaries. As we

43

apply the equity method of accounting to our Brazilian operations, the increase in net deferred tax liabilities associated with the newly enacted rate is reflected in net investment income.

## Results of Operations by Segment

For results of operations by segment see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Segment Information."

### U.S. Asset Accumulation Segment

#### U.S. Asset Accumulation Segment Summary Financial Data

Account values are a key indicator of earnings growth for the segment, as account values are the asset base by which the segment generates much of its fee and spread-based revenues. Net cash flow and market performance are the two main drivers of account value growth. Net cash flow reflects the segment's ability to attract and retain client deposits. Market performance reflects not only the equity market performance, but also the investment performance of fixed income investments supporting our spread business. The percentage growth in earnings of the businesses that make up this segment should closely track the percentage growth in account values. This segment's trend may vary due to changes in business and/or product mix.

The following table presents the U.S. Asset Accumulation account value rollforward for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in billions)			
Account values, beginning of period	\$ 174.5	\$ 167.7	\$ 180.8	\$ 163.3
Net cash flow	2.9	0.4	6.0	2.0
Credited investment performance	—	6.3	(8.4)	9.2
Other	(0.2)	—	(1.2)	(0.1)
Account values, end of period	\$ 177.2	\$ 174.4	\$ 177.2	\$ 174.4

The following table presents certain summary financial data relating to the U.S. Asset Accumulation segment for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	\$ 178.3	\$ 196.1	\$ (17.8)	\$ 301.6	\$ 331.3	\$ (29.7)
Fees and other revenues	386.0	396.6	(10.6)	767.5	779.9	(12.4)
Net investment income	691.4	673.2	18.2	1,391.3	1,333.8	57.5
Total operating revenues	1,255.7	1,265.9	(10.2)	2,460.4	2,445.0	15.4
Expenses:						
Benefits, claims and settlement expenses, including dividends to policyholders	703.3	702.9	0.4	1,360.1	1,334.5	25.6
Operating expenses	354.2	358.4	(4.2)	724.8	715.0	9.8
Total expenses	1,057.5	1,061.3	(3.8)	2,084.9	2,049.5	35.4
Operating earnings before income taxes	198.2	204.6	(6.4)	375.5	395.5	(20.0)
Income taxes	45.3	40.1	5.2	83.5	76.3	7.2
Operating earnings	\$ 152.9	\$ 164.5	\$ (11.6)	\$ 292.0	\$ 319.2	\$ (27.2)

44

### *Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007*

#### **Operating Earnings**

Operating earnings decreased \$6.5 million in our full service accumulation business, as the growth in operating earnings within full service accumulation was more that offset by a decline in the tax benefits associated with the dividends received deduction. Furthermore, operating earnings decreased \$4.1 million in our full service payout business primarily due to lower prepayment fee income in 2008 and more beneficial annuitant mortality experience in 2007.

#### **Operating Revenues**

Premiums decreased \$57.0 million in our full service payout business primarily due to a decrease in sales of annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. Partially offsetting this decrease was a \$39.2 million increase in our individual payout annuity business primarily due to increased sales of annuities with life contingencies from certain distribution channels.

Fees in our Principal Funds business decreased \$10.9 million primarily due to a decline in distribution income and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Net investment income increased primarily due to a \$3,394.5 million increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 5.5% for the three months ended June 30, 2008, and 5.8% for the three months ended June 30, 2007.

#### **Total Expenses**

Benefits, claims and settlement expenses, including dividends to policyholders, increased \$71.6 million in our individual annuities business due to an increase in the change in reserves resulting from higher sales of our payout annuities with life contingencies and, to a lesser extent, an increase in cost of interest credited resulting from a growing block of fixed deferred annuities. Partially offsetting the increase was a \$52.6 million decrease in our full service payout business primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies. In addition, our investment only business benefits, claims and settlement expenses decreased \$21.8 million primarily due to a decline in variable crediting rates.

Operating expenses in Principal Funds decreased \$9.1 million primarily due to lower fees paid to advisors resulting from a decrease in average account values. In addition, operating expenses in our full service accumulation business decreased \$6.6 million primarily due to a change in DPAC assumptions reflected in late 2007. Partially offsetting these decreases was a \$10.6 million increase in our individual annuity business, primarily due to growth in this business.

#### **Income Taxes**

The effective income tax rates for this segment were 23% and 20% for the three months ended June 30, 2008 and 2007, respectively. The effective income tax rates for the three months ended June 30, 2008 and 2007, were lower than the corporate income tax rate of 35% as a result of income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

### *Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007*

#### **Operating Earnings**

Operating earnings decreased \$20.8 million in our in full service accumulation business, as growth in operating earnings generated from the increased account values was slowed by a change in the mix of investments and products within full service accumulation. Operating earnings growth for this business was also reduced by a decline in the tax benefits associated with the dividends received deduction and market value adjustments on customer withdrawals stemming from a declining interest rate environment. Furthermore, operating earnings decreased \$4.9 million in Principal Funds primarily due to a decline

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in distribution and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

#### **Operating Revenues**

Premiums decreased \$106.4 million in our full service payout business primarily due to a decrease in sales of annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. Partially offsetting this decrease was a \$76.7 million increase in our individual payout annuity business primarily due to increased sales of annuities with life contingencies from certain distribution channels.

Fees in our Principal Funds business decreased \$15.5 million primarily due to a decline in distribution and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Net investment income increased primarily due to a \$3,631.9 million increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 5.5% for the six months ended June 30, 2008, and 5.8% for the six months ended June 30, 2007.

#### **Total Expenses**

Benefits, claims and settlement expenses, including dividends to policyholders, increased \$137.5 million in our individual annuities business due to an increase in the change in reserves resulting from higher sales of our payout annuities with life contingencies and, to a lesser extent, an increase in cost of interest credited resulting from a growing block of fixed deferred annuities. Partially offsetting the overall increase was a \$100.9 million decrease in our full service payout business benefits, claims and settlement expenses primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies. In addition, our investment only business benefits, claims and settlement expenses decreased \$17.7 million primarily due to a decline in variable crediting rates.

Operating expenses increased \$16.3 million in our individual annuity business, primarily due to growth in this business. Partially offsetting the increase was a \$7.7 million decrease in Principal Funds operating expenses, primarily due to lower fees paid to advisors stemming from a decrease in average account values.

### Income Taxes

The effective income tax rates for this segment were 22% and 19% for the six months ended June 30, 2008 and 2007, respectively. The effective income tax rates for the six months ended June 30, 2008 and 2007, were lower than the corporate income tax rate of 35% as a result of income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

46

## Global Asset Management Segment

### Global Asset Management Segment Summary Financial Data

AUM is a key indicator of earnings growth for our Global Asset Management segment, as AUM is the base by which we generate fee mandate revenues. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects equity, fixed income and real estate market performance. The percentage growth in earnings of the segment will generally track with the percentage growth in AUM. This trend may vary due to changes in business and/or product mix.

The following table provides the AUM rollforward for assets managed by Global Asset Management for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in billions)			
AUM, beginning of period	\$ 229.9	\$ 203.7	\$ 236.0	\$ 191.4
Net cash flow	3.9	2.1	7.3	6.5
Investment performance	—	5.2	(7.7)	8.9
Other	(0.8)	(0.5)	(2.6)	3.7
AUM, end of period	\$ 233.0	\$ 210.5	\$ 233.0	\$ 210.5

In our spread and securitization business, we have an equity method investee that originates commercial mortgage loans, warehouses pool loans and facilitates the issuance of commercial mortgage-backed securities ("CMBS"). Due to the nature of these operations, AUM is not a key indicator of earnings growth for the spread and securitization business.

The following table presents certain summary financial data relating to the Global Asset Management segment for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Fees and other revenues	\$ 140.0	\$ 140.3	\$ (0.3)	\$ 275.1	\$ 262.6	\$ 12.5
Net investment income (loss)	6.1	14.2	(8.1)	(10.7)	26.7	(37.4)
Total operating revenues	146.1	154.5	(8.4)	264.4	289.3	(24.9)
Expenses:						
Total expenses	109.4	104.7	4.7	223.5	202.8	20.7
Operating earnings before income taxes	36.7	49.8	(13.1)	40.9	86.5	(45.6)
Income taxes	13.0	17.6	(4.6)	14.5	30.6	(16.1)
Operating earnings	\$ 23.7	\$ 32.2	\$ (8.5)	\$ 26.4	\$ 55.9	\$ (29.5)

### Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

#### Operating Earnings

Operating earnings in our spread and securitization business decreased \$8.2 million primarily due to the current inactivity in the commercial mortgage-backed securitization business resulting from continued adverse credit market conditions.

#### Operating Revenues

Fees in our spread and securitization business decreased \$7.5 million due to lower loan and securitization volumes in 2008 compared to 2007. Partially offsetting this decrease is an increase in our fee mandate business of \$7.2 million due to continued growth in management fees across all lines of business, in addition to the acquisition of Morley Financial Services.

47

Net investment income decreased \$6.9 million in our spread and securitization business due to the continued adverse global credit market conditions which resulted in lower earnings from our equity method investment in Principal Commercial Funding II ("PCF II").

#### Total Expenses

Total expenses increased \$6.3 million in our fee mandate business due to growth in staff and staff related costs resulting from continued growth in AUM and the acquisition of Morley Financial Services.

#### Income Taxes

The effective income tax rate for this segment was 35% for both the three months ended June 30, 2008 and 2007.

#### Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

#### Operating Earnings

Operating earnings in our spread and securitization business decreased \$31.4 million driven in large part by volatile spread movement in 2008 resulting in mark to market losses on the mortgage loan inventory within PCF II.

#### Operating Revenues

Fees in our fee mandate business increased \$26.8 million due to continued growth in management fees across all lines of business resulting from growth in AUM, in addition to the acquisition of Morley Financial Services. This growth was partially offset by a \$14.3 million decrease in fees within our spread and securitization business resulting from lower loan and securitization volumes in 2008 compared to 2007.

Net investment income decreased \$36.2 million in our spread and securitization business due in large part to the adverse global credit market conditions which resulted in lower earnings from our equity method investment in PCF II.

#### Total Expenses

Total expenses increased \$22.7 million in our fee mandate business due to growth in staff and staff related costs resulting from continued growth in AUM and the acquisition of Morley Financial Services.

#### Income Taxes

The effective income tax rate for this segment was 35% for both the six months ended June 30, 2008 and 2007.

### International Asset Management and Accumulation Segment

#### International Asset Management and Accumulation Segment Summary Financial Data

AUM is a key indicator of earnings growth for the segment, as AUM is the base by which we can generate profits. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects the investment returns on our underlying AUM. The percentage growth in the earnings of our International Asset Management and Accumulation segment will generally track with the percentage growth in AUM. This trend may vary due to changes in business and/or product mix. Our financial results are also impacted by fluctuations of the foreign currency to U.S. dollar exchange rates for the countries in which we have business.

The following table presents the International Asset Management and Accumulation AUM rollforward for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in billions)			
AUM, beginning of period	\$ 30.2	\$ 22.0	\$ 28.7	\$ 19.1
Net cash flow	0.5	0.9	1.2	0.8
Investment performance	(0.1)	1.4	(0.4)	1.9
Effect of exchange rates	(0.6)	1.0	0.7	1.3
Other (1)	—	—	(0.2)	2.2
AUM, end of period	<u>\$ 30.0</u>	<u>\$ 25.3</u>	<u>\$ 30.0</u>	<u>\$ 25.3</u>

(1) Other increases to AUM include \$2.2 billion in 2007 related to our SBB acquisition in Malaysia.

The following table presents certain summary financial data of the International Asset Management and Accumulation segment for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	\$ 97.0	\$ 55.0	\$ 42.0	\$ 139.8	\$ 103.2	\$ 36.6



Fees and other revenues	33.6	31.8	1.8	68.9	62.8	6.1
Net investment income	120.6	88.2	32.4	226.2	150.3	75.9
Total operating revenues	251.2	175.0	76.2	434.9	316.3	118.6
Expenses:						
Benefits, claims and settlement expenses	192.4	109.6	82.8	303.9	195.2	108.7
Operating expenses	39.0	37.0	2.0	75.3	71.8	3.5
Total expenses	231.4	146.6	84.8	379.2	267.0	112.2
Operating earnings before income taxes	19.8	28.4	(8.6)	55.7	49.3	6.4
Income taxes (benefits)	(12.0)	1.7	(13.7)	(7.8)	3.3	(11.1)
Operating earnings	\$ 31.8	\$ 26.7	\$ 5.1	\$ 63.5	\$ 46.0	\$ 17.5

**Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007**

**Operating Earnings**

Operating earnings in Mexico increased \$2.7 million primarily related to growth in AUM as well as lower DPAC and present value of future profit (“PVFP”) amortization resulting from a change in Afore fee structure in November 2007. Operating earnings in Chile increased \$2.6 million primarily due to inflation and the strengthening of the Chilean peso against the U.S. dollar.

49

**Operating Revenues**

Premiums in Chile increased \$41.7 million primarily due to higher sales of single premium annuities with life contingencies and a strengthening of the Chilean peso against the U.S. dollar.

Fees and other revenues in our operations in Mexico increased primarily due to growth in AUM.

Net investment income increased primarily due to a higher annualized yield on average invested assets and cash, excluding our equity method investments. The annualized yield on average invested assets and cash, excluding our equity method investments, was 12.2% for the three months ended June 30, 2008, compared to 8.8% for the three months ended June 30, 2007. To a lesser extent, the increase was due to strengthening of the Chilean peso against the U.S. dollar and a \$672.8 million increase in average invested assets and cash, excluding our equity method investments. Partially offsetting these increases in net investment income were lower earnings from our equity method investment in Brazil as a result of the second quarter 2008 enactment of legislation to increase the Brazilian tax rate. This decrease in net investment income is offset by a corresponding change in income taxes for U.S. foreign tax credits.

**Total Expenses**

Benefits, claims and settlement expenses increased \$78.0 million in Chile, primarily due to a higher change in reserves associated with increased sales of single premium annuities with life contingencies and the strengthening of the Chilean peso against the U.S. dollar.

Operating expenses within our international operations increased primarily due to continued growth in our international operations and the strengthening of the Chilean peso against the U.S. dollar. Partially offsetting these increases was lower DPAC and PVFP amortization in Mexico resulting from a change in Afore fee structure in November 2007.

**Income Taxes**

The effective tax rates for this segment were (61)% and 6% for the three months ended June 30, 2008 and 2007, respectively. The effective income tax rate for the three months ended June 30, 2008, was lower than the U.S. corporate income tax rate of 35%, primarily due to additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate and lower tax rates of foreign jurisdictions. The Brazil tax rate change does not impact operating earnings because a U.S. foreign tax credit is allowed for the increase in Brazil deferred income taxes; however, it does impact the effective tax rate because our Brazilian subsidiary is reported on the equity method of accounting. The impact of the increased Brazil deferred income taxes flows through pre-tax income but the decrease in income taxes due to the U.S. foreign tax credits is reflected in income taxes, the result of which is a decrease to the effective tax rate. The effective income tax rate for the three months ended June 30, 2007, was lower than the U.S. corporate income tax rate of 35%, as a result of taxes on our share of earnings generated from our equity method investments that are included in net investment income and due to the lower tax rates of foreign jurisdictions.

**Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007**

**Operating Earnings**

Operating earnings in Chile increased \$6.0 million primarily due to inflation and the strengthening of the Chilean peso against the U.S. dollar. Operating earnings in Mexico increased \$5.3 million primarily related to lower DPAC and PVFP amortization resulting from a change in Afore fee structure in November 2007 and to growth in AUM. In addition, operating earnings from our equity method investments in China and Malaysia increased due to growth in AUM.

**Operating Revenues**

Premiums in Chile increased \$38.2 million due to higher sales of single premium annuities with life contingencies and a strengthening of the Chilean peso against the U.S. dollar.

Fees and other revenues in our Mexico and Hong Kong operations increased primarily due to growth in AUM and the strengthening of the Mexican peso against the U.S. dollar.

Net investment income increased primarily due to a higher annualized yield on average invested assets and cash, excluding our equity method investments. The annualized yield on average invested assets and cash, excluding our equity method investments, was 11.1% for the six months ended June 30, 2008, compared to 7.5% for the six months ended June 30, 2007. To a lesser extent, the increase was due to strengthening of the Chilean peso against the U.S. dollar and a \$475.2 million increase in average invested assets and cash, excluding our equity method investments. Partially offsetting these increases in net investment income was lower earnings from our equity method investment in Brazil as a result of the second quarter 2008 enactment of legislation to increase the Brazilian tax rate. This decrease in net investment income is offset by a corresponding change in income taxes for U.S. foreign tax credits.

### Total Expenses

Benefits, claims and settlement expenses increased \$105.2 million in Chile, primarily due to higher interest crediting rates to customers, a higher change in reserves due to increased sales of single premium annuities with life contingencies and the strengthening of the Chilean peso against the U.S. dollar.

Operating expenses within our international operations increased primarily due to the strengthening of the Chilean peso against the U.S. dollar and continued growth in our international operations. Partially offsetting these increases was lower DPAC and PVFP amortization in Mexico resulting from a change in Afore fee structure in November 2007.

### Income Taxes

The effective tax rates for this segment were (14)% and 7% for the six months ended June 30, 2008 and 2007, respectively. The effective income tax rate for the six months ended June 30, 2008, was lower than the U.S. corporate income tax rate of 35%, primarily due to additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate, lower tax rates of foreign jurisdictions and taxes on our share of earnings generated from our equity method investments that are included in net investment income. The Brazil tax rate change does not impact operating earnings because a U.S. foreign tax credit is allowed for the increase in Brazil deferred income taxes; however, it does impact the effective tax rate because our Brazilian subsidiary is reported on the equity method of accounting. The impact of the increased Brazil deferred income taxes flows through pre-tax income but the decrease in income taxes due to the U.S. foreign tax credits is reflected in income taxes, the result of which is a decrease to the effective tax rate. The effective income tax rate for the six months ended June 30, 2007, was lower than the U.S. corporate income tax rate of 35%, as a result of taxes on our share of earnings generated from our equity method investments that are included in net investment income and due to the lower tax rates of foreign jurisdictions.

## Life and Health Insurance Segment

### Individual Life Insurance Trends

Our life insurance premiums are influenced by both economic and industry trends. In addition, we have experienced increased sales of universal and variable universal life insurance as we continue to shift our marketing emphasis to universal life insurance products from traditional life insurance products. Due to this shift in marketing emphasis, premiums related to our traditional life insurance products have declined, while fee revenues from our universal and variable universal life insurance products have grown.

The following table provides a summary of our individual universal and variable universal life insurance fee revenues and our individual traditional life insurance premiums for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Universal and variable universal life insurance fee revenue	\$ 81.2	\$ 64.9	\$ 163.5	\$ 130.6
Traditional life insurance premiums	150.9	154.8	299.2	307.4

### Health Insurance Trends

We have experienced lower premium revenue as increases in premium per member have been more than offset by a decrease in covered medical members.

Our health insurance premium and fees were as follows for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Premium and fees:				
Group medical insurance	\$ 408.2	\$ 458.1	\$ 827.9	\$ 924.7
Fee-for-service	35.7	42.2	72.7	84.1

### Specialty Benefits Insurance Trends

Premium and fee growth for our specialty benefits insurance business, while still positive, is slowing as competitive market conditions and pricing discipline result in slower sales and an increase in lapses.

The following table provides a summary of our specialty benefits insurance premium and fees for the periods indicated:

	For the three months ended June 30,		For the six months ended June 30,	
	2008	2007	2008	2007
	(in millions)			
Premium and fees:				
Group dental and vision insurance	\$ 138.6	\$ 134.4	\$ 277.5	\$ 266.7
Group life insurance	88.8	85.7	174.9	169.4
Group disability insurance	77.1	74.5	153.6	147.0
Individual disability insurance	43.6	39.7	85.4	77.9

### Life and Health Insurance Segment Summary Financial Data

There are several key indicators for earnings growth in our Life and Health Insurance segment. The ability of our distribution channels to generate new sales and retain existing business drives growth in our block of business, premium revenue and fee revenues. Our earnings growth also depends on our ability to price our products at a level that enables us to earn a margin over the cost of providing benefits and the expense of acquiring and administering those products. Factors impacting pricing decisions include competitive conditions, persistency, our ability to assess and manage trends in mortality and morbidity experience and our ability to manage operating expenses.

52

The following table presents certain summary financial data relating to the Life and Health Insurance segment for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	\$ 879.5	\$ 924.5	\$ (45.0)	\$ 1,765.1	\$ 1,847.5	\$ (82.4)
Fees and other revenues	129.2	117.7	11.5	260.2	236.4	23.8
Net investment income	171.9	169.3	2.6	342.9	340.0	2.9
Total operating revenues	1,180.6	1,211.5	(30.9)	2,368.2	2,423.9	(55.7)
Expenses:						
Benefits, claims and settlement expenses	742.2	775.5	(33.3)	1,449.8	1,559.7	(109.9)
Dividends to policyholders	68.2	73.5	(5.3)	138.5	146.6	(8.1)
Operating expenses	270.8	273.6	(2.8)	561.8	561.1	0.7
Total expenses	1,081.2	1,122.6	(41.4)	2,150.1	2,267.4	(117.3)
Operating earnings before income taxes	99.4	88.9	10.5	218.1	156.5	61.6
Income taxes	32.7	28.8	3.9	72.2	50.9	21.3
Operating earnings	\$ 66.7	\$ 60.1	\$ 6.6	\$ 145.9	\$ 105.6	\$ 40.3

### Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

#### Operating Earnings

Operating earnings in our specialty benefits business increased \$7.8 million primarily due to favorable claims experience in our disability and group life businesses.

#### Operating Revenues

Premiums decreased \$49.9 million in our health insurance business due to a reduction in covered medical members, primarily resulting from medical expense driven pricing actions.

Fees and other revenues increased \$17.2 million in our individual life insurance business due to growth in the universal life and variable universal life insurance lines of business. Partially offsetting this increase in fees and other revenues was a decrease of \$6.7 million in our health insurance business, largely due to a reclassification of the reimbursement of certain expenses from fee revenues to operating expenses and a decrease in fee-for-service medical members.

#### Total Expenses

Benefits, claims and settlement expenses decreased \$42.7 million in our health insurance business due to a decrease in average covered medical members partially offset by higher claim costs per member. Further offsetting this decrease was a \$10.9 million increase in benefits, claims and settlement expenses for our individual life insurance business as a result of higher interest credited resulting from growth in the universal life insurance business and increased death benefit costs due to more favorable mortality experience in the prior period.

Operating expenses decreased \$13.8 million in our health insurance business primarily due to a reclassification of the reimbursement of certain expenses from fee revenues to operating expenses and due to staff and other reductions associated with the decline in insured medical and fee-for-service medical covered members. Partially offsetting this decrease was a \$7.0 million increase in operating expenses for our individual life insurance business primarily related to sales growth. Additionally, operating expenses increased \$3.9 million in our specialty benefits insurance business due to moderate growth in the business.

## Income Taxes

The effective income tax rates for this segment were 33% and 32% for the three months ended June 30, 2008 and 2007, respectively. The effective income tax rates were lower than the U.S. corporate income tax rate of 35% as a result of interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

### Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007

#### Operating Earnings

Operating earnings in our health insurance business increased \$21.3 million primarily due to favorable prior period claim development relative to the same period a year ago. At the end of a reporting period, we recognize a liability for the estimate of claims incurred but not reported. In subsequent periods, an adjustment of prior period claim development is made to reflect actual or updated estimates of incurred claims. In addition, operating earnings in our specialty benefits business increased \$13.4 million primarily due to favorable claims experience in our disability businesses.

#### Operating Revenues

Premiums decreased \$95.9 million in our health insurance business due to a reduction in covered medical members, primarily resulting from medical expense driven pricing actions.

Fees and other revenues increased \$35.0 million in our individual life insurance business due to growth in the universal life and variable universal life insurance lines of business. Partially offsetting this increase in fees and other revenues was a decrease of \$12.6 million in our health insurance business, largely due to a reclassification of the reimbursement of certain expenses from fee revenues to operating expenses and a decrease in fee-for-service medical members.

#### Total Expenses

Benefits, claims and settlement expenses decreased \$118.4 million in our health insurance business due to a decrease in average covered medical members and favorable prior period claim development relative to the same period a year ago. This decrease was slightly offset by a moderate increase in claim costs per member.

Operating expenses increased \$16.3 million in our individual life insurance business primarily related to sales growth and higher DPAC amortization due to mortality and sales growth. Additionally, operating expenses increased \$10.5 million in our specialty benefits insurance business due to moderate growth in the business. Partially offsetting these increases was a \$26.3 million decrease in our health insurance business due to a reclassification of the reimbursement of certain expenses from fee revenues to operating expenses; staff and other reductions associated with the decline in insured medical and fee-for-service medical covered members; and lower commission expense resulting from a reduction in premium.

## Income Taxes

The effective income tax rate for this segment was 33% for both the six months ended June 30, 2008 and 2007. The effective income tax rates were lower than the U.S. corporate income tax rate of 35% as a result of interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

## Corporate and Other Segment

### Corporate and Other Segment Summary Financial Data

The following table presents certain summary financial data relating to the Corporate and Other segment for the periods indicated:

	For the three months ended June 30,			For the six months ended June 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Total operating revenues	\$ (44.5)	\$ (21.4)	\$ (23.1)	\$ (99.8)	\$ (65.3)	\$ (34.5)
Expenses:						
Total expenses	(24.0)	(28.5)	4.5	(52.3)	(57.3)	5.0
Operating earnings (loss) before income taxes and preferred stock dividends	(20.5)	7.1	(27.6)	(47.5)	(8.0)	(39.5)
Income tax benefits	(7.4)	(0.6)	(6.8)	(31.2)	(17.5)	(13.7)
Preferred stock dividends	8.3	8.3	—	16.5	16.5	—
Operating loss	\$ (21.4)	\$ (0.6)	\$ (20.8)	\$ (32.8)	\$ (7.0)	\$ (25.8)

### Three Months Ended June 30, 2008, Compared to Three Months Ended June 30, 2007

#### Operating Loss

Operating loss increased due to a decline in average annualized investment yields and a decrease in average invested assets for the segment. Also contributing to the increase in operating loss was an increase in interest expense related to federal income tax activities.

### **Operating Revenues**

Operating revenues decreased due to a decline in average annualized investment yields resulting from above average gains on equity real estate sales activity in the prior year, as well as a decrease in average invested assets for the segment.

### **Total Expenses**

Total expenses increased due to higher interest expense related to federal income tax activities and interest expense on corporate debt.

### **Income Taxes**

Income tax benefits increased primarily due to an increase in operating loss before income taxes. The increased income tax benefits were offset in part by the reduction of synthetic fuel tax credits due to their expiration as of December 31, 2007.

## ***Six Months Ended June 30, 2008, Compared to Six Months Ended June 30, 2007***

### **Operating Loss**

Operating loss increased primarily due to a decline in average annualized investment yields and a decrease in average invested assets for the segment. Also contributing to the increase in operating loss was the expiration of the synthetic fuel tax credit structure as of December 31, 2007, as well as higher interest expense related to federal income tax activities. These increases were partially offset by the release of state deferred income tax liabilities following the reorganization of certain subsidiaries in 2008.

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### **Operating Revenues**

Operating revenues decreased due to a decline in average annualized investment yields, resulting from above average gains on equity real estate sales activity in the prior year, as well as a decrease in average invested assets for the segment. Further contributing to the decline in operating revenues was an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses.

### **Total Expenses**

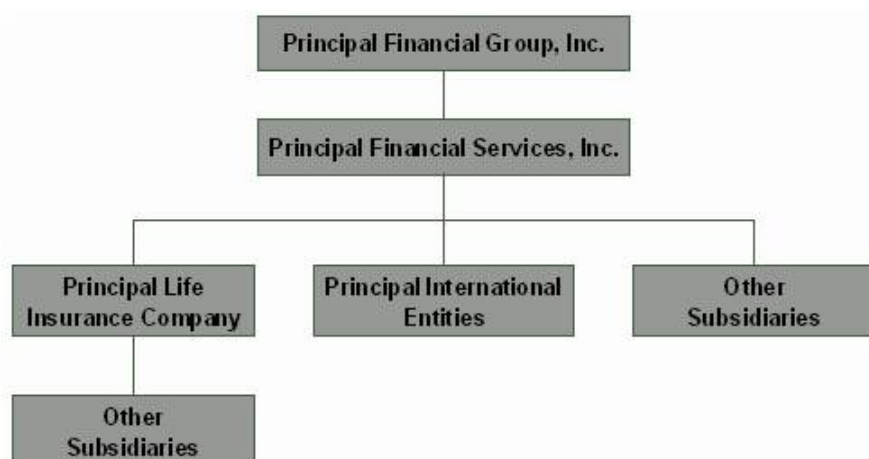
Total expenses increased due to higher interest expense related to federal income tax activities and interest expense on corporate debt. These increases were partially offset by an increase in inter-segment eliminations included in this segment.

### **Income Taxes**

Income tax benefits increased due to an increase in operating loss before income taxes. Also contributing to the increased income tax benefits was the release of state deferred income tax liabilities associated with the reorganization of certain subsidiaries in 2008. The increased income tax benefits were offset in part by the reduction of synthetic fuel tax credits due to their expiration as of December 31, 2007.

### **Liquidity and Capital Resources**

Liquidity and capital resources reflect the overall strength of a company and its ability to generate strong cash flows, borrow funds at a competitive rate and raise new capital to meet operating and growth needs. Our legal entity organizational structure has an impact on our ability to meet cash flow needs as an organization. Following is a simplified organizational structure.



### **Liquidity**

Our liquidity requirements have been and will continue to be met by funds from consolidated operations as well as the issuance of commercial paper, common stock, debt or other capital securities and borrowings from credit facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of our operations, including reasonably foreseeable contingencies. However, there can be no assurance that future experience

regarding benefits and surrenders will be similar to historic experience since benefits and surrender levels are influenced by such factors as the interest rate environment, our claims paying ability and our financial strength ratings. For factors that could affect our expectations for liquidity, see Item 3. "Quantitative and Qualitative Disclosures About Market Risk."

**The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc.** The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and raise capital to meet operating and growth needs. Dividends from Principal Life, our primary

subsidiary, are limited by Iowa law. Under Iowa laws, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa ("the Commissioner") to pay a stockholder dividend if such a stockholder dividend would exceed certain statutory limitations. The current statutory limitation is the greater of (i) 10% of Principal Life's statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year.

Iowa law gives the Commissioner discretion to disapprove requests for dividends in excess of these limits. Based on this limitation and 2007 statutory results, Principal Life could pay approximately \$686.5 million in stockholder dividends in 2008 without exceeding the statutory limitation. As of June 30, 2008, no dividends have been paid by Principal Life to its parent company.

**Operations.** Historically, our primary consolidated cash flow sources have been premiums and fees from life and health insurance products, pension and annuity deposits, asset management fee revenues, administrative services fee revenues, income from investments and proceeds from the sales or maturity of investments. Cash outflows consist primarily of payment of benefits to policyholders and beneficiaries, income and other taxes, current operating expenses, payment of dividends to policyholders, payments in connection with investments acquired, payments made to acquire subsidiaries, payments relating to policy and contract surrenders, withdrawals, policy loans, interest expense and repayment of short-term debt and long-term debt. Our investment strategies are generally intended to provide adequate funds to pay benefits without forced sales of investments. For a discussion of our investment objectives, strategies and a discussion of duration matching, see "Investments" as well as Item 3. "Quantitative and Qualitative Disclosures About Market Risk — Interest Rate Risk".

**Cash Flows.** Activity, as reported in our consolidated statements of cash flows, provides relevant information regarding our sources and uses of cash. The following discussion of our operating, investing and financing portions of the cash flows excludes cash flows attributable to our discontinued operations, which were as follows:

	For the six months ended June 30,	
	2008	2007
	(in millions)	
<b>Cash flows attributable to discontinued operations:</b>		
Net cash provided by operating activities	\$ —	\$ 1.4
Net cash used in investing activities	—	(1.1)
Net cash used in financing activities	—	(0.3)
Net cash provided by discontinued operations	<u>\$ —</u>	<u>\$ —</u>

Net cash provided by operating activities was \$1,073.1 million and \$1,920.5 million for the six months ended June 30, 2008 and 2007, respectively. The decrease in cash provided by operating activities was primarily related to fluctuations in operational receivables and payables. Also contributing to the decrease in cash provided by operating activities was a decrease in net cash flows from trading securities.

Net cash used in investing activities was \$2,326.7 million and \$1,037.5 million for the six months ended June 30, 2008 and 2007, respectively. The increase in cash used in investing activities between periods was primarily related to an increase in net purchases of available-for-sale securities, which was partially offset by a decrease in the net purchases of mortgage loans.

Net cash provided by financing activities was \$1,433.7 million for the six months ended June 30, 2008, compared to net cash used in financing activities of \$615.8 million for the six months ended June 30, 2007. The increase in cash provided by financing activities was primarily due to an increase in net cash flows of investment contracts, as well as a reduction in treasury stock acquired in 2008 compared to 2007.

Given the historical cash flow of our subsidiaries and the financial results of these subsidiaries, we believe the cash flow from our consolidated operating activities over the next year will provide sufficient liquidity for our operations, as well as satisfy interest payments and any payments related to debt servicing.

**Shelf Registration.** On June 11, 2008, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2004, as it was scheduled to expire in the fourth quarter of 2008. Under our current shelf registration, we have the ability to issue unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and

unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration statement.

**FHLB of Des Moines Membership.** Principal Life became a member of the FHLB of Des Moines in June 2008 and held \$21.1 million of common stock of the FHLB of Des Moines as of June 30, 2008. Through its membership, Principal Life is able to participate in different long-term and short-term advance programs with the FHLB of Des Moines and has entered into an agreement whereby Principal Life has issued a funding agreement in exchange for

cash and has pledged collateral to secure the obligation. The amount of our liability for the funding agreement with the FHLB of Des Moines as of June 30, 2008, was \$250.0 million, which was reported in contractholder funds in the consolidated statements of financial position. The funding agreement was collateralized by commercial and residential mortgage-backed securities with a carrying value of \$295.2 million as of June 30, 2008.

**Short-Term Debt and Long-Term Debt.** The components of short-term debt as of June 30, 2008, and December 31, 2007, were as follows:

	June 30, 2008	December 31, 2007
	(in millions)	
Commercial paper	\$ 159.9	\$ 233.3
Other recourse short-term debt	55.2	57.5
<b>Total short-term debt</b>	<b>\$ 215.1</b>	<b>\$ 290.8</b>

As of June 30, 2008, there have been no significant changes to long-term debt since December 31, 2007.

**Stockholders' Equity.** For stockholders' equity information, see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 5, Stockholders' Equity".

#### **Contractual Obligations and Contractual Commitments**

As of June 30, 2008, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2007.

#### **Off-Balance Sheet Arrangements**

**Variable Interest Entities.** As of June 30, 2008, there have been no significant changes to our variable interest entities since December 31, 2007.

**Guarantees and Indemnifications.** For guarantee and indemnification information, see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Contingencies, Guarantees and Indemnifications" under the caption, "Guarantees and Indemnifications".

#### **Fair Value Measurement**

SFAS 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). This standard establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three levels for disclosure purposes. On January 1, 2008, we adopted SFAS 157. For further discussion, see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 6, Fair Value Measurement."

As of June 30, 2008, we categorized net assets of \$50.4 billion in Level 1, \$66.4 billion in Level 2 and \$9.0 billion in Level 3. During the three months ended June 30, 2008, the fair value balance of Level 3 instruments decreased \$263.3 million. This decrease is primarily attributed to the change in fair value of the separate account assets, mainly as a result of unrealized losses, which are not reflected in the consolidated statements of operations, as the change in value of separate account assets is offset by a change in value of separate account liabilities. During the six months ended June 30, 2008, the fair value balance of Level 3 instruments decreased \$571.6 million. This decrease is primarily attributed to the fixed maturities, available-for-sale securities and separate account assets. The decrease in fixed maturities, available-for-sale securities resulted mostly from unrealized losses recognized in other comprehensive income. Most of the unrealized losses related to collateralized debt obligations, with lesser amounts attributed to corporate bonds, commercial mortgage-backed securities, asset-backed securities and collateralized mortgage obligations. The decrease in separate account assets is

primarily a result of unrealized losses, which are not reflected in the consolidated statements of operations, as the change in value of separate account assets is offset by a change in value of separate account liabilities.

#### **Investments**

We had total consolidated assets as of June 30, 2008, of \$151.5 billion, of which \$65.1 billion were invested assets. The rest of our total consolidated assets are comprised primarily of separate account assets for which we do not bear investment risk. Because we generally do not bear any investment risk on assets held in separate accounts, the discussion and financial information below does not include such assets.

#### **Overall Composition of Invested Assets**

Invested assets as of June 30, 2008, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of invested assets are fixed maturity securities and commercial mortgage loans. The remainder is invested in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets.

#### **Invested Assets**

	June 30, 2008		December 31, 2007	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
<b>Fixed maturity securities:</b>				
Public	\$ 33,164.4	51%	\$ 32,215.0	50%
Private	14,603.9	22	15,053.2	24
Equity securities	527.1	1	586.2	1
<b>Mortgage loans:</b>				
Commercial	10,857.3	17	10,763.5	17
Residential	1,915.8	3	1,896.1	3
Real estate held for sale	125.0	—	82.4	—

Real estate held for investment	763.7	1	780.1	1
Policy loans	875.6	1	869.9	1
Other investments	2,296.1	4	2,118.6	3
Total invested assets	65,128.9	100%	64,365.0	100%
Cash and cash equivalents	1,524.5		1,344.4	
Total invested assets and cash	\$ 66,653.4		\$ 65,709.4	

## Investment Results

The following tables present the yield and investment income, excluding net realized/unrealized capital gains and losses for our invested assets. The annualized yield on invested assets and on cash and cash equivalents was 6.0% for the three months ended June 30, 2008, compared to 6.2% for the three months ended June 30, 2007. The annualized yield on invested assets and on cash and cash equivalents was 5.9% for the six months ended June 30, 2008, compared to 6.1% for the six months ended June 30, 2007. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period.

59

### Invested Assets Investment Income Yields by Asset Type

	For the three months ended June 30,			
	2008		2007	
	Yield	Amount	Yield	Amount
	(\$ in millions)			
Fixed maturity securities	6.4%	\$ 763.4	6.1%	\$ 690.3
Equity securities	3.4	4.4	3.9	5.8
Mortgage loans — commercial	6.0	162.7	6.8	176.9
Mortgage loans — residential	8.0	39.1	7.2	28.0
Real estate	7.3	15.9	11.7	23.8
Policy loans	7.1	15.6	6.1	12.9
Cash and cash equivalents	4.3	14.2	5.7	23.8
Other investments	1.8	11.1	12.4	50.9
Total before investment expenses	6.2	1,026.4	6.4	1,012.4
Investment expenses	0.2	(35.4)	0.2	(35.8)
Net investment income	6.0%	\$ 991.0	6.2%	\$ 976.6

### Invested Assets Investment Income Yields by Asset Type

	For the six months ended June 30,			
	2008		2007	
	Yield	Amount	Yield	Amount
	(\$ in millions)			
Fixed maturity securities	6.3%	\$ 1,504.7	6.1%	\$ 1,362.8
Equity securities	3.3	9.1	3.4	12.3
Mortgage loans — commercial	6.2	333.4	6.7	344.7
Mortgage loans — residential	7.6	72.7	6.4	49.8
Real estate	7.0	30.4	10.7	44.1
Policy loans	6.6	28.9	6.1	25.9
Cash and cash equivalents	4.0	29.0	5.7	49.3
Other investments	1.4	15.8	10.2	80.9
Total before investment expenses	6.1	2,024.0	6.3	1,969.8
Investment expenses	0.2	(72.7)	0.2	(70.0)
Net investment income	5.9%	\$ 1,951.3	6.1%	\$ 1,899.8

The following tables present the contributors to net realized/unrealized capital gains and losses for our invested assets for the three months ended June 30, 2008 and 2007.

	For the three months ended June 30, 2008			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities (1)	\$ (34.6)	\$ 4.1	\$ (186.0)	\$ (216.5)
Fixed maturity securities, trading	—	(19.6)	—	(19.6)
Equity securities (2)	(11.2)	0.9	—	(10.3)
Equity securities, trading	—	8.4	—	8.4
Mortgage loans on real estate (3)	(0.1)	—	—	(0.1)
Derivatives (4)	—	—	110.5	110.5
Other (5)	—	4.0	12.1	16.1
Total	\$ (45.9)	\$ (2.2)	\$ (63.4)	\$ (111.5)

60



- (1) Impairments include \$35.4 million of credit impairment write-downs and \$1.0 million in realized credit recoveries on the sale of previously impaired assets. Credit losses include \$0.5 million in realized losses related to credit triggered sales.
- (2) Impairments include \$11.2 million of credit impairment write-downs.
- (3) Impairments include \$6.0 million in realized losses due to a deed in lieu foreclosure and a \$5.9 million decrease in the commercial mortgage valuation allowance.
- (4) Derivatives include \$197.2 million of net unrealized gains related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities. The net unrealized gains were partially offset by mark to market adjustments on derivatives not designated as hedging instruments, with the largest component being \$66.4 million of net losses on interest rate swaps and the remainder relating to net losses from other risk management activities.
- (5) Other gains (losses) include net realized/unrealized losses on certain seed money investments.

	For the three months ended June 30, 2007			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	\$ (23.5)	\$ 10.0	\$ (85.6)	\$ (99.1)
Fixed maturity securities, trading	—	(7.5)	—	(7.5)
Equity securities	—	5.3	—	5.3
Equity securities, trading	—	13.1	—	13.1
Mortgage loans on real estate(2)	0.2	—	—	0.2
Derivatives (3)	—	—	114.0	114.0
Other (4)	—	14.0	15.4	29.4
Total	<u>\$ (23.3)</u>	<u>\$ 34.9</u>	<u>\$ 43.8</u>	<u>\$ 55.4</u>

- (1) Impairments include \$1.4 million of credit impairment write-downs and \$7.8 million in realized credit recoveries on the sale of previously impaired assets. Certain fixed maturity securities moved into a loss position during the second quarter of 2007, and we determined that we did not have the ability and intent to hold these securities. As a result, we recognized impairment losses on these securities of \$24.5 million, net of recoveries on the subsequent sale, primarily due to a change in interest rates. Credit losses include \$6.4 million in realized losses and \$1.0 million in realized gains related to credit triggered sales.
- (2) Impairments include a \$0.2 million decrease in the commercial mortgage valuation allowance.
- (3) Derivatives include \$94.1 million of net unrealized gains related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities. The remainder of the net gain resulted primarily from mark to market adjustments on derivatives not designated as hedging instruments.
- (4) Other gains (losses) include net realized/unrealized gains on certain seed money investments.

The following tables present the contributors to net realized/unrealized capital gains and losses for our invested assets for the six months ended June 30, 2008 and 2007.

	For the six months ended June 30, 2008			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities (1)	\$ (78.1)	\$ 7.4	\$ (11.7)	\$ (82.4)
Fixed maturity securities, trading	—	(22.6)	—	(22.6)
Equity securities (2)	(35.2)	2.1	—	(33.1)
Equity securities, trading	—	(11.6)	—	(11.6)
Mortgage loans on real estate (3)	(13.1)	—	—	(13.1)
Derivatives (4)	—	—	(86.1)	(86.1)
Other (5)	—	2.0	9.4	11.4
Total	<u>\$ (126.4)</u>	<u>\$ (22.7)</u>	<u>\$ (88.4)</u>	<u>\$ (237.5)</u>

- (1) Impairments include \$79.7 million of credit impairment write-downs and \$5.3 million in realized credit recoveries on the sale of previously impaired assets. Credit losses include \$4.9 million in realized losses related to credit triggered sales.
- (2) Impairments include \$35.2 million of credit impairment write-downs.
- (3) Impairments include \$6.0 million in realized losses due to a deed in lieu foreclosure and a \$7.1 million increase in the commercial mortgage valuation allowance.

- (4) Derivatives include \$11.5 million of net unrealized gains related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities. The remainder of the net loss resulted primarily from mark to market adjustments on derivatives not designated as hedging instruments, with the largest components being \$53.0 million of net losses on credit default swaps and \$51.7 million of net losses on interest rate swaps and the remainder relating to net gains from other risk management activities.
- (5) Other gains (losses) include net realized/unrealized losses on certain seed money investments.

	For the six months ended June 30, 2007			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	\$ (28.5)	\$ 13.9	\$ (74.3)	\$ (88.9)
Fixed maturity securities, trading	—	(6.3)	—	(6.3)
Equity securities(2)	1.0	5.3	—	6.3
Equity securities, trading	—	16.5	—	16.5
Mortgage loans on real estate(3)	(1.2)	—	—	(1.2)
Derivatives (4)	—	—	96.1	96.1
Other(5)	—	42.9	27.6	70.5
Total	\$ (28.7)	\$ 72.3	\$ 49.4	\$ 93.0

- (1) Impairments include \$3.3 million of credit impairment write-downs and \$7.8 million in realized credit recoveries on the sale of previously impaired assets. Certain fixed maturity securities moved into a loss position during the second quarter of 2007, and we determined that we did not have the ability and intent to hold these securities. As a result, we recognized impairment losses on these securities of \$24.5 million, net of recoveries on the subsequent sale, primarily due to a change in interest rates. Credit losses include \$10.0 million in realized losses and \$1.4 million in realized gains related to credit triggered sales.
- (2) Impairments include \$1.0 million in realized recoveries on sale of previously impaired assets.
- (3) Impairments include a \$1.2 million increase in the commercial mortgage valuation allowance.

- (4) Derivatives include \$82.7 million of net unrealized gains related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities. The remainder of the net gain resulted primarily from mark to market adjustments on derivatives not designated as hedging instruments.
- (5) Other gains (losses) include a \$24.6 million realized gain on the sale of stock of an equity method investment and net realized/unrealized gains on certain seed money investments.

## U.S. Investment Operations

Of our invested assets, \$61.1 billion were held by our U.S. operations. Our U.S. invested assets are managed by Principal Global Investors, a subsidiary of Principal Life. Our primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters. We seek to protect policyholders' benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing the credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification. We are exposed to three primary sources of investment risk:

- credit risk, relating to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest;
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves and
- equity risk, relating to adverse fluctuations in a particular common stock.

Our ability to manage credit risk is essential to our business and our profitability. We devote considerable resources to the credit analysis of each new investment. We manage credit risk through industry, issuer and asset class diversification. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing all investment policies and approving or authorizing all investments, except the Executive Committee of the Board must approve any investment transaction exceeding \$500.0 million. As of June 30, 2008, there are ten members on the Investment Committee, two of whom are members of our Board of Directors. The remaining members are senior management members representing various areas of our company.

We also seek to reduce call or prepayment risk arising from changes in interest rates in individual investments. We limit our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer and we require additional yield on these investments to compensate for the risk that the issuer will exercise such option. We assess option risk in all investments we make and, when we take that risk, we price for it accordingly.

Our Fixed Income Securities Committee, consisting of fixed income securities senior management members, approves the credit rating for the fixed maturity securities we purchase. Teams of security analysts, organized by industry, focus either on the public or private markets and analyze and monitor these investments. In addition, we have teams who specialize in residential mortgage-backed securities, CMBS, asset-backed securities ("ABS") and public below investment grade securities. We establish a credit reviewed list of approved public issuers to provide an efficient way for our portfolio managers to purchase liquid bonds for which credit review has already been completed. Issuers remain on the list for one year unless removed by our analysts. Our analysts monitor issuers on the list on a continuous basis with a formal review documented annually or more frequently if material events affect the issuer. The analysis includes both fundamental and technical factors. The fundamental analysis encompasses both quantitative and qualitative analysis of the issuer.

The qualitative analysis includes an assessment of both accounting and management aggressiveness of the issuer. In addition, technical indicators such as stock price volatility and credit default swap levels are monitored.

Our Fixed Income Securities Committee also reviews private transactions on a continuous basis to assess the quality ratings of our privately placed investments. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

- material declines in the issuer's revenues or margins;
- significant management or organizational changes;

63

- significant uncertainty regarding the issuer's industry;
- debt service coverage or cash flow ratios that fall below industry-specific thresholds;
- violation of financial covenants and
- other business factors that relate to the issuer.

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage loan portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering the origination of new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying security, conduct a comprehensive market analysis and compare against industry lending practices. We use a proprietary risk rating model to evaluate all new and a majority of existing loans within the portfolio. The proprietary risk model is designed to stress projected cash flows under simulated economic and market downturns. Our lending guidelines are designed to encourage 75% or less loan-to-value ratios and a debt service coverage ratio of at least 1.2 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The weighted average loan-to-value ratio at origination for brick and mortar commercial mortgages in our portfolio was 60% and the debt service coverage ratio at loan inception was 1.7 times as of June 30, 2008.

We have limited exposure to equity risk in our common stock portfolio. Equity securities accounted for only 1% of our U.S. invested assets as of June 30, 2008.

Our investment decisions and objectives are a function of the underlying risks and product profiles of each primary business operation. In addition, we diversify our product portfolio offerings to include products that contain features that will protect us against fluctuations in interest rates. Those features include adjustable crediting rates, policy surrender charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 3. "Quantitative and Qualitative Disclosures About Market Risk."

#### **Overall Composition of U.S. Invested Assets**

U.S. invested assets as of June 30, 2008, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of U.S. invested assets are fixed maturity securities and commercial mortgage loans. The remainder is invested in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets. The following discussion analyzes the composition of U.S. invested assets, but excludes invested assets of the separate accounts.

#### **U.S. Invested Assets**

	June 30, 2008		December 31, 2007	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
<b>Fixed maturity securities:</b>				
Public	\$ 30,512.3	50%	\$ 29,495.5	49%
Private	14,603.9	24	15,053.2	25
Equity securities	470.8	1	533.5	1
<b>Mortgage loans:</b>				
Commercial	10,857.3	18	10,763.5	18
Residential	1,373.9	2	1,337.5	2
Real estate held for sale	122.4	—	82.4	—
Real estate held for investment	763.7	1	777.2	1
Policy loans	859.2	1	853.7	2
Other investments	1,531.1	3	1,391.4	2
<b>Total invested assets</b>	<b>61,094.6</b>	<b>100%</b>	<b>60,287.9</b>	<b>100%</b>
Cash and cash equivalents	1,458.9		1,261.5	
<b>Total invested assets and cash</b>	<b>\$ 62,553.5</b>		<b>\$ 61,549.4</b>	

64

#### **Fixed Maturity Securities**

Fixed maturity securities consist of short-term investments, publicly traded debt securities, privately placed debt securities and redeemable preferred stock, and represented 74% of total U.S. invested assets for both June 30, 2008, and December 31, 2007. The fixed maturity securities portfolio was comprised, based on carrying amount, of 68% in publicly traded fixed maturity securities and 32% in privately placed fixed maturity securities as of June 30,

2008, and 66% in publicly traded fixed maturity securities and 34% in privately placed fixed maturity securities as of December 31, 2007. Included in the privately placed category as of June 30, 2008, and December 31, 2007, were \$7.9 billion and \$8.4 billion, respectively, of securities eligible for resale to qualified institutional buyers under Rule 144A under the Securities Act of 1933. Fixed maturity securities were diversified by category of issuer as of June 30, 2008, and December 31, 2007, as shown in the following table:

**U.S. Invested Assets**  
**Fixed Maturity Securities by Type of Issuer**

	June 30, 2008		December 31, 2007	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
U.S. Government and agencies	\$ 577.1	1%	\$ 672.3	1%
States and political subdivisions	2,242.1	5	2,071.5	5
Non-U.S. governments	434.7	1	453.9	1
Corporate — public	20,045.0	44	19,875.2	45
Corporate — private	11,782.6	26	11,813.1	27
Residential pass-through securities	2,146.2	5	1,496.1	3
Commercial mortgage-backed securities	4,961.9	11	4,665.6	10
Residential collateralized mortgage obligations	852.2	2	936.9	2
Asset-backed securities	2,074.4	5	2,564.1	6
Total fixed maturities	\$ 45,116.2	100%	\$ 44,548.7	100%

We held \$10,034.7 million of mortgage-backed and ABS as of June 30, 2008, and \$9,662.7 million as of December 31, 2007.

We believe that it is desirable to hold residential mortgage-backed pass-through securities due to their credit quality and liquidity as well as portfolio diversification characteristics. Our portfolio is comprised of GNMA, FNMA and FHLMC pass-through securities. In addition, our residential collateralized mortgage obligation portfolio offers structural features that allow cash flows to be matched to our liabilities.

CMBS provide high levels of credit protection, diversification and reduced event risk. CMBS are predominantly comprised of rated large pool securitizations that are individually and collectively diverse by property type, borrower and geographic dispersion.

We purchase ABS to diversify the overall credit risks of the fixed maturity securities portfolio and to provide attractive returns. The principal risks in holding ABS are structural and credit risks. Structural risks include the security's priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from the collateral and the potential for prepayments. Credit risks involve issuer/servicer risk where collateral values can become impaired in the event of servicer credit deterioration. Our ABS portfolio is diversified both by type of asset and by issuer. We actively monitor holdings of ABS to ensure that the risk profile of each security improves or remains consistent. Prepayments in the ABS portfolio are, in general, insensitive to changes in interest rates or are insulated to such changes by call protection features. In the event that we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we diversify the risks of ABS by holding a diverse class of securities, which limits our exposure to any one security.

The international exposure in our U.S. fixed maturity securities totaled \$9,825.4 million, or 22% of total fixed maturity securities, as of June 30, 2008, comprised of corporate and foreign government fixed maturity securities. Of the \$9,825.4 million as of June 30, 2008, investments totaled \$2,890.4 million in the continental European Union, \$2,449.3 million in the United Kingdom, \$1,052.2 million in Asia, \$936.0 million in Australia, \$564.1 million in South America, \$320.0 million in Mexico and \$58.2 million in Japan. The remaining \$1,555.2 million is invested in 24 other countries. All international fixed maturity securities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control

concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturity securities investments to 20% of total statutory general account assets with a 4% limit in emerging markets. Exposure to Canada is not included in our international exposure. As of June 30, 2008, our investments in Canada totaled \$1,555.1 million.

The following tables present the amortized cost of our top ten exposures including approved counterparty exposure limits as of June 30, 2008, and December 31, 2007.

	June 30, 2008 Amortized cost (in millions)
Bank of America Corp. (1)	\$ 423.0
JP Morgan Chase & Co. (1)	376.3
MBIA Inc. (2)	325.7
American International Group Inc. (1)	267.0
AT&T Inc.	250.8
General Electric Co	244.9
Royal Bank of Scotland Group PLC (1)	237.2
Citigroup Inc. (1)	233.2
Ambac Financial Group Inc. (3)	232.0
Wachovia Corp (1)	202.8
Total top ten exposures	\$ 2,792.9

(1) Includes approved counterparty limit. The actual and the stressed potential exposures are less than the approved limit.

- (2) MBIA Inc. exposure is comprised of the guarantee of underlying securities that are predominately rated “A-” equivalent or better by the rating agencies on a stand-alone basis.
- (3) Of the Ambac Financial Group Inc. exposure, 83% is comprised of the guarantee of underlying securities that are predominantly rated “A-” equivalent or better by the rating agencies on a stand-alone basis.

	December 31, 2007 Amortized cost (in millions)
Bank of America Corp. (1)	\$ 360.7
MBIA Inc. (2)	323.6
American International Group Inc. (1)	270.1
General Electric Co	259.6
AT&T Inc.	250.9
Royal Bank of Scotland Group PLC (1)	240.9
JP Morgan Chase & Co. (1)	237.6
Ambac Financial Group Inc. (3)	235.3
Citigroup Inc. (1)	233.2
Deutsche Bank AG (1)	203.7
Total top ten exposures	<u>\$ 2,615.6</u>

- (1) Includes approved counterparty limit. The actual and the stressed potential exposures are less than the approved limit.
- (2) MBIA Inc. exposure is comprised of the guarantee of underlying securities that are rated “A-” equivalent or better by the rating agencies on a stand-alone basis. The MBIA wrap guarantees performance in the event of default of the underlying securities, bringing the combined rating to AAA.
- (3) Of the Ambac Financial Group Inc. exposure, 84% is comprised of the guarantee of underlying securities that are predominantly rated “A-” equivalent or better by the rating agencies on a stand-alone basis. The Ambac Financial Group Inc. wrap guarantees performance in the event of default of the underlying securities, bringing the combined rating to AAA.

Our top ten exposures were rated an “A” equivalent or better by the rating agencies as of June 30, 2008, and December 31, 2007. As of June 30, 2008, and December 31, 2007, no individual non-government issuer represented more than 1% of U.S. invested assets.

We have exposure to monoline bond and mortgage insurers with an amortized cost of \$819.6 million and a carrying amount of \$804.0 million as of June 30, 2008. The \$819.6 million includes wrapped guarantees on \$714.6 million of underlying municipal bonds, corporate credit or ABS. Our direct exposure to these insurers was \$105.0 million. Of the \$714.6 million in wrapped guarantees, 47% was municipal bonds, of which 99% was investment grade; 36% was investment grade bank perpetual preferred securities; 10% was ABS backed by sub-prime first lien mortgages, of which 83% was investment grade; and 7% was corporate fixed maturities, of which 90% was investment grade.

Valuation techniques for the fixed maturity securities portfolio vary by security type and the availability of market data. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different pricing models or assumptions could produce different financial results. Valuations are generally obtained from third-party pricing services and broker quotes when available. For corporate bonds where quoted market prices are not available, a matrix pricing valuation approach is used. Securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data or market clearing data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors. Certain market events that could impact the valuation of securities include issuer credit ratings, business climate, management changes, litigation and government actions among others. Internal models specific to the asset class may also be used. Prices are then reviewed by pricing analysts for reasonableness based on asset class given observable market data. In addition, investment analysts who are familiar with specific securities review prices for reasonableness through direct interaction with external sources, recent trade activity or internal models. Monthly, all bonds placed on the “watch list” are analyzed by investment analysts or analysts that focus on troubled securities (“Workout Group”). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative inputs.

The Securities Valuation Office (“SVO”) of the National Association of Insurance Commissioners (“NAIC”) evaluates the bond investments of insurers for regulatory reporting purposes and assigns securities to one of six investment categories. The NAIC designations closely mirror the nationally recognized securities rating organizations’ credit ratings for marketable bonds. NAIC designations 1 and 2 include bonds considered investment grade by such rating organizations. Bonds are considered investment grade when rated “Baa3” or higher by Moody’s, or “BBB-” or higher by Standard & Poor’s. NAIC designations 3 through 6 are referred to as below investment grade. Bonds are considered below investment grade when rated “Ba1” or lower by Moody’s, or “BB+” or lower by Standard & Poor’s. As of June 30, 2008, the percentage, based on estimated fair value, of total publicly traded and privately placed fixed maturity securities that were investment grade with an NAIC designation 1 or 2 was 95%.

We also monitor the credit drift of our corporate fixed maturity securities portfolio. Credit drift is defined as the ratio of the percentage of rating downgrades, including defaults, divided by the percentage of rating upgrades. We measure credit drift once each fiscal year, assessing the changes in our internally developed credit ratings that have occurred during the year. Standard & Poor’s annual credit ratings drift ratio measures the credit rating change, within a specific year, of companies that have been assigned ratings by Standard & Poor’s. The annual internal credit drift ratio on corporate fixed maturity securities we held in our general account was 0.89 times compared to the Standard & Poor’s drift ratio of 0.69 times, as of December 31, 2007.

The following table presents our total fixed maturity securities by NAIC designation and the equivalent ratings of the nationally recognized securities rating organizations as of June 30, 2008, and December 31, 2007, as well as the percentage, based on estimated fair value, that each designation comprises:

67

**U.S. Invested Assets**  
**Fixed Maturity Securities by Credit Quality (1)**

NAIC rating	Rating agency equivalent	June 30, 2008			December 31, 2007		
		Amortized cost	Carrying amount	% of total carrying amount	Amortized cost	Carrying amount	% of total carrying amount
		(\$ in millions)					
1	Aaa/Aa/A	\$ 26,967.8	\$ 25,745.8	57%	\$ 25,635.0	\$ 25,644.1	57%
2	Baa	17,663.3	17,060.9	38	16,661.8	16,742.0	38
3	Ba	2,182.3	2,028.0	5	1,904.7	1,872.1	4
4	B	179.3	171.4	—	179.0	179.4	1
5	Caa and lower	95.8	86.2	—	103.1	99.2	—
6	In or near default	24.6	23.9	—	12.0	11.9	—
	Total fixed maturities	\$ 47,113.1	\$ 45,116.2	100%	\$ 44,495.6	\$ 44,548.7	100%

(1) Includes 45 securities with an amortized cost of \$453.4 million, gross gains of \$3.7 million, gross losses of \$15.8 million and a carrying amount of \$441.3 million as of June 30, 2008, that are still pending a review and assignment of a rating by the SVO. Due to the timing of when fixed maturity securities are purchased, legal documents are filed and the review by the SVO, there will always be securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent rating is assigned based on our fixed income analyst's assessment.

The following tables present credit quality and year of issuance ("vintage") for our CMBS and ABS home equity portfolio. Our ABS home equity portfolio is backed by subprime first lien mortgages. As of June 30, 2008, based on amortized cost, 88% of our CMBS portfolio had ratings of A or higher and 61% was issued in 2005 or before and 96% of our ABS home equity portfolio had ratings of A or higher and 86% was issued in 2005 or before.

**U.S. Invested Assets**  
**Commercial Mortgage-Backed Securities by Rating and Vintage**

	June 30, 2008		December 31, 2007	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount
	(in millions)			
<b>Lowest agency rating</b>				
AAA	\$ 3,352.8	\$ 3,231.7	\$ 2,818.8	\$ 2,829.6
AA	827.6	725.2	645.3	631.3
A	661.2	530.1	636.4	601.4
BBB	566.8	399.2	569.8	504.8
BB and below	81.0	75.7	84.1	98.5
Total by lowest agency rating	\$ 5,489.4	\$ 4,961.9	\$ 4,754.4	\$ 4,665.6
<b>Vintage</b>				
2003 and prior	\$ 2,009.7	\$ 1,981.9	\$ 2,092.9	\$ 2,174.9
2004	614.0	552.9	545.6	523.4
2005	737.3	647.0	716.2	683.4
2006 (1)	515.9	415.8	428.2	389.7
2007 (1)	1,535.5	1,290.6	971.5	894.2
2008	77.0	73.7	—	—
Total by vintage	\$ 5,489.4	\$ 4,961.9	\$ 4,754.4	\$ 4,665.6

(1) As of June 30, 2008, 52% of the 2006 vintage are rated AAA and 13% are rated AA, and 62% of the 2007 vintage are rated AAA and 19% are rated AA.

68

**U.S. Invested Assets**  
**Asset-Backed Securities – Home Equity by Rating and Vintage**

	June 30, 2008		December 31, 2007	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount
	(in millions)			
<b>Lowest agency rating</b>				
AAA	\$ 354.3	\$ 309.7	\$ 454.4	\$ 434.1
AA	126.9	93.6	105.1	90.9
A	62.4	44.0	31.4	27.4
BBB	4.1	3.7	8.1	4.6
BB and below	18.8	12.4	—	—
Total by lowest agency rating	\$ 566.5	\$ 463.4	\$ 599.0	\$ 557.0

Vintage					
2003 and prior	\$	285.7	\$	241.4	\$ 307.6 \$ 290.2
2004		95.6		81.9	104.3 100.2
2005		103.2		80.9	107.6 97.6
2006		18.8		14.3	16.3 15.7
2007		63.2		44.9	63.2 53.3
Total by vintage	\$	566.5	\$	463.4	\$ 599.0 \$ 557.0

We believe that our long-term fixed maturity securities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturity securities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of cash flow. As of June 30, 2008, we had invested 3.6% of new cash flow for the year in below investment grade assets. While the general account investment returns have improved due to the below investment grade asset class, we manage its growth strategically by limiting it to 10% of the total fixed maturity securities portfolios.

We invest in privately placed fixed maturity securities to enhance the overall value of the portfolio, increase diversification and obtain higher yields than are possible with comparable quality public market securities. Generally, private placements provide broader access to management information, strengthened negotiated protective covenants, call protection features and, where applicable, a higher level of collateral. They are, however, generally not freely tradable because of restrictions imposed by federal and state securities laws and illiquid trading markets.

The following table shows the carrying amount of our corporate fixed maturity securities by Salomon industry category, as well as the percentage of the total corporate portfolio that each Salomon industry category comprises as of June 30, 2008, and December 31, 2007.

69

#### U.S. Invested Assets Corporate Fixed Maturity Securities by Salomon Industry

Industry class	June 30, 2008		December 31, 2007	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Finance — Bank	\$ 3,979.4	12%	\$ 4,125.7	13%
Finance — Insurance	3,101.4	10	3,147.8	10
Finance — Other	4,373.9	14	4,770.1	15
Industrial — Consumer	1,325.0	4	1,241.3	4
Industrial — Energy	3,184.7	10	3,143.0	10
Industrial — Manufacturing	6,072.8	19	5,638.7	18
Industrial — Other	168.3	1	171.4	1
Industrial — Service	4,421.8	14	4,432.1	14
Industrial — Transport	1,027.9	3	1,020.1	3
Utility — Electric	2,573.3	8	2,325.5	7
Utility — Other	42.9	—	46.5	—
Utility — Telecom	1,556.2	5	1,626.1	5
Total	\$ 31,827.6	100%	\$ 31,688.3	100%

We monitor any decline in the credit quality of fixed maturity securities through the designation of “problem securities”, “potential problem securities” and “restructured securities”. We define problem securities in our fixed maturity portfolio as securities: (i) as to which principal and/or interest payments are in default or where default is perceived to be imminent in the near term, or (ii) issued by a company that went into bankruptcy subsequent to the acquisition of such securities. We define potential problem securities in our fixed maturity portfolio as securities included on an internal “watch list” for which management has concerns as to the ability of the issuer to comply with the present debt payment terms and which may result in the security becoming a problem or being restructured. The decision whether to classify a performing fixed maturity security as a potential problem involves significant subjective judgments by our management as to the likely future industry conditions and developments with respect to the issuer. We define restructured securities in our fixed maturity portfolio as securities where a concession has been granted to the borrower related to the borrower’s financial difficulties that would not have otherwise been considered. We determine that restructures should occur in those instances where greater economic value will be realized under the new terms than through liquidation or other disposition and may involve a change in contractual cash flows. If at the time of restructure, the present value of the new future cash flows is less than the current cost of the asset being restructured, a realized capital loss is recorded in net income and a new cost basis is established.

We have a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers’ credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Every month, a group of individuals including the Chief Investment Officer, our Portfolio Managers, members of our Workout Group and representatives from Investment Accounting review all securities to determine whether an other than temporary decline in value exists and whether losses should be recognized. The analysis focuses on each issuer’s ability to service its debts in a timely fashion and the length of time the security has been trading below cost. Formal documentation of the analysis and our decision is prepared and approved by management.

We consider relevant facts and circumstances in evaluating whether a credit or interest-rate related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) our ability and intent to hold the security for a period of time that allows for the recovery in value which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other than temporarily impaired, the difference between amortized cost and fair value would be charged to net income.

There are a number of significant risks and uncertainties inherent in the process of monitoring credit impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to hold the security to maturity or until it recovers in value. Any of these situations could result in a charge to earnings in a future period.

The net realized loss relating to other than temporary credit impairments of fixed maturity securities was \$74.4 million for the six months ended June 30, 2008.

For the six months ended June 30, 2008, we realized \$5.7 million of gross losses upon disposal of bonds excluding hedging adjustments. Included in this \$5.7 million is \$4.9 million related to sales of ten names that experienced credit deterioration during the period. We generally intend to hold securities in unrealized loss positions until they mature or recover. However, we do sell bonds under certain circumstances such as when we have evidence of a deterioration in the issuer's creditworthiness, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities. Sales generate both gains and losses.

The following tables present our fixed maturity securities available-for-sale by industry category and the associated gross unrealized gains and losses as of June 30, 2008, and December 31, 2007.

**U.S. Invested Assets**  
**Fixed Maturity Securities Available-for-Sale by Industry Category**

	June 30, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance — Bank	\$ 4,365.1	\$ 29.3	\$ 415.0	\$ 3,979.4
Finance — Insurance	3,244.4	47.3	190.3	3,101.4
Finance — Other	4,532.0	88.4	246.5	4,373.9
Industrial — Consumer	1,344.1	18.8	37.9	1,325.0
Industrial — Energy	3,140.3	93.7	49.3	3,184.7
Industrial — Manufacturing	6,178.9	81.3	187.4	6,072.8
Industrial — Other	169.9	1.2	2.8	168.3
Industrial — Service	4,458.2	77.0	113.4	4,421.8
Industrial — Transport	1,052.9	26.2	51.2	1,027.9
Utility — Electric	2,567.9	53.5	48.1	2,573.3
Utility — Other	39.4	3.5	—	42.9
Utility — Telecom	1,548.4	43.7	35.9	1,556.2
Total corporate securities	<u>32,641.5</u>	<u>563.9</u>	<u>1,377.8</u>	<u>31,827.6</u>
Residential pass-through securities	1,667.3	18.2	17.2	1,668.3
Commercial mortgage-backed securities	5,489.4	45.4	572.9	4,961.9
Residential collateralized mortgage obligations (1)	921.5	1.4	70.7	852.2
Asset-backed securities — Home equity (2)	566.5	—	103.1	463.4
Asset-backed securities — All other	859.6	12.1	25.4	846.3
Collateralized debt obligations — Credit	678.3	—	315.4	362.9
Collateralized debt obligations — CMBS	316.7	—	146.6	170.1
Collateralized debt obligations — Loans	85.6	—	15.6	70.0
Collateralized debt obligations — ABS (3)	101.5	0.5	44.4	57.6
Total mortgage-backed and other asset-backed securities	<u>10,686.4</u>	<u>77.6</u>	<u>1,311.3</u>	<u>9,452.7</u>
U.S. Government and agencies	558.1	19.1	0.1	577.1
States and political subdivisions	2,068.8	31.9	27.1	2,073.6
Non-U.S. governments	407.8	30.2	3.3	434.7
Total fixed maturity securities, available-for-sale	<u>\$ 46,362.6</u>	<u>\$ 722.7</u>	<u>\$ 2,719.6</u>	<u>\$ 44,365.7</u>

(1) Includes exposure to Alt-a mortgage loans with an amortized cost of \$76.1 million, gross unrealized losses of \$13.4 million and a carrying amount of \$62.7 million. All of these securities are rated AAA and 61% are 2005 and prior vintages.

(2) This exposure is all related to sub-prime mortgage loans.

(3) Includes exposure to sub-prime mortgage loans with an amortized cost of \$67.9 million, gross unrealized gains of \$0.5 million, gross unrealized losses of \$41.0 million and a carrying amount of \$27.4 million.



**U.S. Invested Assets**  
**Fixed Maturity Securities Available-for-Sale by Industry Category**

	December 31, 2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance — Bank	\$ 4,226.4	\$ 46.0	\$ 176.7	\$ 4,095.7
Finance — Insurance	3,115.6	100.6	68.4	3,147.8
Finance — Other	4,784.1	133.4	147.4	4,770.1
Industrial — Consumer	1,230.2	30.2	19.1	1,241.3
Industrial — Energy	3,012.3	153.7	23.0	3,143.0
Industrial — Manufacturing	5,601.8	145.0	108.1	5,638.7
Industrial — Other	169.9	2.5	1.0	171.4
Industrial — Service	4,341.6	137.2	46.7	4,432.1
Industrial — Transport	1,001.4	42.2	23.5	1,020.1
Utility — Electric	2,268.6	79.9	23.0	2,325.5
Utility — Other	41.0	5.5	—	46.5
Utility — Telecom	1,558.9	86.3	19.1	1,626.1
Total corporate securities	31,351.8	962.5	656.0	31,658.3
Residential pass-through securities	1,481.5	23.6	9.0	1,496.1
Commercial mortgage-backed securities	4,754.4	107.4	196.2	4,665.6
Residential collateralized mortgage obligations (1)	947.7	3.3	14.1	936.9
Asset-backed securities — Home equity (2)	599.0	0.1	42.1	557.0
Asset-backed securities — All other	892.6	19.1	8.3	903.4
Collateralized debt obligations — Credit	735.4	0.1	123.6	611.9
Collateralized debt obligations — CMBS	332.7	1.4	71.6	262.5
Collateralized debt obligations — Loans	88.8	—	5.7	83.1
Collateralized debt obligations — ABS (3)	94.1	—	30.1	64.0
Total mortgage-backed and other asset-backed securities	9,926.2	155.0	500.7	9,580.5
U.S. Government and agencies	628.5	29.0	0.1	657.4
States and political subdivisions	1,867.6	39.1	10.2	1,896.5
Non-U.S. governments	419.4	35.7	1.2	453.9
Total fixed maturity securities, available-for-sale	\$ 44,193.5	\$ 1,221.3	\$ 1,168.2	\$ 44,246.6

- (1) Includes exposure to Alt-a mortgage loans with an amortized cost of \$78.7 million, gross unrealized gains of \$0.4 million, gross unrealized losses of \$4.1 million and a carrying amount of \$75.0 million. All of these securities are rated AAA and 62% are 2005 and prior vintages.
- (2) This exposure is all related to sub-prime mortgage loans.
- (3) Includes exposure to sub-prime mortgage loans with an amortized cost of \$79.1 million, gross unrealized losses of \$28.8 million and a carrying amount of \$50.3 million.

The credit disruption in the market that began in the last half of 2007, and continued into 2008, has led to reduced liquidity and wider credit spreads. As a result, we have seen an increase in unrealized losses in our securities portfolio. The losses were more pronounced in the finance sectors and in structured products such as collateralized debt obligations, ABS and CMBS. The decline in value in large part reflects the illiquid markets.

The total unrealized losses on our fixed maturity securities available-for-sale were \$2,719.6 million and \$1,168.2 million as of June 30, 2008, and December 31, 2007, respectively. Of the \$2,719.6 million in gross unrealized losses as of June 30, 2008, there were \$5.9 million in losses attributed to securities scheduled to mature in one year or less, \$215.5 million attributed to securities scheduled to mature between one to five years, \$500.3 million attributed to securities scheduled to mature between five to ten years, \$686.6 million attributed to securities scheduled to mature after ten years and \$1,311.3 million related

to mortgage-backed and other ABS that are not classified by maturity year. The gross unrealized losses as of June 30, 2008, were concentrated primarily in the Commercial mortgage-backed securities, Finance — Bank, Collateralized debt obligations — Credit, Finance — Other and Finance - Insurance sectors. The gross unrealized losses as of December 31, 2007, were concentrated primarily in the Commercial mortgage-backed securities, Finance — Bank, Finance — Other, Collateralized debt obligations — Credit and Industrial — Manufacturing sectors.

The increase in unrealized losses was primarily due to the recent credit spread widening stemming from concerns in the sub-prime mortgage and leveraged finance markets. The credit concerns in the sub-prime market led to a fairly broad repricing of all credit based assets and strained market liquidity. This market disruption has impacted valuations at June 30, 2008, particularly in the CMBS, CDO and Finance sectors. Future changes in the fair value of these securities will be dependent on the return of market liquidity and changes in general market conditions including interest rates and credit spread movements. Due to the issuers' continued satisfaction of the securities' obligations in accordance with their contractual terms, the expectation that they will continue to do so given the evaluation of the fundamentals of the issuers' financial condition and other objective evidence and management's intent and ability to hold these securities to recovery, we believe the prices of the securities in the sectors were temporarily depressed.

The following tables present our fixed maturity securities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses as of June 30, 2008, and December 31, 2007.

**U.S. Invested Assets**  
**Fixed Maturity Securities Available-for-Sale by Quality**

	June 30, 2008			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Investment grade:				
Public	\$ 29,562.7	\$ 447.6	\$ 1,270.8	\$ 28,739.5
Private	14,317.9	242.2	1,243.4	13,316.7
Below investment grade:				
Public	1,173.5	15.4	91.1	1,097.8
Private	1,308.5	17.5	114.3	1,211.7
Total fixed maturity securities, available-for-sale	<u>\$ 46,362.6</u>	<u>\$ 722.7</u>	<u>\$ 2,719.6</u>	<u>\$ 44,365.7</u>

**U.S. Invested Assets**  
**Fixed Maturity Securities Available-for-Sale by Quality**

	December 31, 2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Investment grade:				
Public	\$ 27,966.9	\$ 752.8	\$ 577.5	\$ 28,142.2
Private	14,027.8	410.3	496.3	13,941.8
Below investment grade:				
Public	1,149.9	27.4	63.8	1,113.5
Private	1,048.9	30.8	30.6	1,049.1
Total fixed maturity securities, available-for-sale	<u>\$ 44,193.5</u>	<u>\$ 1,221.3</u>	<u>\$ 1,168.2</u>	<u>\$ 44,246.6</u>

74

The following tables present our investment grade fixed maturity securities available-for-sale and the associated gross unrealized losses as of June 30, 2008, and December 31, 2007.

**U.S. Invested Assets**  
**Unrealized Losses on Investment Grade Fixed Maturity Securities**  
**Available-for-Sale by Aging Category**

	June 30, 2008					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
(in millions)						
Three months or less	\$ 5,583.2	\$ 102.0	\$ 2,278.3	\$ 40.4	\$ 7,861.5	\$ 142.4
Greater than three to six months	3,451.3	155.1	1,593.2	122.6	5,044.5	277.7
Greater than six to nine months	1,428.7	188.9	996.1	117.5	2,424.8	306.4
Greater than nine to twelve months	945.1	158.8	799.3	248.8	1,744.4	407.6
Greater than twelve to twenty-four months	2,463.7	380.4	1,862.5	571.5	4,326.2	951.9
Greater than twenty-four to thirty-six months	2,160.3	245.7	896.6	118.4	3,056.9	364.1
Greater than thirty-six months	611.3	39.9	290.1	24.2	901.4	64.1
Total fixed maturities, available-for-sale	<u>\$ 16,643.6</u>	<u>\$ 1,270.8</u>	<u>\$ 8,716.1</u>	<u>\$ 1,243.4</u>	<u>\$ 25,359.7</u>	<u>\$ 2,514.2</u>

**U.S. Invested Assets**  
**Unrealized Losses on Investment Grade Fixed Maturity Securities**  
**Available-for-Sale by Aging Category**

	December 31, 2007					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
(in millions)						
Three months or less	\$ 2,858.8	\$ 71.9	\$ 1,556.3	\$ 36.0	\$ 4,415.1	\$ 107.9
Greater than three to six months	1,249.7	89.4	1,058.8	120.0	2,308.5	209.4
Greater than six to nine months	1,502.7	114.7	1,243.8	117.7	2,746.5	232.4
Greater than nine to twelve months	993.2	74.6	719.4	107.1	1,712.6	181.7
Greater than twelve to twenty-four months	1,545.8	100.8	580.2	45.4	2,126.0	146.2
Greater than twenty-four to thirty-six months	3,054.3	104.5	1,114.9	57.8	4,169.2	162.3
Greater than thirty-six months	617.9	21.6	354.2	12.3	972.1	33.9
Total fixed maturities, available-for-sale	<u>\$ 11,822.4</u>	<u>\$ 577.5</u>	<u>\$ 6,627.6</u>	<u>\$ 496.3</u>	<u>\$ 18,450.0</u>	<u>\$ 1,073.8</u>

75

The following tables present our below investment grade fixed maturity securities available-for-sale and the associated gross unrealized losses as of June 30, 2008, and December 31, 2007.

**U.S. Invested Assets**  
**Unrealized Losses on Below Investment Grade Fixed Maturity Securities**  
**Available-for-Sale by Aging Category**

	June 30, 2008					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 187.2	\$ 4.4	\$ 198.7	\$ 4.7	\$ 385.9	\$ 9.1
Greater than three to six months	132.1	10.8	139.2	19.8	271.3	30.6
Greater than six to nine months	50.8	9.2	181.1	20.5	231.9	29.7
Greater than nine to twelve months	36.8	6.5	158.4	27.4	195.2	33.9
Greater than twelve to twenty-four months	261.1	37.1	95.8	22.1	356.9	59.2
Greater than twenty-four to thirty-six months	122.3	18.4	80.4	18.6	202.7	37.0
Greater than thirty-six months	54.3	4.7	7.5	1.2	61.8	5.9
Total fixed maturities, available-for-sale	<u>\$ 844.6</u>	<u>\$ 91.1</u>	<u>\$ 861.1</u>	<u>\$ 114.3</u>	<u>\$ 1,705.7</u>	<u>\$ 205.4</u>

**U.S. Invested Assets**  
**Unrealized Losses on Below Investment Grade Fixed Maturity Securities**  
**Available-for-Sale by Aging Category**

	December 31, 2007					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 95.4	\$ 4.0	\$ 187.0	\$ 5.5	\$ 282.4	\$ 9.5
Greater than three to six months	62.8	2.6	115.6	5.4	178.4	8.0
Greater than six to nine months	130.5	22.8	91.3	3.0	221.8	25.8
Greater than nine to twelve months	91.5	11.3	17.3	0.7	108.8	12.0
Greater than twelve to twenty-four months	57.0	11.1	21.7	13.0	78.7	24.1
Greater than twenty-four to thirty-six months	138.3	11.4	72.9	2.1	211.2	13.5
Greater than thirty-six months	16.5	0.6	26.6	0.9	43.1	1.5
Total fixed maturities, available-for-sale	<u>\$ 592.0</u>	<u>\$ 63.8</u>	<u>\$ 532.4</u>	<u>\$ 30.6</u>	<u>\$ 1,124.4</u>	<u>\$ 94.4</u>

Of total gross unrealized losses as of June 30, 2008, and December 31, 2007, \$2,514.2 million and \$1,073.8 million were related to investment grade securities, respectively. Gross unrealized losses related to below investment grade securities were \$205.4 million and \$94.4 million as of June 30, 2008, and December 31, 2007, respectively.

The following tables present the carrying amount and gross unrealized losses on fixed maturity securities available-for-sale, where the estimated fair value has declined and remained below amortized cost by 20% or more as of June 30, 2008, and December 31, 2007.

76

**U.S. Invested Assets**  
**Unrealized Losses on Fixed Maturity Securities**  
**Fair Value 80% or Less of Amortized Cost**  
**Available-for-Sale by Aging Category**

	June 30, 2008					
	Problem, potential problem, and restructured		All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ —	\$ —	\$ 740.5	\$ 247.1	\$ 740.5	\$ 247.1
Greater than three to six months	0.2	2.1	1,126.5	531.3	1,126.7	533.4
Greater than six to nine months	—	—	330.8	403.0	330.8	403.0
Greater than nine to twelve months	—	—	65.3	92.5	65.3	92.5
Greater than twelve months	—	—	0.4	0.4	0.4	0.4
Total fixed maturity securities, available-for-sale	<u>\$ 0.2</u>	<u>\$ 2.1</u>	<u>\$ 2,263.5</u>	<u>\$ 1,274.3</u>	<u>\$ 2,263.7</u>	<u>\$ 1,276.4</u>

**U.S. Invested Assets**  
**Unrealized Losses on Fixed Maturity Securities**  
**Fair Value 80% or Less of Amortized Cost**  
**Available-for-Sale by Aging Category**

	December 31, 2007					
	Problem, potential		All other fixed		Total	

	problem, and restructured		maturity securities		Carrying amount	Gross unrealized losses
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses		
	(in millions)					
Three months or less	\$ —	\$ —	\$ 670.2	\$ 240.2	\$ 670.2	\$ 240.2
Greater than three to six months	—	—	110.7	80.9	110.7	80.9
Greater than six to nine months	—	—	0.5	0.3	0.5	0.3
Greater than nine to twelve months	—	—	—	—	—	—
Greater than twelve months	—	—	—	—	—	—
Total fixed maturity securities, available-for-sale	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 781.4</u>	<u>\$ 321.4</u>	<u>\$ 781.4</u>	<u>\$ 321.4</u>

Gross unrealized losses on fixed maturity securities where the estimated fair value has been 20% or more below amortized cost were \$1,276.4 million as of June 30, 2008, and \$321.4 million as of December 31, 2007. The gross unrealized losses attributed to those securities considered to be “problem”, “potential problem” or “restructured” were \$2.1 million as of June 30, 2008. There were no gross unrealized losses attributed to those securities considered to be “problem”, “potential problem” or “restructured” as of December 31, 2007.

The following table presents the total carrying amount of our fixed maturity portfolio, as well as its problem, potential problem and restructured fixed maturities for the periods indicated:

77

### U.S. Invested Assets Problem, Potential Problem and Restructured Fixed Maturities at Carrying Amount

	June 30, 2008	December 31, 2007
	(\$ in millions)	
Total fixed maturity securities (public and private)	<u>\$ 45,116.2</u>	<u>\$ 44,548.7</u>
Problem fixed maturity securities	\$ 28.1	\$ 13.1
Potential problem fixed maturity securities	9.9	29.2
Restructured fixed maturity securities	4.6	5.9
Total problem, potential problem and restructured fixed maturity securities	<u>\$ 42.6</u>	<u>\$ 48.2</u>
Total problem, potential problem and restructured fixed maturity securities as a percent of total fixed maturity securities	.09%	.11%

### *Mortgage Loans*

Mortgage loans consist primarily of commercial mortgage loans on real estate. The carrying amount of our commercial mortgage loan portfolio was \$10,857.3 million as of June 30, 2008, and \$10,763.5 million as of December 31, 2007. Commercial mortgage loans on real estate are generally reported at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances. Commercial mortgage loans held for sale are carried at the lower of cost or fair value, less cost to sell, and reported as mortgage loans in the statements of financial position.

Commercial mortgage loans play an important role in our investment strategy by:

- providing strong risk-adjusted relative value in comparison to other investment alternatives;
- enhancing total returns and
- providing strategic portfolio diversification.

As a result, we have focused on constructing a solid, high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Our commercial mortgage loan portfolio consists of primarily non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised of general-purpose industrial properties, manufacturing office properties and credit oriented retail properties.

Credit extensions in the state of California accounted for 18% of our commercial mortgage loan portfolio as of June 30, 2008. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building’s design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses, by building and geographic fault lines, the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

Our commercial loan portfolio is highly diversified by borrower. As of June 30, 2008, 32% of the U.S. commercial mortgage loan portfolio was comprised of mortgage loans with principal balances of less than \$10.0 million. The total number of commercial mortgage loans outstanding was 1,225 as of June 30, 2008, and 1,254 as of December 31, 2007. The average loan size of our commercial mortgage portfolio was \$8.9 million as of June 30, 2008.

We actively monitor and manage our commercial mortgage loan portfolio. Substantially all loans within the portfolio are analyzed regularly and are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. Based on ongoing monitoring, mortgage loans with a likelihood of becoming delinquent are identified and placed on an internal “watch list”. Among criteria which would indicate a potential problem are: imbalances in

78

ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

We review our mortgage loan portfolio and analyze the need for a valuation allowance for any loan which is delinquent for 60 days or more, in process of foreclosure, restructured, on the "watch list", or which currently has a valuation allowance. We categorize loans that are delinquent, loans in process of foreclosure, and loans to borrowers in bankruptcy as "problem" loans. Potential problem loans are loans placed on an internal "watch list" for which management has concerns as to the ability of the borrower to comply with the present loan payment terms and which may result in the loan becoming a problem or being restructured. The decision whether to classify a performing loan as a potential problem involves significant subjective judgments by management as to the likely future economic conditions and developments with respect to the borrower. We categorize loans for which the original terms of the mortgages have been modified or for which interest or principal payments have been deferred as "restructured" loans. We also consider matured loans that are refinanced at below market rates as restructured.

The valuation allowance for commercial mortgage loans includes a loan specific allowance for impaired loans and a provision for losses based on past loss experience believed to be adequate to absorb estimated probable credit losses. The changes in this valuation allowance are reported in net income on our consolidated statements of operations.

Commercial mortgage loans on real estate are considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine that a loan is impaired, a valuation allowance is established or a direct write-down of the loan is recorded for the difference between the carrying amount of the mortgage loan and the estimated value. Estimated value is based on either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or fair value of the collateral. When a valuation allowance is established, subsequent recoveries are credited to the valuation allowance and subsequent losses may be charged to the valuation allowance or as a direct write-down of the loan.

The determination of the calculation and the adequacy of the mortgage loan loss provision based on past experience and mortgage impairments are subjective. Our periodic evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. The current portfolio statistics and past loss experience produced a provision for the Principal Life general account totaling \$31.1 million. The evaluation of our impaired loan component of the allowance is subjective, as it requires estimating the amounts and timing of future cash flows expected to be received on impaired loans. Our financial position is sensitive to changes in estimated cash flows from mortgages, the value of the collateral and changes in the economic environment in general. The valuation allowance for PFG increased by \$7.1 million for the six months ended June 30, 2008, and increased by \$10.6 million for the year ended December 31, 2007. These increases are primarily related to specific reserves taken on certain problem loans of \$12.4 million and \$10.0 million as of June 30, 2008, and December 31, 2007, respectively.

The following table represents our commercial mortgage valuation allowance for the periods indicated:

**U.S. Invested Assets  
Commercial Mortgage Valuation Allowance**

	June 30, 2008	December 31, 2007
	(\$ in millions)	
Beginning balance	\$ 42.8	\$ 32.2
Provision	13.0	10.8
Release	(5.9)	(0.2)
Ending balance	\$ 49.9	\$ 42.8
Valuation allowance as % of carrying value before reserves	.46%	.40%

79

The following table presents the carrying amounts of problem, potential problem and restructured commercial mortgages relative to the carrying amount of all commercial mortgages for the periods indicated:

**U.S. Invested Assets  
Problem, Potential Problem and Restructured Commercial Mortgages at Carrying Amount**

	June 30, 2008	December 31, 2007
	(\$ in millions)	
Total commercial mortgages	\$ 10,857.3	\$ 10,763.5
Problem commercial mortgages (1)	\$ 54.8	\$ 35.8
Potential problem commercial mortgages	35.6	14.5
Restructured commercial mortgages	—	14.8
Total problem, potential problem and restructured commercial mortgages	\$ 90.4	\$ 65.1
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	.83%	.60%

(1) Problem commercial mortgages includes three mortgage loans in foreclosure of \$28.0 million as of June 30, 2008, and one mortgage loan in foreclosure of \$13.0 million as of December 31, 2007. One of the loans in foreclosure as of June 30, 2008, is the same mortgage loan that was in foreclosure as of December 31, 2007.

## Equity Real Estate

We hold commercial equity real estate as part of our investment portfolio. As of June 30, 2008, and December 31, 2007, the carrying amount of equity real estate investment was \$886.1 million and \$859.6 million, respectively, or 1% of U.S. invested assets. Our commercial equity real estate is held in the form of wholly owned real estate, real estate acquired upon foreclosure of commercial mortgage loans and majority owned interests in real estate joint ventures.

Equity real estate is categorized as either “real estate held for investment” or “real estate held for sale.” Real estate held for investment totaled \$763.7 million as of June 30, 2008, and \$777.2 million as of December 31, 2007. The carrying value of real estate held for investment is generally adjusted for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as realized investment losses and, accordingly, are reflected in our consolidated results of operations. For the six months ended June 30, 2008, and for the year ended December 31, 2007, there were no such impairment adjustments.

The carrying amount of real estate held for sale as of June 30, 2008, was \$122.4 million. There was no valuation allowance at June 30, 2008. The carrying amount of real estate held for sale as of December 31, 2007, was \$82.4 million. There was no valuation allowance at December 31, 2007. Once we identify a real estate property to be sold and commence a plan for marketing the property, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Equity real estate is distributed across geographic regions of the country with larger concentrations in the South Atlantic, West South Central and Pacific regions of the United States as of June 30, 2008. By property type, there is a concentration in office, industrial site buildings, and retail that represented approximately 77% of the equity real estate portfolio as of June 30, 2008.

## Other Investments

Our other investments totaled \$1,531.1 million as of June 30, 2008, compared to \$1,391.4 million as of December 31, 2007. Derivatives accounted for \$1,223.3 million in other investments as of June 30, 2008. The remaining invested assets include equity method investments, which include properties owned jointly with venture partners and operated by the partners.

## International Investment Operations

Of our invested assets, \$4.0 billion were held by our International Asset Management and Accumulation segment as of June 30, 2008. Our international investment operations consist of the investments of Principal International. Principal Global Investors advises each Principal International affiliate on investment policies and strategies that are consistent with the products they offer. Due to the regulatory constraints in each country, each company maintains its own investment policies. As shown in the following table, the major categories of international invested assets as of June 30, 2008, and December 31, 2007, were fixed maturity securities, other investments and residential mortgage loans. The following discussion analyzes the composition of general account assets, but excludes invested assets of the separate accounts.

### International Invested Assets

	June 30, 2008		December 31, 2007	
	Carrying amount	% of total	Carrying amount	% of total
(\$ in millions)				
Fixed maturity securities:				
Public	\$ 2,652.1	66%	\$ 2,719.5	67%
Equity securities	56.3	1	52.7	1
Mortgage loans:				
Residential	541.9	14	558.6	14
Real estate held for sale	2.6	—	2.9	—
Policy loans	16.4	—	16.2	—
Other investments	765.0	19	727.2	18
Total invested assets	<u>4,034.3</u>	<u>100%</u>	<u>4,077.1</u>	<u>100%</u>
Cash and cash equivalents	65.6		82.9	
Total invested assets and cash	<u>\$ 4,099.9</u>		<u>\$ 4,160.0</u>	

Our other investments totaled \$765.0 million as of June 30, 2008, compared to \$727.2 million as of December 31, 2007. Investments in equity method subsidiaries and direct financing leases accounted for \$474.0 million and \$280.3 million, respectively, of other investments as of June 30, 2008. Investments in equity method subsidiaries and direct financing leases accounted for \$455.6 million and \$256.3 million, respectively, of other investments as of December 31, 2007. The remaining invested assets as of June 30, 2008, and December 31, 2007, are primarily related to derivatives and seed money.

## Item 3. Quantitative and Qualitative Disclosures About Market Risk

### Market Risk Exposures and Risk Management

Market risk is the risk that we will incur losses due to adverse fluctuations in market rates and prices. Our primary market risk exposure is to changes in interest rates, although we also have exposures to changes in equity prices and foreign currency exchange rates.

The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges by using the following approaches:

- rebalance our existing asset or liability portfolios;
- control the risk structure of newly acquired assets and liabilities or
- use derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

## Interest Rate Risk

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. One source of interest rate risk is the inherent difficulty in obtaining assets that mature or have their rate reset at the exact same time as the liabilities they support. Assets may have to be reinvested or sold in the future to meet the liability cash flows in unknown interest rate environments. Also, there may be timing differences between when new liabilities are priced and when assets are purchased or procured that can cause fluctuations in profitability if interest rates move materially in the interim. A third source of interest rate risk is the prepayment options embedded within asset and liability contracts that can alter the cash flow profiles from what was originally expected.

One of the measures we use to quantify our exposure to interest rate risk is duration. To calculate duration, we project asset and liability cash flows. These cash flows are discounted to a net present value basis using a spot yield curve, which is a blend of the spot yield curves for each of the asset types in the portfolio. Duration is calculated by re-calculating these cash flows, re-determining the net present value based upon an alternative level of interest rates, and determining the percentage change in fair value.

We manage interest rate risks in a number of ways. Differences in durations between assets and liabilities are measured and kept within acceptable tolerances. Derivatives are also commonly used to mitigate interest rate risk due to cash flow mismatches and timing differences. Prepayment risk is controlled by limiting our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer. We also require additional yield on these investments to compensate for the risk the issuer will exercise such option. Prepayment risk is also controlled by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times.

**Duration-Managed.** Our exposure to interest rate risk stems largely from our substantial holdings of guaranteed fixed rate liabilities in our U.S. Asset Accumulation segment. We actively manage the duration of assets and liabilities in these products by minimizing the difference between the two. We have established a maximum tolerance for this difference and seek to stay within this tolerance.

As of June 30, 2008, the difference between the asset and liability durations on our primary duration-managed portfolio was +0.12. This duration gap indicates that, as of this date, the sensitivity of the fair value of our assets to interest rate movements is greater than that of the fair value of our liabilities. Our goal is to minimize the duration gap. Currently, our guidelines indicate that total duration gaps between the asset and liability portfolios should be within +/-0.25. The value of the assets in this portfolio was \$33,015.7 million as of June 30, 2008.

**Duration-Monitored.** For products such as whole life insurance and term life insurance that are less sensitive to interest rate risk, and for other products such as individual fixed deferred annuities, we manage interest rate risk based on a modeling process that considers the target average life, maturities, crediting rates and assumptions of policyholder behavior. As of June 30, 2008, the difference between the asset and liability durations on these portfolios was +0.12. This duration gap indicates that, as of this date, the sensitivity of the fair value of our assets to interest rate movements is greater than that of the fair value of our liabilities. We attempt to monitor this duration gap consistent with our overall risk/reward tolerances. The value of the assets in these portfolios was \$19,355.8 million as of June 30, 2008.

**Non Duration-Managed.** We also have a block of participating general account pension business that passes most of the actual investment performance of the assets to the customer. The investment strategy of this block is to maximize investment return to the customer on a "best efforts" basis, and there is little or no attempt to manage the duration of this portfolio since there is little or no interest rate risk. The value of the assets in these portfolios was \$3,962.7 million as of June 30, 2008.

Using the assumptions and data in effect as of June 30, 2008, we estimate that a 100 basis point immediate, parallel increase in interest rates decreases the net fair value of our portfolio by approximately \$63.0 million. The following table details the estimated changes by risk management strategy. The table also gives the weighted-average duration of the asset portfolio for each category, and the net duration gap (i.e., the weighted-average difference between the asset and liability durations).

Risk Management Strategy	June 30, 2008			
	Value of total assets (in millions)	Duration of assets	Net duration gap	Net fair value change (in millions)
Primary duration-managed	\$ 33,015.7	3.69	0.12	\$ (39.6)
Duration-monitored	19,355.8	4.75	0.12	(23.4)
Non duration-managed	3,962.7	8.69	N/A	N/A
Total	\$ 56,334.2			\$ (63.0)

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing portfolio transactions in response to new business, management's assessment of changing market conditions and available investment opportunities.

**Debt Issued and Outstanding.** As of June 30, 2008, the aggregate fair value of long-term debt was \$1,354.4 million. A 100 basis point immediate, parallel decrease in interest rates would increase the fair value of debt by approximately \$93.5 million. Debt is not recorded at fair value on the statement of financial position.

	June 30, 2008		
	Fair value (no accrued interest)		
	-100 basis point change	No change (in millions)	+100 basis point change
8.2% notes payable, due 2009	\$ 485.6	\$ 480.5	\$ 475.4
3.31% notes payable, due 2011	61.4	59.4	57.6
3.63% notes payable, due 2011	31.7	30.7	29.8
6.05% notes payable, due 2036	607.6	532.1	470.5
8% surplus notes payable, due 2044	117.5	108.9	99.8
Non-recourse mortgages and notes payable	122.0	120.8	119.6
Other mortgages and notes payable	22.1	22.0	21.9
Total long-term debt	<u>\$ 1,447.9</u>	<u>\$ 1,354.4</u>	<u>\$ 1,274.6</u>

**Use of Derivatives to Manage Interest Rate Risk.** We use various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, swaptions, futures, treasury lock agreements and options. We use interest rate swaps and futures contracts to hedge changes in interest rates subsequent to the issuance of an insurance liability, such as a guaranteed investment contract, but prior to the purchase of a supporting asset, or during periods of holding assets in anticipation of near term liability sales. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities. They can be used to change the sensitivity to the interest rate of specific assets and liabilities as well as an entire portfolio. We have also used these instruments to hedge the interest rate exposure in our CMBS operations within PCF II, an equity method investment. Occasionally, we will sell a callable investment-type agreement and will use written interest rate swaptions to transform the callable liability into a fixed term liability.

### Foreign Currency Risk

Foreign currency risk is the risk that we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements issued to non-qualified institutional investors in the international market, foreign currency-denominated fixed maturity securities and demand deposits purchased and our international operations.

We estimate that as of June 30, 2008, a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we are exposed would result in no material change to the net fair value of our foreign currency denominated instruments identified above because we effectively hedge foreign currency denominated instruments to minimize exchange rate impacts. The selection of a 10% immediate unfavorable change in all currency exchange rates should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event.

**Use of Derivatives to Manage Foreign Currency Risk.** The foreign currency risk on funding agreements and fixed maturity securities is mitigated by using currency swaps that swap the foreign currency interest and principal payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities as of June 30, 2008, was \$4,338.6 million. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturity securities as of June 30, 2008, was \$1,996.7 million.

With regard to our international operations, we attempt to do as much of our business as possible in the functional currency of the country of operation. At times, however, we are unable to do so and in these cases we use foreign exchange derivatives to economically hedge the resulting risks. As of June 30, 2008, our operations in Chile had currency swaps with a notional amount of \$24.1 million that are used to swap cash flows on U.S. dollar-denominated bonds to a local currency. Chile also utilized currency forwards with a notional amount of \$52.1 million in order to mitigate currency exposure related to bonds denominated in currencies other than Chilean pesos.

Additionally, we may take measures to hedge our net equity investments in our foreign subsidiaries from currency risks. Currently, there are no outstanding net equity investment hedges.

### Equity Risk

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in a particular common stock. As of June 30, 2008, the fair value of our equity securities was \$527.1 million. A 10% decline in the value of the equity securities would result in an unrealized loss of \$52.7 million. The selection of a 10% unfavorable change in the equity markets should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event.

We also have equity risk associated with (1) fixed deferred annuity products that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a guaranteed minimum withdrawal benefit (“GMWB”) rider that allows the customer to receive at least the principal deposit back through withdrawals of a specified annual amount, even if the account value is reduced to zero; (3) variable annuity contracts that have a guaranteed minimum death benefit (“GMDB”) that allows the death benefit to be paid, even if the account value has fallen below the GMDB amount; (4) investment-type contracts in which the return is tied to an external equity index and (5) investment-type contracts in which the return is subject to minimum contractual guarantees.

**Use of Derivatives to Manage Equity Risk.** We economically hedge the fixed deferred annuity product by purchasing options that match the product’s profile. We economically hedge the GMWB exposure using futures, options and interest rate swaps. We economically hedge the investment contract exposure to an external equity index using equity call options.

### Credit Risk



Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. Our ability to manage credit risk is essential to our business and our profitability. See Item 2. "Management's Discussion and Analysis of Financial Condition and Results of Operations, Investments" for additional information about credit risk.

**Use of Derivatives to Diversify or Hedge Credit Risk.** We sometimes purchase credit default swaps to hedge credit exposures in our investment portfolio. We sell credit default swaps to offer credit protection to investors. If there is an event of default by the referenced name, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security.

We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of \$477.8 million at June 30, 2008. We also utilized credit default swaps with a notional amount of \$30.0 million at June 30, 2008, to economically hedge spread risk in our portfolio. We have credit exposure through credit default swaps with a notional amount of \$200.0 million as of June 30, 2008, by investing \$200.0 million in various tranches of synthetic collateralized debt obligations. In addition, we sold credit default swaps creating replicated assets with a notional amount of \$1,311.9 million as of June 30, 2008.

84

## Derivative Summary

Notional amounts are used to express the extent of our involvement in derivative transactions and represent a standard measurement of the volume of our derivative activity. Notional amount is not a quantification of market risk or credit risk and it may not necessarily be recorded on the statement of financial position. Notional amounts represent those amounts used to calculate contractual flows to be exchanged and are not paid or received, except for contracts such as currency swaps. Actual credit exposure represents the amount owed to us under derivative contracts as of the valuation date. The following tables present our position in, and credit exposure to, derivative financial instruments as of June 30, 2008, and December 31, 2007.

### Derivative Financial Instruments — Notional Amounts

	June 30, 2008		December 31, 2007	
	Notional amount	% of total	Notional amount	% of total
	(\$ in millions)			
Interest rate swaps	\$ 21,570.0	64%	\$ 18,627.3	62%
Foreign currency swaps	6,359.4	19	6,349.2	21
Embedded derivative financial instruments	2,303.1	7	2,088.9	7
Credit default swaps	2,019.7	6	1,134.8	4
Options	712.4	2	572.0	2
Currency forwards	408.3	1	361.9	1
Swaptions	170.6	1	488.8	2
Futures	103.0	—	57.7	—
Commodity swaps	40.0	—	40.0	—
Treasury lock agreements	—	—	150.0	1
<b>Total</b>	<b>\$ 33,686.5</b>	<b>100%</b>	<b>\$ 29,870.6</b>	<b>100%</b>

### Derivative Financial Instruments — Credit Exposures

	June 30, 2008		December 31, 2007	
	Credit exposure	% of total	Credit exposure	% of total
	(\$ in millions)			
Foreign currency swaps	\$ 873.9	68%	\$ 805.5	69%
Interest rate swaps	318.0	25	286.0	24
Options	85.2	6	64.4	5
Credit default swaps	12.0	1	5.6	1
Currency forwards	1.7	—	6.2	1
Commodity swaps	—	—	0.3	—
<b>Total credit exposure</b>	<b>1,290.8</b>	<b>100%</b>	<b>1,168.0</b>	<b>100%</b>
Less: Collateral received	(380.6)		(326.5)	
<b>Total</b>	<b>\$ 910.2</b>		<b>\$ 841.5</b>	

85

The following table shows the interest rate sensitivity of our derivatives measured in terms of fair value. These exposures will change as a result of ongoing portfolio and risk management activities.

	Notional amount	Weighted average term (years)	June 30, 2008		
			Fair value (no accrued interest)		
			-100 basis point change	No change	+100 basis point change
	(\$ in millions)				
Interest rate swaps	\$ 21,570.0	6.37(1)	\$ (138.3)	\$ (28.5)	\$ 66.5
Swaptions	170.6	10.17(2)	(21.9)	(11.4)	(5.9)
Options	21.0	0.97(2)	1.4	0.2	—
Futures	43.8	0.22(3)	(3.1)	0.1	3.2
<b>Total</b>	<b>\$ 21,805.4</b>		<b>\$ (161.9)</b>	<b>\$ (39.6)</b>	<b>\$ 63.8</b>

(1) Based on maturity date of swap.

- (2) Based on option date.
- (3) Based on maturity date.

We use U.S. Treasury futures to manage our over/under commitment position and our position in these contracts changes daily.

### Counterparty Risk

In conjunction with our use of derivatives, we are exposed to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- establishing exposure limits which take into account non-derivative exposure we have with the counterparty as well as derivative exposure;
- performing similar credit analysis prior to approval on each derivative counterparty that we do when lending money on a long-term basis;
- diversifying our risk across numerous approved counterparties;
- limiting exposure to A+ credit or better;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;
- implementing credit support annex (collateral) agreements with selected counterparties to further limit counterparty exposures and
- daily monitoring of counterparty credit ratings.

All new derivative counterparties are approved by the Investment Committee. We believe the risk of incurring losses due to nonperformance by our counterparties is manageable.

### Effects of Inflation

We do not believe that inflation, in the United States or in the other countries in which we operate, has had a material effect on our consolidated operations over the past five years. In the future, however, we may be affected by inflation to the extent it causes interest rates to rise.

## Item 4. Controls and Procedures

### Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### Disclosure Controls and Procedures

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer, Larry D. Zimpleman, and our Chief Financial Officer, Michael H. Gersie, have reviewed and evaluated our disclosure controls and procedures as of June 30, 2008, and have concluded that our disclosure controls and procedures are effective.

## PART II — OTHER INFORMATION

### Item 1. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Item 1. “Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Contingencies, Guarantees and Indemnifications” under the caption, “Litigation and Regulatory Contingencies,” which is incorporated here by this reference.

### Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table presents the amount of our common share purchase activity for the periods indicated:

#### Issuer Purchases of Equity Securities

Period	Total number of shares (or units) purchased(1)	Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs	Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under

				the plans or programs (in millions) (2)
January 1, 2008 — January 31, 2008	901,207	\$	0.03(2)	250.0
February 1, 2008 — February 29, 2008	102,476	\$	58.42	250.0
March 1, 2008 — March 31, 2008	881	\$	55.21	250.0
April 1, 2008 — April 30, 2008	766	\$	57.07	250.0
May 1, 2008 — May 31, 2008	—	\$	—	250.0
June 1, 2008 — June 30, 2008	720	\$	55.48	250.0
Total	1,006,050			900,831

- (1) The number of shares includes shares of common stock utilized to execute certain stock incentive awards in 2008: 376 shares in January, 102,476 shares in February, 881 shares in March, 766 shares in April and 720 shares in June.
- (2) During November 2007, our Board of Directors authorized a share repurchase program of up to \$500.0 million of our outstanding common stock. On November 30, 2007, we entered into an accelerated common stock repurchase agreement with a third party investment bank for an aggregate purchase price of \$250.0 million. On this date, we paid \$250.0 million and received the initial delivery of 2.9 million common shares, while retaining the right to receive additional common shares depending on the volume weighted-average price for our common stock over the program's execution period. The program was completed in January 2008, at which time we received 0.9 million additional common shares under this agreement. As of June 30, 2008, \$250.0 million remained under the November 2007 authorization.

88

#### Item 4. Submission of Matters to a Vote of Security Holders

At the Company's annual meeting of stockholders on May 20, 2008, the stockholders elected four Class I directors each for a term expiring at the Company's 2011 annual meeting. The voting results are as follows:

	SHARES VOTED FOR	SHARES VOTED AGAINST	SHARES ABSTAINING
Betsy J. Bernard	138,877,784	274,328	2,229,850
Jocelyn Carter-Miller	138,870,307	285,735	2,225,920
Gary E. Costley	137,652,740	1,519,901	2,209,321
William T. Kerr	136,782,448	2,359,234	2,240,280

The directors whose terms of office continued and the years their terms expire are as follows:

#### CLASS II DIRECTORS – TERM EXPIRES IN 2009

J. Barry Griswell  
Richard L. Keyser  
Arjun K. Mathrani  
Elizabeth E. Tallett  
Therese M. Vaughan

#### CLASS III DIRECTORS – TERM EXPIRES IN 2010

Michael T. Dan  
C. Daniel Gelatt  
Sandra L. Helton  
Larry D. Zimpleman

In addition, the stockholders ratified the appointment of Ernst & Young LLP as the Company's independent auditors for 2008. The voting results are as follows:

FOR	AGAINST	ABSTAIN
138,733,954	519,027	2,128,981

#### Item 6. Exhibits

Exhibit Number	Description
10.16.1	Amended and Restated Employment Agreement dated as of May 1, 2008, by and between Principal Financial Group, Inc., Principal Financial Services, Inc., Principal Life Insurance Company, and Larry D. Zimpleman
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Larry D. Zimpleman
31.2	Certification of Michael H. Gersie
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code — Larry D. Zimpleman
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code — Michael H. Gersie

89

## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRINCIPAL FINANCIAL GROUP, INC.

Dated: August 6, 2008

By /s/ Michael H. Gersie

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Michael H. Gersie  
Executive Vice President and Chief Financial Officer

Duly Authorized Officer, Principal Financial Officer, and Chief  
Accounting Officer

90

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## Exhibit Index

<b>Exhibit Number</b>	<b>Description</b>
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91

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**AMENDED AND RESTATED  
EMPLOYMENT AGREEMENT**

This AMENDED AND RESTATED EMPLOYMENT AGREEMENT (the “Agreement”) dated as of May 1, 2008 (“Agreement Date”) is by and between Principal Financial Group, Inc., a Delaware corporation, (together with all successors thereto “PFGI”), Principal Financial Services, Inc., an Iowa corporation, and Principal Life Insurance Company, an Iowa corporation (together with all successors thereto, “Life”) (each of the foregoing referred to individually as a “Company” or collectively as “Companies”, and Larry D. Zimpleman (“Executive”), a resident of Iowa. The parties previously entered into an Employment Agreement dated June 1, 2006 (“Prior Agreement”), and have determined that the Prior Agreement should be modified. This Agreement shall supersede the Prior Agreement in its entirety.

**Article I.**

**DEFINITIONS**

The terms set forth below have the following meanings (such meanings to be applicable to both the singular and plural forms, except where otherwise expressly indicated):

- 1.1 “Accrued Annual Bonus” means the amount of any Annual Bonus earned but not yet paid with respect to any Fiscal Year ended prior to the Date of Termination.
- 1.2 “Accrued Base Salary” means the amount of Executive’s Base Salary, which is accrued but not yet paid as of the Date of Termination.
- 1.3 “Affiliate” means any Person that directly or indirectly controls, is controlled by, is under common control with, a Company. For the purposes of this definition, the term “control” when used with respect to any Person, means (a) the power to direct or cause the direction of management or policies of such Person, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise, or (b) for purposes of Section 1.11 and Article VII, the power substantially to influence the direction of strategic management policies of such Person, and provided a Company has a direct or indirect commercial relationship with such Person, all as determined by the Human Resources Committee of the Board or its successor.
- 1.4 “Agreement” – see the introductory paragraph of this Agreement.
- 1.5 “Agreement Date” – see the introductory paragraph in this Agreement.
- 1.6 “Anniversary Date” – means any annual anniversary of the Agreement Date.
- 1.7 “Annual Bonus” – see Section 4.2.
- 1.8 “Base Salary” – see Section 4.1.
- 1.9 “Beneficiary” – see Section 9.6.
- 1.10 “Board” means the Board of Directors of PFGI unless the context indicates otherwise.
- 1.11 “Cause” means any of the following:

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- (a) Executive’s conviction of, plea of guilty to, or plea of nolo contendere to a felony or misdemeanor (other than a traffic-related felony or misdemeanor) that involves fraud, dishonesty or moral turpitude,
- (b) any willful action by Executive resulting in any criminal conviction or civil or internal Company sanction or judgment under (i) any Federal or State workplace harassment or discrimination laws or (ii) any internal Company workplace harassment, discrimination or other workplace policy under which such action could be or could reasonably be expected to be grounds for immediate termination of a member of Senior Management (other than mere failure to meet performance goals, objectives, or measures),
- (c) Executive’s habitual abuse of or addiction to alcohol or controlled substances, which interferes with the performance of Executive’s duties,
- (d) Executive’s willful and intentional material breach of this Agreement, including, but not limited to, the restrictive covenants contained in Article VII,
- (e) Executive’s habitual neglect of duties (other than resulting from Executive’s incapacity due to physical or mental illness), which results in substantial financial detriment to any of the Companies or any Affiliate,
- (f) Executive’s personally engaging in such conduct that results or is likely to result in (i) substantial damage to the reputation of any of the Companies or any Affiliate, as a respectable business, or (ii) substantial financial detriment (whether immediately or over time) to any of the Companies or Affiliates,
- (g) Executive’s willful and intentional material misconduct in the performance of or gross negligence of his duties under this Agreement that results in substantial financial detriment to a Company or any Affiliate,
- (h) Executive’s intentional failure (including a failure caused by gross negligence) to cause any of the Companies to comply with applicable law and regulations material to the business of such Company which results in substantial financial detriment to any of the Companies or

any Affiliate, or

(i) Executive's willful or intentional failure to comply in all material respects with a specific written direction of the Board that is consistent with normal business practice and not inconsistent with this Agreement and Executive's responsibilities hereunder.

For purposes of clauses (d), (e), (f), (g) and (h) of the preceding sentence, Cause shall not mean the mere existence or occurrence of any one or more of the following, and for purposes of clause (i) of the preceding sentence, Cause shall not mean the mere existence or occurrence of item (iv) below:

- (i) bad judgment,
- (ii) negligence, other than Executive's habitual neglect of duties or gross negligence,
- (iii) any act or omission that Executive believed in good faith to have been in the interest of the Company (without intent of Executive to gain therefrom, directly or indirectly, a profit to which he was not legally entitled), or
- (iv) failure to meet performance goals, objectives or measures;

provided, that for purposes of clauses (c), (d), (e), (f), (g), (h) and (i), any act or omission that is curable shall not constitute Cause unless the Company gives Executive written notice of such act or omission that specifically refers to this Section and, within 10 days after such notice is received by Executive, Executive fails to cure such act or omission. Notwithstanding anything to the contrary herein, any act or omission of which any member of the Board who is not a party to such act or omission has had actual knowledge for at least six months shall not constitute "Cause" under any clause of this Section.

1.12 "Code" means the Internal Revenue Code of 1986, as amended from time to time.

2

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1.13 "Company" – see the introductory paragraph to this Agreement.

1.14 "Competitive Business" means as of any date any corporation or other Person (and any branch, office or operation thereof) that engages in, or proposes to engage in:

- (a) the underwriting, reinsurance, marketing or sale of (i) any form of insurance of any kind that any of the Companies as of such date does, or has under active consideration a proposal to, underwrite, reinsure, market or sell (any such form of insurance, a "Company Insurance Product") or (ii) any other form of insurance that is marketed or sold in competition with any Company Insurance Product, or
- (b) the sale of financial services which involve (i) the management, for a fee or other remuneration, of an investment account or fund (or portions thereof or a group of investment accounts or funds), (ii) the giving of advice, for a fee or other remuneration, with respect to the investment and/or reinvestment of assets or funds (or any group of assets or funds), or (iii) financial planning services, or
- (c) the design, implementation and administration of employee benefit plans, including plan documents, employee communications, reporting, disclosure, financial advice, investment advice, and fiduciary services, or
- (d) any other business that as of such date is a direct and material competitor of a Company and its Affiliates to the extent that prior to the Date of Termination any of the Companies or its Affiliates engaged at any time within 12 months in or had under active consideration a proposal to engage in such competitive business;

and that is located anywhere in the United States or anywhere outside of the United States where such Company or its Affiliates is then engaged in, or has under active consideration a proposal to engage in, any of such activities.

1.15 "Date of Termination" means the date of the receipt of the Notice of Termination by Executive (if such Notice is given by or on behalf of PFGI) or by PFGI (if such Notice is given by Executive), or any later date, not more than 15 days after the giving of such Notice, specified in such notice, as of which Executive's employment with the Companies shall be terminated; provided, however, that:

- (i) if Executive's employment is terminated by reason of death, the Date of Termination shall be the date of Executive's death; and
- (ii) if Executive's employment is terminated by reason of Disability, the Date of Termination shall be the 30<sup>th</sup> day after Executive's receipt of the physician's certification of Disability, unless, before such date, Executive shall have resumed the full-time performance of Executive's duties; and
- (iii) if Executive terminates his employment without Good Reason, the Date of Termination shall be the 30<sup>th</sup> day after the giving of such Notice; and
- (iv) if no Notice of Termination is given, the Date of Termination shall be the last date on which Executive is employed by the Companies.

Notwithstanding anything else contained herein to the contrary, where termination of employment is not a full cessation of Executive's services for the Companies and each other member of the same controlled group of corporations as the Companies, for purposes of determining the timing of any payment or distribution of compensation in accordance with this Agreement that is deferred compensation for purposes of Section 409A and that is payable upon or in connection with a termination of employment, the Date of Termination shall be deemed to be the date on which Executive has incurred a separation from service, as defined in the regulations promulgated under Section 409A of the Code.

1.16 “Disability” means a mental or physical condition which renders Executive unable or incompetent to carry out the material job responsibilities which such Executive held or the material duties to which Executive was assigned at the time the disability was incurred, which has existed for at least six months and which in the certified opinion of a physician mutually agreed upon by PFGI and Executive (which agreement neither party shall unreasonably withhold) is expected to be permanent or to last for an additional duration in excess of six months.

3

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1.17 “Employment Period” – see Section 3.1.

1.18 “Executive” – see the introductory paragraph of this Agreement.

1.19 “Fiscal Year” means the fiscal year used in connection with the preparation of the consolidated financial statements of PFGI.

1.20 “Good Reason” means the occurrence of any one of the following events unless Executive specifically agrees in writing that such event shall not be Good Reason:

- (a) any material breach of the Agreement by any of the Companies, including any of the following, each of which shall be deemed material:
  - (i) any adverse change in the title, responsibilities or authorities of Executive;
  - (ii) any failure of Executive to be nominated, appointed or elected and to continue to be nominated, re-elected, or re-appointed as President and Chief Executive Officer of PFGI without Executive’s prior written consent;
  - (iii) any failure of Executive to be nominated and to continue to be nominated as a member of the Board of Directors of PFGI or the Board of Directors of Life;
  - (iv) causing or requiring Executive to report to anyone other than the Board of PFGI ;
  - (v) assignment to Executive of duties materially inconsistent with his position and duties described in this Agreement, including offices, or responsibilities as contemplated under Section 2.1 or any other action by any of the Companies which results in an adverse change in such position, offices, titles or responsibilities;
  - (vi) any reduction or failure to pay Executive’s Base Salary in violation of Section 4.1 or his Annual Bonus in violation of Section 4.2; or
  - (vii) any failure to grant or pay an LTIP Award or LTIP Bonus required under Section 4.3;

provided that the creation, existence or appointment of a president or chief executive officer other than Executive of any subsidiary of PFGI shall not be deemed to be Good Reason if such other chief executive officer or president reports, directly or indirectly, to Executive; and provided, further, that no act or omission described in clauses (i) through (vii) of this Section 1.20(a) shall constitute Good Reason unless Executive gives PFGI written notice of such act or omission within 60 days of becoming aware of such act or omission, the Company fails to cure such act or omission within 30-days after delivery of such notice and Executive terminates his employment promptly (but not more than 60 days) after the expiration of the Company’s opportunity to cure any such act or omission; or

(b) the failure of PFGI to assign this Agreement to its successor or the failure of a successor of PFGI or Life to expressly assume and agree to be bound by the Agreement; or

(c) relocation of the Company’s executive offices or Executive’s own office location to a location that is outside the United States;

In the event of an occurrence or omission described in this Section 1.20(b) or (c) constituting Good Reason, Executive shall not be entitled to terminate his employment for Good Reason unless within 3 months after Executive first obtains actual knowledge of such an event constituting Good Reason, he notifies PFGI of the events constituting such Good Reason and of his intention to terminate his employment for Good Reason by a Notice of Termination.

4

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Notwithstanding any provision in this Section to the contrary, no reduction in base salary, bonus or incentive (including without limitation the LTIP) that applies to all members of Senior Management shall constitute Good Reason pursuant to clauses (a) (vi) or (vii) of this Section.

1.21 “including” means including without limitation.

1.22 “Life” – see introductory paragraph to this Agreement

1.23 “LTIP” means, the Principal Financial Group Stock Incentive Plan, the Principal Financial Group 2005 Stock Incentive Plan and any other successor long-term incentive plan (other than the LTPP) established by any of the Companies or the Surviving Corporation.

1.24 “LTIP Award” means a grant under the LTIP.

1.25 “LTIP Bonus” means the amount paid or earned in respect of an LTIP Award.

1.26 “LTIP Performance Period” means any performance period applicable to an LTIP Award, as designated in accordance with the LTIP.

1.27 “LTPP”. means the 1999 Long-Term Performance Plan, as may be amended from time to time.

1.28 “PFGI” – see introductory paragraph to this Agreement.

1.29 “Notice of Termination” means a written notice of termination of Executive’s employment given in accordance with Section 9.12 by PFGI on behalf of the Companies, or by Executive, as the case may be, which sets forth (a) the specific termination provision in this Agreement relied upon by the party giving such notice, (b) in reasonable detail the specific facts and circumstances claimed to provide a basis for such Termination of Employment, and (c) if the Date of Termination is other than the date of receipt of such Notice of Termination, the Date of Termination.

1.30 “Person” means any individual, sole proprietorship, partnership, joint venture, limited liability company, trust, unincorporated organization, corporation, institution, public benefit corporation, entity or government instrumentality, division, agency, body or department.

1.31 “Prorata Annual Bonus” means the product of (i) the Target Annual Bonus (provided that no effect shall be given to any reduction in such Target Annual Bonus that would qualify as Good Reason if Executive were to terminate his employment on account thereof) multiplied by (ii) a fraction of which the numerator is the number of days which have elapsed in such Fiscal Year through the Date of Termination and the denominator of which is 365.

1.32 “Retirement” means any Termination of Employment after Executive reaches age 57, other than for Cause and other than for Good Reason.

1.33 “Senior Management” means Executive Vice President or higher-level officers of PFGI in the United States.

1.34 “Target Annual Bonus” – see Section 4.2.

1.35 “Target Annual Goals” – see Section 4.2.

5

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1.36 “Tax Gross-Up Payment” means an amount payable to Executive such that after payment of Taxes on such amount there remains a balance sufficient to pay the Taxes being reimbursed.

1.37 “Taxes” means the incremental federal, state, local and foreign income, employment, excise and other taxes payable by Executive with respect to any applicable item of income.

1.38 “Termination For Good Reason” means a Termination of Employment by Executive for a Good Reason.

1.39 “Termination of Employment” means a termination by the Companies or Executive of Executive’s employment with the Companies and their Affiliates.

1.40 “Termination Without Cause” means a Termination of Employment by the Companies for any reason other than Cause or Executive’s death or Disability.

## Article II.

### DUTIES

2.1 Duties. PFGI shall employ Executive during the Employment Period as its President and Chief Executive Officer, and Executive shall have the authority, duties, and responsibilities as are commensurate and consistent with such position and title, and as provided in, PFGI’s by-laws. Executive shall also serve as President and Chief Executive Officer of Life. It is contemplated that the stockholders of PFGI and of Life, respectively, will elect Executive to their respective Boards. Executive shall report solely to the Board of PFGI. During the Employment Period, Executive shall have broad discretion and authority to manage and direct the day-to-day affairs and operations of the Companies in compliance with applicable law, including the sole authority to direct the strategic direction of the Companies, except to the extent required in connection with the exercise by the Board of its corporate governance duties and responsibilities under PFGI’s by-laws and other applicable law. During the Employment Period, Executive shall follow the directives of the Board and shall meet with the Board on a periodic basis sufficient to enable the Board to fulfill its corporate governance responsibilities. All operating, staff, other executives, and divisions of the Companies shall report solely to Executive, either directly or indirectly through subordinates of Executive who report to Executive. During the Employment Period, Executive shall perform the duties assigned to him hereunder, and, subject to Section 2.2, shall devote his full business time, attention and effort, excluding any periods of disability, vacation, or sick leave to which Executive is entitled, to the affairs of the Companies and shall use his best efforts to promote the interests of the Companies. The Executive acknowledges that his business time is not limited to a fixed number of hours per week.

2.2 Other Activities. Executive may serve on corporate, civic or charitable boards or committees, deliver lectures, fulfill speaking engagements or teach at educational institutions, and manage personal investments; provided that such activities do not individually or in the aggregate significantly interfere with the performance of Executive’s duties under this Agreement.

## Article III.

### EMPLOYMENT PERIOD

3.1 Employment Period. Subject to the termination provisions hereinafter provided, the term of Executive’s employment under this Agreement (the “Employment Period”) shall begin on the Agreement Date and end on the Anniversary Date which is one year after such date to which the Employment Period is extended pursuant to the following sentence unless terminated sooner pursuant to Article VI. At the expiration of the initial term of this Agreement, as set forth in the immediately preceding sentence, or the term of this Agreement as the same may

6

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previously have been extended in accordance with this sentence, the Employment Period shall be automatically extended for a period of one additional year unless PFGI or Executive delivers written notice to the other party not later than ninety (90) days prior to the date on which the Agreement is scheduled to expire that it or he is electing not to extend the Employment Period.

Notwithstanding anything to the contrary set forth in this Section 3.1, the Employment Period shall automatically end on Executive's 65<sup>th</sup> birthday unless PFGI delivers written notice to Executive not less than ninety (90) days prior to such date that it desires the Agreement not so expire in which case the Employment Period shall continue as set forth above.

#### Article IV.

#### COMPENSATION

4.1 Salary. Executive shall be paid in accordance with normal payroll practices (but not less frequently than monthly) an annual salary at a rate of \$800,000 per year ("Base Salary"). During the Employment Period, the Base Salary may be reviewed periodically and may be increased from time to time as shall be determined by the Board, in accordance with normal Company administrative practices for Senior Management. After any such increase, the term "Base Salary" shall thereafter refer to the increased amount. Any increase in Base Salary shall not limit or reduce any other obligation of the Company to Executive under this Agreement. Base Salary shall not be reduced at any time without the express written consent of Executive; provided that the Board may, in its discretion and prior to the commencement of the calendar year with respect to which the related services are to be performed, restructure or alter the time of payment of Base Salary in order to enhance the deductibility thereof, provided (i) there is no economic detriment to the Executive and that the Board and Executive shall cooperate in good faith in such restructuring or alteration and (ii) any delayed payment of such Base Salary that is treated as deferred compensation under Section 409A of the Code is made upon the occurrence of a permissible distribution date or event under such Section 409A.

#### 4.2 Annual Bonus.

(a) Executive shall be eligible to receive an annual bonus ("Annual Bonus") in accordance with the terms hereof for each Fiscal Year that begins or ends during the Employment Period. Executive shall be eligible for an Annual Bonus based upon target performance goals (the "Target Annual Goals"), which goals shall be determined by the Board on an annual basis consistent (unless the Board otherwise determines) with the requirements of Section 162(m) of the Code to ensure full deductibility by the Company, in accordance with normal Company administrative practices for Senior Management, and which provides for a payment opportunity of 125% of Executive's Base Salary ("Target Annual Bonus") upon achievement of the Target Annual Goals. The parties agree that the Annual Bonus shall be administered and shall be subject to the same terms and conditions as are generally applicable to other members of Senior Management in the applicable year.

(b) The entire Annual Bonus that is payable to Executive with respect to a Fiscal Year shall be paid in cash, or such other medium as is generally applicable to members of Senior Management, as soon as practicable after the appropriate Board has determined whether and the degree to which Target Annual Goals have been achieved following the close of such Fiscal Year, but in no event later than the March 15 following the end of such Fiscal Year. In any event, the entire Annual Bonus that is payable to Executive with respect to a Fiscal Year shall be paid at the same time as the Annual Bonus is paid to the other members of Senior Management, but in any event no later than 75 days after the end of the Fiscal Year.

4.3 Long-Term Incentive Plan Bonus and Other Incentive Compensation. Executive shall have the opportunity to participate in the LTIP (if such plan exists) and any other incentive compensation plan or program

7

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available to Senior Management. Executive's target award opportunity under the LTIP will be a percentage of his Base Salary as determined by the Board, with the value of such award opportunity to be determined in accordance with the otherwise applicable compensation practices of the Companies. The appropriate Board may structure or establish the time of payment of amounts under the LTIP or other incentive compensation plan or program in order to enhance the deductibility thereof, provided (i) there is no economic detriment to the Executive and (ii) any delayed payment of any such award that is treated as deferred compensation under Section 409A of the Code is made upon the occurrence of a permissible distribution date or event under such Section 409A. The Board and Executive shall cooperate in good faith in such structuring the payment of such awards.

4.4 Savings and Retirement Plans. Executive shall be eligible to participate during the Employment Period in any Company's savings and retirement plans, practices, policies and programs, in accordance with the terms thereof, if any, applicable from time to time to members of Senior Management, including any supplemental executive retirement plan.

#### Article V.

#### OTHER BENEFITS

5.1 Welfare Benefits. During the Employment Period, Executive and his family shall be eligible to participate in, and shall receive all benefits under, any Company's welfare benefit plans, practices, policies and programs provided or made generally available by the Company to Senior Management (including medical, dental, vision, short and long term disability, group-term life, accidental death and dismemberment (AD&D) insurance plans and programs), in accordance with their terms as in effect from time to time.

5.2 Fringe Benefits. During the Employment Period, Executive shall be entitled to fringe benefits generally applicable to Senior Management in accordance with their terms as in effect from time to time.

5.3 Vacation. During the Employment Period, Executive shall be entitled to paid time under the plans, practices, policies and programs generally applicable to members of Senior Management in accordance with their terms as in effect from time to time.

5.4 Expenses. Executive shall be promptly reimbursed for all actual and reasonable employment-related business expenses he incurs during the Employment Period in accordance with any Company's practices, policies, and procedures generally applicable to members of Senior Management in accordance with their terms as in effect from time to time, including the timely submission of required receipts and accountings. Any expenses to be reimbursed to Executive pursuant to this Section 5.4 shall be paid to Executive not later than the end of the calendar year following the calendar year in which such expenses were incurred.

## Article VI.

### TERMINATION BENEFITS

#### 6.1 Termination for Cause or Other than for Good Reason, etc.

(a) If PFGI terminates Executive's employment with the Companies for Cause or Executive terminates his employment other than for Good Reason, death or Disability, the Executive shall be entitled to receive immediately after the Date of Termination a lump sum amount equal to the sum of Executive's Accrued Base Salary and Accrued Annual Bonus, and Executive shall not be entitled to receive any severance or other payment, other than compensation and benefits which relate to or derive from Executive's employment with the Companies on or prior to the Date of Termination (including, without limitation, any deferrals under the LTIP) and which are otherwise payable in case of termination for Cause

8

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or other than for Good Reason, death or Disability, as applicable

(b) Executive's employment may be terminated for Cause only if (i) PFGI provides Executive (before the Date of Termination) with written notice of the Board meeting referred to in clause (ii) of this Section 6.1(b) at least twenty days prior to such meeting and specifies in detail in writing the basis of a claim of Cause and provides Executive, with or without counsel, at Executive's election, an opportunity to be heard and present arguments and evidence on Executive's behalf at such meeting, (ii) the PFGI Board, by affirmative vote of not less than 2/3 of the entire membership of the PFGI Board (excluding the Executive's vote from any such determination) decides that the acts or omissions constitute Cause which Executive failed to cure after being given an opportunity to cure if required by Section 1.11, and to the effect that Executive's employment should be terminated for Cause and (iii) PFGI thereafter provides Executive a Notice of Termination which specifies in detail the basis of such Termination of Employment for Cause. Nothing in this Section 6.1(b) shall preclude the Board, by majority vote, from suspending Executive from his duties, with pay at any time.

6.2 Termination for Retirement, Death or Disability. If, before the end of the Employment Period, Executive's employment terminates due to his Retirement, death or Disability, Executive or his Beneficiaries, as the case may be, shall be entitled to receive immediately after the Date of Termination, a lump sum amount which is equal to the sum of Executive's Accrued Base Salary, Accrued Annual Bonus, and, subject to compliance with Section 162(m) of the Code, Prorata Annual Bonus. All of Executive's rights under any non-qualified retirement plan (including any non-qualified defined contribution plan) shall become fully vested (to the extent not previously vested) on the Date of Termination. In calculating the amount payable under any nonqualified defined benefit plan, Executive shall be treated as though he had attained age 57 on the Date of Termination and shall be credited under such plan with additional service in an amount equal to that he would have completed had he continued to work until age 57. Any accrued benefit that is forfeited by Executive due to his death, Disability or Retirement under a qualified plan which is supplemented by a nonqualified plan shall be paid from the applicable supplemental non-qualified plan.

6.3 Termination Without Cause or for Good Reason. In the event of a Termination Without Cause or a Termination for Good Reason (in either case occurring during the Employment Period), Executive shall be entitled to receive the following:

(a) promptly after the Date of Termination (but in no event later than ten business days after the Date of Termination) a lump sum amount equal to the sum of Executive's Accrued Base Salary, Accrued Annual Bonus and, subject to compliance with Section 162(m) of the Code, Prorata Annual Bonus;

(b) six months after the Date of Termination a lump sum amount equal to the product of (i) the sum of Base Salary plus Target Annual Bonus for the Fiscal Year during which the Date of Termination occurs (provided that no effect shall be given to any reduction in Target Annual Bonus that would qualify as Good Reason if Executive were to terminate his employment on account thereof), and multiplied by (ii) 2;

(c) until the earlier of (i) the 18 month anniversary of the Date of Termination or (ii) the date Executive becomes eligible to participate in any plan, program or arrangement providing benefits of a similar nature by reason of his employment or other provision of services, the life insurance benefit specified in Section 5.1 to which Executive is entitled as of Date of Termination, subject to the terms of applicable plans, programs or policies; *provided* that the Executive shall pay the same amount for such benefits as covered members of Senior Management who are actively employed would pay;

(d) if the Date of Termination occurs prior to the Executive's 57<sup>th</sup> birthday, (1) for the six-month period following the Date of Termination, the Companies shall provide Executive and his eligible

9

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dependants the same medical benefits (on the same terms and conditions) as would have applied had Executive continued to be an employee of the Companies for such period, and (2) monthly after such six month period, for the remainder of the life of Executive, benefits equivalent to those payable under the Principal Welfare Benefit Plan for Employees calculated under the terms of such plan as if the Date of Termination occurred after Executive's 57<sup>th</sup> birthday, reduced by amounts actually payable under such plan, provided that, if either Executive or the Company reasonably believes it is likely that the benefits under subclause (2) cannot be provided on a tax-favored basis, the Company shall pay the cost of the insurance premium for such benefits on the same monthly basis as such benefits would have been provided;

(e) if the Date of Termination occurs prior to Executive's 57<sup>th</sup> birthday, for purposes of calculating the retirement benefits payable to Executive under the Supplemental Executive Retirement Plan for Employees, Executive will be treated as though the Date of Termination occurred after Executive's 57<sup>th</sup> birthday;

(f) key executive level outplacement services, the provider of which shall be selected by Executive, up to a maximum of \$10,000; provided that in no event shall any amount be payable to Executive in lieu of his receipt of such services.

Notwithstanding anything herein to the contrary, the benefits provided in Section 6.3 shall be provided only upon Executive's execution of a release and waiver as described in Section 6.5. For the avoidance of doubt, Executive's rights and entitlements with respect to any equity-based or other long-term incentive compensation awards (including any LTIP Award) outstanding as of the Date of Termination shall be determined in accordance with the terms of such awards and the governing plan documents and shall not be enhanced or otherwise modified by the terms of this Agreement.

6.4 **Other Rights.** This Agreement shall not prevent or limit Executive's continuing or future participation in any benefit, bonus, incentive or other plan, program or policy provided by the Company and for which Executive may qualify, and shall not impair the Company's rights to amend or terminate any benefit, bonus, incentive or other plan program or policy; provided however that no such amendment or termination shall treat Executive less favorably than other Senior Management and Executive's benefits, bonus and incentives in the aggregate shall not be reduced. Amounts which are vested benefits or which Executive is otherwise entitled to receive under any plan, program or policy and any other payment or benefit required by law at or after the Date of Termination shall be payable in accordance with such plan, program or policy or applicable law except as expressly modified by this Agreement.

6.5 **Waiver and Release.** Notwithstanding anything herein to the contrary, upon any Termination of Employment (other than due to death)

(a) the Executive shall execute a release and waiver in form mutually agreed by Executive and the Board of PFGI (which agreement neither party shall unreasonably withhold) which releases, waives, and forever discharges the Companies, their Affiliates, and their respective subsidiaries, affiliates, employees, officers, shareholders, members, partners, directors, agents, attorneys, predecessors, successors and assigns, from and against any and all claims, liabilities, demands, causes of action, costs, expenses, attorneys' fees, damages and obligations of every kind and nature in law, equity, or otherwise, known and unknown suspected and unsuspected, disclosed and undisclosed, including but not limited to any and all such claims and demands directly or indirectly arising out of or in any way connected with the Executive's employment with and services as a director of the Companies and their Affiliates; claims or demands related to compensation or other amounts under any compensatory arrangement, stock, stock options, or any other ownership interests in any of the Companies or any Affiliate, vacation pay, fringe benefits, expense reimbursements, severance benefits, or any other form of compensation or equity; claims pursuant to any federal, state, local law, statute of cause of action including, but not limited to, the federal Civil Rights Act of 1964, as amended; the federal Age Discrimination in Employment Act of 1967, as amended; the federal Americans with

10

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Disabilities Act of 1990; tort law, contract law; wrongful discharge, discrimination; defamation; harassment; or emotional distress; provided that Executive's waiver and release shall not relieve the Companies from any of the following obligations, to the extent they are to be performed after the date of the release and waiver: (i) payment of amounts due under Sections 6.1, 6.2 or 6.3, as applicable, (ii) any obligations under the second sentence of Section 6.4, and (iii) payment of any gross-up amount due under Article VIII; and provided further that (x) neither party shall release the other from his or its obligations under Article IX of this agreement, to the extent such obligations are to be performed after the Date of Termination, and (y) Executive shall not be precluded from defending against Cause Claims (as defined in Section 6.5(b)); and

(b) the Company shall execute a release and waiver in form mutually agreed by Executive and the Board of PFGI (which agreement neither party shall unreasonably withhold) which releases, waives, and forever discharges the Executive and his executors, administrators, successors and assigns, from and against any and all claims, liabilities, demands, causes of action, costs, expenses, attorneys' fees, damages and obligations of every kind and nature in law, equity, or otherwise, known and unknown, suspected and unsuspected, disclosed and undisclosed, including but not limited to any and all such claims and demands directly or indirectly arising out of or in any way connected with the Executive's employment with and services as a director of the Companies and their Affiliates, but excluding any such claims liabilities, demands, causes of action, costs, expenses, attorneys' fees, damages or obligations arising out of or in any way connected with events, acts or conduct giving rise to or in any way connected with Executive's Termination of Employment for Cause ("Cause Claims"), provided, however, that (i) neither party shall release the other from his or its obligations under Article IX of this agreement, to the extent such obligations are to be performed after the Date of Termination, (ii) the Company shall not release Executive from his obligation under Article VII and (iii) Executive shall not be precluded from defending against Cause Claims.

(c) Executive hereby agrees that the execution of this Agreement is adequate consideration for the execution of such a release, and hereby acknowledges that the Companies would not have executed this Agreement had Executive not agreed to execute such a release.

## Article VII.

### RESTRICTIVE COVENANTS

7.1 **Non-Competition.** Executive shall not at any time during the period beginning on the Agreement Date and ending 18 months following the Date of Termination (whether or not during the Term), regardless of the reasons for such termination, directly or indirectly, in any capacity:

(a) engage or participate in, become employed by, serve as a director of, or render advisory or consulting or other services in connection with, any Competitive Business; provided, however, that after the Date of Termination this Section 7.1(a) shall not preclude Executive from being an employee of, or consultant to, any business unit of a Competitive Business if (i) such business unit does not qualify as a Competitive Business in its own right and (ii) Executive does not have any direct or indirect involvement in, or responsibility for, any operations of such Competitive Business that cause it to qualify as a Competitive Business; or

(b) make or retain any financial investment, whether in the form of equity or debt, or own any interest, in any Competitive Business; provided, however, that nothing in this subsection shall restrict Executive from making an investment in any Competitive Business if such investment (i) represents no more than 1% of the aggregate market value of the outstanding capital stock or debt (as applicable) of such Competitive Business, (ii) does not give Executive any right or ability, directly or indirectly, to control or

11

influence the policy decisions or management of such Competitive Business, and (iii) does not create a conflict of interest between Executive's duties under this Agreement and his interest in such investment.

7.2 **Non-Solicitation.** Executive shall not at any time during the period beginning on the Agreement Date and ending 18 months following the Date of Termination (whether or not during the Term), regardless of the reasons for such termination, directly or indirectly:

- (a) other than in connection with the good-faith performance of his duties as an officer of any of the Companies, encourage any employee or agent of the Companies or any Affiliate to terminate his relationship with any of the Companies or any Affiliate;
- (b) solicit the employment of or the engagement as a consultant or advisor of, any employee or agent of any of the Companies or any Affiliate (other than by the Company or an Affiliate), or cause or encourage any Person to do any of the foregoing;
- (c) establish (or take preliminary steps to establish) a business with, or encourage others to establish (or take preliminary steps to establish) a business with, any employee or agent of the Company or any Affiliate; or
- (d) interfere with the relationship of any of the Companies with, or endeavor to entice away from any of the Companies, any Person who or which at any time during the period commencing one year prior to the Agreement Date was or is a material client or material supplier of, or maintained a material business relationship with, any of the Companies or an Affiliate.

7.3 **Disparagement.** Executive acknowledges that the Companies' reputations are important and should not be impaired at any time by Executive. Executive agrees not to disparage the reputation of the Companies.

7.4 **Confidentiality.** The Executive acknowledges that in the course of performing services for the Companies and Affiliates, he may create, develop, learn of, receive or contribute non-public information, ideas, processes, methods, designs, devices, inventions, data, models and other information relating to the Companies and their Affiliates or their products, services, businesses, operations, employees or customers, whether in tangible or intangible form, and that the Companies or their Affiliates desire to protect and keep secret and confidential, including trade secrets and information from third parties that the Companies or their Affiliates are obligated to keep confidential ("**Confidential Information**"). Confidential Information shall not include: (i) information that is or becomes generally known through no fault of Executive; (ii) information received from a third party outside of the Company that was disclosed without a breach of any confidentiality obligation; or (iii) information approved for release by written authorization of the Company. The Executive recognizes that all such Confidential Information is the sole and exclusive property of the Companies and their Affiliates, and that disclosure of Confidential Information would cause damage to the Companies and their Affiliates. Except (i) as required by the duties of his employment with any of the Companies or any of their and/or its Affiliates; (ii) with the consent of PFGI, or (iii) in connection with enforcing the Executive's rights under this Agreement or if compelled by a court or governmental agency (provided that this subclause (iii) shall not apply unless Executive has provided PFGI with reasonable prior written notice of any such proposed disclosure in connection with any enforcement action or compelled testimony), the Executive agrees that he will not willfully disseminate or otherwise disclose, directly or indirectly, any Confidential Information obtained during his employment with any of the Companies or their Affiliates, and will take all necessary precautions to prevent disclosure, to any unauthorized individual or entity inside or outside the Company, and will not use the Confidential Information or permit its use for the benefit of Executive or any other person or entity other than the Companies or the Affiliates. These obligations shall continue during and after the termination of Executive's employment (whether or not during the Employment Period).

7.5 **Intellectual Property.** During the Employment Period, Executive shall disclose immediately to the Company all ideas, inventions and business plans that he makes, conceives, discovers or develops alone or with

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others during the course of his employment with the Company, including any inventions, modifications, discoveries, developments, improvements, computer programs, processes, products or procedures (whether or not protectable upon application by copyright, patent, trademark, trade secret or other proprietary rights) ("**Work Product**") that: (i) relate to the business of the Company or any customer or supplier to the Company or any of the products or services being developed, manufactured, sold or otherwise provided by the Company or that may be used in relation therewith; or (ii) result from tasks assigned to Executive by the Company; or (iii) result from the use of the premises or personal property (whether tangible or intangible) owned, leased or contracted for by the Company. Executive agrees that any Work Product shall be the property of the Company and, if subject to copyright, shall be considered a "work made for hire" within the meaning of the Copyright Act of 1976, as amended (the "**Act**"). If and to the extent that any such Work Product is found as a matter of law not to be a "work made for hire" within the meaning of the Act, Executive expressly assigns to the Company all right, title and interest in and to the Work Product, and all copies thereof, and the copyright, patent, trademark, trade secret and all their proprietary rights in the Work Product, without further consideration, free from any claim, lien for balance due or rights of retention thereto on the part of Executive.

(a) The Company hereby notifies Executive that the preceding paragraph does not apply to any inventions for which no equipment, supplies, facility, or trade secret information of the Company was used and which was developed entirely on the Executive's own time, unless: (i) the invention relates (a) to the Company's business, or (b) to the Company's actual or demonstrably anticipated research or development, or (ii) the invention results from any work performed by the Executive for the Company.

(b) Executive agrees that upon disclosure of Work Product to the Company, Executive will, during his employment and at any time thereafter, at the request and cost of the Company, execute all such documents and perform all such acts as the Company or its duly authorized agents may reasonably require: (i) to apply for, obtain and vest in the name of the Company alone (unless the Company otherwise directs) letters patent, copyrights or other analogous protection in any country throughout the world, and when so obtained or vested to renew and restore the same; and (ii) to defend any opposition proceedings in respect of such applications and any opposition proceedings or petitions or applications for revocation of such letters patent, copyright or other analogous protection.

(c) In the event that the Company is unable, after reasonable effort, to secure Executive's signature on any letters patents, copyright or other analogous protection relating to Work Product, whether because of Executive's physical or mental incapacity or for any other reason whatsoever, Executive hereby irrevocably designates and appoints the Company and its duly authorized officers and agents as his agent and attorney-in-fact, to act for and on his behalf to execute and file any such application or applications and to do all other lawfully permitted acts to further the prosecution and issuance of letters patent, copyright and other analogous protection with the same legal force and effect as if personally executed by Executive.

7.6 Reasonableness of Restrictive Covenants.

(a) Executive acknowledges that the covenants contained in Sections 7.1, 7.2, 7.3, 7.4 and 7.5 are reasonable in the scope of the activities restricted, the geographic area covered by the restrictions, and the duration of the restrictions, and that such covenants are reasonably necessary to protect the Companies' relationships with their employees, clients and suppliers. Executive further acknowledges such covenants are essential elements of this Agreement and that, but for such covenants, the Companies would not have entered into this Agreement.

(b) The Companies and Executive have each consulted with their respective legal counsel and have been advised concerning the reasonableness and propriety of such covenants. Executive acknowledges that his observance of the covenants contained in Sections 7.1, 7.2, 7.3, 7.4 and 7.5 will not deprive him of the ability to earn a livelihood or to support his dependents.

13

7.7 Rights to Injunction; Survival of Undertakings.

(a) In recognition of the necessity of the limited restrictions imposed by Sections 7.1, 7.2, 7.3, 7.4 and 7.5, the parties agree that it would be impossible to measure solely in money the damages that any of the Companies would suffer if Executive were to breach any of his obligations under such Sections. Executive acknowledges that any breach of any provision of such Sections would irreparably injure the Companies. Accordingly, Executive agrees that any of the Companies shall be entitled, in addition to any other remedies to which such Company may be entitled under this Agreement or otherwise, to an injunction to be issued by a court of competent jurisdiction, to restrain any actual breach, or threatened breach, of such provisions, and Executive hereby waives any right to assert any defense that any of the Companies has an adequate remedy at law for any such breach.

(b) If a court determines that any of the covenants included in this Article VII are unenforceable in whole or in part because of such covenant's duration or geographical or other scope, such court may modify the duration or scope of such provision, as the case may be, so as to cause such covenant as so modified to be enforceable.

(c) All of the provisions of this Article VII shall survive any Termination of Employment without regard to (i) the reasons for such termination or (ii) the expiration of the Employment Period.

(d) No Company shall have any further obligation to pay or provide severance or benefits under Section 6.3 if a court determines that the Executive has breached any covenant in this Article VII.

**Article VIII.**

**CERTAIN ADDITIONAL PAYMENTS BY THE COMPANY**

8.1 Tax Gross-Up Payment. If at any time or from time to time it shall be determined that any payment to Executive pursuant to this Agreement or any other payment or benefit ("Potential Parachute Payment") hereunder or otherwise would be subject to the excise tax imposed by Section 4999 of the Code or any similar tax payable under any United States federal, state, local, foreign or other law ("Excise Tax"), then Executive shall receive and PFGI shall pay or cause to be paid a Tax Gross-Up Payment with respect to all such excise taxes and other Taxes; provided, however, that this Article VIII shall be subject in its entirety to any Change of Control agreement with Executive entered after the Agreement Date by the Company. The Tax Gross-Up Payment is intended to compensate Executive for all such excise taxes and any federal, state, local, foreign or other income, employment, or excise taxes or other taxes payable by Executive with respect to the Tax Gross-Up Payment. For purposes of this Agreement, a "Tax Gross-Up Payment" shall mean an amount sufficient to enable the Executive to pay (a) any Excise Tax imposed on the Executive by reason of receipt of the Potential Parachute Payments and (b) all incremental federal, state, local and foreign income, employment, excise and other taxes payable by Executive by reason of receipt of the Tax Gross-Up payment. Any Tax Gross-Up Payment to be made hereunder shall be paid on, or promptly following, the date that the Excise Tax related to such Tax Gross-Up Payment is due, but in no event later than the end of the calendar year following the calendar year in which such Excise Tax is incurred.

8.2 Limitations on Gross-Up Payments.

(a) Notwithstanding any other provision of this Article VIII, if the aggregate After-Tax Amount (as defined below) of the Potential Parachute Payments and Tax Gross-Up Payment that, but for this Section 8.2, would be payable to Executive, does not exceed 110% of After-Tax Floor Amount (as defined below), then no Tax Gross-Up Payment shall be made to Executive and the aggregate amount of Potential Parachute Payments payable to Executive shall be reduced (but not below the Floor Amount) to the largest amount which would both (i) not cause any Excise Tax to be payable by Executive and (ii) not cause any Potential Parachute Payments to be come nondeductible by the Company by reason of Section 280G of the Code (or any

14

successor provision). For purposes of the preceding sentence, Executive shall be deemed to be subject to the highest effective after-tax marginal rate of Taxes.

(b) For purposes of this Agreement:

(i) "After-Tax Amount" means the portion of a specified amount that would remain after payment of all Taxes paid or payable by Executive in respect of such specified amount; and

(ii) "Floor Amount" means the greatest pre-tax amount of Potential Parachute Payments that could be paid to Executive without causing Executive to become liable for any Excise Taxes in connection therewith; and

(iii) "After-Tax Floor Amount" means the After-Tax Amount of the Floor Amount.

## Article IX.

### MISCELLANEOUS

9.1 Approvals. The Companies represent and warrant to Executive they have taken all corporate action necessary to authorize this Agreement.

9.2 No Mitigation. In no event shall Executive be obligated to seek other employment or take any other action to mitigate the amounts payable to Executive under any of the provisions of this Agreement, nor shall the amount of any payment hereunder be reduced by any compensation earned as a result of Executive's employment by another employer, except that any continued welfare benefits provided for by Section 6.3(d) shall not duplicate any benefits that are provided to Executive and his family by such other employer and shall be secondary to any coverage provided by such other employer.

The Companies' obligation to make the payments provided for in this Agreement and otherwise perform the obligations hereunder shall not (unless Executive is terminated for Cause) be affected by any circumstances, including set-off, counterclaim, recoupment, defense or other claim, right or action, which the Companies may have against Executive.

9.3 Enforcement.

(a) If Executive incurs legal, accounting, expert witness or other fees, costs or expenses (including arbitration fees, costs or expenses) in an effort to secure, preserve, establish entitlement to, or obtain compensation or benefits under this Agreement, the Company shall promptly reimburse Executive for such fees, costs and expenses whether or not Executive is successful; provided, however, that no reimbursement shall be made of such expenses if Executive does not prevail (after exhaustion of all available judicial remedies) on at least one material issue or Executive's assertion of rights was in bad faith and Executive does not prevail (after exhaustion of all available judicial remedies).

(b) If the Companies fail to pay any amount provided under any provision of this Agreement when due, the Executive shall be entitled to interest, compounded monthly, on such amount at a rate equal to the lesser of (i) (A) the highest rate of interest charged by the relevant Company's principal lender on its revolving credit agreements, or (B) in the absence of such a lender, the prime commercial lending rate announced *The Wall Street Journal* in effect from time to time during the period of such nonpayment, or (ii) the highest legally-permissible interest rate allowed to be charged under applicable law.

9.4 Indemnification and Insurance. The Executive shall be indemnified and held harmless by the Companies to the greatest extent permitted under applicable Iowa law as the same now exists or may hereafter be amended (but, in the case of any such amendment, only to the extent that such amendment permits a Company to

provide broader indemnification that was permitted prior to such amendment) and the Companies' respective by-laws as such exist on the Agreement Date if the Executive was, is, or is threatened to be, made a party to any pending, completed or threatened action, suit, arbitration, alternate dispute resolution mechanism, investigation, administrative hearing or any other proceeding whether civil, criminal, administrative or investigative, and whether formal or informal, by reason of the fact that the Executive is or was, or had agreed to become, a director, officer, employee, agent, or fiduciary of a Company or any other entity which the Executive is or was serving at the request of a Company ("Proceeding"), against all expenses (including all reasonable attorneys' fees) and all claims, damages, liabilities and losses incurred or suffered by the Executive or to which the Executive may become subject for any reason. A Proceeding shall not include any proceeding to the extent it concerns or relates to a matter described in Section 9.3(a). Upon receipt from Executive of (i) a written request for an advancement of expenses, which Executive reasonably believes will be subject to indemnification hereunder and (ii) a written undertaking by Executive to repay any such amounts if it shall ultimately be determined that Executive is not entitled to indemnification under this Agreement or otherwise, the Companies shall advance such expenses to Executive or pay such expenses for Executive, all in advance of the final disposition of any such matter. During Executive's employment and thereafter, Companies shall provide Executive with coverage under a director's and officer's liability insurance policy in amounts no less than, and on terms no less favorable than, those provide to senior executive officers and directors of the Companies on the Agreement Date and in amounts no less than, and on terms no less favorable than those, as provided to senior executive officers and directors of the Companies from time to time.

9.5 Cooperation With Regard to Litigation. The Executive agrees to cooperate with the Companies during his employment with any of the Companies (whether or not during the Employment Period) and thereafter (including following Executive's termination of employment for any reason, whether or not pursuant to this Agreement) by making himself reasonably available to testify on behalf of the Companies or their Affiliates, in any action, suit or proceeding, whether civil, criminal, administrative, or investigative and to assist each Company or any of its Affiliates in any such action, suit, or proceeding by providing information and meeting and consulting with the Board of such Company or Affiliate or counsel or representatives or counsel to the Company or its Affiliates, as reasonably requested by the Board or such counsel. The Executive shall be entitled to reimbursement for any expenses (including legal fees) reasonably incurred by the Executive in connection with his compliance with the foregoing covenant; provided, however, that during the Employment Period the Executive shall not be reimbursed for his time spent in connection with his compliance with the foregoing covenant. The Companies agree to pay Executive a per diem of \$3,500 per day for each day of service (including travel days) performed by Executive in accordance with this Section after Executive is no longer employed by the Companies.

9.6 Beneficiary. If Executive dies prior to receiving all of the amounts payable to him in accordance with the terms and conditions of this Agreement, such amounts shall be paid to the beneficiary ("Beneficiary") designated by Executive in writing to the Company during his lifetime, or if no such Beneficiary is designated, to Executive's estate. Such payments shall be made in a lump sum to the extent so payable and, to the extent not payable in a lump sum, in accordance with the terms of this Agreement. Such payments shall not be less than the amount payable to Executive as if Executive had lived to the date of payment and were the payee. Executive, without the consent of any prior Beneficiary, may change his designation of Beneficiary or Beneficiaries at any time or from time to time by submitting to the Company a new designation in writing.

9.7 Assignment; Successors. This Agreement is personal to Executive and he may not assign his duties or obligations under it. No Company may assign its respective rights and obligations under this Agreement without the prior written consent of Executive, except to a successor to the Company's business, which expressly assumes the Company's obligations hereunder in writing. This Agreement shall be binding upon and inure to the benefit of Executive, his estate and Beneficiaries, the Companies and their successors and permitted assigns. Each Company shall require any successor to all or substantially all of the business and/or assets of such Company, whether direct or indirect, by purchase, merger, consolidation, acquisition of stock, or

9.8 Non-alienation. Except as is otherwise expressly provided herein, benefits payable under this Agreement shall not be subject in any manner to anticipation, alienation, sale, transfer, assignment, pledge, encumbrance, charge, garnishment, execution or levy of any kind, either voluntary or involuntary, prior to actually being received by Executive, and any such attempt to dispose of any right to benefits payable hereunder shall be void.

9.9 Severability. If all or any part of this Agreement is declared to be unlawful or invalid, such unlawfulness or invalidity shall not serve to invalidate any portion of this Agreement not declared to be unlawful or invalid. Any provision so declared to be unlawful or invalid shall, if possible, be construed in a manner which will give effect to the terms of such provision to the fullest extent possible while remaining lawful and valid.

9.10 Amendment; Waiver. This Agreement shall not be amended or modified except by written instrument executed by PFGI and Executive. A waiver of any term, covenant or condition contained in this Agreement shall not be deemed a waiver of any other term, covenant or condition, and any waiver of any default in any such term, covenant or condition shall not be deemed a waiver of any later default thereof or of any other term, covenant or condition.

9.11 Arbitration. Any dispute, controversy or claim arising out of or in connection with or relating to this Agreement or any breach or alleged breach thereof shall be submitted to and settled by binding arbitration in Des Moines, Iowa, in accordance with the Commercial Arbitration Rules of the American Arbitration Association (or at any other place or under any other form of arbitration mutually acceptable to the parties so involved). Any dispute, controversy or claim submitted for resolution shall be submitted to three (3) arbitrators, each of whom is a nationally recognized executive compensation specialist. The Company involved in the dispute, controversy or claim, or PFGI if more than one Company is so involved, shall select one arbitrator, the Executive shall select one arbitrator and the third arbitrator shall be selected by the first two arbitrators. The arbitrators shall be required to render their award in a written statement setting forth their findings of fact and the bases for their conclusions. Any award rendered shall be final and conclusive upon the parties and a judgment thereon may be entered in the highest court of a forum, state or federal, having jurisdiction. The expenses of the arbitration shall be borne according to Section 9.3, except that in the discretion of the arbitrators any award may include the fees and costs of a party's attorneys if the arbitrator expressly determines that the party against whom such award is entered has caused the dispute, controversy or claim to be submitted to arbitration in bad faith or as a dilatory tactic. No arbitration shall be commenced after the date when institution of legal or equitable proceedings based upon such subject matter would be barred by the applicable statute of limitations. Notwithstanding anything to the contrary contained in this Section 9.11 or elsewhere in this Agreement, either party may bring an action in the Iowa District Court for Polk County, or the United State District Court for the Southern District of Iowa, if jurisdiction there lies, in order to maintain the status quo ante of the parties. The "status quo ante" is defined as the last peaceable, uncontested status between the parties. However, neither the party bringing the action nor the party defending the action thereby waives its right to arbitration of any dispute, controversy or claim arising out of or in connection or relating to this Agreement. Notwithstanding anything to the contrary contained in this Section 9.11 or elsewhere in this Agreement, either party may seek relief in the form of specific performance, injunctive or other equitable relief in order to enforce the decision of the arbitrator. The parties agree that in any arbitration commenced pursuant to this Agreement, the parties shall be entitled to such discovery (including depositions, requests for the production of documents and interrogatories) as would be available in a federal district court pursuant to Rules 26 through 37 of the Federal Rules of Civil Procedure. In the event that either party fails to comply with its discovery obligations hereunder, the arbitrator(s) shall have full power and authority to compel disclosure or impose sanctions to the full extent of Rule 37, Fed. R. Civ. P.

9.12 Notices. All notices hereunder shall be in writing and delivered by hand, by nationally-recognized delivery service that guarantees overnight delivery, or by first-class, registered or certified mail, return receipt requested, postage prepaid, addressed as follows:

If to a Company, to:	Principal Financial Group, Inc. 711 High Street Des Moines, Iowa 50392 Attention: Karen E. Shaff Executive Vice President and General Counsel Facsimile No.: (515) 235-9852
If to Executive, to:	at his most recent home address or facsimile number on file with the Company.

Either party may from time to time designate a new address by notice given in accordance with this Section. Notice shall be effective when actually received by the addressee.

9.13 Counterparts. This Agreement may be executed in multiple counterparts, each of which shall be deemed to be an original, but all of which together will constitute one and the same instrument.

9.14 Captions. The captions of this Agreement are not a part of the provisions hereof and shall have no force or effect.

9.15 Entire Agreement. This Agreement forms the entire agreement between the parties hereto with respect to the subject matter contained in the Agreement and shall supersede all prior agreements, promises and representations regarding employment, compensation, severance or other payments contingent upon termination of employment, whether in writing or otherwise.

9.16 Applicable Law. This Agreement shall be interpreted and construed in accordance with the laws of the State of Iowa, without regard to its choice of law principles.

9.17 Survival of Executive's Rights. All of Executive's rights hereunder, including his rights to compensation and benefits, and his obligations under Article VIII hereof, shall survive the termination of Executive's employment or the termination of this Agreement.

IN WITNESS WHEREOF, the parties have executed this Agreement on the date first above written.

EXECUTIVE

/s/ Larry D. Zimpleman  
Larry D. Zimpleman

PRINCIPAL FINANCIAL GROUP, INC.

By: /s/ William T. Kerr  
Its: Chairman, Human Resources Committee of the Board of  
Directors

PRINCIPAL LIFE INSURANCE COMPANY

By: /s/ William T. Kerr  
Its: Chairman, Human Resources Committee of the Board of  
Directors

PRINCIPAL FINANCIAL SERVICES, INC.

By: /s/ William T. Kerr  
Its: Chairman, Human Resources Committee of the Board of  
Directors



**Principal Financial Group, Inc.**  
**Computation of Earnings to Fixed Charges Ratio**

	For the six months ended June 30,		For the years ended December 31,				
	2008	2007	2007	2006	2005	2004	2003
	(in millions)						
1. Income from continuing operations before income taxes	\$ 418.0	\$ 747.0	\$ 1,048.2	\$ 1,331.3	\$ 1,121.6	\$ 878.7	\$ 819.0
2. Interest expense	55.0	56.3	115.3	86.0	77.8	93.5	114.1
3. Interest factor of rental expense	6.1	5.6	12.3	11.1	7.0	4.6	4.8
4. Undistributed income from equity investees	(7.5)	(55.3)	(71.6)	(62.7)	(34.1)	(19.4)	(18.3)
5. Earnings before interest credited on investment products	471.6	753.6	1,104.2	1,365.7	1,172.3	957.4	919.6
6. Interest credited on investment products	489.2	480.3	988.3	901.1	832.2	763.7	735.7
7. Earnings	<u>\$ 960.8</u>	<u>\$ 1,233.9</u>	<u>\$ 2,092.5</u>	<u>\$ 2,266.8</u>	<u>\$ 2,004.5</u>	<u>\$ 1,721.1</u>	<u>\$ 1,655.3</u>
8. Interest expense	\$ 55.0	\$ 56.3	\$ 115.3	\$ 86.0	\$ 77.8	\$ 93.5	\$ 114.1
9. Interest factor of rental expense	6.1	5.6	12.3	11.1	7.0	4.6	4.8
10. Preferred stock dividends by registrant	16.5	16.5	33.0	33.0	17.7	—	—
11. Preferred stock dividend requirements of majority-owned subsidiaries (non-intercompany)	—	—	—	—	—	—	1.2
12. Fixed charges before interest credited on investment products	77.6	78.4	160.6	130.1	102.5	98.1	120.1
13. Interest credited on investment products	489.2	480.3	988.3	901.1	832.2	763.7	735.7
14. Fixed charges	<u>\$ 566.8</u>	<u>\$ 558.7</u>	<u>\$ 1,148.9</u>	<u>\$ 1,031.2</u>	<u>\$ 934.7</u>	<u>\$ 861.8</u>	<u>\$ 855.8</u>
15. Ratio of earnings to fixed charges before interest credited on investment products (Line item 5/Line item 12)	6.1	9.6	6.9	10.5	11.4	9.8	7.7
16. Ratio of earnings to fixed charges (Line item 7/Line item 14)	1.7	2.2	1.8	2.2	2.1	2.0	1.9

## CERTIFICATIONS

I, Larry D. Zimpleman, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Principal Financial Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2008

/s/ Larry D. Zimpleman

Larry D. Zimpleman

President and Chief Executive Officer

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## CERTIFICATIONS

I, Michael H. Gersie, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Principal Financial Group, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 6, 2008

/s/ Michael H. Gersie

Michael H. Gersie

Executive Vice President and Chief Financial Officer

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**Certification Pursuant to Section 1350 of Chapter 63  
of Title 18 of the United States Code**

I, Larry D. Zimpleman, President and Chief Executive Officer of Principal Financial Group, Inc., certify that (i) the Form 10-Q for the quarter ended June 30, 2008, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10-Q for the quarter ended June 30, 2008, fairly presents, in all material respects, the financial condition and results of operations of Principal Financial Group, Inc.

/s/ Larry D. Zimpleman

Larry D. Zimpleman

President and Chief Executive Officer

Date: August 6, 2008

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**Certification Pursuant to Section 1350 of Chapter 63  
of Title 18 of the United States Code**

I, Michael H. Gersie, Executive Vice President and Chief Financial Officer of Principal Financial Group, Inc., certify that (i) the Form 10-Q for the quarter ended June 30, 2008, fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10-Q for the quarter ended June 30, 2008, fairly presents, in all material respects, the financial condition and results of operations of Principal Financial Group, Inc.

/s/ Michael H. Gersie

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Michael H. Gersie

Executive Vice President and Chief Financial Officer

Date: August 6, 2008

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