UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2006

OR

o **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	**42-1520346**
(State or other jurisdiction of incorporation or organization)	(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 o

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

Large Accelerated Filer ☒ Accelerated Filer o Non-accelerated Filer o

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

The total number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of October 25, 2006 was 269,761,529.

PRINCIPAL FINANCIAL GROUP, INC.

TABLE OF CONTENTS

	Page
Part I - FINANCIAL INFORMATION	
Item 1. Financial Statements	
Consolidated Statements of Financial Position at September 30, 2006 (Unaudited) and December 31, 2005	3
Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2006 and 2005	4

	Unaudited Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2006 and 2005	5
	Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2006 and 2005	6
	Notes to Unaudited Consolidated Financial Statements — September 30, 2006	8
Item 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations	42
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	85
Item 4.	Controls and Procedures	90
Part II — OTHER INFORMATION		
Item 1.	Legal Proceedings	91
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	92
Item 6.	Exhibits	93
Signature		94

PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.
Consolidated Statements of Financial Position

	September 30, 2006 (Unaudited)	December 31, 2005
	(in millions)	
Assets		
Fixed maturities, available-for-sale	**$ 44,128.7**	$ 42,117.2
Fixed maturities, trading	**283.7**	113.2
Equity securities, available-for-sale	**671.7**	724.4
Equity securities, trading	**166.3**	90.3
Mortgage loans	**11,395.5**	11,484.3
Real estate	**959.2**	999.4
Policy loans	**847.5**	827.7
Other investments	**1,261.6**	1,113.5
Total investments	**59,714.2**	57,470.0
Cash and cash equivalents	**1,396.6**	1,641.3
Accrued investment income	**702.3**	682.7
Premiums due and other receivables	**682.9**	592.7
Deferred policy acquisition costs	**2,383.7**	2,174.1
Property and equipment	**419.0**	419.8
Goodwill	**298.3**	282.3
Other intangibles	**228.0**	202.6
Separate account assets	**68,534.2**	62,070.0
Other assets	**1,806.4**	1,499.9
Total assets	**$ 136,165.6**	$ 127,035.4
Liabilities		
Contractholder funds	**$ 36,207.2**	$ 33,612.1
Future policy benefits and claims	**17,176.6**	16,825.5
Other policyholder funds	**637.6**	657.1
Short-term debt	**114.7**	476.4
Long-term debt	**873.6**	898.8
Income taxes currently payable	**0.5**	—
Deferred income taxes	**893.3**	974.8
Separate account liabilities	**68,534.2**	62,070.0
Other liabilities	**4,039.8**	3,713.5
Total liabilities	**128,477.5**	119,228.2
Stockholders' equity		
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 2006 and 2005	**—**	—
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 2006 and 2005	**0.1**	0.1
Common stock, par value $.01 per share - 2,500.0 million shares authorized, 383.1 million and 381.3 million shares issued, and 269.6 million and 280.6 million shares outstanding in 2006 and 2005, respectively	**3.8**	3.8
Additional paid-in capital	**8,106.6**	8,000.0

	2006	2005
Retained earnings	**2,755.8**	2,008.6
Accumulated other comprehensive income	**777.6**	994.8
Treasury stock, at cost (113.5 million and 100.7 million shares in 2006 and 2005, respectively)	**(3,955.8)**	(3,200.1)
Total stockholders' equity	**7,688.1**	7,807.2
Total liabilities and stockholders' equity	**$ 136,165.6**	$ 127,035.4

See accompanying notes.

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions, except per share data)			
Revenues				
Premiums and other considerations	**$ 1,060.0**	$ 943.4	**$ 3,206.4**	$ 2,826.4
Fees and other revenues	**454.0**	423.3	**1,354.1**	1,245.8
Net investment income	**931.6**	853.5	**2,695.4**	2,483.4
Net realized/unrealized capital gains (losses)	**(6.7)**	(1.8)	**23.1**	6.9
Total revenues	**2,438.9**	2,218.4	**7,279.0**	6,562.5
Expenses				
Benefits, claims, and settlement expenses	**1,426.2**	1,281.3	**4,227.6**	3,780.1
Dividends to policyholders	**73.0**	73.9	**217.4**	219.0
Operating expenses	**608.2**	576.8	**1,832.4**	1,714.5
Total expenses	**2,107.4**	1,932.0	**6,277.4**	5,713.6
Income from continuing operations before income taxes	**331.5**	286.4	**1,001.6**	848.9
Income taxes	**72.3**	67.1	**229.7**	201.1
Income from continuing operations, net of related income taxes	**259.2**	219.3	**771.9**	647.8
Income from discontinued operations, net of related income taxes	**—**	0.1	**—**	16.0
Net income	**259.2**	219.4	**771.9**	663.8
Preferred stock dividends	**8.2**	9.4	**24.7**	9.4
Net income available to common stockholders	**$ 251.0**	$ 210.0	**$ 747.2**	$ 654.4
Earnings per common share				
Basic earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.93**	$ 0.75	**$ 2.73**	$ 2.20
Income from discontinued operations, net of related income taxes	**—**	¾	**¾**	0.05
Net income	**$ 0.93**	$ 0.75	**$ 2.73**	$ 2.25
Diluted earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.92**	$ 0.74	**$ 2.70**	$ 2.18
Income from discontinued operations, net of related income taxes	**—**	¾	**¾**	0.05
Net income	**$ 0.92**	$ 0.74	**$ 2.70**	$ 2.23

See accompanying notes.

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	Treasury stock	Total stockholders' equity
				(in millions)				
Balances at January 1, 2005	$ —	$ —	$ 3.8	$ 7,269.4	$ 1,289.5	$ 1,313.3	$ (2,331.7)	$ 7,544.3
Series A preferred stock issued	—	—	—	296.0	—	—	—	296.0
Series B preferred stock issued	—	0.1	—	245.9	—	—	—	246.0
Common stock issued	—	—	—	40.6	—	—	—	40.6
Capital transactions of equity method investee, net of related income taxes	—	—	—	0.1	—	—	—	0.1
Stock-based compensation, and additional related tax benefits	—	—	—	35.9	—	—	—	35.9
Treasury stock acquired, common	—	—	—	¾	—	—	(868.4)	(868.4)
Dividends to preferred stockholders	¾	¾	¾	¾	(9.4)	¾	¾	(9.4)
Comprehensive income:								
Net income	—	—	—	—	663.8	—	—	663.8
Net unrealized losses	—	—	—	—	—	(335.6)	—	(335.6)
Provision for deferred income tax benefits	—	—	—	—	—	142.0	—	142.0
Foreign currency translation adjustment, net of related income taxes	—	—	—	—	—	44.8	—	44.8
Comprehensive income								515.0
Balances at September 30, 2005	$ —	$ 0.1	$ 3.8	$ 7,887.9	$ 1,943.9	$ 1,164.5	$ (3,200.1)	$ 7,800.1

Balances at January 1, 2006	**$ —**	**$ 0.1**	**$ 3.8**	**$ 8,000.0**	**$ 2,008.6**	**$ 994.8**	**$ (3,200.1)**	**$ 7,807.2**
Common stock issued	**—**	**—**	**—**	**51.6**	**—**	**—**	**—**	**51.6**
Capital transactions of equity method investee, net of related income taxes	**—**	**—**	**—**	**1.4**	**—**	**—**	**—**	**1.4**
Stock-based compensation, and additional related tax benefits	**—**	**—**	**—**	**53.6**	**—**	**—**	**—**	**53.6**
Treasury stock acquired, common	**—**	**—**	**—**	**—**	**—**	**—**	**(755.7)**	**(755.7)**
Dividends to preferred stockholders	**—**	**—**	**—**	**—**	**(24.7)**	**—**	**—**	**(24.7)**
Comprehensive income:								
Net income	**—**	**—**	**—**	**—**	**771.9**	**—**	**—**	**771.9**
Net unrealized losses	**—**	**—**	**—**	**—**	**—**	**(328.9)**	**—**	**(328.9)**
Provision for deferred income tax benefits	**—**	**—**	**—**	**—**	**—**	**121.5**	**—**	**121.5**
Foreign currency translation adjustment, net of related income taxes	**—**	**—**	**—**	**—**	**—**	**(9.8)**	**—**	**(9.8)**
Comprehensive income								**554.7**
Balances at September 30, 2006	**$ —**	**$ 0.1**	**$ 3.8**	**$ 8,106.6**	**$ 2,755.8**	**$ 777.6**	**$ (3,955.8)**	**$ 7,688.1**

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

	For the nine months ended September 30,	
	2006	**2005 (As Restated - See Note 1)**
	(in millions)	
Operating activities		
Net income	**$ 771.9**	$ 663.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of related income taxes	**—**	(16.0)
Amortization of deferred policy acquisition costs	**184.6**	179.2
Additions to deferred policy acquisition costs	**(364.2)**	(362.0)
Accrued investment income	**(19.6)**	18.4
Net cash flows from trading securities	**(161.7)**	1.9
Premiums due and other receivables	**(40.9)**	(11.4)
Contractholder and policyholder liabilities and dividends	**1,311.5**	1,315.1
Current and deferred income taxes	**14.1**	(420.6)
Net realized/unrealized capital gains	**(23.1)**	(6.9)
Depreciation and amortization expense	**82.2**	73.9
Mortgage loans held for sale, acquired or originated	**(398.4)**	(1,737.7)
Mortgage loans held for sale, sold or repaid, net of gain	**706.9**	1,721.6
Real estate acquired through operating activities	**(19.7)**	(34.6)
Real estate sold through operating activities	**31.3**	39.0
Stock-based compensation	**52.6**	36.1
Other	**(76.4)**	(95.6)
Net adjustments	**1,279.2**	700.4
Net cash provided by operating activities	**2,051.1**	1,364.2
Investing activities		
Available-for-sale securities:		
Purchases	**(6,287.6)**	(6,024.9)
Sales	**1,101.0**	1,940.7
Maturities	**2,656.7**	3,089.4
Mortgage loans acquired or originated	**(1,798.7)**	(1,937.3)
Mortgage loans sold or repaid	**1,588.6**	1,945.0
Real estate acquired	**(22.3)**	(165.6)
Real estate sold	**22.9**	287.6
Net purchases of property and equipment	**(34.4)**	(28.7)
Purchases of interest in subsidiaries, net of cash acquired	**(37.2)**	(58.1)
Net change in other investments	**16.1**	(58.9)
Net cash used in investing activities	**$ (2,794.9)**	$ (1,010.8)

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

	For the nine months ended, September 30,	
	2006	**2005 (As Restated - See Note 1)**
	(in millions)	
Financing activities		
Issuance of preferred stock	**$ —**	$ 542.0

Issuance of common stock	**51.8**	40.6
Acquisition and sales of treasury stock, net	**(755.7)**	(868.4)
Proceeds from financing element derivatives	**126.3**	160.6
Payments for financing element derivatives	**(110.0)**	(95.7)
Excess tax benefits from share-based payment arrangements	**5.9**	—
Dividends to preferred stockholders	**(16.5)**	(9.4)
Issuance of long-term debt	**1.3**	12.7
Principal repayments of long-term debt	**(20.2)**	(42.4)
Net proceeds (repayments) of short-term borrowings	**(359.7)**	100.4
Investment contract deposits	**6,691.7**	5,172.6
Investment contract withdrawals	**(5,247.5)**	(4,722.2)
Net increase in banking operation deposits	**131.7**	21.8
Net cash provided by financing activities	**499.1**	312.6
Discontinued operations		
Net cash used in operating activities	**—**	(1.2)
Net cash used in investing activities	**—**	(0.7)
Net cash used in discontinued operations	**—**	(1.9)
Net increase (decrease) in cash and cash equivalents	**(244.7)**	664.1
Cash and cash equivalents at beginning of period	**1,641.3**	452.5
Cash and cash equivalents at end of period	**$ 1,396.6**	$ 1,116.6
Cash and cash equivalents of discontinued operations included above		
At beginning of period	**$ —**	$ 1.9
At end of period	**$ —**	**$ —**

See accompanying notes

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2006
(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 ("VIE"), 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 nine months ended September 30, 2006, are not necessarily indicative of the results that may be expected for the year ended December 31, 2006. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2005, included in our Form 10-K for the year ended December 31, 2005, filed with the United States Securities and Exchange Commission ("SEC"). The accompanying consolidated statement of financial position at December 31, 2005, 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 September 30, 2005, financial statements to conform to the September 30, 2006, presentation.

Restatements

For the year ended December 31, 2005, we separately disclosed the operating, investing and financing portions of the cash flows attributable to our discontinued operations, which in the prior interim periods were excluded from the statement of cash flows. We have restated the statements of cash flows for the interim periods of 2005 to include and separately disclose the operating, investing, and financing portions of the cash flows attributable to our discontinued operations.

Recent Accounting Pronouncements

The Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("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"), on September 29, 2006. SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status. This statement 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. Changes in the funded status of a defined benefit postretirement plan will be recognized in comprehensive income in the year the changes occur. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements are effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the annual balance sheet date is effective for fiscal years ending after December 15, 2008. SFAS 158 is not expected to have a material impact on our consolidated financial statements.

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. SFAS 157

is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are still evaluating the impact this guidance will have on our consolidated financial statements.

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

The SEC staff published Staff Accounting Bulletin ("SAB") No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"), on September 13, 2006. SAB 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. Under SAB 108, registrants are required to quantify the effects on the current year financial statements of correcting all misstatements, including both the carryover and reversing effects of uncorrected prior year misstatements. After considering all relevant quantitative and qualitative factors, if a misstatement is material, a registrant's prior year financial statements must be restated. SAB 108 offers special transition provisions only for circumstances where its application would have altered previous materiality conclusions. When applying the special transition provisions, instead of restating prior period financial statements, a registrant must record the effect as a cumulative-effect adjustment to beginning-of-year retained earnings. SAB 108 is effective for fiscal years ending after November 15, 2006. We are still evaluating the impact this guidance will have on our consolidated financial statements.

On July 13, 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48, which is an interpretation of SFAS No. 109, *Accounting for Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. FIN 48 requires the affirmative evaluation that it is more likely than not, based on the technical merits of a tax position, that an enterprise is entitled to economic benefits resulting from positions taken in income tax returns. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. FIN 48 also requires companies to disclose additional quantitative and qualitative information in their financial statements about uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, and the cumulative effect of applying this Interpretation shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 is not expected to have a material impact on our consolidated financial statements.

On March 17, 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* ("SFAS 156"), which amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS 140"). This Statement (1) requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specified situations, (2) requires all separately recognized servicing assets and liabilities to be initially measured at fair value, (3) for subsequent measurement of each class of separately recognized servicing assets and liabilities, an entity can elect either the amortization or fair value measurement method, (4) permits a one-time reclassification of available-for-sale ("AFS") securities to trading securities by an entity with recognized servicing rights, without calling into question the treatment of other AFS securities, provided the AFS securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value, and (5) requires separate presentation of servicing assets and liabilities measured at fair value in the statement of financial position and also requires additional disclosures. The initial measurement requirements of this statement should be applied prospectively to all transactions entered into after the fiscal year beginning after September 15, 2006. The election related to the subsequent measurement of servicing assets and liabilities is also effective the first fiscal year beginning after September 15, 2006. SFAS 156 is not expected to have a material impact on our consolidated financial statements.

On February 16, 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140* ("SFAS 155"), which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133") and SFAS 140. SFAS 155 (1) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (2) clarifies which interest-only and principal-only strips are not subject to the requirements of SFAS 133, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (5) amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006. At adoption, the fair value election may also be

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

applied to hybrid financial instruments that have been bifurcated under SFAS 133 prior to adoption of this Statement. Any changes resulting from the adoption of this Statement should be recognized as a cumulative effect adjustment to beginning retained earnings. We are still evaluating the impact this guidance will have on our consolidated financial statements.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"). SFAS 123R requires all share-based payments to employees to be recognized at fair value in the financial statements. SFAS 123R replaces SFAS No. 123, *Accounting for Stock-Based*

Compensation ("SFAS 123"), supersedes Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure - an Amendment of FASB Statement No. 123* and amends SFAS No. 95, *Statement of Cash Flows*. On April 14, 2005, the SEC approved a new rule delaying the effective date of SFAS 123R to annual periods that begin after June 15, 2005. Accordingly, we adopted SFAS 123R effective January 1, 2006 using the modified-prospective method.

The provisions of our stock awards allow approved retirees to retain all or a portion of their awards if they retire prior to the end of the required service period. SFAS 123R considers this to be a nonsubstantive service condition. Accordingly, it is appropriate to recognize compensation cost either immediately for stock awards granted to retirement eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if retirement eligibility is expected to occur during the nominal vesting period. Our approach was to follow the widespread practice of recognizing compensation cost over the explicit service period (up to the date of actual retirement). For any awards that are granted after our adoption of SFAS 123R on January 1, 2006, we recognize compensation cost through the period that the employee first becomes eligible to retire and is no longer required to provide service to earn the award. If we had applied the nonsubstantive vesting provisions of SFAS 123R to awards granted prior to January 1, 2006, our consolidated financial statements would not have been materially impacted.

SFAS 123R requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. While we cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of financing cash flows recognized for the nine months ended September 30, 2006, for such excess tax deductions, was $5.9 million.

Under the modified-prospective method, any excess income tax deduction realized for awards accounted for under SFAS 123R (regardless of the type of award or the jurisdiction in which the tax benefit is generated) is eligible to absorb write-offs of deferred income tax assets for any awards accounted for under SFAS 123R. SFAS 123R does not require separate pools of excess income tax benefits for separate types of awards, rather the excess income tax benefits of employee and nonemployee awards may be combined in a single pool of excess tax benefits. Our policy is to pool the employee and nonemployee awards together in this manner. Deferred income tax asset write-offs resulting from deficient deductions on employee awards may be offset against previous excess income tax benefits arising from nonemployee awards, and vice versa.

This Statement did not have a material impact on our consolidated financial statements as we began expensing all stock options using a fair-value based method effective for the year beginning January 1, 2002. In addition, any stock options granted prior to January 1, 2002 were fully vested at the time of adoption of SFAS 123R. We use the Black-Scholes formula to estimate the value of stock options granted to employees. We applied the prospective method of transition as prescribed by SFAS 123 when we elected to begin expensing stock-based compensation in 2002. The cumulative effect of the change in accounting principle as a result of adopting this Statement is immaterial. Therefore, the pre-tax cumulative effect of the change in accounting principle is reflected in operating expenses.

See note 9, Stock-Based Compensation Plans, for further details on our stock-based compensation.

---

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

Separate Accounts

As of September 30, 2006 and December 31, 2005, the separate accounts include a separate account valued at $731.5 million and $726.6 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. Significant Unconsolidated Variable Interest Entities

Synthetic Collateralized Debt Obligation. On June 21, 2006, we invested $285.0 million in a secured limited recourse note issued by a segregated portfolio company. The note represents Class B notes. Class A notes are senior and Class C through Class F notes are subordinated to Class B notes. The entity entered into a credit default swap with a third party providing credit protection in exchange for a fee. Defaults in an underlying reference portfolio will only affect the note if cumulative losses of a synthetic reference portfolio exceed the loss attachment point on the portfolio. We have determined we are not the primary beneficiary, as we do not hold the majority of the risk of loss. Our maximum exposure to loss as a result of our involvement with this entity is our recorded investment of $285.0 million as of September 30, 2006.

3. Federal Income Taxes

The effective income tax rate on income from continuing operations for the three months ended September 30, 2006, is lower than the prevailing corporate federal income tax rate primarily due to income tax deductions allowed for the corporate dividends received, tax refinements in Mexico and interest exclusion from taxable income. The effective income tax rate on income from continuing operations for the nine months ended September 30, 2006, is lower than the prevailing corporate federal income tax rate due to income tax deductions allowed for the corporate dividends received, a favorable court ruling on a contested Internal Revenue Service issue for 1991 and later years and interest exclusion from taxable income. The effective income tax rate on income from continuing operations for the three months and nine months ended September 30, 2005, is lower than the prevailing corporate federal income tax rate primarily due to income tax deductions allowed for corporate dividends received, tax credits received on our investment in a synthetic fuel facility and interest exclusion from taxable income.

4. Employee and Agent Benefits

Effective January 1, 2006, we made changes to our retirement program, including the Principal Select Saving Plan ("401(k)"), the Principal Pension Plan ("Pension Plan") and the corresponding nonqualified plans. The qualified and nonqualified Pension Plans' changes include a reduction to the traditional and cash balance formulas, a change in the early retirement factors, and the removal of the cost of living adjustments for traditional benefits earned after January 1, 2006. The qualified and nonqualified 401(k) plans' company match increased from 50% of a 6% deferral to 75% of an 8% deferral. The Pension Plan changes reduced the Pension Plan expense in 2006, while the 401(k) changes increased the 401(k) expense.

4. Employee and Agent Benefits (continued)

Components of net periodic benefit cost (income):

	Pension benefits		Other postretirement benefits	
	For the three months ended September 30,		For the three months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Service cost	**$ 11.7**	$ 12.4	**$ 2.4**	$ 2.5
Interest cost	**20.4**	19.4	**4.0**	4.2
Expected return on plan assets	**(26.3)**	(24.1)	**(8.1)**	(7.3)
Amortization of prior service cost (benefit)	**(2.2)**	0.4	**(0.7)**	(0.6)
Recognized net actuarial loss	**5.1**	4.1	**0.1**	0.1
Net periodic benefit cost (income)	**$ 8.7**	$ 12.2	**$ (2.3)**	$ (1.1)

	Pension benefits		Other postretirement benefits	
	For the nine months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Service cost	**$ 35.2**	$ 37.3	**$ 7.1**	$ 7.5
Interest cost	**61.2**	58.1	**12.1**	12.7
Expected return on plan assets	**(79.0)**	(72.2)	**(24.2)**	(22.0)
Amortization of prior service cost (benefit)	**(6.7)**	1.0	**(2.0)**	(2.0)
Recognized net actuarial loss	**15.3**	12.3	**0.2**	0.4
Net periodic benefit cost (income)	**$ 26.0**	$ 36.5	**$ (6.8)**	$ (3.4)

Contributions

Our funding policy for the 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 2006 will be zero so we will not be required to fund the Pension Plan during 2006. However, it is possible that we may fund the qualified and nonqualified plans in 2006 in the range of $20.0 million to $50.0 million. During the three months and nine months ended September 30, 2006, $7.9 and $13.1 million were contributed to the plans, respectively.

5. Contingencies, Guarantees and Indemnifications

Litigation

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 National Association of Securities Dealers, Inc., 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.

Several lawsuits have been filed against other insurance companies and insurance brokers alleging improper conduct relating to the payment and non-disclosure of contingent compensation and bid-rigging activity. Several of these suits were filed as purported class actions. Several state attorneys general and insurance regulators have initiated industry-wide inquiries or other actions relating to compensation arrangements between insurance brokers and insurance companies and other industry issues. Beginning in March of 2005, we have received subpoenas and interrogatories from the offices of the Attorneys General of New York and Connecticut seeking information related to compensation agreements with brokers and agents and the sale of retirement products and services. We are cooperating with these inquiries. We have received other requests from regulators and other governmental authorities relating to industry issues and may receive additional such requests, including subpoenas and interrogatories, in the future.

On December 23, 2004, a lawsuit was filed in Iowa state court against us and our wholly owned subsidiaries, Principal Life Insurance Company ("Principal Life") and Principal Financial Services, Inc., on behalf of a proposed class comprised of the settlement class in the Principal Life sales practices class action settlement, which was approved in April 2001 by the United States District Court for the Southern District of Iowa. This more recent lawsuit claims that the treatment of the settlement costs of that sales practices litigation in relation to the allocation of demutualization consideration to Principal Life policyholders was inappropriate. Demutualization allocation was done pursuant to the terms of a plan of demutualization approved by the policyholders in July 2001 and Insurance Commissioner of the State of Iowa in August 2001. The lawsuit further claims that such allocation was not accurately described to policyholders during the demutualization process and is a breach of the sales practices settlement. On January 27, 2005, we filed a notice to remove the action from state court to the United States District Court for the Southern District of Iowa. On July 22, 2005, the plaintiff's motion to remand the action to state court was denied, and our motion to dismiss the lawsuit was granted. On September 21, 2005, the plaintiff's motion to alter or amend the judgment was denied. On October 4, 2005, the plaintiff filed a notice of appeal to the United States Court of Appeals for the Eighth Circuit. Oral argument was held on April 20, 2006. On October 20, 2006, the Court of Appeals affirmed our motion to dismiss.

A lawsuit was filed against us, Principal Life, and Principal Financial Services, Inc. in the United States District Court for the Southern District of Iowa on October 31, 2005, but the plaintiff dismissed the case without prejudice on March 17, 2006. The claims and allegations in the lawsuit were substantially the same as those in the December 23, 2004, lawsuit, but the proposed class was limited to those members of the settlement class in the Principal Life sales practices class action settlement who did not own annuities and who received demutualization consideration in the form of cash under the plan of demutualization.

5. Contingencies, Guarantees and Indemnifications (continued)

While the outcome of any pending or future litigation cannot be predicted, management does not believe that any pending litigation will have a material adverse effect on our business or financial position. The outcome of litigation 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 from 2006 through 2019. The maximum exposure under these agreements as of September 30, 2006, was approximately $172.0 million; however, we believe the likelihood is remote that material payments will be required and therefore have not accrued for a liability on our consolidated statements of financial position. 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 such outcomes could materially affect net income in a particular quarter or annual period. The fair value of such guarantees is not material.

In connection with the 2002 sale of BT Financial Group, we agreed to indemnify the purchaser, Westpac Banking Corporation ("Westpac"), for among other things, the costs associated with potential late filings made by BT Financial Group in New Zealand prior to Westpac's ownership, up to a maximum of A$250.0 million Australian dollars (approximately U.S. $187.0 million as of September 30, 2006). New Zealand securities regulations allow Australian issuers to issue their securities in New Zealand provided that certain documents are appropriately filed with the New Zealand Registrar of Companies. Specifically, the regulations require that any amendments to constitutions and compliance plans be filed in New Zealand. In April 2003, the New Zealand Securities Commission opined that such late filings would result in certain New Zealand investors having a right to a return of their investment plus interest at 10% per annum from the date of investment. This technical issue affected many in the industry.

On December 24, 2004, Westpac lodged several warranty and indemnification claims related to the sale of BT Financial Group. The claims aggregated approximately A$50.0 million Australian dollars (approximately U.S. $37.0 million as of September 30, 2006) with the majority of the claims (approximately A$45.0 million Australian dollars, or U.S. $34.0 million as of September 30, 2006) related to fund pricing and accounting issues around a tax asset called future income tax benefit ("FITB"). FITB is an asset used in calculating unit pricing of funds. Westpac claimed that BT Financial Group incorrectly accrued FITB assets in valuing asset portfolios of BT funds in Australia and New Zealand and that, as a result, fund values were overstated.

The claims made by Westpac related to both indemnifications were settled and paid by us in 2006. This settlement did not have a material impact on net income.

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. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe the likelihood is remote that material payments would be required under such indemnifications and

therefore such indemnifications would not result in a material adverse effect on our business or financial position. It is possible that such outcomes could materially affect net income in a particular quarter or annual period. The fair value of such indemnifications is not material.

6. Stockholders' Equity

Common Stock

On May 19, 2006, following our Board of Directors' share repurchase authorization, we entered into an accelerated common stock repurchase agreement with a third party investment bank for an aggregate purchase price of $500.0 million. On this date, we paid $500.0 million and received the initial delivery of 7.7 million common shares, while retaining the right to receive additional common shares depending on the volume weighted average share price of our common stock over the program's duration. The maximum number of shares eligible for repurchase under this program is 19.5 million common shares. The program will be completed in the fourth quarter 2006, at which time we will receive any remaining common shares owed to us under this agreement.

Reconciliation of Outstanding Shares

	Series A Preferred Stock	Series B Preferred Stock	Common Stock
		(in millions)	
Outstanding shares at January 1, 2005	—	—	300.6
Shares issued	3.0	10.0	1.5
Treasury stock acquired	—	—	(22.2)
Outstanding shares at September 30, 2005	3.0	10.0	279.9
Outstanding shares at January 1, 2006	**3.0**	**10.0**	**280.6**
Shares issued	**—**	**—**	**1.8**
Treasury stock acquired	**—**	**—**	**(12.8)**
Outstanding shares at September 30, 2006	**3.0**	**10.0**	**269.6**

7. Comprehensive Income (Loss)

Comprehensive income (loss) is as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
		(in millions)		
Comprehensive income (loss):				
Net income	**$ 259.2**	$ 219.4	**$ 771.9**	$ 663.8
Net change in unrealized gains and losses on fixed maturities, available-for-sale	**975.1**	(660.6)	**(393.2)**	(502.1)
Net change in unrealized gains and losses on equity securities, available-for-sale	**(0.3)**	(2.5)	**(9.9)**	1.3
Net change in unrealized gains and losses on equity method subsidiaries and minority interest adjustments	**(6.1)**	11.7	**12.2**	(5.3)
Adjustments for assumed changes in amortization patterns	**(151.3)**	67.6	**29.9**	71.8
Net change in unrealized gains and losses on derivative instruments	**(33.3)**	18.2	**(1.6)**	43.4
Adjustments to unrealized gains and losses for Closed Block policyholder dividend obligation	**—**	65.3	**33.7**	55.3
Change in net foreign currency translation adjustment	**24.5**	26.2	**(5.7)**	41.4
Provision for deferred income taxes (benefits)	**(249.5)**	184.7	**117.4**	145.4
Comprehensive income (loss)	**$ 818.3**	$ (70.0)	**$ 554.7**	$ 515.0

8. Segment Information

We provide financial products and services through the following segments: U.S. Asset Management and Accumulation, 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.

The U.S. Asset Management and Accumulation segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals and provides asset management services to our asset accumulation business, the 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 operations in Chile, Mexico, Hong Kong, Brazil, India, China, and Malaysia. We focus on countries with favorable demographics and a trend toward private sector defined contribution pension systems. 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, throughout 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.

Management uses segment operating earnings for goal setting, determining employee compensation and 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 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. Segment operating revenues exclude net realized/unrealized capital gains 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 treatment under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). 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 our tax position. The Corporate and Other segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

8. Segment Information (continued)

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

	September 30, 2006	December 31, 2005
	(in millions)	
Assets:		
U.S. Asset Management and Accumulation	**$ 111,800.2**	$ 103,506.1
International Asset Management and Accumulation	**7,648.2**	6,856.2
Life and Health Insurance	**14,285.2**	14,080.2
Corporate and Other	**2,432.0**	2,592.9
Total consolidated assets	**$ 136,165.6**	$ 127,035.4

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Operating revenues by segment:				
U.S. Asset Management and Accumulation	**$ 1,100.0**	$ 975.4	**$ 3,266.0**	$ 2,903.8
International Asset Management and Accumulation	**169.2**	148.4	**476.8**	439.4
Life and Health Insurance	**1,183.4**	1,106.1	**3,526.1**	3,264.2
Corporate and Other	**(7.6)**	(8.0)	**(13.5)**	(46.1)

Total segment operating revenues	**2,445.0**	2,221.9	**7,255.4**	6,561.3
Add:				
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**(6.1)**	(3.2)	**23.6**	3.4
Subtract:				
Operating revenues from discontinued real estate investments	**—**	0.3	**—**	2.2
Total revenues per consolidated statements of operations	**$ 2,438.9**	$ 2,218.4	**$ 7,279.0**	$ 6,562.5
Operating earnings (loss) by segment, net of related income taxes:				
U.S. Asset Management and Accumulation	**$ 157.4**	$ 133.3	**$ 466.4**	$ 402.4
International Asset Management and Accumulation	**23.2**	19.7	**56.9**	48.3
Life and Health Insurance	**82.0**	65.4	**217.6**	211.2
Corporate and Other	**(7.9)**	(4.1)	**(20.8)**	(17.4)
Total segment operating earnings, net of related income taxes	**254.7**	214.3	**720.1**	644.5
Net realized/unrealized capital gains (losses), as adjusted	**(3.7)**	(4.2)	**8.3**	(4.7)
Other after-tax adjustments (1)	**—**	(0.1)	**18.8**	14.6
Net income available to common stockholders per consolidated statements of operations	**$ 251.0**	$ 210.0	**$ 747.2**	$ 654.4

(1) For the three months ended September 30, 2005, other after-tax adjustments of $(0.1) million included the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($7.7 million); and the positive effect of gains on sales of real estate properties that qualify for discontinued operations treatment under SFAS 144 ($7.6 million).

For the nine months ended September 30, 2006, other after-tax adjustments of $18.8 million included the positive effect of a favorable court ruling on a contested IRS issue for 1991 and later years.

For the nine months ended September 30, 2005, other after-tax adjustments of $14.6 million include the positive effect of gains on sales of real estate properties that qualify for discontinued operations treatment under SFAS 144 ($22.3 million); and the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($7.7 million).

9. Stock-Based Compensation Plans

As of September 30, 2006, 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. Under the terms of the 2005 Stock Incentive Plan, grants may be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units, or other stock based awards. The 2005 Directors Stock Plan provides for the grant of nonqualified stock options, restricted stock, restricted stock units, or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock, or performance units.

As of September 30, 2006, 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 21.7 million.

For awards with graded vesting, we use an accelerated expense attribution method. The compensation cost that was charged against income for the Stock-Based Compensation Plans is as follows:

	For the nine months ended September 30,	
	2006	2005
	(in millions)	
Compensation cost	**$ 47.3**	$ 35.4
Related income tax benefit	**15.3**	11.2
Capitalized as part of an asset	**2.4**	1.2

Nonqualified Stock Options

We issue nonqualified stock options under the 2005 Stock Incentive Plan, 2005 Directors Stock Plan, Stock Incentive Plan, , and Directors Stock Plan. Nonqualified stock options are treated as an equity award.

Nonqualified stock options were granted to certain employees under the 2005 Stock Incentive Plan and the Stock Incentive Plan. Total options granted under the 2005 Stock Incentive Plan and the Stock Incentive Plan were 2.1 million and 2.7 million for the nine months ended September 30, 2006 and 2005, respectively. Options outstanding under the 2005 Stock Incentive Plan and the Stock Incentive Plan were granted at an exercise price equal to the fair market value of our common stock on the date of grant, and expire ten years after the grant date. These options have graded or cliff vesting over a three-year period, except in the case of approved retirement.

Nonqualified stock options granted under the Directors stock plans have an exercise price equal to the fair market value of our common stock on the date of the grant and a contractual term equal to the earlier of five years from the date the participant ceases to provide service or the tenth anniversary of the

date the option was granted. Beginning with the 2003 grant, options become exercisable in four approximately equal installments on the three, six and nine month anniversaries of the grant date, and on the date that the Director's full term of office expires. There were no options granted during the nine months ended September 30, 2006 or 2005.

The fair value of stock options is estimated using the Black-Scholes option pricing model that uses the assumptions noted in the following table. Expected volatilities are based on historical volatility of our stock and other factors. Due to our limited public company history, we use peer data to estimate option exercise and employee termination within the valuation model. Separate groups of employees that have similar historical exercise behavior are considered separately for valuation purposes. The expected term of options granted is estimated based on peer data and represents the period of time that options granted are expected to be outstanding. The risk-free rate for periods within the expected life of the option is based on the U.S. Treasury risk-free interest rate in effect at the time of grant.

9. Stock-Based Compensation Plans (continued)

Cash received from stock options exercised under these share-based payment arrangements for the nine months ended September 30, 2006 was $28.7 million. The actual tax benefits realized for the tax deductions for option exercise of the share-based payment arrangements for the nine months ended September 30, 2006 was $8.7 million.

The following is a summary of assumptions for the stock options granted during the period:

Options	For the nine months ended September 30, 2006	2005
Dividend yield	**1.32%**	1.41%
Expected volatility	**16.2%**	19.1%
Risk-free interest rate	**4.6%**	4.1%
Expected life (in years)	**6**	6

Using the Black-Scholes option valuation model, the weighted-average estimated fair value of stock options granted was $11.41 and $9.18 per share during the nine months ended September 30, 2006 and 2005, respectively.

The following is a summary of the status of all of our stock option plans for the nine months ended September 30, 2006:

	Number of options (in millions)	Weighted-average exercise price	Intrinsic Value (in millions)
Options outstanding at January 1, 2006	**7.8**	**$ 33.06**	
Granted	**2.1**	**49.28**	
Exercised	**1.0**	**28.72**	
Canceled	**0.1**	**40.18**	
Options outstanding at September 30, 2006	**8.8**	**$ 37.32**	**$ 149.6**
Vested or expected to vest at September 30, 2006	**8.6**	**$ 36.94**	**$ 149.3**
Options exercisable at September 30, 2006	**4.5**	**$ 31.46**	**$ 101.8**

The total intrinsic value of stock options exercised was $25.6 million and $19.1 million during the nine months ended September 30, 2006 and 2005, respectively.

The following is a summary of weighted-average remaining contractual lives for stock options outstanding and the range of exercise prices on the stock options as of September 30, 2006:

Range of exercise prices	Number of options outstanding (in millions)	Weighted-average remaining contractual life
$22.23 - $29.78	**2.3**	**6**
$30.16 - $36.50	**1.9**	**7**
$38.20 - $44.13	**2.5**	**8**
$46.40 - $54.45	**2.1**	**9**
$22.23 - $54.45	**8.8**	**8**

The weighted-average remaining contractual lives for stock options exercisable is approximately 7 years as of September 30, 2006.

9. Stock-Based Compensation Plans (continued)

Performance Share Awards

Beginning in 2006, we granted performance share awards to certain employees under the 2005 Stock Incentive Plan. The performance share awards are treated as an equity award and are paid in shares. Whether the performance shares are earned depends upon the participant's continued employment through the performance period (except in the case of an approved retirement)and our performance against three-year goals set at the beginning of the performance period. A return on equity objective and an earnings per share objective must be achieved for any of the performance shares to be earned. If the performance requirements are not met, the performance shares will be forfeited and no compensation cost is recognized and any previously recognized compensation cost is reversed. There is no maximum contractual term on these awards. As of September 30, 2006, there were $22.6 million of total unrecognized compensation costs related to nonvested performance share awards granted. The cost is expected to be recognized over a weighted-average service period of approximately 2 years.

The fair value of performance share awards is determined based on the closing stock price of our shares on the grant date. The weighted-average grant-date fair value of performance share awards granted during the nine months ended September 30, 2006 was $49.28. Because no performance share awards vested, the intrinsic value of performance share awards vested is $0.0 million for the nine months ended September 30, 2006.

The following is a summary of activity for the nonvested performance share awards for the nine months ended September 30, 2006:

	Number of performance share awards (in millions)	Weighted-average grant-date fair value
Nonvested performance share awards at January 1, 2006	¾	$ —
Granted	**0.8**	**49.28**
Vested	¾	¾
Forfeited	¾	¾
Nonvested performance share awards at September 30, 2006	**0.8**	$ **49.28**

Restricted Stock Units

We issue restricted stock units under the 2005 Stock Incentive Plan, 2005 Directors Stock Plan, Stock Incentive Plan, and Directors Stock Plan. Restricted stock units are treated as an equity award. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. There is no maximum contractual term on these awards.

Restricted stock units were issued to certain employees and agents pursuant to the Stock Incentive Plan and 2005 Stock Incentive Plan. Under these plans, awards have a graded or cliff vesting over a three-year service period. When service for the Company ceases (except in the case of an approved retirement), all vesting stops and unvested units are forfeited.

Beginning in 2005, pursuant to the 2005 Directors Stock Plan, restricted stock units are now granted to each non-employee director in office immediately following each annual meeting of stockholders and to each person who becomes a member of the Board other than on the date of the annual meeting of stockholders. Prior to this time, awards of restricted stock units were granted pursuant to the Directors Stock Plan on the date of each Board member's election or re-election date. Under the 2005 Directors Stock Plan, awards are granted on an annual basis and cliff vest over the one-year service period. Non-vested awards under the prior plan have graded vesting over a three-year service period. When service to the Company ceases, all vesting stops and unvested units are forfeited.

---

9. Stock-Based Compensation Plans (continued)

For the nine months ended September 30, 2006 and 2005, 0.2 million and 0.4 million restricted stock units were granted, respectively. The weighted-average grant-date fair value of restricted stock units granted during the nine months ended September 30, 2006 and 2005 was $49.72 and $39.19, respectively.

The actual tax benefits realized for the tax deductions for option exercise under these share-based payment arrangements for the nine months ended September 30, 2006 was $5.4 million.

As of September 30, 2006, there were $13.6 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted under these plans. The cost is expected to be recognized over a weighted-average period of approximately 1 year. The total intrinsic value of restricted stock units vested was $19.3 million and $1.2 million during the nine months ended September 30, 2006 and 2005, respectively.

The following is a summary of activity for the nonvested restricted stock units for the nine months ended September 30, 2006:

	Number of restricted stock units (in millions)	Weighted-average grant-date fair value
Nonvested restricted stock units at January 1, 2006	**0.9**	**$ 36.89**
Granted	**0.2**	**49.72**
Vested	**0.3**	**34.24**
Forfeited	**—**	**—**
Nonvested restricted stock units at September 30, 2006	**0.8**	**$ 41.06**

Employee Stock Purchase Plan

Under our Employee Stock Purchase Plan, participating employees have the opportunity to purchase shares of our common stock on a quarterly basis. Employees may purchase up to $25,000 worth of company stock each year. Employees may purchase shares of our common stock at a price equal to 85% of the shares' fair market value as of the beginning or end of the quarter, whichever is lower. Under the Employee Stock Purchase Plan, employees purchased 0.5 million and 0.6 million shares during the nine months ended September 30, 2006 and 2005.

We recognize compensation expense for the fair value of the discount granted to employees participating in the employee stock purchase plan in the quarter of grant. Shares of the Employee Stock Purchase Plan are treated as an equity award. The weighted-average fair value of the discount on the stock purchased was $9.82 and $8.16 during the nine months ended September 30, 2006 and 2005, respectively. The total intrinsic value of the Employee Stock Purchase Plan settled was $5.3 million and $4.8 million during the nine months ended September 30, 2006 and 2005, respectively.

Cash received from shares issued under these share-based payment arrangements for the nine months ended September 30, 2006 was $23.0 million. The actual tax benefits realized for the tax deductions for option exercise of the share-based payment arrangements for the nine months ended September 30, 2006 was $0.7 million.

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 September 30, 2006, a total of 3.4 million of new shares are available to be made issuable by us for this plan.

Long-Term Performance Plan

We also maintain the Long-Term Performance Plan, which provides the opportunity for eligible executives to receive additional awards if specified minimum corporate performance objectives are achieved over a three-year period. This plan utilizes stock as an option for payment and is treated as a liability award during vesting and a liability award or equity award subsequent to vesting, based on the participant payment election. Effective with stockholder approval of the 2005

9. Stock-Based Compensation Plans (continued)

Stock Incentive Plan, no further grants will be made under the Long-Term Performance Plan, and any future awards earned under the Long-Term Performance Plan will be issued under the 2005 Stock Incentive Plan. As of December 31, 2005, all awards under this plan were fully vested and no awards were granted under this plan in 2006 or 2005. There is no maximum contractual term on these awards.

The amount of cash used to settle Long-Term Performance Plan units granted was $10.7 million and $6.1 million for the nine months ended September 30, 2006 and 2005, respectively. The total intrinsic value of Long-Term Performance Plan units settled was $11.1 million and $6.4 million during the nine months ended September 30, 2006 and 2005, respectively.

The fair value of Long-Term Performance Plan liability units is determined as of each reporting period based on the Black-Scholes option pricing model that uses the assumptions noted in the following table:

Long-Term Performance Plan	For the nine months ended September 30, 2006
Dividend yield	**—%**
Expected volatility	**11.4%**
Risk-free interest rate	**4.7%**
Expected life (in years)	**3**

10. Earnings Per Common Share

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

	For three months ended September 30,		For nine months ended September 30,	
	2006	2005	2006	2005
	(in millions, except per share data)			
Income from continuing operations, net of related income taxes	**$ 259.2**	$ 219.3	**$ 771.9**	$ 647.8
Subtract:				

Preferred stock dividends	**8.2**	9.4	**24.7**	9.4
Income from continuing operations available to common stockholders, net of related income taxes	**$ 251.0**	$ 209.9	**$ 747.2**	$ 638.4
Weighted-average shares outstanding:				
Basic	**269.5**	279.8	**274.1**	290.4
Dilutive effects:				
Stock options	**2.0**	1.8	**2.0**	1.6
Restricted stock units	**0.6**	0.5	**0.6**	0.4
Long term performance plan	**—**	0.1	**—**	0.1
Accelerated stock repurchase agreement	**—**	1.7	**—**	1.5
Diluted	**272.1**	283.9	**276.7**	294.0
Income from continuing operations per common share:				
Basic	**$ 0.93**	$ 0.75	**$ 2.73**	$ 2.20
Diluted	**$ 0.92**	$ 0.74	**$ 2.70**	$ 2.18

11. 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 Principal Financial Group, Inc. 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.

We received a subpoena on March 31, 2005 from the Attorney General of West Virginia for documents and other information relating to funding agreement-backed securities, special purpose vehicles related to funding agreement-backed securities, and related subjects. A response has been sent. We understand that other U.S.-based life insurers that have funding agreement-backed note programs such as our on-going programs have received similar subpoenas from the Attorney General of West Virginia. Other than the subpoena, we have received no notification of any pending or threatened investigation or other proceeding by West Virginia governmental authorities involving funding agreement-backed securities.

The following tables set forth condensed consolidating financial information of Principal Life and PFG as of September 30, 2006 and December 31, 2005, and for the nine months ended September 30, 2006 and 2005.

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	**$ —**	**$ 40,392.2**	**$ 4,516.1**	**$ (779.6)**	**$ 44,128.7**
Fixed maturities, trading	**—**	**45.8**	**237.9**	**¾**	**283.7**
Equity securities, available-for-sale	**—**	**644.8**	**26.9**	**¾**	**671.7**
Equity securities, trading	**—**	**10.2**	**156.1**	**¾**	**166.3**
Mortgage loans	**—**	**9,535.4**	**2,186.1**	**(326.0)**	**11,395.5**
Real estate	**—**	**405.9**	**553.3**	**—**	**959.2**
Policy loans	**—**	**847.5**	**—**	**—**	**847.5**
Investment in unconsolidated entities	**7,512.1**	**271.2**	**4,614.4**	**(12,113.8)**	**283.9**
Other investments	**3.9**	**2,592.3**	**161.0**	**(1,779.5)**	**977.7**
Cash and cash equivalents	**181.1**	**709.2**	**731.0**	**(224.7)**	**1,396.6**
Accrued investment income	**—**	**654.8**	**52.6**	**(5.1)**	**702.3**

Premiums due and other receivables	¾	688.6	102.5	(108.2)	682.9
Deferred policy acquisition costs	—	2,243.1	140.6	—	2,383.7
Property and equipment	—	393.9	25.1	—	419.0
Goodwill	—	77.2	221.1	—	298.3
Other intangibles	—	39.0	189.0	—	228.0
Separate account assets	—	64,515.9	4,018.3	—	68,534.2
Other assets	(1.2)	1,166.8	208.5	432.3	1,806.4
Total assets	$ 7,695.9	$ 125,233.8	$ 18,140.5	$ (14,904.6)	$ 136,165.6
Liabilities					
Contractholder funds	$ —	$ 36,403.5	$ 15.1	$ (211.4)	$ 36,207.2
Future policy benefits and claims	—	14,893.9	2,283.8	(1.1)	17,176.6
Other policyholder funds	—	632.1	5.5	—	637.6
Short-term debt	—	—	201.1	(86.4)	114.7
Long-term debt	—	234.1	1,303.3	(663.8)	873.6
Income taxes currently payable (receivable)	(0.7)	(435.9)	14.7	422.4	0.5
Deferred income taxes	(0.5)	637.5	254.1	2.2	893.3
Separate account liabilities	—	64,515.9	4,018.3	¾	68,534.2
Other liabilities	9.0	1,728.5	2,532.5	(230.2)	4,039.8
Total liabilities	7.8	118,609.6	10,628.4	(768.3)	128,477.5
Stockholders' equity					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.8	2.5	—	(2.5)	3.8
Additional paid-in capital	8,106.6	5,397.1	7,118.0	(12,515.1)	8,106.6
Retained earnings (deficit)	2,755.8	610.5	(382.0)	(228.5)	2,755.8
Accumulated other comprehensive income	777.6	614.1	776.1	(1,390.2)	777.6
Treasury stock, at cost	(3,955.8)	—	—	—	(3,955.8)
Total stockholders' equity	7,688.1	6,624.2	7,512.1	(14,136.3)	7,688.1
Total liabilities and stockholders' equity	$ 7,695.9	$ 125,233.8	$ 18,140.5	$ (14,904.6)	$ 136,165.6

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2005

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$ —	$ 38,886.6	$ 3,896.5	$ (665.9)	$ 42,117.2
Fixed maturities, trading	—	18.9	94.3	¾	113.2
Equity securities, available-for-sale	—	658.8	65.6	¾	724.4
Equity securities, trading	—	—	90.3	¾	90.3
Mortgage loans	—	9,448.9	2,365.5	(330.1)	11,484.3
Real estate	—	412.8	586.6	—	999.4
Policy loans	—	827.7	—	—	827.7
Investment in unconsolidated entities	7,784.2	275.6	5,515.1	(13,311.0)	263.9
Other investments	—	2,041.8	129.6	(1,321.8)	849.6
Cash and cash equivalents	21.6	1,261.9	542.3	(184.5)	1,641.3
Accrued investment income	—	638.8	48.5	(4.6)	682.7
Premiums due and other receivables	—	589.2	112.7	(109.2)	592.7
Deferred policy acquisition costs	—	2,069.9	104.2	—	2,174.1
Property and equipment	—	397.2	22.6	—	419.8
Goodwill	—	50.4	231.9	—	282.3
Other intangibles	—	39.2	163.4	—	202.6
Separate account assets	—	58,670.7	3,415.5	(16.2)	62,070.0
Other assets	3.5	1,361.4	258.1	(123.1)	1,499.9

Total assets	$ 7,809.3	$ 117,649.8	$ 17,642.7	$ (16,066.4)	$ 127,035.4
Liabilities					
Contractholder funds	$ —	$ 33,797.0	$ 13.5	$ (198.4)	$ 33,612.1
Future policy benefits and claims	—	14,650.3	2,175.2	—	16,825.5
Other policyholder funds	—	654.1	3.0	—	657.1
Short-term debt	—	—	565.6	(89.2)	476.4
Long-term debt	—	241.9	1,223.9	(567.0)	898.8
Income taxes currently payable (receivable)	—	—	0.3	(0.3)	—
Deferred income taxes	—	753.1	237.1	(15.4)	974.8
Separate account liabilities	—	58,670.7	3,415.5	(16.2)	62,070.0
Other liabilities	2.1	1,800.1	2,224.4	(313.1)	3,713.5
Total liabilities	2.1	110,567.2	9,858.5	(1,199.6)	119,228.2
Stockholders' equity					
Series A preferred stock	¾	—	—	—	¾
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.8	2.5	—	(2.5)	3.8
Additional paid-in capital	8,000.0	5,354.8	7,071.3	(12,426.1)	8,000.0
Retained earnings (deficit)	2,008.6	870.4	(281.9)	(588.5)	2,008.6
Accumulated other comprehensive income	994.8	854.9	994.8	(1,849.7)	994.8
Treasury stock, at cost	(3,200.1)	—	—	—	(3,200.1)
Total stockholders' equity	7,807.2	7,082.6	7,784.2	(14,866.8)	7,807.2
Total liabilities and stockholders' equity	$ 7,809.3	$ 117,649.8	$ 17,642.7	$ (16,066.4)	$ 127,035.4

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$ —	$ 3,001.4	$ 205.0	$ —	$ 3,206.4
Fees and other revenues	—	940.2	680.8	(266.9)	1,354.1
Net investment income	4.2	2,359.7	345.7	(14.2)	2,695.4
Net realized/unrealized capital gains (losses)	—	(28.7)	54.8	(3.0)	23.1
Total revenues	4.2	6,272.6	1,286.3	(284.1)	7,279.0
Expenses					
Benefits, claims, and settlement expenses	—	3,911.7	327.8	(11.9)	4,227.6
Dividends to policyholders	—	217.4	—	—	217.4
Operating expenses	8.7	1,394.8	657.6	(228.7)	1,832.4
Total expenses	8.7	5,523.9	985.4	(240.6)	6,277.4
Income (loss) from continuing operations before income taxes	(4.5)	748.7	300.9	(43.5)	1,001.6
Income taxes (benefits)	(1.5)	166.4	63.3	1.5	229.7
Equity in the net income of subsidiaries	774.9	132.8	537.3	(1,445.0)	—
Net income	771.9	715.1	774.9	(1,490.0)	771.9
Preferred stock dividends	24.7	—	—	—	24.7
Net income available to common stockholders	$ 747.2	$ 715.1	$ 774.9	$ (1,490.0)	$ 747.2

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2005

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$ —	$ 2,617.6	$ 208.8	$ —	$ 2,826.4
Fees and other revenues	—	864.6	572.0	(190.8)	1,245.8
Net investment income	1.4	2,242.4	230.7	8.9	2,483.4
Net realized/unrealized capital gains (losses)	—	(22.4)	28.8	0.5	6.9
Total revenues	1.4	5,702.2	1,040.3	(181.4)	6,562.5
Expenses					
Benefits, claims, and settlement expenses	—	3,481.8	306.3	(8.0)	3,780.1
Dividends to policyholders	—	219.0	¾	—	219.0
Operating expenses	7.5	1,315.7	554.3	(163.0)	1,714.5
Total expenses	7.5	5,016.5	860.6	(171.0)	5,713.6
Income (loss) from continuing operations before income taxes	(6.1)	685.7	179.7	(10.4)	848.9
Income taxes (benefits)	(2.6)	177.6	25.3	0.8	201.1
Equity in the net income of subsidiaries, excluding discontinued operations	651.3	79.2	496.9	(1,227.4)	—
Income (loss) from continuing operations, net of related income taxes	647.8	587.3	651.3	(1,238.6)	647.8
Income from discontinued operations, net of related income taxes	16.0	23.8	16.0	(39.8)	16.0
Net income	663.8	611.1	667.3	(1,278.4)	663.8
Preferred stock dividends	9.4	—	—	—	9.4
Net income available to common stockholders	$ 654.4	$ 611.1	$ 667.3	$ (1,278.4)	$ 654.4

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Operating activities					
Net cash provided by (used in) operating activities	**$ (0.9)**	**$ 1,686.9**	**$ 433.0**	**$ (67.9)**	**$ 2,051.1**
Investing activities					
Available-for-sale securities:					
Purchases	**—**	**(5,518.0)**	**(782.8)**	**13.2**	**(6,287.6)**
Sales	**—**	**786.2**	**314.8**	**—**	**1,101.0**
Maturities	**—**	**2,527.7**	**129.0**	**—**	**2,656.7**

Mortgage loans acquired or originated	—	(1,538.8)	(313.5)	53.6	(1,798.7)
Mortgage loans sold or repaid	—	1,451.9	194.4	(57.7)	1,588.6
Real estate acquired	—	(12.8)	(9.5)	—	(22.3)
Real estate sold	—	0.3	22.6	—	22.9
Net purchases of property and equipment	—	(21.6)	(12.8)	—	(34.4)
Purchases of interest in subsidiaries, net of cash acquired	—	—	(37.2)	—	(37.2)
Dividends received from (contributions to) unconsolidated entities	880.8	(314.1)	980.8	(1,547.5)	—
Net change in other investments	¾	(76.4)	(12.7)	105.2	16.1
Net cash provided by (used in) investing activities	$ 880.8	$ (2,715.6)	$ 473.1	$ (1,433.2)	$ (2,794.9)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows (continued)
For the nine months ended September 30, 2006

	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
Financing activities					
Issuance of common stock	$ 51.8	$ —	$ —	$ —	$ 51.8
Acquisition of treasury stock, net	(755.7)	—	—	—	(755.7)
Proceeds from financing element derivatives	—	126.3	—	—	126.3
Payments for financing element derivatives	—	(110.0)	—	—	(110.0)
Excess tax benefits from share-based payment arrangements	—	4.1	1.8	—	5.9
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	5.8	84.9	(89.4)	1.3
Principal repayments of long-term debt	—	(13.6)	(6.6)	—	(20.2)
Net repayments of short-term borrowings	—	—	(362.5)	2.8	(359.7)
Capital dividends paid to parent	—	(980.8)	(566.7)	1,547.5	—
Investment contract deposits	—	6,691.7	—	—	6,691.7
Investment contract withdrawals	—	(5,247.5)	—	—	(5,247.5)
Net increase in banking operation deposits	—	—	131.7	—	131.7
Net cash provided by (used in) financing activities	(720.4)	476.0	(717.4)	1,460.9	499.1
Net increase (decrease) in cash and cash equivalents	159.5	(552.7)	188.7	(40.2)	(244.7)
Cash and cash equivalents at beginning of period	21.6	1,261.9	542.3	(184.5)	1,641.3
Cash and cash equivalents at end of period	$ 181.1	$ 709.2	$ 731.0	$ (224.7)	$ 1,396.6

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows — (As Restated — See Note 1)
For the nine months ended September 30, 2005

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

Operating activities					
Net cash provided by (used in) operating activities	$ (4.5)	$ 1,015.3	$ 504.6	$ (151.2)	$ 1,364.2
Investing activities					
Available-for-sale securities:					
Purchases	—	(4,773.8)	(1,382.8)	131.7	(6,024.9)
Sales	—	1,366.1	574.6	—	1,940.7
Maturities	—	2,824.9	264.5	—	3,089.4
Mortgage loans acquired or originated	—	(1,605.8)	(452.0)	120.5	(1,937.3)
Mortgage loans sold or repaid	—	1,785.6	283.7	(124.3)	1,945.0
Real estate acquired	—	(126.9)	(38.7)	—	(165.6)
Real estate sold	—	221.9	65.7	—	287.6
Net purchases of property and equipment	—	(21.8)	(6.9)	—	(28.7)
Purchases of interest in subsidiaries, net of cash acquired	—	—	(58.1)	—	(58.1)
Dividends received from (paid to) unconsolidated entities	251.1	(429.9)	(65.0)	243.8	—
Net change in other investments	—	22.8	(58.0)	(23.7)	(58.9)
Net cash provided by (used in) investing activities	$ 251.1	$ (736.9)	$ (873.0)	$ 348.0	$ (1,010.8)

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2006
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows — (As Restated — See Note 1) (continued)
For the nine months ended September 30, 2005

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Financing activities					
Issuance of preferred stock	$ 542.0	$ —	$ —	$ —	$ 542.0
Issuance of common stock	40.6	—	—	—	40.6
Acquisition and sales of treasury stock, net	(868.4)	—	—	—	(868.4)
Proceeds from financing element derivatives	—	160.6	—	—	160.6
Payments for financing element derivatives	—	(95.7)	—	—	(95.7)
Dividends to preferred stockholders	(9.4)	—	—	—	(9.4)
Issuance of long-term debt	—	78.8	76.2	(142.3)	12.7
Principal repayments of long-term debt	—	(7.5)	(34.9)	—	(42.4)
Net proceeds of short-term borrowings	—	0.6	95.7	4.1	100.4
Capital received from (dividends paid to) parent	—	35.0	176.3	(211.3)	—
Investment contract deposits	—	5,172.6	—	—	5,172.6
Investment contract withdrawals	—	(4,722.2)	—	—	(4,722.2)
Net increase in banking operation deposits	—	—	21.8	—	21.8
Net cash provided by (used in) financing activities	(295.2)	622.2	335.1	(349.5)	312.6
Discontinued operations					
Net cash used in operating activities	—	(1.2)	—	—	(1.2)
Net cash used in investing activities	¾	(0.7)	—	—	(0.7)
Net cash used in discontinued operations	—	(1.9)	—	—	(1.9)
Net increase (decrease) in cash and cash equivalents	(48.6)	898.7	(33.3)	(152.7)	664.1
Cash and cash equivalents at beginning of period	75.4	31.8	410.0	(64.7)	452.5
Cash and cash equivalents at end of period	$ 26.8	$ 930.5	$ 376.7	$ (217.4)	$ 1,116.6
Cash and cash equivalents of discontinued operations included above					
At beginning of period	$ —	$ 1.9	$ —	$ —	$ 1.9
At end of period	$ —	$ —	$ —	$ —	$ —

11. Condensed Consolidating Financial Information (continued)

On June 30, 2004, our shelf registration statement with the SEC was declared effective. Following our June 2005 issuance of perpetual preferred stock under the shelf registration, we now have the ability to issue up to $1.95 billion (See Note 12 "Subsequent Event") of debt securities, preferred stock, common stock, warrants, stock purchase contracts and stock purchase units of PFG and trust preferred securities of three subsidiary trusts. If we issue additional securities, we intend to use the proceeds from the sale of the securities for general corporate purposes, including working capital, capital expenditures, investments in subsidiaries, share repurchase, acquisitions and refinancing of debt, including commercial paper and other short-term indebtedness. Principal Financial Services, Inc. unconditionally guarantees our obligations with respect to one or more series of debt securities described in the shelf registration statement.

The following tables set forth condensed consolidating financial information of Principal Financial Services, Inc. and PFG as of September 30, 2006 and December 31, 2005, and for the nine months ended September 30, 2006 and 2005.

Condensed Consolidating Statements of Financial Position
September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$ —	$ 13.5	$ 44,115.2	$ —	$ 44,128.7
Fixed maturities, trading	—	0.7	283.0	—	283.7
Equity securities, available-for-sale	—	1.1	670.6	—	671.7
Equity securities, trading	—	1.0	165.3	—	166.3
Mortgage loans	—	—	11,395.5	—	11,395.5
Real estate	—	—	959.2	—	959.2
Policy loans	—	—	847.5	—	847.5
Investment in unconsolidated entities	7,512.1	7,788.6	283.9	(15,300.7)	283.9
Other investments	3.9	4.6	973.8	(4.6)	977.7
Cash and cash equivalents	181.1	745.3	1,337.1	(866.9)	1,396.6
Accrued investment income	—	0.2	702.1	—	702.3
Premiums due and other receivables	¾	2.1	680.8	¾	682.9
Deferred policy acquisition costs	—	—	2,383.7	—	2,383.7
Property and equipment	—	—	419.0	—	419.0
Goodwill	—	—	298.3	—	298.3
Other intangibles	—	—	228.0	—	228.0
Separate account assets	—	—	68,534.2	—	68,534.2
Other assets	(1.2)	1.1	1,802.3	4.2	1,806.4
Total assets	$ 7,695.9	$ 8,558.2	$ 136,079.5	$ (16,168.0)	$ 136,165.6

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position (continued)
September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Liabilities					
Contractholder funds	$ —	$ —	$ 36,207.2	$ —	$ 36,207.2
Future policy benefits and claims	—	—	17,176.6	—	17,176.6
Other policyholder funds	—	—	637.6	—	637.6
Short-term debt	—	¾	484.2	(369.5)	114.7
Long-term debt	—	464.5	409.1	—	873.6

Income taxes currently payable (receivable)	**(0.7)**	**(3.4)**	**0.2**	**4.4**	**0.5**
Deferred income taxes	**(0.5)**	**5.2**	**887.0**	**1.6**	**893.3**
Separate account liabilities	**—**	**—**	**68,534.2**	**—**	**68,534.2**
Other liabilities	**9.0**	**579.8**	**3,954.8**	**(503.8)**	**4,039.8**
Total liabilities	**7.8**	**1,046.1**	**128,290.9**	**(867.3)**	**128,477.5**
Stockholders' equity					
Series A preferred stock	**—**	**—**	**—**	**—**	**—**
Series B preferred stock	**0.1**	**—**	**—**	**—**	**0.1**
Common stock	**3.8**	**—**	**16.8**	**(16.8)**	**3.8**
Additional paid-in capital	**8,106.6**	**7,118.0**	**6,168.5**	**(13,286.5)**	**8,106.6**
Retained earnings (deficit)	**2,755.8**	**(382.0)**	**826.9**	**(444.9)**	**2,755.8**
Accumulated other comprehensive income	**777.6**	**776.1**	**778.4**	**(1,554.5)**	**777.6**
Treasury stock, at cost	**(3,955.8)**	**—**	**(2.0)**	**2.0**	**(3,955.8)**
Total stockholders' equity	**7,688.1**	**7,512.1**	**7,788.6**	**(15,300.7)**	**7,688.1**
Total liabilities and stockholders' equity	**$ 7,695.9**	**$ 8,558.2**	**$ 136,079.5**	**$ (16,168.0)**	**$ 136,165.6**

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2006
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2005

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$ —	$ 14.7	$ 42,102.5	$ —	$ 42,117.2
Fixed maturities, trading	—	—	113.2	—	113.2
Equity securities, available-for-sale	—	1.0	723.4	—	724.4
Equity securities, trading	—	—	90.3	—	90.3
Mortgage loans	—	—	11,484.3	—	11,484.3
Real estate	—	—	999.4	—	999.4
Policy loans	—	—	827.7	—	827.7
Investment in unconsolidated entities	7,784.2	8,168.9	263.8	(15,953.0)	263.9
Other investments	—	8.4	841.2	—	849.6
Cash and cash equivalents	21.6	701.3	1,822.4	(904.0)	1,641.3
Accrued investment income	—	0.2	682.5	—	682.7
Premiums due and other receivables	—	2.3	590.4	—	592.7
Deferred policy acquisition costs	—	—	2,174.1	—	2,174.1
Property and equipment	—	—	419.8	—	419.8
Goodwill	—	—	282.3	—	282.3
Other intangibles	—	—	202.6	—	202.6
Separate account assets	—	—	62,070.0	—	62,070.0
Other assets	3.5	15.0	1,499.9	(18.5)	1,499.9
Total assets	$ 7,809.3	$ 8,911.8	$ 127,189.8	$ (16,875.5)	$ 127,035.4
Liabilities					
Contractholder funds	$ —	$ —	$ 33,612.1	$ —	$ 33,612.1
Future policy benefits and claims	—	—	16,825.5	—	16,825.5
Other policyholder funds	—	—	657.1	—	657.1
Short-term debt	—	349.9	774.1	(647.6)	476.4
Long-term debt	—	464.3	434.5	—	898.8
Deferred income taxes	—	7.0	983.8	(16.0)	974.8
Separate account liabilities	—	—	62,070.0	—	62,070.0
Other liabilities	2.1	306.4	3,663.8	(258.8)	3,713.5
Total liabilities	2.1	1,127.6	119,020.9	(922.4)	119,228.2
Stockholders' equity					
Series A preferred stock	¾	—	—	—	—
Series B preferred stock	0.1	—	—	—	0.1
Common stock	3.8	—	16.8	(16.8)	3.8
Additional paid-in capital	8,000.0	7,071.3	6,108.7	(13,180.0)	8,000.0
Retained earnings (deficit)	2,008.6	(281.9)	1,050.1	(768.2)	2,008.6
Accumulated other comprehensive income	994.8	994.8	995.3	(1,990.1)	994.8
Treasury stock, at cost	(3,200.1)	—	(2.0)	2.0	(3,200.1)
Total stockholders' equity	7,807.2	7,784.2	8,168.9	(15,953.1)	7,807.2

Total liabilities and stockholders' equity	$ 7,809.3	$ 8,911.8	$ 127,189.8	$ (16,875.5)	$ 127,035.4

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2006
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$ —	$ —	$ 3,206.4	$ —	$ 3,206.4
Fees and other revenues	—	—	1,355.5	(1.4)	1,354.1
Net investment income	4.2	9.2	2,682.0	—	2,695.4
Net realized/unrealized capital gains (losses)	—	(0.5)	23.6	—	23.1
Total revenues	4.2	8.7	7,267.5	(1.4)	7,279.0
Expenses					
Benefits, claims, and settlement expenses	—	—	4,227.6	—	4,227.6
Dividends to policyholders	—	—	217.4	—	217.4
Operating expenses	8.7	32.8	1,792.3	(1.4)	1,832.4
Total expenses	8.7	32.8	6,237.3	(1.4)	6,277.4
Income (loss) from continuing operations before income taxes	(4.5)	(24.1)	1,030.2	—	1,001.6
Income taxes (benefits)	(1.5)	(8.4)	239.6	—	229.7
Equity in the net income of subsidiaries	774.9	790.6	—	(1,565.5)	—
Net income	771.9	774.9	790.6	(1,565.5)	771.9
Preferred stock dividends	24.7	—	—	—	24.7
Net income available to common stockholders	$ 747.2	$ 774.9	$ 790.6	$ (1,565.5)	$ 747.2

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2005

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$ —	$ —	$ 2,826.4	$ —	$ 2,826.4
Fees and other revenues	—	—	1,245.9	(0.1)	1,245.8
Net investment income	1.4	5.4	2,476.6	—	2,483.4
Net realized/unrealized capital gains (losses)	—	(1.0)	7.9	—	6.9
Total revenues	1.4	4.4	6,556.8	(0.1)	6,562.5
Expenses					
Benefits, claims, and settlement expenses	—	—	3,780.1	—	3,780.1
Dividends to policyholders	—	—	219.0	—	219.0
Operating expenses	7.5	33.7	1,673.4	(0.1)	1,714.5
Total expenses	7.5	33.7	5,672.5	(0.1)	5,713.6

Income (loss) from continuing operations before income taxes	(6.1)	(29.3)	884.3	—	848.9
Income taxes (benefits)	(2.6)	(5.2)	208.9	—	201.1
Equity in the net income of subsidiaries, excluding discontinued operations	651.3	675.4	¾	(1,326.7)	—
Income (loss) from continuing operations, net of related income taxes	647.8	651.3	675.4	(1,326.7)	647.8
Income from discontinued operations, net of related income taxes	16.0	16.0	16.0	(32.0)	16.0
Net income	663.8	667.3	691.4	(1,358.7)	663.8
Preferred stock dividends	9.4	¾	¾	¾	9.4
Net income available to common stockholders	$ 654.4	$ 667.3	$ 691.4	$ (1,358.7)	$ 654.4

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2006

	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
Operating activities					
Net cash provided by (used in) operating activities	**$ (0.9)**	**$ 209.4**	**$ 2,062.7**	**$ (220.1)**	**$ 2,051.1**
Investing activities					
Available-for-sale securities:					
Purchases	**—**	**48.2**	**(6,335.8)**	**—**	**(6,287.6)**
Sales	**—**	**3.1**	**1,097.9**	**—**	**1,101.0**
Maturities	**—**	**—**	**2,656.7**	**—**	**2,656.7**
Mortgage loans acquired or originated	**—**	**—**	**(1,798.7)**	**—**	**(1,798.7)**
Mortgage loans sold or repaid	**—**	**—**	**1,588.6**	**—**	**1,588.6**
Real estate acquired	**—**	**—**	**(22.3)**	**—**	**(22.3)**
Real estate sold	**—**	**—**	**22.9**	**—**	**22.9**
Net purchases of property and equipment	**—**	**—**	**(34.4)**	**—**	**(34.4)**
Purchases of interest in subsidiaries, net of cash acquired	**—**	**—**	**(37.2)**	**—**	**(37.2)**
Dividends received from unconsolidated entities	**880.8**	**984.7**	**—**	**(1,865.5)**	**—**
Net change in other investments	**¾**	**29.4**	**7.6**	**(20.9)**	**16.1**
Net cash provided by (used in) investing activities	**$ 880.8**	**$ 1,065.4**	**$ (2,854.7)**	**$ (1,886.4)**	**$ (2,794.9)**

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows (continued)
For the nine months ended September 30, 2006

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Financing activities					
Issuance of common stock	$ 51.8	$ —	$ —	$ —	$ 51.8
Acquisition of treasury stock, net	(755.7)	—	—	—	(755.7)
Proceeds from financing element derivatives	—	—	126.3	—	126.3
Payments for financing element derivatives	—	—	(110.0)	—	(110.0)
Excess tax benefits from share-based payment arrangements	—	—	5.9	—	5.9
Dividends to preferred stockholders	(16.5)	—	—	—	(16.5)
Issuance of long-term debt	—	—	1.4	(0.1)	1.3
Principal repayments of long-term debt	—	—	(20.3)	0.1	(20.2)
Net repayments of short-term borrowings	—	(350.0)	(287.8)	278.1	(359.7)
Dividends paid to parent	—	(880.8)	(984.7)	1,865.5	—
Investment contract deposits	—	—	6,691.7	—	6,691.7
Investment contract withdrawals	—	—	(5,247.5)	—	(5,247.5)
Net increase in banking operation deposits	—	—	131.7	—	131.7
Net cash provided by (used in) financing activities	(720.4)	(1,230.8)	306.7	2,143.6	499.1
Net increase (decrease) in cash and cash equivalents	159.5	44.0	(485.3)	37.1	(244.7)
Cash and cash equivalents at beginning of period	21.6	701.3	1,822.4	(904.0)	1,641.3
Cash and cash equivalents at end of period	$ 181.1	$ 745.3	$ 1,337.1	$ (866.9)	$ 1,396.6

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows — (As Restated — See Note 1)
For the nine months ended September 30, 2005

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Operating activities					
Net cash provided by (used in) operating activities	$ (4.5)	$ 146.4	$ 1,434.4	$ (212.1)	$ 1,364.2
Investing activities					
Available-for-sale securities:					
Purchases	—	(9.1)	(6,015.8)	—	(6,024.9)
Sales	—	6.5	1,934.2	—	1,940.7
Maturities	—	—	3,089.4	—	3,089.4
Mortgage loans acquired or originated	—	—	(1,937.3)	—	(1,937.3)
Mortgage loans sold or repaid	—	—	1,945.0	—	1,945.0
Real estate acquired	—	—	(165.6)	—	(165.6)
Real estate sold	—	—	287.6	—	287.6
Net purchases of property and equipment	—	—	(28.7)	—	(28.7)
Purchases of interest in subsidiaries, net of cash acquired	—	—	(58.1)	—	(58.1)
Dividends received from unconsolidated entities	251.1	22.3	4.2	(277.6)	—
Net change in other investments	—	14.6	(73.2)	(0.3)	(58.9)
Net cash provided by (used in) investing activities	251.1	34.3	(1,018.3)	(277.9)	(1,010.8)
Financing activities					
Issuance of common stock	40.6	—	—	—	40.6
Issuance of preferred stock	542.0	—	—	—	542.0
Acquisition and sales of treasury stock, net	(868.4)	—	—	—	(868.4)
Proceeds from financing element derivatives	—	—	160.6	—	160.6
Payments for financing element derivatives	—	—	(95.7)	—	(95.7)
Dividends to preferred stockholders	(9.4)	—	—	—	(9.4)
Issuance of long-term debt	—	—	12.7	—	12.7
Principal repayments of long-term debt	—	—	(42.4)	—	(42.4)
Net proceeds of short-term borrowings	—	75.0	25.0	0.4	100.4
Dividends paid to parent	—	(251.1)	(26.5)	277.6	—
Investment contract deposits	—	—	5,172.6	—	5,172.6
Investment contract withdrawals	—	—	(4,722.2)	—	(4,722.2)
Net increase in banking operation deposits	—	—	21.8	—	21.8

Net cash provided by (used in) financing activities	$ (295.2)	$ (176.1)	$ 505.9	$ 278.0	$ 312.6

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2006
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows — (As Restated — See Note 1) (continued)
For the nine months ended September 30, 2005

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Discontinued operations					
Net cash used in operating activities	$ —	$ —	$ (1.2)	$ —	$ (1.2)
Net cash used in investing activities	—	—	(0.7)	—	(0.7)
Net cash used in discontinued operations	—	—	(1.9)	—	(1.9)
Net increase (decrease) in cash and cash equivalents	(48.6)	4.6	920.1	(212.0)	664.1
Cash and cash equivalents at beginning of period	75.4	551.9	521.0	(695.8)	452.5
Cash and cash equivalents at end of period	$ 26.8	$ 556.5	$ 1,441.1	$ (907.8)	$ 1,116.6
Cash and cash equivalents of discontinued operations included above					
At beginning of period	$ —	$ —	$ 1.9	$ —	$ 1.9
At end of period	$ —	$ —	$ —	$ —	$ —

12. Subsequent Event

On October 11, 2006, we issued $500.0 million of senior notes from our shelf registration, which was filed with the SEC in December 2003. The notes will bear interest at a rate of 6.05% per year. Interest on the notes is payable on April 15 and October 15 of each year, beginning on April 15, 2007. The notes will mature on October 15, 2036. A portion of the proceeds will be used to fund the acquisition of WM Advisors, Inc., with the remaining proceeds being used for general corporate purposes.

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

The following analysis discusses our financial condition as of September 30, 2006, compared with December 31, 2005, and our consolidated results of operations for the three and nine months ended September 30, 2006 and 2005, prepared in conformity with accounting principles generally accepted in the U.S. ("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, 2005, filed with the United States Securities and Exchange Commission ("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) a decline or increased 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; (2) our investment portfolio is subject to several risks which may diminish the value of our invested assets and affect our sales, profitability and the investment returns credited to our customers; (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 any of our ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors and cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations; (5) our efforts to reduce the impact of interest rate changes on our profitability and surplus may not be effective; (6) if we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced; (7) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (8) our reserves

established for future policy benefits and claims may prove inadequate, requiring us to increase liabilities; (9) 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 Insurance Company ("Principal Life"); (10) the pattern of amortizing our deferred policy acquisition costs on our Statement of Financial Accounting Standard ("SFAS") No. 97 *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments* products may change, impacting both the level of the asset and the emergence of our operating earnings; (11) we may need to fund deficiencies in our closed block ("Closed Block") assets; (12) changes in laws, regulations or accounting standards may reduce our profitability; (13) litigation and regulatory investigations may affect our financial strength or reduce our profitability; (14) fluctuations in foreign currency exchange rates could reduce our profitability; and (15) 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. For a more comprehensive discussion of these risks and uncertainties, please see Item 1A, Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2005.

Overview

We provide financial products and services through the following segments:

- U.S. Asset Management and Accumulation, which consists of our asset accumulation operations, which provide retirement savings and related investment products and services, and our asset management operations conducted through Principal Global Investors. 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, which we define as businesses with fewer than 1,000 employees. 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. Principal Global Investors 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, long-term mutual funds and life insurance through operations in Chile, Mexico, Hong Kong, Brazil, India, China, and Malaysia.

- 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 benefit 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 2006 and 2005:

WM Advisors, Inc. On July 25, 2006, we announced a definitive agreement to acquire WM Advisors, Inc. ("WM Advisors") and its subsidiaries from Washington Mutual, Inc., for $740.0 million in cash, subject to closing adjustments. WM Advisors, with more than $26.0 billion in assets under management, provides investment advisory services to mutual funds, variable trust funds and asset allocation portfolios to approximately 800,000 shareholder accounts nationwide. We expect the transaction to close in the fourth quarter 2006 or early 2007. The operations of WM Advisors, Inc. will be reported and consolidated in our U.S. Asset Management and Accumulation segment.

Principal Global Services Private Limited. In December 2005, we formed Principal Global Services Private Limited ("PGS"), which began operations in Pune, India as of August 2006. PGS employees perform services for our U.S. operations including claims data entry, 401(k) processing, IT coding/application development, and IT quality assurance. PGS start up costs will be reported in our Corporate and Other segment through 2006. Beginning in 2007, expenses will be allocated to the segments for which services are performed.

Principal Commercial Funding II. On October 24, 2005, Principal Real Estate Investors and U.S. Bank National Association announced that they agreed to create Principal Commercial Funding II, a jointly-owned business that will compete in the commercial mortgage-backed securities ("CMBS") market. Principal Real Estate Investors is the real estate investment arm of Principal Global Investors. U.S. Bank National Association is the principal banking subsidiary of U.S. Bancorp. The new company is the CMBS platform for both Principal Real Estate Investors and U.S. Bank National Association and focuses on securitizing commercial mortgages originated by both Principal Real Estate Investors and U.S. Bank National Association on its behalf. Principal Commercial Funding II began operations immediately, and began contributing collateral to securitizations during the first quarter of 2006. The operations of Principal Commercial Funding II are reported in our U.S. Asset Management and Accumulation segment using the equity method of accounting.

CCB-Principal Asset Management Company, Ltd. On August 7, 2005, we announced that we entered into a joint venture agreement with China Construction Bank ("CCB") to market mutual funds in the People's Republic of China. We closed the transaction on September 19, 2005, with a 25% ownership in CCB-Principal Asset Management Company, Ltd. The operations of CCB-Principal Asset Management Company, Ltd are reported in our International Asset Management and Accumulation segment using the equity method of accounting.

PNB Principal Insurance Advisory Company Pvt. Ltd. On February 21, 2005, Principal Financial Group (Mauritius) Ltd. ("PFGM") acquired a 26% stake and management control of PNB Principal Insurance Advisory Company Pvt. Ltd. ("PPIAC"), an insurance brokerage company in India. The operations of PPIAC are reported and consolidated in our International Asset Management and Accumulation segment.

Dispositions

We entered into disposition agreements or disposed of the following business, among others, during 2006 and 2005:

ING/Principal Pensions Company Ltd. On May 26, 2005, we announced jointly with our partner, ING, the intent to liquidate the ING/Principal Pensions Company, Ltd. operation in Japan. On December 20, 2005, the liquidation process was

completed with a formal liquidation filing to the Japanese corporate registry. The results of ING/Principal Pensions Company Ltd. were reported in our International Asset Management and Accumulation segment.

Real Estate Investments. In the second and third quarters of 2005, we sold certain real estate properties previously held for investment purposes. These properties qualify for discontinued operations treatment under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ("SFAS 144"). Therefore, the results of operations have been removed from our results of continuing operations for all periods presented. The gains on disposal are reported as other after-tax adjustments in our Corporate and Other segment.

Selected financial information for the discontinued operations is as follows:

	For the three months ended September 30, 2006	For the three months ended September 30, 2005	For the nine months ended September 30, 2006	For the nine months ended September 30, 2005
	(in millions)			
Total revenues	$ —	$ 0.3	$ —	$ 2.2
Income from discontinued operations:				
Income before income taxes	$ —	$ 0.3	$ —	$ 2.2
Income taxes	—	0.1	—	0.8
Income from discontinued operations, net of related income taxes	—	0.2	—	1.4
Gain on disposal of discontinued operations, net of related income taxes	—	7.6	—	22.3
Net income	$ —	$ 7.8	$ —	$ 23.7

Principal Residential Mortgage, Inc. On July 1, 2004, we closed the sale of Principal Residential Mortgage, Inc. to CitiMortgage, Inc. Our total after-tax proceeds from the sale were approximately U.S. $620.0 million. Our Mortgage Banking segment, which included Principal Residential Mortgage, Inc., is accounted for as a discontinued operation, under SFAS 144.

For the year ended December 31, 2004, we accrued for an estimated after-tax gain on disposal. For the three and nine months ended September 30, 2005, we refined our estimate which resulted in an after-tax loss of $7.7 million, primarily due to additional tax expense related to the sale. This loss on disposal is reported as an other after-tax adjustment in our Mortgage Banking segment.

Other

Senior Note Issuance. On October 11, 2006, we issued $500.0 million of senior notes from our shelf registration, which was filed with the SEC in December 2003. The notes will bear interest at a rate of 6.05% per year. Interest on the notes is payable on April 15 and October 15 of each year, beginning on April 15, 2007. The notes will mature on October 15, 2036. A portion of the proceeds will be used to fund the acquisition of WM Advisors, with the remaining proceeds being used for general corporate purposes.

SBB Mutual Berhad and SBB Asset Management Sdn Bhd. On October 30, 2006, our joint venture company in Malaysia, CIMB-Principal, announced its intention to purchase the mutual fund and asset management companies of the former Southern Bank Bhd ("SBB")—SBB Mutual Berhad and SBB Asset Management Sdn Bhd. We expect to invest an additional $52 million to retain our 40% ownership interest in the larger CIMB-Principal, pending completion of appropriate legal agreements and regulatory approvals. Funding is expected within the next 90 days.

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 income from continuing operations. Our consolidated income from continuing operations was positively impacted by $1.0 million and $3.4 million for the three months ended September 30, 2006 and 2005, respectively, and positively impacted $4.4 million and $4.8 million for the nine months ended September 30, 2006 and 2005, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to foreign currency exchange rate risk, see Item 3. "Quantitative and Qualitative Disclosures about Market Risk."

Stock-Based Compensation Plans

As of September 30, 2006, 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. Under the terms of the 2005 Stock Incentive Plan, grants may

be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units, or other stock based awards. The 2005 Directors Stock Plan provides for the grant of nonqualified stock options, restricted stock, restricted stock units, or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock or performance units.

The compensation cost that was charged against income for the Stock-Based Compensation Plans was $19.7 million and $15.9 million, and the related income tax benefit recognized in the income statement was $6.8 million and $5.2 million for the three months ended September 30, 2006 and 2005, respectively. The compensation cost that was charged against income for the Stock-Based Compensation Plans was $47.3 million and $35.4 million, and the related income tax benefit recognized in the income statement was $15.3 million and $11.2 million for the nine months ended September 30, 2006 and 2005, respectively. For awards with graded vesting, we use an accelerated expense attribution method. The total compensation cost capitalized as part of the cost of an asset was $0.5 million for the three months ended September 30, 2006 and 2005. The total compensation cost capitalized as part of the cost of an asset was and $2.4 million and $1.2 million for the nine months ended September 30, 2006 and 2005, respectively.

Beginning in 2006, we granted performance share awards to certain employees. The performance share awards are treated as an equity award and are paid in shares. Whether the performance shares are earned depends upon the participant's continued employment through the performance period (except in the case of an approved retirement) and our performance against three-year goals set at the beginning of the performance period. A return on equity objective and an earnings per share objective must be achieved for any of the performance shares to be earned. If the performance requirements are not met, the performance shares will be forfeited and no compensation cost is recognized and any previously recognized compensation cost is reversed. There is no maximum contractual term on these awards.

The total compensation cost related to nonvested awards not yet recognized is $36.2 million. This compensation cost is expected to be recognized over a weighted average period of approximately 2 years.

Pension and 401(k) Benefit Expense

Effective January 1, 2006, we made changes to our retirement program, including the Principal Select Savings Plan ("401(k)") and the Principal Pension Plan ("Pension Plan") and the corresponding nonqualified plans. The qualified and nonqualified Pension Plans' changes include a reduction to the traditional and cash balance formulas, a change in the early retirement factors, and the removal of the cost of living adjustments for traditional benefits earned after January 1, 2006. The qualified and nonqualified 401(k) Plans' company match increased from 50% of a 6% deferral to 75% of an 8% deferral. The Pension Plan changes reduced the Pension Plan expense in 2006, while the 401(k) changes increased the 401(k) expense.

The 2006 pension expense for substantially all of our employees and certain agents is expected to be approximately $34.6 million. This is a decrease of $14.0 million over the 2005 pension expense. This decrease is due to the reduction in the Pension Plan formulas and asset performance in excess of our 8.5% long-term assumption. Partially offsetting this was an increase attributable to the use of a lower discount rate and lower long-term asset return assumption. Approximately $8.7 million and $26.0 million of pre-tax pension expense was reflected in the determination of net income for the three and nine months ended September 30, 2006, respectively. In addition, approximately $8.6 million of pre-tax pension expense will be reflected in fourth quarter 2006. The discount rate used to develop the 2006 expense was lowered to 5.75%, from the 6.0% discount rate used to develop the 2005 expense. The long-term asset assumption was also lowered to 8.25%, from the 8.50% assumption used to develop the 2005 expense. The 2006 decrease in pension expense is expected to be offset by a $19.7 million increase in the qualified and nonqualified 401(k) Plans' company matching expense resulting from the January 1, 2006 changes.

Recent Accounting Pronouncements

The Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("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"), on September 29, 2006. SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status. This statement 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. Changes in the funded status of a defined benefit postretirement plan will be recognized in comprehensive income in the year the changes occur. The requirement to recognize the funded status of a defined benefit postretirement plan and the disclosure requirements are effective for fiscal years ending after December 15, 2006. The requirement to measure plan assets and benefit obligations as of the annual balance sheet date is effective for fiscal years ending after December 15, 2008. SFAS 158 is not expected to have a material impact on our consolidated financial statements.

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. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are still evaluating the impact this guidance will have on our consolidated financial statements.

The SEC staff published Staff Accounting Bulletin ("SAB") No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ("SAB 108"), on September 13, 2006. SAB 108 addresses quantifying the financial statement effects of misstatements, specifically, how the effects of prior year uncorrected errors must be considered in quantifying misstatements in the current year financial statements. Under SAB 108, registrants are required to quantify the effects on the current year financial statements of correcting all misstatements, including both the carryover and reversing effects of uncorrected prior year misstatements. After considering all relevant quantitative and qualitative factors, if a misstatement is material, a registrant's prior year financial statements must be restated. SAB 108 offers special transition provisions only for circumstances where its application would have altered previous materiality conclusions. When applying the special transition provisions, instead of restating prior period financial statements, a registrant must record the effect as a cumulative-effect adjustment to beginning-of-year retained earnings. SAB 108 is effective for fiscal years ending after November 15, 2006. We are still evaluating the impact this guidance will have on our consolidated financial statements.

On July 13, 2006, the FASB issued FASB Interpretation ("FIN") No. 48, *Accounting for Uncertainty in Income Taxes* ("FIN 48"). FIN 48, which is an interpretation of SFAS No. 109, *Accounting for Income Taxes*, prescribes a recognition threshold and measurement attribute for the financial statement

recognition and measurement of a tax position taken, or expected to be taken, in a tax return. FIN 48 requires the affirmative evaluation that it is more likely than not, based on the technical merits of a tax position, that an enterprise is entitled to economic benefits resulting from positions taken in income tax returns. If a tax position does not meet the more-likely-than-not recognition threshold, the benefit of that position is not recognized in the financial statements. FIN 48 also requires companies to disclose additional quantitative and qualitative information in their financial statements about uncertain tax positions. FIN 48 is effective for fiscal years beginning after December 15, 2006, and the cumulative effect of applying this Interpretation shall be reported as an adjustment to the opening balance of retained earnings for that fiscal year. FIN 48 is not expected to have a material impact on our consolidated financial statements.

On March 17, 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* ("SFAS 156"), which amends SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* ("SFAS 140"). This Statement (1) requires an entity to recognize a servicing asset or liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in specified situations, (2) requires all separately recognized servicing assets and liabilities to be initially measured at fair value, (3) for subsequent measurement of each class of separately recognized servicing assets and liabilities, an entity can elect either the amortization or fair value measurement method, (4) permits a one-time reclassification of available-for-sale ("AFS") securities to trading securities by an entity with recognized servicing rights, without calling into question the treatment of other AFS securities, provided the AFS securities are identified in some manner as offsetting the entity's exposure to changes in fair value of servicing assets or liabilities that a servicer elects to subsequently measure at fair value, and (5) requires separate presentation of servicing assets and liabilities measured at fair value in the statement of financial position and also requires additional disclosures. The initial measurement requirements of this statement should be applied prospectively to all transactions entered into after the fiscal year beginning

after September 15, 2006. The election related to the subsequent measurement of servicing assets and liabilities is also effective the first fiscal year beginning after September 15, 2006. SFAS 156 is not expected to have a material impact on our consolidated financial statements.

On February 16, 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments — an amendment of FASB Statements No. 133 and 140* ("SFAS 155"), which amends SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("SFAS 133") and SFAS 140. SFAS 155 (1) permits fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation, (2) clarifies which interest-only and principal-only strips are not subject to the requirements of SFAS 133, (3) establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation, (4) clarifies that concentrations of credit risk in the form of subordination are not embedded derivatives, and (5) amends SFAS 140 to eliminate the prohibition on a qualifying special-purpose entity from holding a derivative financial instrument that pertains to a beneficial interest other than another derivative financial instrument. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's fiscal year that begins after September 15, 2006. At adoption, the fair value election may also be applied to hybrid financial instruments that have been bifurcated under SFAS 133 prior to adoption of this Statement. Any changes resulting from the adoption of this Statement should be recognized as a cumulative effect adjustment to beginning retained earnings. We are still evaluating the impact this guidance will have on our consolidated financial statements.

On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), *Share-Based Payment* ("SFAS 123R"). SFAS 123R requires all share-based payments to employees to be recognized at fair value in the financial statements. SFAS 123R replaces SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), supersedes Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees* ("APB 25"), and SFAS No. 148, *Accounting for Stock-Based Compensation-Transition and Disclosure - an Amendment of FASB Statement No. 123* and amends SFAS No. 95, *Statement of Cash Flows*. On April 14, 2005, the SEC approved a new rule delaying the effective date of SFAS 123R to annual periods that begin after June 15, 2005. Accordingly, we adopted SFAS 123R effective January 1, 2006, using the modified-prospective method.

The provisions of our stock awards allow approved retirees to retain all or a portion of their awards if they retire prior to the end of the required service period. SFAS 123R considers this to be a nonsubstantive service condition. Accordingly, it is appropriate to recognize compensation cost either immediately for stock awards granted to retirement eligible employees, or over the period from the grant date to the date retirement eligibility is achieved, if retirement eligibility is expected to occur during the nominal vesting period. Our approach was to follow the widespread practice of recognizing compensation cost over the explicit service period (up to the date of actual retirement). For any awards that are granted after our adoption of SFAS 123R on January 1, 2006, we recognize compensation cost through the period that the employee first becomes eligible to retire and is no longer required to provide service to earn the award. If we had applied the nonsubstantive vesting provisions of SFAS 123R to awards granted prior to January 1, 2006, our consolidated financial statements would not have been materially impacted.

SFAS 123R requires that the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after the effective date. While we cannot estimate what those amounts will be in the future (because they depend on, among other things, when employees exercise stock options), the amount of financing cash flows recognized for the nine months ended September 30, 2006, for such excess tax deductions, was $5.9 million.

Under the modified-prospective method, any excess income tax deduction realized for awards accounted for under SFAS 123R (regardless of the type of award or the jurisdiction in which the tax benefit is generated) is eligible to absorb write-offs of deferred income tax assets for any awards accounted for under SFAS 123R. SFAS 123R does not require separate pools of excess income tax benefits for separate types of awards, rather the excess income tax benefits of employee and nonemployee awards may be combined in a single pool of excess tax benefits. Our policy is to pool the employee and nonemployee awards together in this manner. Deferred income tax asset write-offs resulting from deficient deductions on employee awards may be offset against previous excess income tax benefits arising from nonemployee awards, and vice versa.

This Statement did not have a material impact on our consolidated financial statements as we began expensing all stock options using a fair-value based method effective for the year beginning January 1, 2002. In addition, any stock options granted prior to January 1, 2002 were fully vested at the time of adoption of SFAS 123R. We use the Black-Scholes formula to estimate the value of stock options granted to employees. We applied the prospective method

of transition as prescribed by SFAS 123 when we elected to begin expensing stock-based compensation in 2002. The cumulative effect of the change in accounting principle as a result of adopting this Statement is immaterial. Therefore, the pre-tax cumulative effect of the change in accounting principle is reflected in operating expenses.

Results of Operations

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Revenues:				
Premiums and other considerations	**$ 1,060.0**	$ 943.4	**$ 3,206.4**	$ 2,826.4
Fees and other revenues	**454.0**	423.3	**1,354.1**	1,245.8
Net investment income	**931.6**	853.5	**2,695.4**	2,483.4
Net realized/unrealized capital gains (losses)	**(6.7)**	(1.8)	**23.1**	6.9
Total revenues	**2,438.9**	2,218.4	**7,279.0**	6,562.5
Expenses:				
Benefits, claims and settlement expenses	**1,426.2**	1,281.3	**4,227.6**	3,780.1
Dividends to policyholders	**73.0**	73.9	**217.4**	219.0
Operating expenses	**608.2**	576.8	**1,832.4**	1,714.5
Total expenses	**2,107.4**	1,932.0	**6,277.4**	5,713.6
Income from continuing operations before income taxes	**331.5**	286.4	**1,001.6**	848.9
Income taxes	**72.3**	67.1	**229.7**	201.1
Income from continuing operations, net of related income taxes	**259.2**	219.3	**771.9**	647.8
Income from discontinued operations, net of related income taxes	**—**	0.1	**—**	16.0
Net income	**259.2**	219.4	**771.9**	663.8
Preferred stock dividends	**8.2**	9.4	**24.7**	9.4
Net income available to common stockholders	**$ 251.0**	$ 210.0	**$ 747.2**	$ 654.4

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Premiums and other considerations increased $116.6 million, or 12%, to $1,060.0 million for the three months ended September 30, 2006, from $943.4 million for the three months ended September 30, 2005. The increase was primarily due to a $79.7 million increase from the Life and Health Insurance segment, primarily related to increased covered medical members in our health insurance business and strong sales and stable retention in our specialty benefits business. The increase also reflected a $26.1 million increase from the U.S. Asset Management and Accumulation segment, primarily a result of an increase in sales of payout annuities with life contingencies from our full-service payout and individual annuities business.

Fees and other revenues increased $30.7 million, or 7%, to $454.0 million for the three months ended September 30, 2006, from $423.3 million for the three months ended September 30, 2005. The increase was primarily due to a $41.8 million increase from the U.S. Asset Management and Accumulation segment primarily related to an increase in account values stemming from continued strong full-service accumulation net cash flow and strong performance in the equity markets and an increase in Principal Global Investors management fees. Partially offsetting the increase was a $4.8 million decrease in the International Asset and Accumulation segment, primarily due to a refinement of accrued fee income in Mexico in 2005.

Net investment income increased $78.1 million, or 9%, to $931.6 million for the three months ended September 30, 2006, from $853.5 million for the three months ended September 30, 2005. The increase was primarily related to an increase in average annualized yield on invested assets and cash and a $1,735.2 million, or 3%, increase in average invested assets and cash. The yield on average invested assets and cash was 6.2% for the three months ended September 30, 2006 and 5.8% for the three months ended September 30, 2005.

Net realized/unrealized capital losses increased $4.9 million to $6.7 million for the three months ended September 30, 2006, from $1.8 million for the three months ended September 30, 2005. The increase was due to mark to market losses versus gains on derivatives activities and fewer mark to market gains on certain seed money investments offset, in part, by gains versus losses on the mark to market of fixed maturity trading securities, gains versus losses on the sale of real estate, fewer losses on the sales of fixed maturity securities and gains versus losses on commercial mortgage loans.

The following table highlights the contributors to net realized/unrealized capital gains and losses for the three months ended September 30, 2006.

	For the three months ended September 30, 2006			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	**$ (8.3)**	**$ (5.6)**	**$ 112.7**	**$ 98.8**
Fixed maturity securities, trading	**—**	**5.5**	**—**	**5.5**
Equity securities(2)	**—**	**6.1**	**—**	**6.1**
Mortgage loans on real estate(3)	**(0.2)**	**—**	**—**	**(0.2)**
Derivatives(4)	**—**	**—**	**(125.7)**	**(125.7)**
Other(5)	**—**	**6.5**	**2.3**	**8.8**
Total	**$ (8.5)**	**$ 12.5**	**$ (10.7)**	**$ (6.7)**

(1) Impairments include $2.3 million of credit impairment write-downs. Credit losses include $6.0 million in realized losses related to credit triggered sales. Other gains (losses) include $0.4 million in net gains as the result of prepayment activity, gross realized gains of $0.3 million and gross

realized losses of $6.3 million. The gross realized losses of $6.3 million resulted from the sale of certain hybrid securities that had a regulatory classification change that resulted in increased capital requirements.

(2) Other gains (losses) include $6.2 million in mark to market of net realized/unrealized gains on trading equity securities.

(3) Impairments include a $0.5 million decrease in the commercial mortgage valuation allowance and $0.7 million in realized losses on residential mortgage loans held by our international operations.

(4) Hedging adjustments include $109.3 million of net unrealized losses related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities.

(5) Other gains (losses) include $2.6 million in mark to market net realized/unrealized gains on certain seed money investments.

Benefits, claims and settlement expenses increased $144.9 million, or 11%, to $1,426.2 million for the three months ended September 30, 2006, from $1,281.3 million for the three months ended September 30, 2005. The increase reflected a $72.8 million increase from the U.S. Asset Management and Accumulation segment, primarily reflecting an increase in cost of interest credited, higher benefit payments in our individual annuity business, and an increase in reserves resulting from sales of payout annuities with life contingencies. The increase was also due to a $51.3 million increase from the Life and Health Insurance segment, primarily due to growth in our specialty benefits and health businesses partially offset by reserve refinements in our health business.

Dividends to policyholders decreased $0.9 million to $73.0 million for the three months ended September 30, 2006, from $73.9 million for the three months ended September 30, 2005. The decrease was primarily due to a $1.7 million decrease from the U.S. Asset Management and Accumulation segment primarily due to a decrease in dividends for our participating pension full-service accumulation products. Partially offsetting the decrease was a $0.8 million increase from the Life and Health segment due to an increase in the individual life insurance dividend crediting rates.

Operating expenses increased $31.4 million, or 5%, to $608.2 million for the three months ended September 30, 2006, from $576.8 million for the three months ended September 30, 2005. The increase reflected a $30.6 million increase from the U.S. Asset Management and Accumulation segment, primarily due to an increase in deferred policy acquisition costs ("DPAC") amortization and in other expenses associated with growth in average assets under management.

Income taxes increased $5.2 million, or 8%, to $72.3 million for the three months ended September 30, 2006, from $67.1 million for the three months ended September 30, 2005. The effective income tax rate was 22% for the three months ended September 30, 2006, and 23% for the three months ended September 30, 2005. The effective income tax rate for the three months ended September 30, 2006, was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, tax refinements in Mexico, and interest exclusion from taxable income. The effective income tax rate for the three months ended September 30, 2005, was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, tax credits on our investment in a synthetic fuel production facility, and interest exclusion from taxable income.

As a result of the foregoing factors and the inclusion of income from discontinued operations for 2005, net of related income taxes, net income increased $39.8 million, or 18%, to $259.2 million for the three months ended September 30, 2006, from $219.4 million for the three months ended September 30, 2005. The income from discontinued operations for the three months ended September 30, 2005, was related to gains on sales and operating revenues of real estate properties that qualify for discontinued operations treatment under SFAS 144 partially offset by a loss from discontinued operations for Principal Residential Mortgage, Inc.

Preferred stock dividends decreased $1.2 million, or 13%, to $8.2 million for the three months ended September 30, 2006, from $9.4 million for the three months ended September 30, 2005. Since the preferred stock was issued in June 2005 and the initial dividend was declared in September 2005, the prior year dividend earnings period was longer compared to 2006.

Net income available to common stockholders increased $41.0 million, or 20%, to $251.0 million for the three months ended September 30, 2006, from $210.0 million for the three months ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Premiums and other considerations increased $380.0 million, or 13%, to $3,206.4 million for the nine months ended September 30, 2006, from $2,826.4 million for the nine months ended September 30, 2005. The increase was primarily due to a $251.3 million increase from the Life and Health Insurance segment, primarily related to increased covered medical members in our health insurance business and strong sales and stable retention in our specialty benefits business. The increase also reflected a $132.9 million increase from the U.S. Asset Management and Accumulation segment, primarily a result of an increase in premiums from single premium group annuities with life contingencies, which are typically used to fund defined benefit pension plan terminations, and sales of payout annuities with life contingencies.

Fees and other revenues increased $108.3 million, or 9%, to $1,354.1 million for the nine months ended September 30, 2006, from $1,245.8 million for the nine months ended September 30, 2005. The increase was primarily due to a $114.7 million increase from the U.S. Asset Management and Accumulation segment primarily related to an increase in account values stemming from continued strong full-service accumulation net cash flow and strong performance in the equity markets and an increase in Principal Global Investors management fees.

Net investment income increased $212.0 million, or 9%, to $2,695.4 million for the nine months ended September 30, 2006, from $2,483.4 million for the nine months ended September 30, 2005. The increase was primarily related to a $2,400.1 million, or 4%, increase in average invested assets and cash and an increase in average annualized yield on invested assets and cash. The yield on average invested assets and cash was 6.0% for the nine months ended September 30, 2006 and 5.7% for the nine months ended September 30, 2005.

Net realized/unrealized capital gains increased $16.2 million to $23.1 million for the nine months ended September 30, 2006, from $6.9 million for the nine months ended September 30, 2005. The increase is due to the gain on the sale of stock of an equity method investment, fewer losses on the mark to market adjustment related to derivative activities, a software impairment in 2005 with no corresponding activity in 2006, more gains as the result of the mark to market of

certain seed money investments, and fewer losses on credit triggered bond sales. Offsetting these increases were more other than temporary declines in the value of fixed maturity securities resulting from the determination that we no longer have the ability and intent to hold these securities until recovery due to our need to fund the announced acquisition of WM Advisors and a large recovery of previously impaired securities as the result of a litigation settlement that occurred in 2005.

The following table highlights the contributors to net realized/unrealized capital gains and losses for the nine months ended September 30, 2006.

	For the nine months ended September 30, 2006			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
		(in millions)		
Fixed maturity securities(1)	$ (37.9)	$ (0.9)	$ (19.7)	$ (58.5)
Fixed maturity securities, trading	—	(1.4)	—	(1.4)
Equity securities(2)	—	10.6	—	10.6
Mortgage loans on real estate(3)	0.6	—	—	0.6
Derivatives(4)	—	—	16.6	16.6
Other(5)	—	63.2	(8.0)	55.2
Total	$ (37.3)	$ 71.5	$ (11.1)	$ 23.1

(1) Impairments include $11.0 million of credit impairment write-downs and $3.0 million in realized credit recoveries on the sale of previously impaired assets. As the result of the need to fund our recently announced acquisition of WM Advisors, impairments also include $16.0 million of write-downs that resulted from our determination that we no longer had the ability and intent to hold certain fixed maturity securities until they recovered in value. Credit losses include $0.2 million in realized gains and $14.1 million in realized losses related to credit triggered sales. Other gains (losses) include $3.4 million in net gains as the result of prepayment activity, gross realized gains of $4.1 million and gross realized losses of $8.4 million. Included in the gross realized losses of $8.4 million is $6.3 million that resulted from the sale of certain hybrid securities that had a regulatory classification change that resulted in increased capital requirements.

(2) Other gains (losses) include $10.3 million in mark to market of net realized/unrealized gains on trading equity securities.

(3) Impairments include $2.5 million in realized losses due to the sale of commercial mortgage loans, $3.6 million in realized recoveries on the sale of previously impaired commercial mortgage loans, a $1.3 million decrease in the commercial mortgage valuation allowance, and $1.8 million in realized losses on residential mortgage loans held by our international operations.

(4) Hedging adjustments include $23.2 million of net unrealized gains related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities.

(5) Other gains (losses) include a $44.3 million realized gain on the sale of stock of an equity method investment and $13.0 million in mark to market net realized/unrealized gains on certain seed money investments.

Benefits, claims and settlement expenses increased $447.5 million, or 12%, to $4,227.6 million for the nine months ended September 30, 2006, from $3,780.1 million for the nine months ended September 30, 2005. The increase was due to a $213.8 million increase from the Life and Health Insurance segment, primarily due to growth in our specialty benefits and health businesses. The increase also reflected a $213.0 million increase from the U.S. Asset Management and Accumulation segment, primarily reflecting the increase in reserves resulting from an increase in sales of single premium group annuities with life contingencies and sales of payout annuities with life contingencies.

Dividends to policyholders decreased $1.6 million to $217.4 million for the nine months ended September 30, 2006, from $219.0 million for the nine months ended September 30, 2005. The decrease was primarily due to a $4.1 million decrease in dividends for our participating pension full-service accumulation products. Partially offsetting the decrease was a $2.5 million increase in dividends for our Life and Health segment primarily due to an increase in the individual life insurance dividend crediting rates.

Operating expenses increased $117.9 million, or 7%, to $1,832.4 million for the nine months ended September 30, 2006, from $1,714.5 million for the nine months ended September 30, 2005. The increase reflected a $82.1 million increase from the U.S. Asset Management and Accumulation segment, primarily due to an increase in DPAC amortization and other expenses associated with growth in average assets under management. The increase was also due to a $31.4 million increase from the Life and Health Insurance segment, primarily due to growth in the specialty benefits and insured medical businesses, partially offset by a decrease in individual life insurance expenses due to lower DPAC amortization related to worse claims experience and lower sales and unusually high expenses in 2005 related to a change in the estimate of future reinsurance benefits.

Income taxes increased $28.6 million, or 14%, to $229.7 million for the nine months ended September 30, 2006, from $201.1 million for the nine months ended September 30, 2005. The effective income tax rate was 23% for the nine months ended September 30, 2006, and 24% for the nine months ended September 30, 2005. The effective income tax rate for the nine months ended September 30, 2006, was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, a favorable court ruling on a contested IRS issue for 1991 and later years, and interest exclusion from taxable income. The effective income tax rate for the nine months ended September 30, 2005, was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, tax credits on our investment in a synthetic fuel production facility and interest exclusion from taxable income.

As a result of the foregoing factors and the inclusion of income from discontinued operations for 2005, net of related income taxes, net income increased $108.1 million, or 16%, to $771.9 million for the nine months ended September 30, 2006, from $663.8 million for the nine months ended September 30, 2005. The income from discontinued operations for the nine months ended September 30, 2005, was related to gains on sales and operating revenues of real estate properties that qualify for discontinued operations treatment under SFAS 144 partially offset by a loss from discontinued operations for Principal Residential Mortgage, Inc.

Preferred stock dividends increased $15.3 million to $24.7 million for the nine months ended September 30, 2006, from $9.4 million for the nine months ended September 30, 2005. The preferred stock dividends were a result of issuing preferred stock in June 2005.

Net income available to common stockholders increased $92.8 million, or 14%, to $747.2 million for the nine months ended September 30, 2006, from $654.4 million for the nine months ended September 30, 2005.

Results of Operations by Segment

We use segment operating earnings for goal setting, determining employee compensation, and evaluating performance on a basis comparable to that used by securities analysts. Segment operating earnings are determined 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 we believe are not indicative of overall operating trends. Note that after-tax adjustments have occurred in the past and could recur in future reporting periods. While these items may be significant components in understanding and assessing our consolidated financial performance, we believe the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of our businesses.

The following table presents segment information as of or for the periods indicated:

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Operating revenues by segment				
U.S. Asset Management and Accumulation	**$ 1,100.0**	$ 975.4	**$ 3,266.0**	$ 2,903.8
International Asset Management and Accumulation	**169.2**	148.4	**476.8**	439.4
Life and Health Insurance	**1,183.4**	1,106.1	**3,526.1**	3,264.2
Corporate and Other(1)	**(7.6)**	(8.0)	**(13.5)**	(46.1)
Total segment operating revenues	**2,445.0**	2,221.9	**7,255.4**	6,561.3
Add:				
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues(2)	**(6.1)**	(3.2)	**23.6**	3.4
Subtract:				
Operating revenues from discontinued real estate investments	**¾**	0.3	**¾**	2.2
Total revenue per consolidated statements of operations	**$ 2,438.9**	$ 2,218.4	**$ 7,279.0**	$ 6,562.5
Operating earnings (loss) by segment, net of related income taxes:				
U.S. Asset Management and Accumulation	**$ 157.4**	$ 133.3	**$ 466.4**	$ 402.4
International Asset Management and Accumulation	**23.2**	19.7	**56.9**	48.3
Life and Health Insurance	**82.0**	65.4	**217.6**	211.2
Corporate and Other	**(7.9)**	(4.1)	**(20.8)**	(17.4)
Total segment operating earnings, net of related income taxes	**254.7**	214.3	**720.1**	644.5
Net realized/unrealized capital gains (losses), as adjusted(2)	**(3.7)**	(4.2)	**8.3**	(4.7)
Other after-tax adjustments(3)	**¾**	(0.1)	**18.8**	14.6
Net income available to common stockholders per consolidated statements of operations	**$ 251.0**	$ 210.0	**$ 747.2**	$ 654.4

	September 30, 2006	December 31, 2005
	(in millions)	
Assets by segment:		
U.S. Asset Management and Accumulation(4)	**$ 111,800.2**	$ 103,506.1
International Asset Management and Accumulation	**7,648.2**	6,856.2
Life and Health Insurance	**14,285.2**	14,080.2
Corporate and Other(5)	**2,432.0**	2,592.9
Total consolidated assets	**$ 136,165.6**	$ 127,035.4

(1) Includes inter-segment eliminations primarily related to internal investment management fee revenues and commission fee revenues paid to U.S. Asset Management and Accumulation agents for selling Life and Health Insurance segment insurance products.

(2) In addition to sales activity and other than temporary impairments, net realized/unrealized capital gains (losses) include unrealized gains (losses) on mark to market changes in certain seed money investments and investments classified as trading securities, as well as unrealized gains (losses) on certain derivatives. Net realized/unrealized capital gains (losses), as adjusted, are net of income taxes, net realized capital gains and losses distributed, minority interest capital gains and losses, related changes in the amortization pattern of deferred policy acquisition and sales inducement costs, recognition of front-end fee revenues for sales charges on retirement products and services and certain market value adjustments to fee revenues.

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Net realized/unrealized capital gains (losses)	$ **(6.7)**	$ (1.8)	$ **23.1**	$ 6.9
Certain market value adjustments to fee revenues	**0.1**	(0.4)	**(1.1)**	(4.3)
Recognition of front-end fee revenues	**0.5**	(1.0)	**1.6**	0.8
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**(6.1)**	(3.2)	**23.6**	3.4
Amortization of deferred policy acquisition and sales inducement costs related to net realized capital gains (losses)	**5.1**	3.6	**3.9**	(0.3)
Capital gains distributed	**(2.2)**	(2.6)	**(5.8)**	(3.8)
Minority interest capital gains	**(3.0)**	(2.0)	**(4.8)**	(2.2)
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues, net of related amortization of deferred policy acquisition costs and sales inducement costs, capital gains distributed, and minority interest capital gains	**(6.2)**	(4.2)	**16.9**	(2.9)
Income tax effect	**2.5**	¾	**(8.6)**	(1.8)
Net realized/unrealized capital gains (losses), as adjusted	$ **(3.7)**	$ (4.2)	$ **8.3**	$ (4.7)

(3) For the three months ended September 30, 2005, other after-tax adjustments of $(0.1) million included the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($7.7 million) and the positive effect of gains on sales of real estate properties that qualify for discontinued operations treatment under SFAS 144 ($7.6 million).

For the nine months ended September 30, 2006, other after-tax adjustments of $18.8 million included the positive effect of a favorable court ruling on a contested IRS issue for 1991 and later years.

For the nine months ended September 30, 2005, other after-tax adjustments of $14.6 million include the positive effect of gains on sales of real estate properties that qualify for discontinued operations treatment under SFAS 144 ($22.3 million) and the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($7.7 million).

(4) U.S. Asset Management and Accumulation separate account assets include shares of the Principal Financial Group stock allocated to a separate account, a result of our demutualization. The value of the separate account was $731.5 million and $726.6 million at September 30, 2006 and December 31, 2005, respectively. Changes in the fair value of the separate account are reflected in both separate account assets and separate account liabilities.

(5) Includes inter-segment elimination amounts related to an internal line of credit and internally generated mortgage loans. The Corporate and Other segment managed a revolving line of credit used by other segments. The U.S. Asset Management and Accumulation segment and Life and Health Insurance segment reported mortgage loan assets issued for real estate joint ventures. These mortgage loans were reported as liabilities in the Corporate and Other segment.

U.S. Asset Management and Accumulation Segment

U.S. Asset Management and Accumulation Segment Summary Financial Data

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Premiums and other considerations	$ **96.2**	$ 70.1	$ **335.7**	$ 202.8
Fees and other revenues	**334.6**	294.8	**985.6**	874.9
Net investment income	**669.2**	610.5	**1,944.7**	1,826.1
Total operating revenues	**1,100.0**	975.4	**3,266.0**	2,903.8
Expenses:				
Benefits, claims and settlement expenses, including dividends to policyholders	**594.9**	523.9	**1,762.0**	1,553.0
Operating expenses	**301.4**	275.5	**903.7**	825.6
Total expenses	**896.3**	799.4	**2,665.7**	2,378.6
Operating earnings before income taxes	**203.7**	176.0	**600.3**	525.2
Income taxes	**46.3**	42.7	**133.9**	122.8
Operating earnings	**157.4**	133.3	**466.4**	402.4
Net realized/unrealized capital losses, as adjusted	**(14.0)**	(12.3)	**(18.5)**	(12.4)
U.S. GAAP Reported:				

Net income available to common stockholders	**$**	**143.4**	$	121.0	**$**	**447.9**	$	390.0

(1) Excludes net realized/unrealized capital losses and their impact on recognition of front-end fee revenues and certain market value adjustments to fee revenues.

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Premiums and other considerations increased $26.1 million, or 37%, to $96.2 million for the three months ended September 30, 2006, from $70.1 million for the three months ended September 30, 2005. The increase primarily resulted from a $14.2 million increase in full-service payout sales of annuities with life contingencies. In addition, individual payout annuity premiums and other considerations increased $11.9 million primarily due to increased sales from certain distribution channels.

Fees and other revenues increased $39.8 million, or 14%, to $334.6 million for the three months ended September 30, 2006, from $294.8 million for the three months ended September 30, 2005. Full-service accumulation fees and other revenues increased $18.6 million primarily due to an increase in account values stemming from continued strong net cash flow and strong performance in the equity markets. In addition, Principal Global Investors fees and other revenues increased $7.8 million primarily due to continued growth in management fees related to our real estate, fixed income and equity businesses. Furthermore, mutual fund fees and other revenue increased $7.7 million primarily due to an increase in management fees stemming from an increase in average assets under management.

Net investment income increased $58.7 million, or 10%, to $669.2 million for the three months ended September 30, 2006, from $610.5 million for the three months ended September 30, 2005. The increase reflects a $1,682.1 million, or 4%, increase in average invested assets and cash for the segment and an increase in the average annualized yield on invested assets and cash, which was 5.9% for the three months ended September 30, 2006 and 5.6% for the three months ended September 30, 2005.

Benefits, claims and settlement expenses, including dividends to policyholders, increased $71.0 million, or 14%, to $594.9 million for the three months ended September 30, 2006, from $523.9 million for the three months ended September 30, 2005. The increase primarily resulted from a $26.2 million increase in our individual annuity business due to several factors, including an increase in cost of interest credited, higher benefit payments, and an increase in reserves stemming from an increase in sales related to our payout annuities with life contingencies. In addition, investment only benefits, claims and settlement expenses increased $20.6 million primarily due to an increase in cost of interest credited on this block of business resulting from an increase in account values. Furthermore, full-service payout benefits, claims and settlement expenses increased $17.6 million primarily due to increased sales of payout annuities with life contingencies.

Operating expenses increased $25.9 million, or 9%, to $301.4 million for the three months ended September 30, 2006, from $275.5 million for the three months ended September 30, 2005. The increase primarily resulted from a $7.6 million increase in full-service accumulation operating expenses due to an increase in DPAC amortization and staff related costs. Furthermore, Principal Global Investors operating expenses increased $6.5 million primarily due to an increase in expenses associated with growth in average assets under management and to a lesser extent the fact that expenses associated with the origination of securitized mortgages are now expensed rather than deferred and recognized as a reduction in securitization revenue, as was the case prior to the U.S. Bank joint venture. In addition, individual annuity operating expenses increased $4.1 million primarily due to an increase in DPAC amortization related to the normal growth in the block of business. Also, investment only operating expenses increased $3.4 million primarily due to an increase in non-deferred costs.

Income taxes increased $3.6 million, or 8%, to $46.3 million for the three months ended September 30, 2006, from $42.7 million for the three months ended September 30, 2005. The effective income tax rates for this segment were 23% and 24% for the three months ended September 30, 2006 and 2005, respectively. The effective income tax rates for the three months ended September 30, 2006 and 2005, 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.

As a result of the foregoing factors, operating earnings increased $24.1 million, or 18%, to $157.4 million for the three months ended September 30, 2006, from $133.3 million for the three months ended September 30, 2005.

Net realized/unrealized capital losses, as adjusted, increased $1.7 million, or 14%, to $14.0 million for the three months ended September 30, 2006, from $12.3 million for the three months ended September 30, 2005. The increase is due to market losses versus market gains related to hedging activities offset in part by fewer other than temporary declines in the values of fixed maturity securities and fewer losses generated as the result of sale and call activity of fixed maturity securities.

As a result of the foregoing factors for the three months ended September 30, 2006, net income available to common stockholders increased $22.4 million, or 19%, to $143.4 million from $121.0 million for the three months ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Premiums and other considerations increased $132.9 million, or 66%, to $335.7 million for the nine months ended September 30, 2006, from $202.8 million for the nine months ended September 30, 2005. The increase primarily resulted from a $105.2 million increase in full-service payout sales of single premium group annuities with life contingencies, which are typically used to fund defined benefit plan terminations, and increased sales of payout annuities with life contingencies. The premium income received from these contracts fluctuates due to the variability in the number and size of pension plan terminations, the interest rate environment and the ability to attract new sales. In addition, individual payout annuity premiums and other considerations increased $27.7 million due to increased sales from certain distribution channels.

Fees and other revenues increased $110.7 million, or 13%, to $985.6 million for the nine months ended September 30, 2006, from $874.9 million for the nine months ended September 30, 2005. Full-service accumulation fees and other revenues increased $65.4 million primarily due to an increase in account values stemming from continued strong net cash flow and strong performance in the equity markets. Furthermore, mutual fund fees and other revenue increased $23.9 million primarily due to an increase in management fees stemming from an increase in average assets under management. In addition, Principal Global Investors fees and other revenues increased $20.7 million primarily due to an increase in management fees related to our real estate, fixed income and equity businesses.

Net investment income increased $118.6 million, or 6%, to $1,944.7 million for the nine months ended September 30, 2006, from $1,826.1 million for the nine months ended September 30, 2005. The increase reflects a $1,889.9 million, or 4%, increase in average invested assets and cash for the segment and an increase in the average annualized yield on invested assets and cash, which was 5.8% for the nine months ended September 30, 2006 and 5.7% for the nine months ended September 30, 2005.

Benefits, claims and settlement expenses, including dividends to policyholders, increased $209.0 million, or 13%, to $1,762.0 million for the nine months ended September 30, 2006, from $1,553.0 million for the nine months ended September 30, 2005. The increase primarily resulted from a $107.1 million increase in our full-service payout business as a result of increased sales of single premium group annuities and payout annuities with life contingencies. Also contributing to the increase was a $54.8 million increase in our individual annuity business due to several factors, including an increase in cost of interest credited, higher benefit payments, and an increase in reserves stemming from an increase in sales related to our life payout annuity business. In addition, investment only benefits, claims and settlement expenses increased $45.7 million primarily due to an increase in cost of interest credited on this block of business resulting from an increase in account values.

Operating expenses increased $78.1 million, or 9%, to $903.7 million for the nine months ended September 30, 2006, from $825.6 million for the nine months ended September 30, 2005. The increase primarily resulted from a $45.9 million increase in full-service accumulation operating expenses due to an increase in DPAC amortization, staff related costs and non-deferred sales compensation costs. Furthermore, Principal Global Investors operating expenses increased $14.5 million primarily due to an increase in expenses associated with growth in average assets under management and to a lesser extent the fact that expenses associated with the origination of securitized mortgages are now expensed rather than deferred and recognized as a reduction in securitization revenue, as was the case prior to the U.S. Bank joint venture. In addition, individual annuity operating expenses increased $12.5 million primarily due to an increase in DPAC amortization related to the normal growth in the block of business.

Income taxes increased $11.1 million, or 9%, to $133.9 million for the nine months ended September 30, 2006, from $122.8 million for the nine months ended September 30, 2005. The effective income tax rates for this segment were 22% and 23% for the nine months ended September 30, 2006 and 2005, respectively. The effective income tax rates for the nine months ended September 30, 2006 and 2005, 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.

As a result of the foregoing factors, operating earnings increased $64.0 million, or 16%, to $466.4 million for the nine months ended September 30, 2006, from $402.4 million for the nine months ended September 30, 2005.

Net realized/unrealized capital losses, as adjusted, increased $6.1 million, or 49%, to $18.5 million for the nine months ended September 30, 2006, from $12.4 million for the nine months ended September 30, 2005. The increase was due to a large recovery of previously impaired securities as the result of a litigation settlement that occurred in 2005 offset, in part, by fewer mark to market losses related to hedging activities, fewer other than temporary declines in the value of fixed maturity securities, and gains versus losses on commercial mortgages.

As a result of the foregoing factors for the nine months ended September 30, 2006, net income available to common stockholders increased $57.9 million, or 15%, to $447.9 million from $390.0 million for the nine months ended September 30, 2005.

International Asset Management and Accumulation Segment

International Asset Management and Accumulation Segment Summary Financial Data

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 September 30,		For the nine months ended September 30,	
	2006	2005	2006	2005
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Premiums and other considerations	**$ 57.0**	$ 46.1	**$ 188.3**	$ 192.5
Fees and other revenues	**29.3**	34.1	**85.0**	80.8
Net investment income	**82.9**	68.2	**203.5**	166.1
Total operating revenues	**169.2**	148.4	**476.8**	439.4
Expenses:				
Benefits, claims and settlement expenses	**114.0**	93.2	**320.1**	298.8
Operating expenses	**39.8**	32.3	**102.3**	84.2
Total expenses	**153.8**	125.5	**422.4**	383.0
Operating earnings before income taxes	**15.4**	22.9	**54.4**	56.4
Income taxes (benefits)	**(7.8)**	3.2	**(2.5)**	8.1
Operating earnings	**23.2**	19.7	**56.9**	48.3
Net realized/unrealized capital gains (losses), as adjusted	**2.5**	8.4	**(1.4)**	7.7
U.S. GAAP Reported:				
Net income available to common stockholders	**$ 25.7**	$ 28.1	**$ 55.5**	$ 56.0

(1) Excludes net realized/unrealized capital gains (losses).

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Premiums and other considerations increased $10.9 million, or 24%, to $57.0 million for the three months ended September 30, 2006, from $46.1 million for the three months ended September 30, 2005. An increase of $12.6 million in Chile is due to increased sales of single premium annuities with life contingencies. Partially offsetting the increase was a decrease of $2.4 million in Mexico due to decreased sales of single premium annuities with life contingencies.

Fees and other revenues decreased $4.8 million, or 14%, to $29.3 million for the three months ended September 30, 2006, from $34.1 million for the three months ended September 30, 2005. The decrease is primarily due to a $6.0 million refinement of accrued fee income in Mexico in 2005. Partially offsetting the decrease is an increase of $1.1 million in India due to an increase in fees from PNB Principal Insurance Advisory Company Pvt. Ltd ("PPIAC") and an increase in fees from growth in assets under management.

Net investment income increased $14.7 million, or 22%, to $82.9 million for the three months ended September 30, 2006, from $68.2 million for the three months ended September 30, 2005. The increase was primarily due to an increase of $262.4 million, or 10%, in average invested assets and cash, excluding our equity method investments. Additionally, the increase was due to an increase in annualized yield on average invested assets and cash, excluding our equity method investments, which was 10.1% for the three months ended September 30, 2006, compared to 9.4% for the three months ended September 30, 2005. Furthermore, the increase was due to strengthening of the Chilean peso and Brazilian real versus the U.S. dollar.

Benefits, claims and settlement expenses increased $20.8 million, or 22%, to $114.0 million for the three months ended September 30, 2006, from $93.2 million for the three months ended September 30, 2005. An increase of $18.4 million in Chile was primarily due to higher change in reserves due to an increase in sales of single premium annuities with life contingencies as well as higher interest credited to customers in 2006.

Operating expenses increased $7.5 million, or 23%, to $39.8 million for the three months ended September 30, 2006, from $32.3 million for the three months ended September 30, 2005. An increase of $4.1 million in Mexico was primarily due to increased amortization related to a refinement of present value of future profits ("PVFP") in 2006. An increase of $1.1 million in India was due to higher compensation and occupancy costs in the mutual fund business and PPIAC. An increase of $0.9 million in Hong Kong was due to increased compensation costs coupled with DPAC unlocking in 2006.

Income tax benefits increased $11.0 million to $7.8 million for the three months ended September 30, 2006, from $3.2 million of income taxes for the three months ended September 30, 2005. The increase is primarily due to tax refinements in Mexico.

As a result of the foregoing factors, operating earnings increased $3.5 million, or 18%, to $23.2 million for the three months ended September 30, 2006, from $19.7 million for the three months ended September 30, 2005.

Net realized/unrealized capital gains, as adjusted, decreased $5.9 million, or 70%, to $2.5 million for the three months ended September 30, 2006 from $8.4 million for the three months ended September 30, 2005. The decrease was primarily related to a $7.6 million decrease in Chile due to lower mark-to-market gains on derivatives in 2006 that are held to more effectively match the invested asset portfolio to our policyholder liability risks. Partially offsetting the decrease is an increase of $0.9 million in Mexico due to higher realized gains on our invested asset portfolio.

As a result of the foregoing factors, net income available to common stockholders decreased $2.4 million, or 9%, to $25.7 million for the three months ended September 30, 2006, from $28.1 million for the three months ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Premiums and other considerations decreased $4.2 million, or 2%, to $188.3 million for the nine months ended September 30, 2006, from $192.5 million for the nine months ended September 30, 2005. A decrease of $16.0 million in Chile and Mexico due to decreased sales of single premium annuities with life contingencies was partially offset by an increase of $11.7 million due to the strengthening of the Chilean peso versus the U.S. dollar.

Fees and other revenues increased $4.2 million, or 5%, to $85.0 million for the nine months ended September 30, 2006, from $80.8 million for the nine months ended September 30, 2005. An increase of $4.1 million in India was primarily a result of an increase in fees from PPIAC, along with an increase in fees caused by growth in assets under management.

Net investment income increased $37.4 million, or 23%, to $203.5 million for the nine months ended September 30, 2006, from $166.1 million for the nine months ended September 30, 2005. The increase was primarily due to strengthening of the Chilean peso and Brazilian real versus the U.S. dollar. In addition, the increase was due to an increase of $342.9 million, or 13%, in average invested assets and cash, excluding our equity method investments. Furthermore, the increase was due to higher earnings from our equity method investments.

Benefits, claims and settlement expenses increased $21.3 million, or 7%, to $320.1 million for the nine months ended September 30, 2006, from $298.8 million for the nine months ended September 30, 2005. An increase of $19.3 million is due to the strengthening of the Chilean peso versus the U.S. dollar. An increase in Chile of $6.0 million is primarily due to higher interest credited to customers partially offset by a decrease in reserves due to decreased sales of single premium annuities with life contingencies. The increase in benefits, claims, and settlement expenses is partially offset by $3.8 million decrease in reserves in Mexico as a result of decreased sales of single premium annuities with life contingencies.

Operating expenses increased $18.1 million, or 21%, to $102.3 million for the nine months ended September 30, 2006, from $84.2 million for the nine months ended September 30, 2005. An increase of $6.4 million in Mexico was primarily due to increased amortization related to a refinement of PVFP, higher distribution expenses, professional fees expenses and sales compensation in 2006. An increase of $4.1 million in India was due to higher compensation costs in the mutual fund business and PPIAC. In addition, an increase of $2.2 million in Hong Kong was due to increased incentive compensation costs, commission expenses, and occupancy costs coupled with the impact of DPAC unlocking in 2006.

Income tax benefits increased $10.6 million to $2.5 million for the nine months ended September 30, 2006, from $8.1 million of income taxes for the nine months ended September 30, 2005. The increase is primarily due to tax refinements in Mexico. The increase was partially offset by a tax benefit recorded in 2005 as the result of applying a favorable provision in the American Jobs Creation Act to the 2005 dividend from Mexico.

As a result of the foregoing factors, operating earnings increased $8.6 million, or 18%, to $56.9 million for the nine months ended September 30, 2006, from $48.3 million for the nine months ended September 30, 2005.

Net realized/unrealized capital losses, as adjusted, increased $9.1 million to $1.4 million for the nine months ended September 30, 2006, from $7.7 million of net realized/unrealized capital gains for the nine months ended September 30, 2005. The increase was primarily due to a $9.6 million increase in Chile due to mark-to-market losses in 2006 on derivatives that are held to more effectively match the invested asset portfolio to our policyholder liability risks.

As a result of the foregoing factors, net income available to common stockholders decreased $0.5 million, or 1%, to $55.5 million for the nine months ended September 30, 2006, from $56.0 million for the nine months ended September 30, 2005.

Life and Health Insurance Segment

Life and Health Insurance Segment Summary Financial Data

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 September 30,		For the nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Premiums and other considerations	**$ 905.6**	$ 825.9	**$ 2,678.6**	$ 2,427.3
Fees and other revenues	**106.7**	111.3	**331.5**	333.9
Net investment income	**171.1**	168.9	**516.0**	503.0
Total operating revenues	**1,183.4**	1,106.1	**3,526.1**	3,264.2
Expenses:				
Benefits, claims and settlement expenses	**719.9**	668.6	**2,151.8**	1,938.0
Dividends to policyholders	**72.6**	71.8	**217.5**	215.0
Operating expenses	**267.8**	267.0	**829.2**	792.6
Total expenses	**1,060.3**	1,007.4	**3,198.5**	2,945.6
Operating earnings before income taxes	**123.1**	98.7	**327.6**	318.6
Income taxes	**41.1**	33.3	**110.0**	107.4
Operating earnings	**82.0**	65.4	**217.6**	211.2
Net realized/unrealized capital gains (losses), as adjusted	**0.9**	(2.9)	**(4.1)**	(2.4)
U.S. GAAP Reported:				
Net income available to common stockholders	**$ 82.9**	$ 62.5	**$ 213.5**	$ 208.8

(1) Excludes net realized/unrealized capital gains (losses).

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Premiums and other considerations increased $79.7 million, or 10%, to $905.6 million for the three months ended September 30, 2006, from $825.9 million for the three months ended September 30, 2005. Health insurance premiums increased $46.8 million, primarily from increased covered medical members and higher premium per member. In addition, specialty benefits insurance premiums increased $45.5 million, primarily due to strong sales and stable retention.

Fees and other revenues decreased $4.6 million, or 4%, to $106.7 million for the three months ended September 30, 2006, from $111.3 million for the three months ended September 30, 2005. Fee revenues from our health insurance business decreased $3.9 million, primarily due to a decrease in fee-for-service medical members.

Net investment income increased $2.2 million, or 1%, to $171.1 million for the three months ended September 30, 2006, from $168.9 million for the three months ended September 30, 2005. The increase primarily relates to an increase in the average annualized yield on invested assets and cash. The average annualized yield on invested assets and cash was 6.4% for the three months ended September 30, 2006, compared to 6.2% for the three months ended September 30, 2005. Partially offsetting the increase was a $216.9 million, or 2%, decrease in average invested assets and cash for the segment.

Benefits, claims and settlement expenses increased $51.3 million, or 8%, to $719.9 million for the three months ended September 30, 2006, from $668.6 million for the three months ended September 30, 2005. Despite lower loss ratios, specialty benefits insurance benefits, claims and settlement expenses increased $28.6 million, primarily due to growth in the business. Health insurance benefits, claims and settlement expenses increased $19.4 million primarily due to growth in the business partially offset by reserve refinements.

Dividends to policyholders increased $0.8 million, or 1%, to $72.6 million for the three months ended September 30, 2006, from $71.8 million for the three months ended September 30, 2005. The increase is primarily related to an increase in the individual life insurance dividend crediting rates.

Operating expenses increased $0.8 million to $267.8 million for the three months ended September 30, 2006, from $267.0 million for the three months ended September 30, 2005. Specialty benefits insurance operating expenses increased $11.1 million due to growth in the business. Health insurance operating expenses increased $4.7 million, primarily due to growth in the insured medical business. Partially offsetting the increases was a $13.6 million decrease in

individual life insurance operating expenses due to DPAC unlocking for the individual universal and variable universal businesses and additional reductions in DPAC amortization resulting from higher claims and lower sales.

Income taxes increased $7.8 million, or 23%, to $41.1 million for the three months ended September 30, 2006, from $33.3 million for the three months ended September 30, 2005. The effective income tax rate for the segment was 33% for the three months ended September 30, 2006 and 34% for the three months ended September 30, 2005. The effective income tax rates for the three months ended September 30, 2006 and 2005, were lower than the corporate income tax rate of 35% primarily due to the interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

As a result of the foregoing factors, operating earnings increased $16.6 million, or 25%, to $82.0 million for the three months ended September 30, 2006, from $65.4 million for the three months ended September 30, 2005.

Net realized/unrealized capital gains, as adjusted, increased $3.8 million to $0.9 million of net realized/unrealized capital gains for the three months ended September 30, 2006, from $2.9 million of net realized/unrealized capital losses for the three months ended September 30, 2005. The increase was primarily due to DPAC amortization related to losses on invested assets.

As a result of the foregoing factors, net income available to common stockholders increased $20.4 million, or 33%, to $82.9 million for the three months ended September 30, 2006, from $62.5 million for the three months ended September 30, 2005.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Premiums and other considerations increased $251.3 million, or 10%, to $2,678.6 million for the nine months ended September 30, 2006, from $2,427.3 million for the nine months ended September 30, 2005. Health insurance premiums increased $144.0 million, primarily due to increased covered medical members and higher premium per member. In addition, specialty benefits insurance premiums increased $137.1 million, primarily due to strong sales and steady retention.

Fees and other revenues decreased $2.4 million, or 1%, to $331.5 million for the nine months ended September 30, 2006, from $333.9 million for the nine months ended September 30, 2005. Health insurance fees and other revenues decreased $4.9 million primarily due to a decrease in fee-for-service medical members. In addition, specialty benefits fees and other revenues decreased $1.4 million due to lower dental fees resulting from the sale of the dental offices in June 2006. Partially offsetting the decreases was a $5.3 million increase from our individual life insurance business primarily due to growth in our fee-based universal and variable universal life insurance business.

Net investment income increased $13.0 million, or 3%, to $516.0 million for the nine months ended September 30, 2006, from $503.0 million for the nine months ended September 30, 2005. The increase primarily relates to a $221.0 million, or 2% increase in average invested assets and cash and an increase in the average annualized yield on invested assets and cash for the segment. The average annualized yield on invested assets and cash was 6.3% for the nine months ended September 30, 2006, compared to 6.2% for the nine months ended September 30, 2005.

Benefits, claims and settlement expenses increased $213.8 million, or 11%, to $2,151.8 million for the nine months ended September 30, 2006, from $1,938.0 million for the nine months ended September 30, 2005. Health insurance benefits, claims and settlement expenses increased $112.7 million primarily due to growth in the block of business and higher claim costs per member. Despite lower loss ratios, specialty benefits insurance benefits, claims and settlement expenses increased $80.6 million, primarily due to growth in the business.

Dividends to policyholders increased $2.5 million, or 1%, to $217.5 million for the nine months ended September 30, 2006, from $215.0 million for the nine months ended September 30, 2005. The increase is primarily related to an increase in the individual life insurance dividend crediting rates.

Operating expenses increased $36.6 million, or 5%, to $829.2 million for the nine months ended September 30, 2006, from $792.6 million for the nine months ended September 30, 2005. Specialty benefits insurance operating expenses increased $36.9 million due to growth in the business. Health insurance operating expenses increased $22.4 million, primarily due to growth in the insured medical business. Partially offsetting the increases was a $21.3 million decrease in individual life insurance operating expenses due to lower DPAC amortization related to worse claims experience and lower sales and unusually high expenses in 2005 related to a change in the estimate of future reinsurance benefits.

Income taxes increased $2.6 million, or 2%, to $110.0 million for the nine months ended September 30, 2006, from $107.4 million for the nine months ended September 30, 2005. The effective income tax rate for the segment was 34% for the nine months ended September 30, 2006 and 2005. The effective income tax rates for the nine months ended September 30, 2006 and 2005, were lower than the corporate income tax rate of 35% primarily due to the interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

As a result of the foregoing factors, operating earnings increased $6.4 million, or 3%, to $217.6 million for the nine months ended September 30, 2006, from $211.2 million for the nine months ended September 30, 2005.

Net realized/unrealized capital losses, as adjusted, increased $1.7 million, or 71%, to $4.1 million for the nine months ended September 30, 2006, from $2.4 million for the nine months ended September 30, 2005. The increase was primarily due to a large recovery of previously impaired securities received in 2005 as the result of a litigation settlement and increased impairments in 2006 as the result of a change in our ability and intent to hold certain fixed maturity securities until recovery due to the need to fund our recently announced acquisition of WM Advisors. These increases were partially offset by a software impairment in 2005 with no corresponding activity in 2006, increased DPAC amortization associated with losses on invested assets and fewer losses on the sale and call activity of fixed maturity securities.

As a result of the foregoing factors, net income available to common stockholders increased $4.7 million, or 2%, to $213.5 million for the nine months ended September 30, 2006, from $208.8 million for the nine months ended September 30, 2005.

Corporate and 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 September 30,		For the nine months ended September 30,	
	2006	**2005**	**2006**	**2005**
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Total operating revenues	**$ (7.6)**	$ (8.0)	**$ (13.5)**	$ (46.1)
Expenses:				
Total expenses	**(3.1)**	(1.3)	**(6.5)**	0.1
Operating loss before income taxes	**(4.5)**	(6.7)	**(7.0)**	(46.2)
Income tax benefits	**(4.8)**	(12.0)	**(10.9)**	(38.2)
Preferred stock dividends	**8.2**	9.4	**24.7**	9.4
Operating loss	**(7.9)**	(4.1)	**(20.8)**	(17.4)
Net realized/unrealized capital gains, as adjusted	**6.9**	2.6	**32.3**	2.4
Other after-tax adjustments	**—**	7.6	**18.8**	22.3
U.S. GAAP Reported:				
Net income (loss) available to common stockholders	**$ (1.0)**	$ 6.1	**$ 30.3**	$ 7.3

(1) Excludes net realized/unrealized capital gains.

Three Months Ended September 30, 2006 Compared to Three Months Ended September 30, 2005

Total operating revenues increased $0.4 million, or 5%, to negative $7.6 million for the three months ended September 30, 2006, from negative $8.0 million for the three months ended September 30, 2005. Net investment income increased $0.7 million primarily due to a decrease in investment expenses related to a significant variable interest in a coal-based synthetic fuel production facility, largely offset by a decrease in average annualized investment yields for the segment. The decrease in investment expense from the synthetic fuel investment largely corresponds to an increase in income taxes due to fewer estimated tax credits generated from fuel production.

Total expense decreased $1.8 million to a negative $3.1 million for the three months ended September 30, 2006, from a negative $1.3 million for the three months ended September 30, 2005. The decrease in total expenses was primarily the result of a $9.0 million decrease in interest related to federal income tax audit activities. Partially offsetting the decrease in total expenses is a $4.3 million increase in corporate funded initiatives as well as a $3.2 million increase in interest expense related to the issuance of corporate debt.

Income tax benefits decreased $7.2 million, or 60%, to $4.8 million for the three months ended September 30, 2006, from $12.0 million for the three months ended September 30, 2005. The decrease was primarily due to fewer estimated tax credits from our investment in a synthetic fuel production facility.

Preferred stock dividends decreased $1.2 million, or 13%, to $8.2 million for the three months ended September 30, 2006, from $9.4 million for the three months ended September 30, 2005. Since the preferred stock was issued in June 2005 and the initial dividend was declared in September 2005, the prior year dividend earnings period was longer compared to 2006.

As a result of the foregoing factors, operating loss increased $3.8 million, or 93%, to $7.9 million for the three months ended September 30, 2006, from $4.1 million for the three months ended September 30, 2005.

Net realized/unrealized capital gains, as adjusted, increased $4.3 million to $6.9 million for the three months ended September 30, 2006, from $2.6 million for the three months ended September 30, 2005. The increase was due to increased gains on sales of invested assets.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net loss available to common stockholders increased $7.1 million to $1.0 million for the three months ended September 30, 2006, from $6.1 million of net income available to common stockholders for the three months ended September 30, 2005. For the three months ended September 30, 2005, net income included the positive effect of other after-tax adjustments totaling $7.6 million due to a gain on sale of a real estate property that qualified for discontinued operations treatment under SFAS 144.

Nine Months Ended September 30, 2006 Compared to Nine Months Ended September 30, 2005

Total operating revenues increased $32.6 million, or 71%, to negative $13.5 million for the nine months ended September 30, 2006, from negative $46.1 million for the nine months ended September 30, 2005. Net investment income increased $35.8 million reflecting an increase in average annualized investment yields as well as a decrease in investment expenses related to a significant variable interest in a coal-based synthetic fuel production facility. The decrease in investment expense from the synthetic fuel investment largely corresponds to an increase in income taxes due to fewer estimated tax credits generated from fuel production.

Total expenses decreased $6.6 million to negative $6.5 million for the nine months ended September 30, 2006, from a positive $0.1 million for the nine months ended September 30, 2005. The decrease in total expenses was mostly due to a $12.9 million decrease in interest related to federal income tax audit activities. The decrease in total expenses was partially offset by a $7.8 million increase in interest related to the issuance of corporate debt.

Income tax benefits decreased $27.3 million, or 71%, to $10.9 million for the nine months ended September 30, 2006, from $38.2 million for the nine months ended September 30, 2005. The decrease was primarily due to a decrease in the estimated tax credits from our investment in a synthetic fuel production facility in 2006, as well as a decrease in operating loss before income taxes and preferred stock dividends.

Preferred stock dividends increased $15.3 million to $24.7 million for the nine months ended September 30, 2006, from $9.4 million from the nine months ended September 30, 2005. The preferred stock dividends were a result of issuing preferred stock in June 2005.

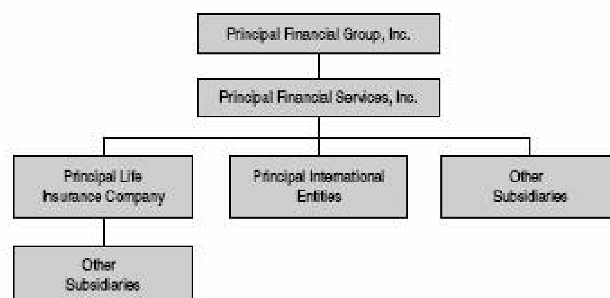
As a result of the foregoing factors, operating loss increased $3.4 million, or 20%, to $20.8 million for the nine months ended September 30, 2006, from $17.4 million for the nine months ended September 30, 2005.

Net realized/unrealized capital gains, as adjusted, increased $29.9 million to $32.3 million for the nine months ended September 30, 2006, from $2.4 million for the nine months ended September 30, 2005. The increase was primarily due to the gain on sale of stock of an equity method investment.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income available to common stockholders increased $23.0 million to $30.3 million for the nine months ended September 30, 2006, from $7.3 million for the nine months ended September 30, 2005. For the nine months ended September 30, 2006, net income included the positive effect of other after-tax adjustments of $18.8 million related to a favorable court ruling on a contested IRS issue for 1991 and later years. For the nine months ended September 30, 2005, net income included the positive effect of other after-tax adjustments totaling $22.3 million due to gains on sales of real estate properties that qualify for discontinued operations treatment under SFAS 144.

Liquidity and Capital Resources

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.



Dividends from Principal Life

The payment of stockholder dividends by Principal Life to its parent company is limited by Iowa laws. 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:

- 10% of Principal Life's statutory policyholder surplus as of the previous year-end; or
- 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 2005 statutory results, Principal Life could pay approximately $630.7 million in stockholder dividends in 2006 without exceeding the statutory limitation.

On February 28, 2006, Principal Life declared a common stock dividend to its parent company of up to $625.0 million, $425.0 million of which has been paid as of September 30, 2006. On May 16, 2006, Principal Life declared an extraordinary dividend to its parent company in an amount of up to $550.0 million. As required by Iowa law, Principal Life sought permission from the Commissioner to pay this dividend. On May 17, 2006, the Commissioner approved this dividend and $550.0 million was subsequently paid on May 22, 2006.

Shelf Registration

Registration Statement. Although we generate adequate cash flow to meet the needs of our normal operations, periodically the need may arise to issue debt to fund internal expansion, acquisitions, investment opportunities and retirement of existing debt and equity. In December 2003, we filed a shelf registration statement with the SEC, which became effective on September 30, 2004. The shelf registration totals $3.0 billion, with the ability to issue debt securities, preferred stock, common stock, warrants, stock purchase contracts and stock purchase units of Principal Financial Group, Inc. ("PFG") and trust preferred securities of three subsidiary trusts. If we issue additional securities, we intend to use the proceeds from the sale of the securities for general corporate purposes, including working capital, capital expenditures, investments in subsidiaries, share repurchase, acquisitions and refinancing of debt, including commercial paper and other short-term indebtedness. Principal Financial Services, Inc. unconditionally guarantees our obligations with respect to one or more series of debt securities described in the shelf registration statement.

Preferred Stock Issuances. On June 16, 2005, we issued 13.0 million shares of non-cumulative perpetual preferred stock under our shelf registration for net proceeds of $542.0 million. Substantially all of the preferred securities proceeds were used to repurchase shares of outstanding common stock.

Preferred Stock Dividend Restrictions and Payments. The certificates of designations for the preferred stock restrict the declaration of preferred dividends if we fail to meet specified capital adequacy, net income or stockholders' equity levels. As of September 30, 2006, we have no preferred dividend

restrictions.

On March 30, 2006, June 30, 2006, and October 2, 2006, we paid a dividend of $8.2 million, $8.3 million and $8.2 million, respectively, equal to $1.39 per share on Series A non-cumulative perpetual preferred stock and equal to $0.41 per share on Series B non-cumulative perpetual preferred stock. Dividends were paid to stockholders of record as of March 15, 2006, June 15, 2006, and September 15, 2006, respectively.

Senior Note Issuance. On October 11, 2006, we issued $500.0 million of senior notes from our shelf registration, which was filed with the SEC in December 2003. The notes will bear interest at a rate of 6.05% per year. Interest on the notes is payable on April 15 and October 15 of each year, beginning on April 15, 2007. The notes will mature on October 15, 2036. A portion of the proceeds will be used to fund the acquisition of WM Advisors, with the remaining proceeds being used for general corporate purposes.

Following our issuance of perpetual preferred stock and senior notes, we now have the ability to issue up to $1.95 billion of debt securities, preferred stock, common stock, warrants, stock purchase contracts and stock purchase units of PFG and trust preferred securities of three subsidiary trusts, under the shelf registration.

Common Stock Issued and Treasury Stock Acquired

Our Board of Directors has authorized various repurchase programs under which we are allowed to purchase shares of our outstanding common stock. Shares repurchased under these programs are accounted for as treasury stock, carried at cost and reflected as a reduction to stockholders' equity. The repurchases are made in the open market or through privately negotiated transactions, from time to time, depending on market conditions.

On May 19, 2006, following our Board of Directors' share repurchase authorization, we entered into an accelerated common stock repurchase agreement with a third party investment bank for an aggregate purchase price of $500.0 million. On this date, we paid $500.0 million and received the initial delivery of 7.7 million common shares, while retaining the right to receive additional common shares depending on the volume weighted average share price of our common stock over the program's duration. The maximum number of shares eligible for repurchase under this program is 19.5 million common shares. The program will be completed in the fourth quarter 2006, at which time we will receive any remaining common shares owed to us under this agreement.

In November 2005, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. This program was completed in May 2006. We acquired 5.1 million shares in the open market at an aggregate cost of $250.0 million under this program.

International Asset Management and Accumulation Operations

Our operations in Brazil, Hong Kong, Chile, Mexico, and India produced positive cash flow from operations for the nine months ended September 30, 2006 and 2005. These cash flows have been historically maintained at the local country level for strategic expansion purposes and local capital requirements. Our international operations may require infusions of capital primarily to fund acquisitions and to a lesser extent, to meet the cash flow and capital requirements of certain operations. Our capital funding of these operations is consistent with our long-term strategy to establish viable companies that can sustain future growth from internally generated sources. Based on reviews of our current capital needs and strategic opportunities within our foreign operations, except for acquisitions, we are able to meet our capital needs.

Sources and Uses of Cash of Consolidated Operations

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 nine months ended September 30,	
	2006	2005
	(in millions)	
Cash flows attributable to discontinued operations:		
Net cash used in operating activities	$ —	$ (1.2)
Net cash used in investing activities	—	(0.7)
Net cash used in discontinued operations	$ —	$ (1.9)

Net cash provided by operating activities was $2,051.1 million and $1,364.2 million for the nine months ended September 30, 2006 and 2005, respectively. The increase in cash provided by operations was primarily related to the payment in 2005 of an IRS deficiency related to the examination for 1999 — 2001. Also contributing to the increase in cash provided by operating activities was an increase in proceeds in the net mortgage loans held for sale activity, due to the transition of our CMBS platform from Principal Commercial Funding I to a newly created entity, Principal Commercial Funding II, which is accounted for under the equity method of accounting. Offsetting these increases was an increase in the acquisition of trading securities.

Net cash used in investing activities was $2,794.9 million and $1,010.8 million for the nine months ended September 30, 2006 and 2005, respectively. The increase in cash used in investing activities between periods was primarily related to an increase in acquisitions, a decrease in the sales, and fewer maturities of available for sale securities, a decrease in mortgage loans sold as well as a reduction in real estate acquired and sold. This increase in cash used in investing activities was partially offset by a sale of stock of an equity method investment in 2006.

Net cash provided by financing activities was $499.1 million and $312.6 million for the nine months ended September 30, 2006 and 2005, respectively. The increase in cash provided by financing activities is due to an increase in net deposits of investment contracts, a reduction in the amount of treasury stock acquired in the current year as well as an increase in bank deposits. This increase was partially offset by the issuance of preferred stock in the prior year with no corresponding issuance in the current year as well as a reduction of short-term debt proceeds in the current year.

On July 25, 2006, we announced a definitive agreement to acquire WM Advisors Inc. and its subsidiaries. Upon closing of this transaction, expected in fourth quarter 2006 or early 2007, we will pay approximately $740.0 million in cash, a portion of which will be funded by the aforementioned October 11, 2006, debt issuance.

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.

Ratio of Earnings to Fixed Charges

The ratio of earnings to fixed charges is a measure of our ability to cover fixed costs with current period earnings. A high ratio indicates that earnings are sufficiently covering committed expenses. The following table sets forth, for the periods indicated, our ratios of:

· earnings to fixed charges before interest credited on investment products; and

· earnings to fixed charges.

We calculate the ratio of “earnings to fixed charges before interest credited on investment products” by dividing the sum of income from continuing operations before income taxes (BT), interest expense (I), interest factor of rental expense (IF) less undistributed income from equity investees (E) by the sum of interest expense (I), interest factor of rental expense (IF), preferred stock dividends by the registrant (PD) and dividends on majority-owned subsidiary redeemable preferred securities (non-intercompany) (D). The formula for this ratio is: (BT+I+IF-E)/(I+IF+PD+D).

We calculate the ratio of “earnings to fixed charges” by dividing the sum of income from continuing operations before income taxes (BT), interest expense (I), interest factor of rental expense (IF) less undistributed income from equity investees (E) and the addition of interest credited on investment products (IC) by interest expense (I), interest factor of rental expense (IF), preferred stock dividends by the registrant (PD), dividends on majority-owned subsidiary redeemable preferred securities (non-intercompany) (D) and interest credited on investment products (IC). The formula for this calculation is: (BT+I+IF-E+IC)/(I+IF+PD+D+IC). “Interest credited on investment products” includes interest paid on guaranteed investment contracts, funding agreements and other investment-only pension products. Similar to debt, these products have a total fixed return and a fixed maturity date.

	For the nine months ended September 30,		For the year ended December 31,		
	2006	**2005**	**2005**	**2004**	**2003**
Ratio of earnings to fixed charges and preferred dividends before interest credited on investment products	**10.9**	12.1	11.1	9.5	7.5
Ratio of earnings to fixed charges	**2.2**	2.2	2.1	2.0	1.9

Contractual Obligations and Commercial Commitments

As of September 30, 2006, there have been no significant changes to contractual obligations and commitments since December 31, 2005.

Short-Term Debt

As of September 30, 2006, we had credit facilities with various financial institutions in an aggregate amount of $891.6 million. As of September 30, 2006 we had $114.7 million of outstanding borrowings related to our credit facilities with $102.9 million of assets pledged as support, compared to $476.4 million of outstanding borrowings at December 31, 2005 with $110.6 million of assets pledged as support. Assets pledged consisted primarily of commercial mortgages and securities. Our credit facilities also include a $600.0 million back-stop facility to provide 100% support for our commercial paper program, of which there were no outstanding balances as of September 30, 2006.

Off-Balance Sheet Arrangements

Synthetic Collateralized Debt Obligation. On June 21, 2006, we invested $285.0 million in a secured limited recourse note issued by a segregated portfolio company. The note represents Class B notes. Class A notes are senior and Class C through Class F notes are subordinated to Class B notes. The entity entered into a credit default swap with a third party providing credit protection in exchange for a fee. Defaults in an underlying reference portfolio will only affect the note if cumulative losses of a synthetic reference portfolio exceed the loss attachment point on the portfolio. We have determined we are not the primary beneficiary, as we do not hold the majority of the risk of loss. Our maximum exposure to loss as a result of our involvement with this entity is our recorded investment of $285.0 million as of September 30, 2006.

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 from 2006 through 2019. The maximum exposure under these agreements as of September 30, 2006, was approximately $172.0 million; however, we believe the likelihood is remote that material payments will be required and therefore have not accrued for a liability on our consolidated statements of financial position. 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 such outcomes could materially affect net income in a particular quarter or annual period. The fair value of such guarantees is not material.

In connection with the 2002 sale of BT Financial Group, we agreed to indemnify the purchaser, Westpac Banking Corporation ("Westpac"), for among other things, the costs associated with potential late filings made by BT Financial Group in New Zealand prior to Westpac's ownership, up to a maximum of A$250.0 million Australian dollars (approximately U.S. $187.0 million as of September 30, 2006). New Zealand securities regulations allow Australian issuers to issue their securities in New Zealand provided that certain documents are appropriately filed with the New Zealand Registrar of Companies. Specifically, the regulations require that any amendments to constitutions and compliance plans be filed in New Zealand. In April 2003, the New Zealand Securities Commission opined that such late filings would result in certain New Zealand investors having a right to a return of their investment plus interest at 10% per annum from the date of investment. This technical issue affected many in the industry.

On December 24, 2004, Westpac lodged several warranty and indemnification claims related to the sale of BT Financial Group. The claims aggregated approximately A$50.0 million Australian dollars (approximately U.S. $37.0 million as of September 30, 2006) with the majority of the claims (approximately A$45.0 million Australian dollars, or U.S. $34.0 million as of September 30, 2006) related to fund pricing and accounting issues around a tax asset called future income tax benefit ("FITB"). FITB is an asset used in calculating unit pricing of funds. Westpac claimed that BT Financial Group incorrectly accrued FITB assets in valuing asset portfolios of BT funds in Australia and New Zealand and that, as a result, fund values were overstated.

The claims made by Westpac related to both indemnifications were settled and paid by us in 2006. This settlement did not have a material impact on net income.

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. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe the likelihood is remote that material payments would be required under such indemnifications and therefore such indemnifications would not result in a material adverse effect on our business or financial position. It is possible that such outcomes could materially affect net income in a particular quarter or annual period. The fair value of such indemnifications is not material.

Investments

We had total consolidated assets as of September 30, 2006, of $136.2 billion, of which $59.7 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. Of our invested assets, $56.5 billion were held by our U.S. operations and the remaining $3.2 billion were held by our International Asset Management and Accumulation segment.

U.S. Investment 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 September 30, 2006, 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, commercial mortgage-backed securities, asset-backed securities, 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. 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;

· 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 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 68% and the debt service coverage ratio at loan inception was 1.7 times as of September 30, 2006.

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 September 30, 2006.

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 September 30, 2006, were predominantly of 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 mortgages. The remainder is invested in real estate, residential mortgage loans, 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 participating separate accounts.

U.S. Invested Assets

	September 30, 2006		December 31, 2005	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
Fixed maturity securities:				
Public	**$ 28,867.4**	**51%**	$ 27,826.3	51%
Private	**13,319.5**	**24**	12,289.4	23
Equity securities	**786.8**	**2**	764.0	1
Mortgage loans:				
Commercial	**9,812.1**	**17**	9,890.7	18
Residential	**1,057.8**	**2**	1,088.5	2
Real estate held for sale	**212.1**	**—**	133.8	—
Real estate held for investment	**735.8**	**1**	853.9	2
Policy loans	**847.5**	**1**	827.7	2
Other investments	**868.3**	**2**	755.3	1
Total invested assets	**56,507.3**	**100%**	54,429.6	100%
Cash and cash equivalents	**1,338.7**		1,585.1	
Total invested assets and cash	**$ 57,846.0**		$ 56,014.7	

U.S. Investment Results

The following tables present the yield and investment income, excluding net realized/unrealized gains and losses for our U.S. invested assets. The annualized yield on U.S. invested assets and on cash and cash equivalents was 5.9% for the three months ended September 30, 2006, compared to 5.6% for the three months ended September 30, 2005. The annualized yield on U.S. invested assets and on cash and cash equivalents was 5.8% for the nine months ended September 30, 2006, compared to 5.6% for the nine months ended September 30, 2005. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period.

U.S. Invested Assets
Investment Income Yields by Asset Type

	For the three months ended September 30,			
	2006		2005	
	Yield	Amount	Yield	Amount
	($ in millions)			
Fixed maturity securities	**6.1%**	**$ 629.8**	5.7%	$ 573.3
Equity securities	**5.7**	**11.0**	6.2	11.7
Mortgage loans — commercial	**6.4**	**158.8**	6.6	166.2
Mortgage loans — residential	**5.2**	**13.7**	4.6	13.2
Real estate	**7.7**	**18.5**	11.2	27.0
Policy loans	**6.1**	**13.0**	6.2	12.6
Cash and cash equivalents	**4.5**	**13.9**	2.8	7.7
Other investments	**9.1**	**21.3**	3.1	6.6
Total before investment expenses	**6.2**	**880.0**	5.9	818.3
Investment expenses	**0.3**	**31.3**	0.3	33.0
Net investment income	**5.9%**	**$ 848.7**	5.6%	$ 785.3

U.S. Invested Assets
Investment Income Yields by Asset Type

	For the nine months ended September 30,			
	2006		2005	
	Yield	Amount	Yield	Amount
	($ in millions)			
Fixed maturity securities	**6.0%**	**$ 1,841.5**	5.8%	$ 1,718.7
Equity securities	**6.0**	**35.2**	6.4	35.8
Mortgage loans — commercial	**6.5**	**482.7**	6.6	503.6
Mortgage loans — residential	**5.0**	**40.3**	4.5	38.6
Real estate	**7.8**	**56.4**	7.5	52.8
Policy loans	**6.0**	**37.6**	6.1	37.7
Cash and cash equivalents	**3.3**	**36.3**	3.3	18.0
Other investments	**9.2**	**56.4**	1.6	12.8
Total before investment expenses	**6.0**	**2,586.4**	5.8	2,418.0
Investment expenses	**0.2**	**94.5**	0.2	100.7
Net investment income	**5.8%**	**$ 2,491.9**	5.6%	$ 2,317.3

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 75% and 74% of total U.S. invested assets as of September 30, 2006 and December 31, 2005, respectively. 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 September 30, 2006 and 69% in publicly traded fixed maturity securities and 31% in privately placed fixed maturity securities as of December 31, 2005. Included in the privately placed category as of September 30, 2006 and December 31, 2005, were $7.2 billion and $6.5 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 September 30, 2006, and December 31, 2005, as shown in the following table:

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

	September 30, 2006		December 31, 2005	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
U.S. Government and agencies	**$ 582.5**	**1%**	$ 555.5	1%
States and political subdivisions	**1,480.9**	**4**	1,283.4	3
Non-U.S. governments	**432.0**	**1**	463.0	1
Corporate — public	**20,104.3**	**48**	19,590.8	49
Corporate — private	**10,337.0**	**24**	9,901.5	25
Residential pass-through securities	**1,501.0**	**3**	1,526.0	4
Commercial mortgage-backed securities	**4,449.6**	**11**	4,118.6	10
Residential collateralized mortgage obligations	**936.0**	**2**	752.5	2
Asset-backed securities	**2,363.6**	**6**	1,924.4	5
Total fixed maturities	**$ 42,186.9**	**100%**	$ 40,115.7	100%

We held $9,250.2 million of mortgage-backed and asset-backed securities as of September 30, 2006, and $8,321.5 million as of December 31, 2005.

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.

Commercial mortgage-backed securities provide high levels of credit protection, diversification, reduced event risk and enhanced liquidity. Commercial mortgage-backed securities are predominantly comprised of rated large pool securitizations that are individually and collectively diverse by property type,

borrower and geographic dispersion.

We purchase asset-backed securities ("ABS") to diversify the overall credit risks of the fixed maturity securities portfolio and to provide attractive returns. The principal risks in holding asset-backed securities 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 asset-backed securities 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 asset-backed securities. In addition, we diversify the risks of asset-backed securities 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 $8,246.5 million, or 20% of total fixed maturity securities, as of September 30, 2006, comprised of corporate and foreign government fixed maturity securities. Of the $8,246.5 million as of September 30, 2006, investments totaled $2,228.9 million in the United Kingdom, $2,121.0 million in the continental European Union, $926.9 million in Asia, $805.9 million in Australia, $460.5 million in South America, $293.3 million in Mexico and $95.9 million in Japan. The remaining $1,314.1 million is invested in 23 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 18% 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 September 30, 2006, our investments in Canada totaled $1,426.2 million.

The following tables present the amortized cost of our top ten exposures, including approved counterparty exposure limits, as of September 30, 2006, and December 31, 2005.

	September 30, 2006 Amortized Cost (in millions)
HSBC Holdings PLC(1)	**$ 379.1**
American International Group Inc.(3)	**339.9**
Bank of America Corp.(3)	**315.9**
MBIA Inc.(2)	**310.3**
JP Morgan Chase & Co.(3)	**276.9**
Royal Bank of Scotland Group PLC(3)	**258.4**
General Electric Co	**231.2**
Deutsche Bank AG(3)	**223.7**
Citigroup Inc.(3)	**216.5**
Credit Suisse Group(3)	**204.7**
Total top ten exposures	**$ 2,756.6**

(1) Includes a $238.1 million investment classified as an equity security for U.S. GAAP. The investment issuer engages in managing investment grade third party bond investments and HSBC paper. All non-HSBC paper has the ultimate benefit of price support protection provided by HSBC Bank, PLC. Since Principal Life Insurance Company has the senior priority in the issuer, we believe many third party bonds could be liquidated to satisfy our claim. While we calculate our exposure on a gross basis, the value we attribute to the underlying collateral is $125.0 million.

(2) MBIA Inc. exposure is predominately 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) Includes approved counterparty limit. The actual and the stressed potential exposures are less than the approved limit.

	December 31, 2005 Amortized Cost (in millions)
HSBC Holdings PLC(1)	$ 381.6
American International Group Inc.(3)	330.7
Bank of America Corp.(3)	317.5
JP Morgan Chase & Co.(3)	316.3
Royal Bank of Scotland Group PLC(3)	315.6
MBIA Inc.(2)	311.6
General Electric Co	247.5
Citigroup Inc.(3)	235.0
Banco Santander Central Hispano SA	227.4
AT&T Inc.	219.9
Total top ten exposures	$ 2,903.1

(1) Includes a $238.2 million investment classified as an equity security for U.S. GAAP. The investment issuer engages in managing investment grade third party bond investments and HSBC paper. All non-HSBC paper has the ultimate benefit of price support protection provided by HSBC Bank, PLC. Since Principal Life Insurance Company has senior priority in the issuer, we believe many third party bonds could be liquidated to satisfy our claim. While we calculate our exposure on a gross basis, the value we attribute to the underlying collateral is $125.0 million.

(2) MBIA Inc. exposure is predominately comprised of the guarantee of underlying securities which are rated "A-" equivalent or better by the rating agencies on a stand alone basis. The MBIA wrap guarantees performance in the event of a default of the underlying securities bringing the combined rating to AAA.

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

Our top ten exposures were rated an "A" equivalent or better by the rating agencies as of September 30, 2006 and December 31, 2005. As of September 30, 2006 and December 31, 2005, no individual non-government issuer represented more than 1% of U.S. invested assets.

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. Interactive Data Corporation ("IDC") or direct broker quotes are our sources for external prices for our public bonds and those private placement securities that are actively traded in the secondary market. In cases where quoted market prices are not available, a matrix pricing valuation approach is used. Securities are grouped into pricing categories that vary by asset class, 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. The resulting prices are then reviewed by pricing analysts. All loans placed on the "watch list" are valued individually by the investment analysts or the analysts that focus on troubled securities ("Workout Group"). Although we believe our estimates reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other factors involve significant assumptions and may not reflect those of an active market. To the extent that bonds have longer maturity dates, management's estimate of fair value may involve greater subjectivity since they involve judgment about events well into the future. Every month, there is a comprehensive review of all impaired securities and problem loans by a group consisting of the Chief Investment Officer, the Portfolio Managers, and the Workout Group. 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. If the company is likely to continue operations, the estimate of future cash flows is typically based on the expected operating cash flows of the company that are available to make payments of the bonds. If the company is likely to liquidate, the estimate of future cash flows is based on an estimate of the liquidation value of its net assets.

The Securities Valuation Office ("SVO") of the National Association of Insurance Commissioners ("NAIC") evaluates most of the fixed maturity securities that we and other U.S. insurance companies hold. The SVO 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 September 30, 2006, 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 a more favorable ratio at 0.56 times compared to the Standard & Poor's drift ratio of 0.78 times, as of December 31, 2005.

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 September 30, 2006, and December 31, 2005, as well as the percentage, based on estimated fair value, that each designation comprises:

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

		September 30, 2006			December 31, 2005		
NAIC Rating	Rating Agency Equivalent	Amortized Cost	Carrying Amount	% of Total Carrying Amount	Amortized Cost	Carrying Amount	% of Total Carrying Amount
				($ in millions)			
1	Aaa/Aa/A	**$ 23,145.4**	**$ 23,680.0**	**56%**	$ 21,593.3	$ 22,361.9	56%
2	Baa	**15,958.0**	**16,415.5**	**39**	14,978.4	15,590.7	39
3	Ba	**1,746.6**	**1,810.8**	**4**	1,701.7	1,801.6	4
4	B	**263.0**	**270.9**	**1**	258.5	271.2	1
5	Caa and lower	**0.7**	**0.6**	**—**	14.3	14.4	—
6	In or near default	**7.4**	**9.1**	**—**	76.2	75.9	—
	Total fixed maturities	**$ 41,121.1**	**$ 42,186.9**	**100%**	$ 38,622.4	$ 40,115.7	100%

(1) Includes 87 securities with an amortized cost of $978.7 million, gross gains of $32.4 million, gross losses of $6.0 million and a carrying amount of $1,005.1 million as of September 30, 2006, 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.

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 7% of cash flow. As of September 30, 2006, we had invested 3.4% 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 September 30, 2006, and December 31, 2005.

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

	September 30, 2006		December 31, 2005	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
Industry Class				
Finance — Bank	**$ 3,561.6**	**12%**	$ 3,451.0	12%
Finance — Insurance	**3,140.3**	**10**	3,010.3	10
Finance — Other	**4,772.0**	**15**	4,090.1	14
Industrial — Consumer	**1,183.0**	**4**	1,067.2	4
Industrial — Energy	**2,688.4**	**9**	2,718.4	9
Industrial — Manufacturing	**5,476.1**	**18**	5,223.3	18
Industrial — Other	**105.4**	**—**	106.4	—
Industrial — Service	**4,530.0**	**15**	4,548.7	15
Industrial — Transport	**825.1**	**3**	848.6	3
Utility — Electric	**2,361.3**	**8**	2,568.6	9
Utility — Other	**47.6**	**—**	47.9	—
Utility — Telecom	**1,750.5**	**6**	1,811.8	6
Total	**$ 30,441.3**	**100%**	$ 29,492.3	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 the Company's decision is prepared and approved by management.

We consider relevant facts and circumstances in evaluating whether the credit impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the length of time the fair value has been below cost; (2) the financial position and access to capital of the issuer, including the current and future impact of any specific events; and (3) our ability and intent to hold the security to maturity or until it recovers in value. 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 earnings.

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 $8.0 million for the nine months ended September 30, 2006. The single largest other than temporary credit impairment represented less than 0.1% of U.S. fixed maturity securities as of September 30, 2006. As the result of the recently announced acquisition of WM Advisors, we also recognized $16.0 million of impairment write-downs for the nine months ended September 30, 2006, that resulted from our determination that we no longer had the ability and intent to hold certain fixed maturity securities until they recovered in value.

For the nine months ended September 30, 2006, we realized $22.5 million of gross losses upon disposal of bonds excluding hedging adjustments. Included in this $22.5 million is $14.1 million related to sales of twenty-four credit impaired and credit related names. 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 significant 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. Also included in the $22.5 million is $6.3 million resulting from the sale of certain hybrid securities that had a regulatory classification change that resulted in increased capital requirements. 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 September 30, 2006, and December 31, 2005.

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

	September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Finance — Bank	**$ 3,505.5**	**$ 80.6**	**$ 24.9**	**$ 3,561.2**
Finance — Insurance	**3,085.4**	**78.0**	**23.6**	**3,139.8**
Finance — Other	**4,651.2**	**159.9**	**39.6**	**4,771.5**
Industrial — Consumer	**1,162.0**	**31.8**	**10.9**	**1,182.9**
Industrial — Energy	**2,543.3**	**158.9**	**14.9**	**2,687.3**
Industrial — Manufacturing	**5,364.0**	**156.0**	**44.4**	**5,475.6**
Industrial — Other	**104.5**	**1.5**	**0.6**	**105.4**
Industrial — Service	**4,408.4**	**151.5**	**30.7**	**4,529.2**
Industrial — Transport	**780.5**	**47.9**	**3.3**	**825.1**
Utility — Electric	**2,288.2**	**89.4**	**16.4**	**2,361.2**
Utility — Other	**41.0**	**6.6**	**—**	**47.6**
Utility — Telecom	**1,674.2**	**87.1**	**11.0**	**1,750.3**
Total corporate securities	**29,608.2**	**1,049.2**	**220.3**	**30,437.1**
U.S. Government and agencies	**562.0**	**1.4**	**4.2**	**559.2**
States and political subdivisions	**1,407.5**	**46.6**	**4.0**	**1,450.1**
Non-U.S. governments	**395.3**	**37.1**	**0.4**	**432.0**
Mortgage-backed and other asset-backed securities	**8,992.3**	**236.7**	**76.3**	**9,152.7**
Total fixed maturity securities, available-for-sale	**$ 40,965.3**	**$ 1,371.0**	**$ 305.2**	**$ 42,031.1**

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

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Finance — Bank	$ 3,354.9	$ 110.6	$ 14.5	$ 3,451.0
Finance — Insurance	2,915.0	111.3	16.0	3,010.3
Finance — Other	3,932.5	181.5	23.9	4,090.1
Industrial — Consumer	1,038.0	36.5	7.3	1,067.2
Industrial — Energy	2,506.5	220.2	8.3	2,718.4
Industrial — Manufacturing	5,060.9	201.4	39.0	5,223.3
Industrial — Other	104.4	2.3	0.3	106.4
Industrial — Service	4,369.6	204.4	25.3	4,548.7
Industrial — Transport	795.1	57.0	3.5	848.6
Utility — Electric	2,455.3	123.8	10.5	2,568.6
Utility — Other	41.2	6.7	—	47.9
Utility — Telecom	1,701.8	118.6	8.6	1,811.8
Total corporate securities	28,275.2	1,374.3	157.2	29,492.3
U.S. Government and agencies	557.9	1.8	4.2	555.5
States and political subdivisions	1,222.6	45.7	3.8	1,264.5
Non-U.S. governments	416.2	47.2	0.4	463.0
Mortgage-backed and other asset-backed securities	8,045.5	267.8	77.9	8,235.4
Total fixed maturity securities, available-for-sale	$ 38,517.4	$ 1,736.8	$ 243.5	$ 40,010.7

The total unrealized losses on our fixed maturity securities available-for-sale were $305.2 million and $243.5 million as of September 30, 2006 and December 31, 2005, respectively. Of the $305.2 million in gross unrealized losses as of September 30, 2006, there were $4.5 million in losses attributed to securities scheduled to mature in one year or less, $59.3 million is attributed to securities scheduled to mature between one to five years, $98.3 million is attributed to securities scheduled to mature between five to ten years, $66.9 million is attributed to securities scheduled to mature after ten years, and $76.2 million is related to mortgage-backed and other asset-backed securities. The gross unrealized losses as of September 30, 2006 were concentrated primarily in the Mortgage-backed and other asset-backed securities, Industrial — Manufacturing, Financial — Other, and Industrial — Services sectors. The gross unrealized losses as of December 31, 2005 were concentrated primarily in the Mortgage-backed and other asset-backed securities, Industrial — Manufacturing, Industrial — Services, and Financial — Other sectors.

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 September 30, 2006, and December 31, 2005.

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

	September 30, 2006			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Investment Grade:				
Public	$ 27,019.4	$ 796.0	$ 194.9	$ 27,620.5
Private	11,929.3	483.8	92.9	12,320.2
Below Investment Grade:				
Public	1,150.0	43.7	10.1	1,183.6
Private	866.6	47.5	7.3	906.8
Total fixed maturity securities, available-for-sale	$ 40,965.3	$ 1,371.0	$ 305.2	$ 42,031.1

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

	December 31, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Investment Grade:				
Public	$ 25,638.9	$ 1,024.9	$ 164.3	$ 26,499.5
Private	10,827.8	584.5	64.2	11,348.1
Below Investment Grade:				
Public	1,263.4	54.4	9.9	1,307.9
Private	787.3	73.0	5.1	855.2
Total fixed maturity securities, available-for-sale	$ 38,517.4	$ 1,736.8	$ 243.5	$ 40,010.7

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

	September 30, 2006					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 324.0	$ 1.0	$ 156.4	$ 3.6	$ 480.4	$ 4.6
Greater than three to six months	472.4	2.0	246.1	2.9	718.5	4.9
Greater than six to nine months	2,634.8	28.1	1,272.6	12.4	3,907.4	40.5
Greater than nine to twelve months	1,525.8	20.5	609.0	10.3	2,134.8	30.8
Greater than twelve to twenty-four months	5,533.0	126.0	1,708.4	47.8	7,241.4	173.8
Greater than twenty-four to thirty-six months	386.3	12.2	335.8	12.2	722.1	24.4
Greater than thirty-six months	102.3	5.1	74.2	3.7	176.5	8.8
Total fixed maturities, available-for-sale	$ 10,978.6	$ 194.9	$ 4,402.5	$ 92.9	$ 15,381.1	$ 287.8

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

	December 31, 2005					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 1,907.9	$ 11.3	$ 774.3	$ 6.3	$ 2,682.2	$ 17.6
Greater than three to six months	4,332.5	79.6	1,574.5	29.3	5,907.0	108.9
Greater than six to nine months	416.3	12.9	109.5	2.8	525.8	15.7
Greater than nine to twelve months	1,032.0	22.3	212.3	5.2	1,244.3	27.5

Greater than twelve to twenty-four months	1,191.2	33.3	457.2	14.7	1,648.4	48.0
Greater than twenty-four to thirty-six months	118.5	4.8	161.8	5.9	280.3	10.7
Greater than thirty-six months	1.4	0.1	—	—	1.4	0.1
Total fixed maturities, available-for-sale	$ 8,999.8	$ 164.3	$ 3,289.6	$ 64.2	$ 12,289.4	$ 228.5

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

	September 30, 2006					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 50.5	$ 0.1	$ 5.6	$ —	$ 56.1	$ 0.1
Greater than three to six months	64.4	3.0	17.3	0.1	81.7	3.1
Greater than six to nine months	67.7	2.3	85.4	0.4	153.1	2.7
Greater than nine to twelve months	42.5	0.2	67.9	1.4	110.4	1.6
Greater than twelve to twenty-four months	134.2	4.4	117.9	5.3	252.1	9.7
Greater than twenty-four to thirty-six months	9.9	0.1	0.6	0.1	10.5	0.2
Greater than thirty-six months	—	—	—	—	—	—
Total fixed maturities, available-for-sale	$ 369.2	$ 10.1	$ 294.7	$ 7.3	$ 663.9	$ 17.4

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

	December 31, 2005					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 121.9	$ 0.7	$ 55.8	$ 1.8	$ 177.7	$ 2.5
Greater than three to six months	81.9	4.7	36.4	0.8	118.3	5.5
Greater than six to nine months	50.8	0.8	36.8	1.2	87.6	2.0
Greater than nine to twelve months	49.2	1.9	18.4	0.5	67.6	2.4
Greater than twelve to twenty-four months	36.9	1.2	8.5	0.3	45.4	1.5
Greater than twenty-four to thirty-six months	—	—	0.6	0.1	0.6	0.1
Greater than thirty-six months	49.9	0.6	19.8	0.4	69.7	1.0
Total fixed maturities, available-for-sale	$ 390.6	$ 9.9	$ 176.3	$ 5.1	$ 566.9	$ 15.0

Of total gross unrealized losses as of September 30, 2006 and December 31, 2005, $287.8 million and $228.5 million were related to investment grade securities, respectively. Gross unrealized losses related to below investment grade securities were $17.4 million and $15.0 million as of September 30, 2006 and December 31, 2005, 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 September 30, 2006, and December 31, 2005.

U.S. Invested Assets
Unrealized Losses on Fixed Maturity SecuritiesAvailable-for-Sale by Aging Category

	September 30, 2006					
	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	$ —	$ —	$ 0.5	$ 0.2	$ 0.5	$ 0.2
Greater than three to six months	—	—	—	—	—	—
Greater than six to nine months	—	—	—	—	—	—
Greater than nine to twelve months	—	—	—	—	—	—
Greater than twelve months	—	—	—	—	—	—
Total fixed maturity securities, available-for-sale	$ —	$ —	$ 0.5	$ 0.2	$ 0.5	$ 0.2

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

	December 31, 2005					
	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	$ —	$ —	$ 4.2	$ 2.1	$ 4.2	$ 2.1
Greater than three to six months	—	—	—	—	—	—
Greater than six to nine months	—	—	—	—	—	—
Greater than nine to twelve months	—	—	—	—	—	—
Greater than twelve months	—	—	—	—	—	—
Total fixed maturity securities, available-for-sale	$ —	$ —	$ 4.2	$ 2.1	$ 4.2	$ 2.1

Gross unrealized losses on fixed maturity securities where the estimated fair value has been 20% or more below amortized cost were $0.2 million as of September 30, 2006 and $2.1 million as of December 31, 2005. There were no gross unrealized losses attributed to those securities considered to be "problem", "potential problem" or "restructured" as of September 30, 2006 and December 31, 2005.

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:

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

	September 30, 2006	December 31, 2005
	($ in millions)	
Total fixed maturity securities (public and private)	**$ 42,186.9**	$ 40,115.7
Problem fixed maturity securities	**$ 5.3**	$ 42.0
Potential problem fixed maturity securities	**45.9**	101.6
Restructured fixed maturity securities	**12.0**	—
Total problem, potential problem and restructured fixed maturity securities	**$ 63.2**	$ 143.6
Total problem, potential problem and restructured fixed maturity securities as a percent of total fixed maturity securities	**0.15%**	0.36%

Mortgage Loans

Mortgage loans consist primarily of commercial mortgage loans on real estate. At September 30, 2006, commercial mortgage loans aggregated to $9,812.1 million. 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 mortgages 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 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.

California accounted for 17% of our commercial mortgage loan portfolio as of September 30, 2006. 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 September 30, 2006, 38% 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 as of September 30, 2006 and December 31, 2005 was 1,236 and 1,309, respectively. The average loan size of our commercial mortgage portfolio was $8.0 million as of September 30, 2006.

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 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, which 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 as a net realized/unrealized capital loss 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 charged 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 is 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 $31.6 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. Decreases in the valuation allowance aggregated to $0.6 million for the nine months ended September 30, 2006, and $9.2 million for the year ended December 31, 2005.

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

U.S. Invested Assets
Commercial Mortgage Valuation Allowance

	September 30, 2006	December 31, 2005
	($ in millions)	
Beginning balance	**$ 33.2**	$ 42.4
Provision	**1.7**	6.7
Release	**(2.3)**	(15.9)
Ending balance	**$ 32.6**	$ 33.2
Valuation allowance as% of carrying value before reserves	**0.33%**	0.33%

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

	September 30, 2006	December 31, 2005
	($ in millions)	
Total commercial mortgages	**$ 9,812.1**	$ 9,890.7
Problem commercial mortgages(1)	**$ 10.6**	$ 10.4
Potential problem commercial mortgages	**9.1**	10.2
Restructured commercial mortgages	**6.9**	65.1
Total problem, potential problem and restructured commercial mortgages	**$ 26.6**	$ 85.7
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	**0.27%**	0.87%

(1) Problem commercial mortgages include mortgage loans in foreclosure of $10.5 million as of September 30, 2006. This is the same mortgage loan that was in foreclosure as of December 31, 2005.

Equity Real Estate

We hold commercial equity real estate as part of our investment portfolio. As of September 30, 2006, and December 31, 2005, the carrying amount of equity real estate investment was $947.9 million and $987.7 million, or 1% and 2%, of U.S. invested assets, respectively. 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 $735.8 million as of September 30, 2006, and $853.9 million as of December 31, 2005. 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 periods ended September 30, 2006 and December 31, 2005, there were no such impairment adjustments.

The carrying amount of real estate held for sale as of September 30, 2006, and December 31, 2005, was $212.1 million and $133.8 million, net of valuation allowances of $4.2 million and $4.2 million, respectively. 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, Pacific, and West South Central regions of the United States as of September 30, 2006. By property type, there is a concentration in office buildings and industrial sites that represented approximately 67% of the equity real estate portfolio as of September 30, 2006.

Other Investments

Our other investments totaled $868.3 million as of September 30, 2006, compared to $755.3 million as of December 31, 2005. Derivatives accounted for $590.8 million in other investments as of September 30, 2006. The remaining invested assets include equity method investments, which include properties owned jointly with venture partners and operated by the partners.

International Investment Operations

As of September 30, 2006, our international investment operations consist of the investments of Principal International comprised of $3.2 billion in invested assets. 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.

Overall Composition of International Invested Assets

As shown in the following table, the major categories of international invested assets as of September 30, 2006, and December 31, 2005, were fixed maturity securities and residential mortgage loans:

International Invested Assets

	September 30, 2006		December 31, 2005	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
Fixed maturity securities				
Public	**$ 2,225.5**	**70%**	$ 2,114.1	69%
Private	**—**	**—**	0.6	—
Equity securities	**51.2**	**2**	50.7	2
Mortgage loans				
Residential	**525.6**	**16**	505.1	17
Real estate held for investment	**11.3**	**—**	11.7	—
Other investments	**393.3**	**12**	358.2	12
Total invested assets	**3,206.9**	**100%**	3,040.4	100%
Cash and cash equivalents	**57.9**		56.2	
Total invested assets and cash	**$ 3,264.8**		$ 3,096.6	

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 cashflows 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 cashflows. 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 cashflows, 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 cashflow 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 Management and 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 September 30, 2006, the difference between the asset and liability durations on our primary duration managed portfolio was -.04. This duration gap indicates that, as of this date, the sensitivity of the fair value of our assets to interest rate movements is less 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 $32,473.3 million as of September 30, 2006.

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 September 30, 2006, the weighted-average difference between the asset and liability durations on these portfolios was +.46. 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 $16,085.3 million as of September 30, 2006.

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 $4,441.2 million as of September 30, 2006.

Using the assumptions and data in effect as of September 30, 2006, we estimate that a 100 basis point immediate, parallel increase in interest rates decreases the net fair value of our portfolio by approximately $61.2 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).

	September 30, 2006			
Risk Management Strategy	**Value of Total Assets (in millions)**	**Duration of Assets**	**Net Duration Gap**	**Net Fair Value Change (in millions)**
Primary duration-managed	$ 32,473.3	3.67	(.04)	$ 13.0
Duration-monitored	16,085.3	4.96	.46	(74.2)
Non duration-managed	4,441.2	4.71	N/A	N/A
Total	$ 52,999.8			$ (61.2)

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 September 30, 2006, the aggregate fair value of long-term debt was $932.0 million. A 100 basis point, immediate, parallel decrease in interest rates would increase the fair value of debt by approximately $30.0 million. Debt is not recorded at fair value on the statement of financial position.

	September 30, 2006 Fair Value (no accrued interest)		
	-100 Basis Point Change	**No Change (in millions)**	**+100 Basis Point Change**
8.2% notes payable, due 2009	$ 513.2	$ 500.2	$ 487.5
4.59% notes payable, due 2011	57.1	54.6	52.2
4.93% notes payable, due 2011	47.3	45.2	43.3
8% surplus notes payable, due 2044	117.7	109.0	100.2

Non-recourse mortgages and notes payable		186.4		183.1		179.9
Other mortgages and notes payable		40.3		39.9		39.5
Total long-term debt	$	962.0	$	932.0	$	902.6

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, total return swaps, mortgage-backed forwards and options. We use interest rate swaps, futures contracts and mortgage-backed forwards 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 also use these instruments to hedge the interest rate exposure in our commercial mortgage-backed securitization operations. 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 September 30, 2006, 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, including the currency swap agreements, 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 minimized 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 September 30, 2006, was $4,820.1 million. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturity securities as of September 30, 2006, was $1,582.1 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 hedge the resulting risks. As of September 30, 2006, 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 $51.3 million in order to mitigate currency exposure related to U.S. dollar-denominated bonds.

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 September 30, 2006, the fair value of our equity securities was $838.0 million. A 10% decline in the value of the equity securities would result in an unrealized loss of $83.8 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 contacts 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 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 have increased our credit exposure through credit default swaps by investing in $127.5 million of various tranches of synthetic collateralized debt obligations. The outstanding notional amount as of September 30, 2006 was $565.0 million. We also invested in credit default swaps creating replicated assets with a notional amount of $855.9 million as of September 30, 2006.

In addition, on May 26, 2005, we invested $130.0 million in a secured limited recourse credit linked note issued by a grantor trust. The trust entered into a credit default swap providing credit protection on the first 45% of loss of seven mezzanine tranches totaling $288.9 million of seven synthetic reference portfolios. The risk of loss for the seven referenced mezzanine tranches begins at 4.85% and ends at 10.85% of loss on each of the seven synthetic reference portfolios. Therefore, defaults in an underlying reference portfolio will only affect the credit-linked note if cumulative losses exceed 4.85% of a synthetic reference portfolio. As of September 30, 2006, the credit default swap entered into by the trust had an outstanding notional amount of $130.0 million. The creditors of the grantor trusts have no recourse to the assets of our company.

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 balance sheet. 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 September 30, 2006, and December 31, 2005.

Derivative Financial Instruments — Notional Amounts

	September 30, 2006		December 31, 2005	
	Notional Amount	% of Total	Notional Amount	% of Total
		($ in millions)		
Interest rate swaps	$ **11,605.1**	**55%**	$ 8,531.3	50%
Foreign currency swaps	**4,844.1**	**23**	3,854.5	23
Embedded derivative financial instruments	**1,573.7**	**8**	1,199.5	7
Credit default swaps	**1,550.9**	**8**	1,297.6	8
Swaptions	**663.0**	**3**	684.5	4
Currency forwards	**323.8**	**2**	566.6	4
Call options	**290.1**	**1**	189.8	1
Futures	**48.5**	**—**	58.9	—
Interest rate lock commitments	**25.0**	**—**	392.3	2
Bond options	**21.0**	**—**	38.5	—
Commodity swaps	**20.0**	**—**	—	—
Total return swaps	**—**	**—**	100.0	1
Mortgage-backed forwards and options	**—**	**—**	39.3	—
Total	$ **20,965.2**	**100%**	$ 16,952.8	100%

Derivative Financial Instruments — Credit Exposures

	September 30, 2006		December 31, 2005	
	Credit Exposure	% of Total	Credit Exposure	% of Total
		($ in millions)		
Foreign currency swaps	$ **423.0**	**68%**	$ 339.6	72%
Interest rate swaps	**145.4**	**23**	89.3	19
Call options	**28.1**	**5**	18.0	4
Credit default swaps	**11.7**	**2**	14.0	3
Currency forwards	**9.6**	**2**	11.4	2
Bond options	**0.5**	**—**	0.6	—
Total credit exposure	**618.3**	**100%**	472.9	100%
Less: Collateral received	**(124.9)**		(97.6)	
Total	$ **493.4**		$ 375.3	

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.

	September 30, 2006				
			Fair Value (no accrued interest)		
	Notional Amount	Weighted Average Term (Years)	-100 Basis Point Change	No Change	+100 Basis Point Change
			($ in millions)		
Interest rate swaps	$ **11,605.1**	**6.01(1)**	$ **(194.0)**	$ **61.8**	$ **288.6**
Swaptions	**663.0**	**6.84(2)**	**(45.0)**	**(21.7)**	**(10.0)**
Futures	**36.1**	**.21(3)**	**(1.6)**	**—**	**1.7**
Bond options	**21.0**	**1.36(4)**	**0.1**	**0.6**	**1.3**
Total	$ **12,325.2**		$ **(240.5)**	$ **40.7**	$ **281.6**

(1) Based on maturity date of swap.

(2) Based on option date of swaption.

(3) Based on maturity date.

(4) Based on settlement 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 derivatives 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

During the quarter ended September 30, 2006, we converted to a new general ledger application that improves the efficiency of our financial reporting processes. While we do not believe that our prior general ledger had any significant deficiencies or material weaknesses, we expect this new application will enhance our internal control over financial reporting. Pre-implementation testing and post-implementation reviews were conducted by management to ensure that internal controls surrounding the system implementation process, the applications, and the closing process were effective to prevent material financial statement errors. We ensured the data converted to the new general ledger system was accurate by maintaining appropriate data conversion controls throughout the implementation process. We believe this new general ledger system represents a material change to our internal control over financial reporting. Other than changes related to this new system, no other changes in our internal control over financial reporting occurred during the quarter ended September 30, 2006 that have materially affected or are 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, J. Barry Griswell, and our Chief Financial Officer, Michael H. Gersie, have reviewed and evaluated our disclosure controls and procedures as of September 30, 2006, and have concluded that our disclosure controls and procedures are effective.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

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 National Association of Securities Dealers, Inc., 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.

Several lawsuits have been filed against other insurance companies and insurance brokers alleging improper conduct relating to the payment and non-disclosure of contingent compensation and bid-rigging activity. Several of these suits were filed as purported class actions. Several state attorneys general and insurance regulators have initiated industry-wide inquiries or other actions relating to compensation arrangements between insurance brokers and insurance companies and other industry issues. Beginning in March of 2005, we have received subpoenas and interrogatories from the offices of the Attorneys General of New York and Connecticut seeking information related to compensation agreements with brokers and agents and the sale of retirement products and services. We are cooperating with these inquiries. We have received other requests from regulators and other governmental authorities relating to industry issues and may receive additional such requests, including subpoenas and interrogatories, in the future.

On December 23, 2004, a lawsuit was filed in Iowa state court against us and our wholly owned subsidiaries, Principal Life Insurance Company ("Principal Life") and Principal Financial Services, Inc., on behalf of a proposed class comprised of the settlement class in the Principal Life sales practices class action settlement, which was approved in April 2001 by the United States District Court for the Southern District of Iowa. This more recent lawsuit claims that the treatment of the settlement costs of that sales practices litigation in relation to the allocation of demutualization consideration to Principal Life policyholders was inappropriate. Demutualization allocation was done pursuant to the terms of a plan of demutualization approved by the policyholders in July 2001 and Insurance Commissioner of the State of Iowa in August 2001. The lawsuit further claims that such allocation was not accurately described to policyholders during the demutualization process and is a breach of the sales practices settlement. On January 27, 2005, we filed a notice to remove the action from state court to the United States District Court for the Southern District of Iowa. On July 22, 2005, the plaintiff's motion to remand the action to state court was denied, and our motion to dismiss the lawsuit was granted. On September 21, 2005, the plaintiff's motion to alter or amend the judgment was denied. On October 4, 2005, the plaintiff filed a notice of appeal to the United States Court of Appeals for the Eighth Circuit. Oral argument was held on April 20, 2006. On October 20, 2006, the Court of Appeals affirmed our motion to dismiss.

A lawsuit was filed against us, Principal Life, and Principal Financial Services, Inc. in the United States District Court for the Southern District of Iowa on October 31, 2005, but the plaintiff dismissed the case without prejudice on March 17, 2006. The claims and allegations in the lawsuit were substantially the same as those in the December 23, 2004 lawsuit, but the proposed class was limited to those members of the settlement class in the Principal Life sales practices class action settlement who did not own annuities and who received demutualization consideration in the form of cash under the plan of demutualization.

While the outcome of any pending or future litigation cannot be predicted, management does not believe that any pending litigation will have a material adverse effect on our business or financial position. The outcome of litigation 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.

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	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)
January 1, 2006 — January 31, 2006	**886,250(1)**	**$ 47.19**	**886,200**	**$ 208.2(2)**
February 1, 2006 — February 28, 2006	**824,276(1)**	**$ 48.14**	**814,895**	**$ 169.0(2)**
March 1, 2006 — March 31, 2006	**1,672,028(1)**	**$ 49.06**	**1,655,200**	**$ 87.7(2)**
April 1, 2006 — April 30, 2006	**1,102,043(1)**	**$ 49.58**	**1,102,000**	**$ 33.1(2)**
May 1, 2006 — May 31, 2006	**8,296,702**	**$ 64.26(3)**	**8,296,702**	**$ —(2)(3)**
June 1, 2006 — June 30, 2006	**—**	**$ —**	**—**	**$ —**
July 1, 2006 — July 31, 2006	**—**	**$ —**	**—**	**$ —**
August 1, 2006 — August 31, 2006	**—**	**$ —**	**—**	**$ —**
September 1, 2006 — September 30, 2006	**84,406(1)**	**$ 53.59**	**—**	**$ —**
Total	**12,865,705**		**12,754,997**	

(1) The number of shares include shares of common stock utilized to execute certain stock incentive awards in 2006: 50 shares in January, 9,381 shares in February, 16,828 shares in March, 43 shares in April, and 84,406 shares in September.

(2) In November 2005, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. On May 18, 2006, the program announced in November 2005 was completed.

(3) In May 2006, our Board of Directors authorized a repurchase program of up to $500.0 million of our outstanding common stock. We paid $500.0 million and received the initial delivery of 7.7 million common shares, while retaining the right to receive additional common shares depending on the volume weighted average share price of our common stock over the program's duration. The program will be completed in the fourth quarter 2006.

Item 6. Exhibits

Exhibit Number	Description
2.6	Stock Purchase Agreement among Washington Mutual, Inc., New American Capital, Inc., Principal Financial Group, Inc., and Principal Management Corporation for the purchase and sale of the outstanding capital stock of WM Advisors, Inc., dated as of July 25, 2006.
10.6.1	Revised Compensatory Arrangement for Non-Employee Directors of the Principal Financial Group, Inc. Board of Directors (incorporated by reference to the written description of such arrangement included in Principal Financial Group, Inc.'s Current Report on Form 8-K filed on August 28, 2006 (Commission File No. 1-16725))
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of J. Barry Griswell
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— J. Barry Griswell
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code— Michael H. Gersie

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: November 1, 2006

By /s/ Michael H. Gersie

Michael H. Gersie
Executive Vice President and Chief Financial Officer

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

Exhibit Index

Exhibit Number	Description
2.6	Stock Purchase Agreement among Washington Mutual, Inc., New American Capital, Inc., Principal Financial Group, Inc., and Principal Management Corporation for the purchase and sale of the outstanding capital stock of WM Advisors, Inc., dated as of July 25, 2006.
10.6.1	Revised Compensatory Arrangement for Non-Employee Directors of the Principal Financial Group, Inc. Board of Directors (incorporated by reference to the written description of such arrangement included in Principal Financial Group, Inc.'s Current Report on Form 8-K filed on August 28, 2006 (Commission File No. 1-16725))
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of J. Barry Griswell
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 — J. Barry Griswell
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code — Michael H. Gersie

STOCK PURCHASE AGREEMENT

among

WASHINGTON MUTUAL, INC.,

NEW AMERICAN CAPITAL, INC.,

PRINCIPAL FINANCIAL GROUP, INC.,

and

PRINCIPAL MANAGEMENT CORPORATION

for the purchase and sale

of

the outstanding capital stock of

WM ADVISORS, INC.

Dated as of July 25, 2006

TABLE OF CONTENTS

Page

Article I DEFINITIONS

Article II PURCHASE AND DELIVERY OF STOCK

2.1 Delivery of Stock
2.2 Closing; Payment of Purchase Price
2.3 Estimated Working Capital Amount
2.4 Post-Closing Working Capital Purchase Price Adjustment
2.5 Purchase Price Adjustment Based on Changes in Advisory Revenue Run-Rate
2.6 Make-Whole Purchase Price Adjustment
2.7 Post-Closing True-Up

Article III CLOSING DATE

3.1 Closing Date

Article IV REPRESENTATIONS AND WARRANTIES OF SELLER

4.1 Organization, Power, etc
4.2 Authority Relative to Agreements
4.3 Non-Contravention
4.4 Consents, etc
4.5 Title to Stock
4.6 Capital Stock of the Subject Companies
4.7 Company Financial Statements; Accounting Controls
4.8 Litigation
4.9 Compliance with Laws; Permits and Licenses
4.10 Absence of Certain Changes; No Undisclosed Liabilities
4.11 Personnel and Employee Benefits Matters
4.12 Taxes
4.13 Properties
4.14 Certain Labor Matters
4.15 Material Agreements
4.16 Intellectual Property
4.17 Brokers
4.18 Regulatory Reports, Registrations and Agreements
4.19 Certain Fund and Client Matters
4.20 Assets Under Management; Investment Management Revenues
4.21 Intercompany Accounts; Transactions with Affiliates
4.22 Insurance

Article V REPRESENTATIONS AND WARRANTIES OF PURCHASER
5.1 Organization
5.2 Authority Relative to Agreement
5.3 Non-Contravention
5.4 Consents, etc

5.5 Litigation
5.6 Regulatory Reports
5.7 Absence of Certain Changes
5.8 Information Supplied
5.9 Brokers
5.10 Available Funds
5.11 Investment Intent
5.12 Certain Regulatory Matters

Article VI COVENANTS
6.1 Conduct of Business
6.2 Access; Confidentiality
6.3 Reasonable Best Efforts; Taking of Necessary Action; Notices of Certain Events
6.4 CDSC Financing Agreements
6.5 Insurance
6.6 Names of Subject Companies and Sponsored Funds; Websites
6.7 Post-Closing Cooperation; Retention of Records and Confidentiality
6.8 Public Announcements
6.9 Section 15 of the Investment Company Act
6.10 Non-Competition; Non-Solicitation
6.11 401(k) Plans
6.12 Further Assurances
6.13 Settlement of Intercompany Accounts

Article VII EMPLOYEE MATTERS
7.1 General
7.2 Termination and Severance
7.3 Closing Payments
7.4 Welfare Plans
7.5 Accrued Vacation
7.6 Seller Parent Benefit Plans
7.7 Administration

Article VIII CONDITIONS TO THE CLOSING
8.1 Conditions to Obligations of Each Party
8.2 Additional Conditions to the Obligations of Purchaser
8.3 Additional Conditions to the Obligations of Seller and Seller Parent

Article IX TERMINATION, AMENDMENT AND WAIVER
9.1 Termination
9.2 Effect of Termination

Article X TAX MATTERS
10.1 Indemnification for Taxes
10.2 Apportionment of Taxes
10.3 Tax Returns and Payment of Taxes
10.4 Cooperation; Audits

10.5 Transfer Taxes
10.6 Section 338(h)(10) Election
10.7 Allocation of Closing Payments

Article XI INDEMNIFICATION

11.1 Indemnification by Seller and Seller Parent
11.2 Indemnification by Purchaser
11.3 Indemnification Procedures
11.4 General

Article XII GENERAL PROVISIONS
12.1 Survival
12.2 Notices
12.3 Interpretation
12.4 Amendment and Modification; Waiver
12.5 Entire Agreement
12.6 Fees and Expenses
12.7 Disclosure Letters
12.8 Third Party Beneficiaries
12.9 Specific Performance
12.10 Performance by Seller and Purchaser
12.11 Assignment; Binding Effect
12.12 Governing Law
12.13 Jurisdiction; Waiver of Jury Trial
12.14 Severability
12.15 Counterparts

LIST OF SCHEDULES AND EXHIBITS*

Schedules

1 Aggregate Base Advisory Revenue Run-Rate
2 Benchmark Fee Revenue
2.4(a) Applicable Accounting Principles for the Closing Date Balance Sheet
2.4(b) Working Capital Amount Example Calculation
2.6 Fee Rates
3 Purchaser's Retail Mutual Fund Annual Fee Revenue
4 Purchaser's Retail Mutual Fund Business
6.3(e) Fund Mapping
6.3(f) Separate Account Client
8.2(f) Third Party Consents
8.2(g) Retention Agreements
8.2(h) Third Party Distributors
Y Selected AUM Computation Factors
Z Special Clients

Exhibits

8.2(g) Form of Retention Letter for Wholesalers

*Principal Financial Group, Inc. agrees to furnish supplementally to the Commission upon its request a copy of any omitted schedule or exhibit.

STOCK PURCHASE AGREEMENT

STOCK PURCHASE AGREEMENT, dated as of July 25, 2006 (this "Agreement"), among WASHINGTON MUTUAL, INC., a Washington corporation ("Seller Parent"), NEW AMERICAN CAPITAL, INC., a Delaware corporation ("Seller"), PRINCIPAL FINANCIAL GROUP, INC., a Delaware corporation ("Purchaser Parent"), and PRINCIPAL MANAGEMENT CORPORATION, an Iowa corporation ("Purchaser").

WITNESSETH

WHEREAS, Seller owns 3,974 shares of the common stock, par value $0.25 per share (the "Stock"), of WM Advisors, Inc., a Washington corporation (the "Company"), constituting all of the issued and outstanding shares of capital stock of the Company;

WHEREAS, the Company owns all of the outstanding shares of capital stock of each of WM Funds Distributor, Inc., a Washington corporation, and WM Shareholder Services, Inc., a Washington corporation;

WHEREAS, Seller is a wholly owned Subsidiary of Seller Parent, and Purchaser is a wholly owned Subsidiary of Purchaser Parent;

WHEREAS, certain employees of the Subject Companies have entered into employment agreements with the Subject Companies as of the date hereof but to be effective as of the Closing (as hereinafter defined); and

WHEREAS, on the terms and subject to the conditions set forth herein, Seller Parent and Seller desire to sell, and Purchaser desires to purchase, the Stock.

NOW, THEREFORE, in consideration of the premises and of the mutual covenants and agreements hereinafter set forth, the parties hereto agree as follows:

Article I
DEFINITIONS

The following terms when used in this Agreement shall have the following meanings:

"12b-1 Plan" means any distribution plan adopted by a registered investment company in accordance with Rule 12b-1 under the Investment Company Act.

"401(k) Plans" means defined contribution plans that include a qualified cash or deferred arrangement within the meaning of Section 401(k) of the Code.

"Accounting Firm" has the meaning set forth in Section 2.4(b)(ii).

"Adjusted Closing Fee Rate" means the lower of (i) the applicable Schedule 2.6 Fee Rate and (ii) the actual fee rate payable to (A) a Subject Company pursuant to the Advisory Contract relating to the relevant Sponsored Fund, Sub-Advised Fund, Separate

---

Account Client or New Advisory Client (as applicable) that will be in effect as of immediately following the Closing or (B) to Purchaser or any of its Affiliates pursuant to the applicable advisory agreement in effect immediately following the merger, as approved prior to Closing, of a Sponsored Fund into a fund sponsored by Purchaser Parent or any of its Affiliates (not including any performance-based, incentive or similar fees or any sales, exit, switching, administrative, distribution or similar fees and after reduction to take into account any fee waivers, reimbursement obligations or similar offsets or arrangements to be in effect as of immediately following the Closing with respect to advisory or sub-advisory services (as applicable) performed by the Subject Companies or Purchaser or any of its Affiliates, as applicable, for such Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable)); provided that, in the case of a Sponsored Fund, its Schedule 2.6 Fee Rate shall apply in any event if (a) Purchaser initiated the reduction in the applicable fee rate (including a reduction resulting from a merger of a Sponsored Fund with a fund (including any newly-formed "shell" fund) sponsored by Purchaser or any of its Affiliates if and to the extent that, as proposed by Purchaser, such merger contemplated a fee rate less than such Schedule 2.6 Fee Rate) or (b) the board of directors or trustees of any fund sponsored by Purchaser or any of its Affiliates required a reduction in the applicable fee rate as a condition to such board's approval of the merger of a Sponsored Fund with such fund. Notwithstanding anything herein to the contrary, in the case of a Sponsored Fund for which clause (a) or (b) of the proviso in the preceding sentence applies, if the fee rate determined under clause (ii) was further reduced as a result of circumstances not described in clause (a) or (b), then the "Adjusted Closing Fee Rate" shall be the applicable Schedule 2.6 Fee Rate reduced by the amount of the fee rate reduction attributable to such circumstances.

"Adjusted TNW Amount" has the meaning set forth in Section 2.4(c)(III).

"Administration Contract" means any written agreement to which a Sponsored Fund or Subject Company is party that relates to the provision of administrative, accounting, bookkeeping or transfer agent services to a Sponsored Fund.

"Adviser Compliance Policies" has the meaning set forth in Section 4.18(n).

"Advisory Client" means any client to whom any of the Subject Companies provides investment advisory services or investment sub-advisory services (including, without limitation, the Sponsored Funds, the Sub-Advised Funds and the Separate Account Clients).

"Advisory Contract" means any written agreement pursuant to which any of the Subject Companies or any Third Party Adviser provides investment advisory services or investment sub-advisory services to Advisory Clients (or, in the case of a Third Party Adviser, a Subject Company).

"Affected Employees" means employees of any of the Subject Companies immediately prior to the Closing Date (other than employees of any of the Subject Companies who are on long-term disability leave).

"Affiliate" means, with respect to any Person, any other Person that directly or indirectly, through one or more intermediaries, controls, is controlled by, or is under common control with such first Person. The term "control" (including its correlative meanings "controlled by" and "under

common control with”) means possession, directly or indirectly, of power to direct or cause the direction of management or policies (whether through ownership of securities or other ownership interests, by contract, or otherwise).

“Affiliate Transaction” has the meaning set forth in Section 4.21(b).

“Aggregate Base Advisory Revenue Run-Rate” means the amount set forth on Schedule 1 as “Aggregate Base Advisory Revenue Run Rate.”

“Aggregate Closing Advisory Revenue Run-Rate” means the sum of the Closing Advisory Revenue Run-Rates for all Sponsored Funds, Sub-Advised Funds, Separate Account Clients and New Advisory Clients with respect to which Client Consent has been obtained (and remains in effect) as of the Closing Date.

“Agreement” has the meaning set forth in the introductory paragraph hereof.

“Ancillary Agreements” means the Bank Channel Distribution Agreement and the Transition Services Agreement.

“Applicable Law” has the meaning set forth in Section 4.3.

“Appraiser” has the meaning set forth in Section 10.6.

“Assets” has the meaning set forth in Section 4.13(a).

“Bank Channel” means the distribution channel consisting of the marketing and sales of and provision of shareholder, administrative and other services relating to, investment products, by employees holding Series 6 and Series 7 licenses, point of sale representatives and their direct supervisors and others, through the retail branch banking system of or otherwise by Seller and its Affiliates, including all such operations located or accessible at bank branches or online through the website that services the retail bank customers of Seller and its Affiliates.

“Bank Channel Distribution Agreement” means the Distribution Agreement substantially in the form of Exhibit A hereto, including the letter agreement annexed thereto.

“Base Advisory Revenue Run-Rate” means, with respect to a Sponsored Fund, Sub-Advised Fund or Separate Account Client (as applicable), the product of (i) the Base Assets Under Management of such Sponsored Fund, Sub-Advised Fund or Separate Account Client (as applicable), multiplied by (ii) the applicable Schedule 2.6 Fee Rate.

“Base Assets Under Management” means, with respect to a Sponsored Fund, Sub-Advised Fund or Separate Account Client (as applicable), the dollar amount of assets

---

under management by the Subject Companies for such Sponsored Fund, Sub-Advised Fund or Separate Account Client (as applicable) as of the Base Date.

“Base Date” means April 30, 2006.

“Base Purchase Price” has the meaning set forth in Section 2.2.

“Benchmark Fee Revenue” means, for any Make-Whole Year, the amount set forth on Schedule 2 as “Benchmark Fee Revenue”. Notwithstanding the foregoing, if a Client Consent with respect to any Special Client has not been obtained or is not in effect, then, to the extent the Purchase Price has been adjusted as a result thereof pursuant to Section 2.5 and has not been trued-up pursuant to Section 2.7, the Benchmark Fee Revenue shall not include the amount(s) indicated on Schedule 2 that are attributable to such Special Client.

“Benefit Plans” has the meaning set forth in Section 4.11(b).

“Board Governance Matters” has the meaning set forth in Section 6.3(e).

“Broker-Dealer Compliance Policies” has the meaning set forth in Section 4.18(n).

“Business” means the business and operations of the Company and its Subsidiaries as conducted as of the date hereof and at any time between the date hereof and Closing.

“Business Day” means any day which is not a Saturday, Sunday or a day on which banks in Seattle, Washington, or New York, New York, are authorized or obligated by law or executive order to be closed.

“Cap” has the meaning set forth in Section 11.1(b)(A).

“CDSC Financing Agreements” means, collectively, (i) that certain Second Amended and Restated Purchase and Sale Agreement, dated as of March 20, 1998, by and among the Company, Citibank N.A. and Citicorp North America, Inc., (ii) that certain Seventh Facility Amendment, dated as of June 30, 2005, by and among WM Funds Distributor, Inc., the Company, Seller, Citibank N.A. and Citicorp North America, Inc., (iii) that certain Third Amended and Restated Servicing Agreement, dated as of March 5, 1999, by and among the WM Funds Distributor, Inc., Citibank N.A. and Citicorp North America, Inc., (iv) that certain Third Amended and Restated Collection Agency Agreement, dated as of March 5, 1999, by and among WM Funds Distributor, Inc., Citibank, N.A., Citicorp North America, Inc., and Bankers Trust Company, (v) that certain Fourth Amended and Restated Manager Undertaking, dated as of March 20, 1998, by and among the Company, Citibank, N.A. and Citicorp North America, Inc., (vi) that

certain Fourth Amended and Restated Parent Undertaking, dated as of March 20, 1998, by and among Seller, Citibank, N.A., and Citicorp North America, Inc., and (vii) the related agreements amended thereby and other transaction documents contemplated thereby.

"Claim Notice" has the meaning set forth in Section 11.3(a).

"Client Consent" means:

(i) With respect to a Sponsored Fund, that the Subject Companies shall have obtained Fund Board Approval and Sponsored Fund Shareholder Approval of (A) a new Advisory Contract contemplated by Section 6.3(e)(i) to be in effect with respect to such Sponsored Fund as of immediately following the Closing on the terms and conditions contemplated by the first sentence of Section 6.3(e), and (B) in the case of each Sponsored Fund listed in Schedule 8.2(f)(ii) (except to the extent that Purchaser shall have waived in writing the condition set forth in Section 8.2(f)(ii)(B) with respect to any such Sponsored Fund), the merger of such Sponsored Fund with a fund sponsored by Purchaser or any of its Affiliates as contemplated by Section 6.3(e);

(ii) With respect to a Sub-Advised Fund, that the Subject Companies shall have obtained Fund Board Approval and (solely in the event that shareholder approval is required under Section 15 of the Investment Company Act, as determined by the sponsor of such Sub-Advised Fund), Sub-Advised Fund Shareholder Approval of a new Advisory Contract to be in effect with respect to such Sub-Advised Fund as of immediately following the Closing on the terms and conditions contemplated by the first sentence of Section 6.3(e);

(iii) With respect to a Separate Account Client, that the Subject Companies shall have obtained its Separate Account Consent on the terms and conditions contemplated by Section 6.3(f); and

(iv) With respect to a New Advisory Client, that the Subject Companies shall have obtained (A) in the case of a New Advisory Client that is not an investment company (or series thereof) registered under the Investment Company Act, such consent of such New Advisory Client to the "assignment" of its Advisory Contract resulting from the consummation of the transactions contemplated by this Agreement as is required under the terms of such Advisory Contract and Applicable Law, or (B) in the case of a New Advisory Client that is an investment company (or series thereof) registered under the Investment Company Act, such approval by the board of directors or trustees (as applicable) and (in the event that such shareholder approval is required under Section 15 of the Investment Company Act) the shareholders of such New Advisory Client as is required under the Investment Company Act of a new Advisory Contract to be in effect with respect to such New Advisory Client as of immediately following the Closing on the terms and conditions contemplated by the first sentence of Section 6.3(e).

"Closing" has the meaning set forth in Section 3.1.

"Closing Adjusted Assets Under Management" means, with respect to a Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable), the dollar amount of assets under management by the Subject Companies for such Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable) as of the Base Date (or, in the case of a New Advisory Client, such

---

later date as such New Advisory Client first became an Advisory Client of the Subject Companies), as adjusted to reflect net asset flows (i.e., sales, redemptions, purchases, contributions, deposits, withdrawals, exchanges, surrenders, dividend payments, interest payments, reinvestments of dividends and reinvestments of interest) with respect to assets under management by the Subject Companies for such Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable) following the Base Date (or, in the case of a New Advisory Client, such later date as such New Advisory Client first became an Advisory Client of the Subject Companies) (excluding any assets purchased or contributed by Seller Parent or its Affiliates for their own accounts) through and including the Business Day prior to the Closing Date. (For the avoidance of doubt, the calculation of Closing Adjusted Assets Under Management pursuant to the immediately preceding sentence is intended to exclude any increase or decrease in assets under management resulting from market appreciation or depreciation from and after the Base Date (or, in the case of a New Advisory Client, such later date as such New Advisory Client first became an Advisory Client of the Subject Companies).)

"Closing Advisory Revenue Run-Rate" means, with respect to a Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable), the product of (i) the Closing Adjusted Assets Under Management of such Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable), multiplied by (ii) the applicable Adjusted Closing Fee Rate.

"Closing Date" has the meaning set forth in Section 3.1.

"Closing Date Balance Sheet" has the meaning set forth in Section 2.4(a).

"Closing Payment" has the meaning set forth in Section 7.3.

"Code" means the Internal Revenue Code of 1986, as amended, or any successor thereto.

"Company" has the meaning set forth in the preamble to this Agreement.

"Company Financial Statements" has the meaning set forth in Section 4.7(a).

"Confidentiality Agreement" means the Confidentiality Agreement, dated as of April 4, 2006, between Seller Parent and Purchaser relating to, among other things, the confidentiality of certain information provided by or on behalf of Seller Parent to Purchaser with respect to the Company

and its Subsidiaries.

“Contract” has the meaning set forth in Section 4.3.

“Damages” has the meaning set forth in Section 11.1(a).

“Deductible” has the meaning set forth in Section 11.1(b).

“Deferred Compensation Liabilities” has the meaning set forth in Section 7.6.

Deferred Compensation Plans” has the meaning set forth in Section 7.6.

“Distribution Agreement” means (i) any agreement between a Sponsored Fund and a Subject Company or (ii) any agreement between a Sponsored Fund or Subject Company and a Third Party intermediary, Seller, Seller Parent or any of their Subsidiaries (other than the Subject Companies) pursuant to which (A) such intermediary makes available to its clients or customers investment products for which any Subject Company serves as an investment adviser, sub-advisor or distributor or provides shareholder services with respect to such investment products or pursuant to which such intermediary and any Subject Company share revenues relating to such intermediary’s clients or customers or (B) any Subject Company or an Affiliate thereof makes available to its clients or customers investment products for which any Subject Company serves as an investment adviser, sub-advisor or distributor or provides shareholder services with respect to such investment products (including, in each case, without limitation, any agreement or arrangement pursuant to which a Subject Company makes payments to an intermediary out of its own resources, for services relating to the distribution of fund shares, shareholder services or the provision of non-distribution services for or on behalf of purchasers of Sponsored Fund shares or the Sponsored Funds).

“Election Forms” has the meaning set forth in Section 10.6.

“Elections” has the meaning set forth in Section 10.6.

“ERISA” means the Employee Retirement Income Security Act of 1974, as amended.

“Estimated Accruals” has the meaning set forth in Section 7.7(b).

“Estimated Working Capital Amount” has the meaning set forth in Section 2.3.

“Exchange Act” means the Securities Exchange Act of 1934, as amended, and the rules and regulations of the SEC thereunder.

“Fixed Annuity and Variable Annuity Products” means fixed annuity products, variable annuity and variable life insurance products.

“Fund Board Approval” has the meaning set forth in Section 6.3(e).

“Fund Filings” has the meaning set forth in Section 4.19(d).

“Fund Shareholder Approvals” has the meaning set forth in Section 6.3(e).

“GAAP” means generally accepted accounting principles in the United States.

“Governmental Approvals” has the meaning set forth in Section 4.4(a).

“Governmental Authority” has the meaning set forth in Section 4.3.

“HSR Act” has the meaning set forth in Section 4.4(a).

“Indemnified Entity” has the meaning set forth in Section 11.3(a).

“Indemnified Purchaser Entities” has the meaning set forth in Section 11.1(a).

“Indemnified Seller Entities” has the meaning set forth in Section 11.2(a).

“Indemnifying Party” has the meaning set forth in Section 11.3(a).

“Intellectual Property” means U.S. and foreign intellectual property, including patents and patent applications, inventions, discoveries, processes, algorithms, formulae, technology, know-how, designs, ideas, research and development, and related improvements; copyrights and copyrightable works (including software, code, applications, databases, website content, documentation and related items in any and all forms and media), and registrations and applications to register or renew the registration of any of the foregoing; Trademarks, service marks, trade names, corporate names, domain names, logos, trade dress, including all goodwill associated with the foregoing, and other source indicators, and

registrations and applications to register or renew the registration of any of the foregoing (including all product names or other active or dormant Trademarks, whether currently or previously used in the Business); trade secrets and confidential or proprietary information.

"Intercompany Balances" has the meaning set forth in Section 4.21(a).

"Interim Period" has the meaning set forth in Section 10.1.

"Investment Advisers Act" means the Investment Advisers Act of 1940, as amended, and the rules and regulations of the SEC thereunder.

"Investment Company Act" means the Investment Company Act of 1940, as amended, and the rules and regulations of the SEC thereunder.

"IRS" has the meaning set forth in Section 4.11(c).

"Knowledge of Seller" means the actual knowledge of any of the individuals identified in Section 1.1 of the Seller Disclosure Letter, or (except in the case of representations and warranties, other than the representations and warranties in Section 4.19, regarding the Sub-Advised Funds) the actual knowledge that would have been obtained by any of such individuals after due inquiry of those employees of Seller Parent or its Subsidiaries that such individuals would reasonably expect to have knowledge of the relevant subject matter.

"Leased Real Property" has the meaning set forth in Section 4.13(c).

"Lien" means any mortgage, pledge, lien, charge, security interest or other similar encumbrance or any adverse claim of any kind.

"Make-Whole At 95%" means, for any Make-Whole Year, the excess, if any, of (i) the product of (x) the lesser of 95% and the National Channel Shortfall Percentage, multiplied by (y) Benchmark Fee Revenue for such Make-Whole Year over (ii) the Selected Annual Fee Revenue for such Make-Whole Year.

"Make-Whole At 100%" means, for any Make-Whole Year, the excess, if any, of (i) the product of (x) the lesser of 100% and the National Channel Shortfall Percentage, multiplied by (y) Benchmark Fee Revenue for such Make-Whole Year over (ii) the Selected Annual Fee Revenue for such Make-Whole Year.

"Make-Whole Calculation" has the meaning set forth in Section 2.6(a).

"Make-Whole Payment" means, for any Make-Whole Year, the sum of (i) the Make-Whole At 95% plus (ii) 50% of the difference, if any, between (a) the Make-Whole At 100% and (b) the Make-Whole At 95%; provided that the Make-Whole Payment for any Make-Whole Year shall not exceed $30 million.

"Make-Whole Reconciliation Amount" means the following amount, if any: (i) if the Selected Asset Shortfall Amount equals or exceeds the sum of the Make-Whole Payments, zero; and (ii) in each other case, the excess, if any, of (x) the sum of the Make-Whole Payments paid by Seller to Purchaser pursuant to Section 2.6 over (y) the Selected Asset Shortfall Amount (but in no event more than the sum of the Make-Whole Payments).

"Make-Whole Years" means the 12 month periods ending on the first four anniversaries of the Closing.

"Material Adverse Effect" means (a) any effect on or change to any Subject Company that is or would reasonably be expected to be, either individually or in the aggregate, materially adverse to the business, operations or financial or other condition of the Subject Companies, taken as a whole, other than any such effect or change attributable to or resulting from (i) this Agreement or the transactions contemplated hereby (other than relating to or arising out of a breach of Section 4.3), (ii) any change in the capital markets or securities markets, (iii) any change in general economic conditions or interest rates, (iv) any change or condition affecting the industries in which the Subject Companies operate generally, or (v) any change in Applicable Law or GAAP or in the official interpretations thereof; provided, that the exceptions set forth in clauses (ii) through (v) shall only apply to the extent that such effect or change does not have or cause a disproportionate effect or change on the Subject Companies, taken as a whole, relative to comparable Persons in the investment management industry; and further provided that for purposes of the first sentence of Section 4.10 only, any decline in the Aggregate Closing Advisory Revenue Run-Rate compared to the Aggregate Base Advisory Revenue Run-Rate that results solely from the failure to obtain Client Consents with respect to Sponsored Funds, Sub-Advised Funds, Separate Account Clients or New Advisory Clients and/or withdrawals from assets under management by the Subject Companies for Sponsored Funds, Sub-Advised Funds, Separate Account Clients or New Advisory Clients following the Base Date, to the extent that such decline results in an

---

adjustment to the Purchase Price pursuant to Section 2.5, shall not constitute a Material Adverse Effect (but any other factor that causes or contributes to such decline, including any factor that causes clients not to deliver Client Consents or to effect withdrawals, shall not be excluded by this proviso); or (b) any effect, change or circumstance that would reasonably be expected to prohibit or materially impair the ability of Seller Parent, Seller or any Affiliate of Seller, as applicable, to consummate the transactions contemplated hereby and by the Ancillary Agreements or perform their respective obligations hereunder and thereunder on a timely basis.

"Material Contract" means any written or oral Contract to which any of the Subject Companies is a party or by which any of them or any of their assets is bound which (i) is an Advisory Contract or is a Distribution Agreement pursuant to which any Subject Company has preferred provider status as of the date hereof, (ii) by its terms does not terminate or is otherwise not cancelable within 180 days without penalty, cost or liability and requires aggregate payments by the Subject Companies in excess of $100,000 per year for any such Contract, (iii) provides for future payments or

the acceleration or vesting of payments in excess of $25,000 that are conditioned, in whole or in part, on a change in control of any of the Subject Companies, (iv) contains provisions restricting in any material respects the ability of such Subject Company to compete or engage in any business activity in any location, or that would so limit the freedom of Purchaser or any of its Affiliates or any of the Subject Companies after Closing; (v) directly relates to any material Intellectual Property that is owned or licensed by any Subject Company, (vi) contains provisions requiring future contingent or definitive "earnout" or similar payments to be made by a Subject Company in connection with acquisitions of assets or equity interests of a business or the hiring of any employees, which future payments could in the aggregate exceed $250,000 for any such Contract (or series of related Contracts), (vii) is a Distribution Agreement or an Administration Contract, (viii) relates to indebtedness for money borrowed by such Subject Company (or other financing arrangements having the economic effect of indebtedness, whether incurred, assumed, guaranteed or secured by any asset) in excess of $250,000 in the aggregate for any such Contract, (ix) is a lease or sublease of real property which requires aggregate payments by or to the Subject Companies in excess of $100,000 per year for any such lease or sublease, (x) is a Contract between any of the Subject Companies, on the one hand, and Seller Parent or any of its Affiliates (other than the Subject Companies), on the other hand, which provides for aggregate payments by or to the Subject Companies in excess of $100,000 per year for any such Contract, (xi) relates to any joint venture, partnership, limited liability company or other similar agreement or arrangements (including any agreement providing for joint research, development or marketing); (xii) relates to the acquisition or disposition of any business, a material amount of stock or assets of any other Person or any material real property (whether by merger, sale of stock, sale of assets or otherwise), including any option agreement; (xiii) relates to any interest rate, derivatives or hedging transaction; (xiv) is an agreement (including any "take-or-pay" or keepwell agreement) under which (A) any Person has directly or indirectly guaranteed any liabilities or obligations of any of the Subject Companies or (B) any of the Subject Companies has directly or indirectly guaranteed any liabilities or obligations of any other Person (in each case other than endorsements for the purpose of collection in the ordinary course of business); or (xv) is otherwise material to

---

the business or operations of the Subject Companies, taken as a whole; provided, however, in no event shall the definition of Material Contract be deemed to include Benefit Plans; and, provided further, that a Material Contract shall also include any custody agreement, administration contract, transfer agent agreement, accounting services agreement, shareholder services agreement and similar agreement, by which a Sponsored Fund is bound or pursuant to which a Sponsored Funds receives services.

"NASD" has the meaning set forth in Section 4.18(e).

"National Channel Shortfall Percentage" means, as to any Make-Whole Year, the quotient (expressed as a percentage) of (i) Purchaser's Retail Mutual Fund Annual Fee Revenue in such Make-Whole Year divided by (ii) Purchaser's Retail Mutual Fund Benchmark Annual Fee Revenue.

"New Advisory Client" means any Advisory Client (including a Separate Account Client) for whom the Subject Companies first commenced providing investment advisory services following the Base Date and prior to the Closing; provided, that New Advisory Clients shall not include a registered investment company (or series thereof) or Seller, Seller Parent or any of their Affiliates.

"Owned Intellectual Property" has the meaning set forth in Section 4.16(a).

"Permits" has the meaning set forth in Section 4.9.

"Permitted Liens" means (i) Liens for Taxes, assessments or other governmental charges not yet due or which are being contested in good faith by appropriate proceedings, and, in each case, for which adequate reserves with respect thereto have been made in the Company Financial Statements in accordance with GAAP, (ii) carriers', warehousemen's, mechanics', materialmen's, repairman's or other similar Liens that are not material to the Subject Companies in the aggregate, (iii) easements, rights of way, building, zoning and other similar encumbrances or title defects that are not material to the Subject Companies in the aggregate, and (iv) Liens on assets of any of the Subject Companies incurred in the ordinary course of business which do not materially impair business operations or the use of such properties in the ordinary course of business and that are not material to the Subject Companies in the aggregate.

"Person" means any individual, corporation, company, partnership (limited or general), limited liability company, joint venture, association, trust, unincorporated organization or other business entity.

"Pre-Closing Period" has the meaning set forth in Section 10.1.

"Privacy Policies" has the meaning set forth in Section 4.18(n).

"Purchase Price" has the meaning set forth in Section 2.2.

"Purchaser" has the meaning set forth in the introductory paragraph hereof.

"Purchaser Disclosure Letter" means the disclosure letter delivered by Purchaser to Seller at the time of execution hereof.

"Purchaser Fund Board Approval" has the meaning set forth in Section 6.3(e).

"Purchaser Material Adverse Effect" has the meaning set forth in Section 5.4(a).

"Purchaser Parent" has the meaning set forth in the introductory paragraph hereof.

"Purchaser's Affiliated Group" means any corporation, or group of corporations, which files a Tax Return together with Purchaser Parent on a consolidated, combined or unitary basis.

"Purchaser's Retail Mutual Fund Annual Fee Revenue" means, for each Make-Whole Year after Closing, the aggregate advisory or sub-advisory fee revenue that would have been earned in respect of the funds included in Purchaser's Retail Mutual Fund Business based on the daily average Purchaser's Retail Mutual Fund AUM during such Make-Whole Year if the relevant Schedule 2.6 Fee Rate for each such fund applied. For purposes of the determination of "Purchaser's Retail Mutual Fund Annual Fee Revenue," in the case of each Sponsored Fund that is merged into a fund sponsored by Purchaser or any of its Affiliates that exists as of the date hereof, the applicable fee rate shall be the weighted average fee rates of such Sponsored Fund and such fund sponsored by Purchaser or any of its Affiliates, with such weighting calculated based on assets under management as of the Base Date as reflected in Schedule 3.

"Purchaser's Retail Mutual Fund AUM" means, as of any date of determination, the dollar amount of assets under management by Purchaser's Retail Mutual Fund Business (and, for dates prior to Closing, the Subject Companies), as of the Base Date, as adjusted to reflect net asset flows (i.e., sales, redemptions, purchases, contributions, deposits, withdrawals, exchanges, surrenders, dividend payments, interest payments, reinvestments of dividends and reinvestments of interest) with respect to such assets under management following the Base Date through and including the date of determination, but excluding Selected AUM. (For the avoidance of doubt, the calculation of Purchaser's Retail Mutual Fund AUM pursuant to the immediately preceding sentence is intended to exclude any increase or decrease in assets under management resulting from market appreciation or depreciation from and after the Base Date.)

"Purchaser's Retail Mutual Fund Benchmark Annual Fee Revenue" means the amount set forth on Schedule 3.

"Purchaser's Retail Mutual Fund Business" means the operations of Purchaser and its Affiliates (including, after Closing, the Subject Companies) distributing, and acting as an advisor or sub-advisor to, Retail Mutual Funds sold through broker-dealers in the United States; provided, however, that Purchaser's Retail Mutual Fund Business shall exclude the mutual fund business of Purchaser and its Affiliates related to (a) 401(k) Plans sponsored by third parties for which Purchaser or its Affiliates provide recordkeeping, trust, custodial, investment advisory, or other services, (b) participant asset rollovers from such 401(k) Plans into other products manufactured, distributed, or

serviced by Purchaser and its Affiliates, and (c) Purchaser's or its Affiliates' mutual funds sold by Purchaser's or its Affiliates' career insurance agents. For the avoidance of doubt, the Purchaser's Retail Mutual Fund Business as of the Base Date consisted of the assets under management described in Schedule 4.

"Registered Fund Clients" has the meaning set forth in Section 4.19(a).

"Registered Separate Account" has the meaning set forth in Section 4.19(f).

"Retail Mutual Fund" means any corporation, trust or other juridical entity (i) organized under the laws of the United States or any state thereof, (ii) which is registered as an investment company under Section 8 of the Investment Company Act (and which has not elected to be treated as a business development company pursuant to Section 54 of the Investment Company Act), and (iii) which has registered, or proposes to register, its securities under the Securities Act for public offering and sale.

"Schedule 2.6 Fee Rate" means, in respect of any Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client (as applicable), or the Purchaser's Retail Mutual Fund AUM, as the case may be, the fee rate set forth on Schedule 2.6, which schedule sets forth the relevant fee rates as of April 30, 2006.

"Seattle Sublease" means the Sublease Agreement, dated as of July 1, 1999, between Washington Mutual Bank, a Washington state chartered stock savings bank, and the Company, as amended by the First Amendment to Sublease Agreement, made effective as of July 1, 2004, between Washington Mutual Bank, a federal association, successor by way of merger to Washington Mutual Bank, a Washington state chartered stock savings bank, and the Company.

"SEC" means the United States Securities and Exchange Commission.

"Section 338 Allocation" has the meaning set forth in Section 10.6.

"Securities Act" means the Securities Act of 1933, as amended, and the rules and regulations of the SEC thereunder.

"Selected Annual Fee Revenue" means, for each Make-Whole Year after Closing, the advisory or sub-advisory fee revenue that would have been earned in respect of the daily average Selected AUM during such Make-Whole Year if the relevant Schedule 2.6 Fee Rate (or, in the case of Selected AUM managed for a Special Client, such lower rate as applied from time to time during such Make-Whole Year) applied. For illustrative purposes only, the Selected Annual Fee Revenue as of the Base Date is calculated on Schedule 2.

"Selected Asset Shortfall Amount" means the sum of (i) the Selected Asset Shortfall At 95% plus (ii) 50% of the difference, if any, between (a) the Selected Asset Shortfall At 100% and (b) the Selected Asset Shortfall At 95%.

"Selected Asset Shortfall At 95%" means the excess, if any, of (a) the product of (i) 3.8 and (ii) the Benchmark Fee Revenue, over (b) the sum of the Selected Annual Fee Revenues for each Make-Whole Year.

"Selected Asset Shortfall At 100%" means the excess, if any, of (a) the product of (i) 4.0 and (ii) the Benchmark Fee Revenue, over (b) the sum of the Selected Annual Fee Revenues for each Make-Whole Year.

"Selected AUM" means, as of any date of determination, without duplication, the dollar amount of assets under management by the Subject Companies and by Purchaser and its Affiliates (including, after the Closing, the Subject Companies) in the United States (i) through the Bank Channel and (ii) for Seller, Seller Parent or any of their Affiliates (other than the Subject Companies) other than in respect of any 401(k) Plan of such Person, in each case as of the Base Date, as adjusted to reflect net asset flows (i.e., sales, redemptions, purchases, contributions, deposits, withdrawals, exchanges, surrenders, dividend payments, interest payments, reinvestments of dividends and reinvestments of interest) with respect to such assets under management following the Base Date, through and including the date of determination. (For the avoidance of doubt, the calculation of Selected AUM pursuant to the immediately preceding sentence is intended to exclude any increase or decrease in assets under management resulting from market appreciation or depreciation from and after the Base Date.) For illustrative purposes only, the Selected AUM as of the Base Date is set forth on Schedule 2. Notwithstanding anything herein to the contrary, assets advised or subadvised by the Subject Companies as of the date hereof that are related to any Fixed Annuity and Variable Annuity Products and that are not described in Schedule Y of the Seller Disclosure Letter, together with, for the avoidance of doubt, assets advised or subadvised by the Subject Companies or, after the Closing, Purchaser and its Affiliates that are related to any Fixed Annuity and Variable Annuity Products that are first introduced for distribution in the Bank Channel after the date hereof, shall be deemed to be assets under management through the Bank Channel for purposes of the definition of "Selected AUM".

"Seller" has the meaning set forth in the introductory paragraph hereof.

"Seller Disclosure Letter" means the disclosure letter delivered by Seller to Purchaser at the time of execution hereof.

"Seller Parent" has the meaning set forth in the introductory paragraph hereof.

"Seller Parent's Group" means any corporation, or group of corporations, which files a Tax Return together with Seller Parent on a consolidated, combined or unitary basis.

"Seller Permitted Activities" means engaging in the business of distributing and servicing Retail Mutual Funds of third parties at bank branches through WM Financial Services, Inc. and any other controlled Affiliate of Seller Parent.

"Seller Restricted Activities" means engaging in the Territory in the business of (a) acting as investment adviser or subadviser to or otherwise sponsoring or managing a Retail Mutual Fund, or (b) performing fund administration and related activities in respect of the activities covered by the preceding clause (a).

"Seller Restricted Period" means the period beginning on the Closing Date and ending on the fifth anniversary of Closing, provided that the Seller Restricted Period shall in no event exceed the maximum time period allowed by Applicable Law.

"Seller Severance Plan" has the meaning set forth in Section 7.2.

"Separate Account Clients" has the meaning set forth in Section 4.19(a).

"Separate Account Consent" has the meaning set forth in Section 6.3(f).

"Special Client" means any of the entities set forth on Schedule Z of the Seller Disclosure Letter.

"Sponsored Fund Shareholder Approval" has the meaning set forth in Section 6.3(e).

"Sponsored Funds" has the meaning set forth in Section 4.19(a).

"SRO" has the meaning set forth in Section 4.18(n).

"Stock" has the meaning set forth in the preamble to this Agreement.

"Sub-Advised Fund Shareholder Approval" has the meaning set forth in Section 6.3(e).

"Sub-Advised Funds" has the meaning set forth in Section 4.19(a).

"Subject Companies" means, collectively, the Company and its Subsidiaries.

"Subsidiary" means, with respect to any entity, a corporation or other entity of which the outstanding shares of stock or other equity interests having ordinary voting power to elect a majority of the board of directors (or comparable body) of such corporation or other entity are owned, directly or indirectly, through one or more intermediaries, by such entity. Ownership through fiduciary, trust, custodial or similar arrangements for the account of customers shall not constitute ownership of stock or other equity interests for purposes of this definition.

"Tangible Net Worth" means the total tangible assets of the Company consolidated with its Subsidiaries minus the total liabilities of the Company consolidated with its Subsidiaries (in each case as determined in accordance with GAAP, applied on a basis consistent with the Company Financial Statements, and Schedule 2.4(a)).

"Target Working Capital Amount" means $11,575,000.

"Tax-Exempt Municipal Bond Fund" has the meaning set forth in Section 4.19(f).

"Tax Returns" means all returns, declarations, reports, estimates, information returns (including IRS Forms 1098, 1099, 1042 and 1042-S), statements and other documents (including any related or supporting information) required to be filed in respect of Taxes, including any information returns, claims for refunds of Taxes, and any amendments or supplements to any of the foregoing, and "Tax Return" means any of the foregoing Tax Returns.

"Taxes" means any and all federal, state, county, provincial, local, foreign and other taxes, charges, fees, levies or other assessments, including without limitation all net income, alternative or add-on minimum, gross income, gross receipts, premium, estimated, sales, use, ad valorem, value-added, environmental, windfall, capital stock, property, transfer, franchise, profits, license, withholding, payroll, employment, excise, severance, stamp, occupation, customs, duties and guaranty fund assessments, together with any interest, additions to tax or interest, and penalties with respect thereto imposed by any taxing authority.

"Territory" means the United States of America.

"Third Party" has the meaning set forth in Section 11.3(a).

"Third Party Adviser" has the meaning set forth in Section 4.19(w).

"Third Party Claim" has the meaning set forth in Section 11.3(b).

"Third Party Consents" has the meaning set forth in Section 4.4(b).

"Trademarks" has the meaning set forth in Section 6.6(a).

"Transaction Bonus Plan" has the meaning set forth in Section 7.3.

"Transition Services Agreement" means the Transition Services Agreement substantially in the form attached hereto as Exhibit B, with such additions and modifications to the exhibits and schedules thereto as Purchaser and Seller shall agree to, as contemplated by the second sentence of Section 6.12.

"Vacation Policy" has the meaning set forth in Section 7.5.

"Variable Insurance Products Fund" has the meaning set forth in Section 4.19(f).

"Variable Pay Plan" has the meaning set forth in Section 7.7(b).

"Variable Pay Plan Amount" has the meaning set forth in Section 7.7(b).

"Variable Pay Plan Participant" has the meaning set forth in Section 7.7(b).

"Working Capital Amount" means the current assets of the Company consolidated with its Subsidiaries minus the current liabilities of the Company

consolidated with its Subsidiaries (in each case as determined in accordance with GAAP, applied on a basis consistent with the Company Financial Statements, and Schedule 2.4(a), and including only the line items used in the example calculation of the Working Capital Amount set forth in Schedule 2.4(b) hereto).

"Working Capital Deficiency Amount" has the meaning set forth in Section 2.4(c).

"Working Capital Surplus Amount" has the meaning set forth in Section 2.4(c).

Article II
PURCHASE AND DELIVERY OF STOCK

2.1 Delivery of Stock. On the terms and subject to the conditions set forth in this Agreement, Seller shall, at the Closing on the Closing Date, transfer, assign and deliver to Purchaser or its designee certificates evidencing the Stock, free and clear of Liens other than Liens created by Purchaser or its Affiliates. Such certificates evidencing the Stock shall be duly endorsed in blank, or be accompanied by stock transfer powers duly executed in blank, with all necessary stock transfer tax stamps affixed thereto and cancelled.

2.2 Closing; Payment of Purchase Price. On the terms and subject to the conditions set forth in this Agreement and against delivery of the certificates evidencing the Stock as provided in Section 2.1, Purchaser shall pay, at the Closing on the Closing Date, by wire transfer of immediately available funds to such account or accounts as Seller shall designate in writing to Purchaser not less than one Business Day prior to the Closing Date $740,000,000 (the "Base Purchase Price"), subject to adjustment as provided in Sections 2.3 through 2.7 (as so adjusted, the "Purchase Price").

2.3 Estimated Working Capital Amount. (a) Seller shall use its reasonable best efforts to cause a full balance sheet closing to take place on the Closing Date as if it were the last day of a fiscal period for the Company and its Subsidiaries. Not later than five (5) Business Days prior to the

Closing Date, Seller shall deliver to Purchaser a written statement containing an estimated consolidated balance sheet of the Company and its Subsidiaries and an estimated calculation of the Working Capital Amount, in each case as of the close of business on the Closing Date (the "Estimated Working Capital Amount"). The Estimated Working Capital Amount shall be calculated in accordance with GAAP, applied on a basis consistent with the Company Financial Statements, and Schedule 2.4(a).

(b) If the Estimated Working Capital Amount is less than the Target Working Capital Amount, the Purchase Price paid by Purchaser at the Closing shall be decreased by the excess of the Target Working Capital Amount over the Estimated Working Capital Amount. If the Estimated Working Capital Amount is greater than the Target Working Capital Amount, the Purchase Price paid by Purchaser at the Closing shall be increased by the excess of the Estimated Working Capital Amount over the Target Working Capital Amount.

2.4 Post-Closing Working Capital Purchase Price Adjustment. The Purchase Price shall be subject to adjustment after the Closing as specified in this Section 2.4.

(a) Closing Date Balance Sheet. As promptly as practicable, but in any event within 60 days following the Closing, Purchaser shall deliver to Seller a consolidated balance sheet of the Company and its Subsidiaries as of the Closing Date (the "Closing Date Balance Sheet"). The Closing Date Balance Sheet shall be prepared in accordance with GAAP, applied on a basis consistent with the Company Financial Statements, and Schedule 2.4(a), and shall be accompanied by a written statement setting forth a calculation of the Working Capital Amount and the Tangible Net Worth as of the close of business on the Closing Date, based on the Closing Date Balance Sheet. Seller and Seller Parent shall assist and cooperate with Purchaser in all commercially reasonable respects in the preparation of the Closing Date Balance Sheet and the calculation of the Working Capital Amount and the Tangible Net Worth, including by providing Purchaser with reasonable access to any relevant personnel, books and records related to the Company and its Subsidiaries that are in Seller's or Seller Parent's possession.

(b) Disputes. (i) Seller and its accountants shall be provided with reasonable access to the work papers of Purchaser and its accountants and to the books and records of the Company and its Subsidiaries in connection with its review of the Closing Date Balance Sheet and the calculation of the Working Capital Amount and the Tangible Net Worth; provided, however, that the auditors and outside accountants of Purchaser and the Subject Companies shall not be obligated to make work papers available to Seller or its accountants unless Seller and its accountants have signed a customary agreement relating to access to such work papers in form and substance reasonably acceptable to such accountants, as applicable.

(ii) Seller may dispute amounts on the Closing Date Balance Sheet and/or the calculation of the Working Capital Amount and the Tangible Net Worth, by notifying Purchaser in writing within 30 days of Seller's receipt of the Closing Date Balance Sheet and calculation of the Working Capital Amount and the Tangible Net Worth from Purchaser that Seller believes the Closing Date Balance Sheet or the calculation of the Working Capital Amount and the Tangible Net Worth contains mathematical errors or was not prepared in accordance with Section 2.4(a) and setting forth, in reasonable detail, the basis for such dispute. Seller shall not challenge the Closing Date Balance Sheet or calculation of the Working Capital Amount and the Tangible Net Worth on any other basis. In the event of such a dispute, Seller and Purchaser shall attempt to reconcile their differences, and any resolution by them as to any disputed amounts or calculations shall be final, binding and conclusive on the parties hereto. If Seller and Purchaser are unable to reach a resolution with such effect within 30 days after the receipt by Purchaser of Seller's written notice of dispute, Seller and Purchaser shall submit the items remaining in dispute for resolution to KPMG LLP (or, if such firm shall decline or is unable to act or is not, at the time of such submission, independent of Seller and Purchaser, to another independent accounting firm of international reputation mutually acceptable to Seller and Purchaser) (either KPMG LLP or such other accounting firm being referred to herein as the "Accounting Firm"), which shall, within 45 days after such submission, determine and report to Seller and Purchaser upon such remaining disputed items or calculations, and such report shall be final, binding and conclusive on Seller and Purchaser; provided that in no event shall the Accounting Firm's determination of such remaining disputed items or calculations be for an amount that is outside the range of the Purchaser's and Seller's disagreement. Purchaser and Seller shall make reasonably available to the Accounting Firm all relevant

---

books and records, any work papers (including those of the parties' respective accountants, to the extent applicable) and supporting documentation relating to the Closing Date Balance Sheet, the calculation of the Working Capital Amount and the Tangible Net Worth and any other items reasonably requested by the Accounting Firm; provided, however, that the accountants of Seller, Seller Parent, Purchaser and the Subject Companies shall not be obligated to make work papers available to the Accounting Firm unless the Accounting Firm has signed a customary agreement relating to access to such work papers in form and substance reasonably acceptable to such accountants. The fees and disbursements of the Accounting Firm shall be borne by Seller and Purchaser in proportion to the relative differences between their respective calculations of the remaining disputed items or calculations and the aggregate amount of such remaining disputed items or calculations as determined by the Accounting Firm.

(c) Purchase Price Adjustment. The Closing Date Balance Sheet and calculation of the Working Capital Amount and the Tangible Net Worth shall be deemed final for the purposes of this Section 2.4 upon the earliest of (i) the failure of Seller to notify Purchaser of a dispute within 30 days of Seller's receipt of the Closing Date Balance Sheet from Purchaser, (ii) the resolution of all disputes, pursuant to Section 2.4(b), by Seller and Purchaser or (iii) the resolution of all disputes, pursuant to Section 2.4(b), by the Accounting Firm. Within three Business Days of the Closing Date Balance Sheet and calculation of the Working Capital Amount and the Tangible Net Worth being deemed final, a Purchase Price adjustment shall be paid as follows:

(I) If the Working Capital Amount calculated based on the Closing Date Balance Sheet is less than the Estimated Working Capital Amount, Seller shall pay to Purchaser, in immediately available funds, an amount equal to the excess of the Estimated Working Capital Amount over the Working Capital Amount based on the Closing Date Balance Sheet (any such excess, the "Working Capital Deficiency Amount"). Seller shall pay the Working Capital Deficiency Amount, if applicable, to Purchaser in cash by wire transfer of immediately available federal funds to such bank account(s) as shall be designated in writing by Purchaser to Seller within one (1) Business Day of the Closing Date Balance Sheet and calculation of the Working Capital Amount being deemed final.

(II) If the Working Capital Amount calculated based on the Closing Date Balance Sheet is greater than the Estimated Working Capital Amount, Purchaser shall pay to Seller, in immediately available funds, an amount equal to the excess of the Working Capital Amount based on the Closing Date Balance Sheet over the Estimated Working Capital Amount (any such excess, the "Working Capital Surplus Amount"). Purchaser shall pay the Working Capital Surplus Amount, if applicable, to Seller in cash by wire transfer of immediately available federal funds to such bank account(s) as shall be designated in writing by Seller to Purchaser within one (1) Business Day of the Closing Date Balance Sheet and calculation of the Working Capital Amount being deemed final.

(III) If the sum of (i) the Tangible Net Worth on the Closing Date Balance Sheet, plus (ii) any Purchase Price adjustment in favor of Purchaser

---

pursuant to Sections 2.3(b) or 2.4(c)(I), minus (iii) any Purchase Price adjustment in favor of the Seller pursuant to Sections 2.3(b) or 2.4(c)(II) (such sum, the "Adjusted TNW Amount"), is less than $11,575,000, Seller shall pay to Purchaser, in immediately available funds, an amount equal to $11,575,000 less the Adjusted TNW Amount. Seller shall pay such amount, if applicable, to Purchaser in cash by wire transfer of immediately available federal funds to such bank account(s) as shall be designated in writing by Purchaser to Seller within one (1) Business Day of the Closing Date Balance Sheet and calculation of the Tangible Net Worth being deemed final.

(d) Interest on Payments. Any payments required to be made by Seller or Purchaser pursuant to Section 2.4(c) shall be accompanied by cash interest thereon calculated from the Closing through the date of payment at the prime lending rate prevailing during such period as published in The Wall Street Journal.

(e) The provisions in Section 2.4(b) relating to resolutions of disputes by an Accounting Firm are not intended to and shall not be interpreted to require that the parties refer to such a firm (i) any dispute arising out of a breach by one of the parties of its obligations under this Agreement or (ii) any dispute the resolution of which requires the construction or interpretation of this Agreement (apart from the mathematical calculation of the Working Capital Amount and the accounting treatment of current assets and current liabilities insofar as such treatment affects the Closing Date Balance Sheet and the calculation of the Working Capital Amount).

2.5 Purchase Price Adjustment Based on Changes in Advisory Revenue Run-Rate. The Purchase Price shall be subject to adjustment at the Closing as specified in this Section 2.5.

(a) Purchase Price Adjustment. If the Aggregate Closing Advisory Revenue Run-Rate is less than the Aggregate Base Advisory Revenue Run-Rate, the Purchase Price shall be reduced to the amount that is equal to the product of the Base Purchase Price and a fraction, the numerator of which is the Aggregate Closing Advisory Revenue Run-Rate and the denominator of which is the Aggregate Base Advisory Revenue Run-Rate; provided, however, that if the fraction referred to in the preceding clause is less than eight tenths (0.8), then eight tenths (0.8) shall be used in lieu of such fraction.

(b) Delivery of Statements. At least 20 and no more than 30 days before the Closing Date, Seller shall prepare in good faith and deliver to Purchaser:

(i) an estimate of the Aggregate Closing Advisory Revenue Run-Rate, together with supporting calculations in reasonable detail; and

(ii) an estimate of the reduction in the Base Purchase Price, if any, pursuant to this Section 2.5.

Seller and Seller Parent shall give, and shall cause the Subject Companies and their respective advisers, counsel and accountants to give, Purchaser and its advisers, counsel and accountants full access to the Subject Companies' books, records and personnel needed to enable Purchaser

---

to participate meaningfully in determining the estimate of the Aggregate Closing Advisory Revenue Run-Rate and the estimate of the Base Purchase Price reduction, if any; provided, however, that the auditors and outside accountants of Seller, Seller Parent and the Subject Companies shall not be obligated to make accounting work papers available to Purchaser or its advisers, counsel and outside accountants unless Purchaser has signed a customary agreement relating to access to such accounting work papers in form and substance reasonably acceptable to Seller's, Seller Parent's and the Subject Companies' respective accountants, as applicable.

(c) Delivery of Statements. Promptly following the close of business on the Business Day immediately preceding the Closing Date, Seller shall prepare in good faith and deliver to Purchaser:

(i) a statement showing the Aggregate Closing Advisory Revenue Run-Rate, together with supporting calculations in reasonable detail; and

(ii) a statement of the reduction in the Base Purchase Price, if any, pursuant to this Section 2.5.

Seller and Seller Parent shall give, and shall cause the Subject Companies and their respective advisers, counsel and accountants to give, Purchaser and its advisers, counsel and accountants full access to the Subject Companies' books, records and personnel needed to enable Purchaser to review such statements; provided, however, that the auditors and outside accountants of Seller, Seller Parent or the Subject Companies shall not be obligated to make work papers available to Purchaser or its advisers, counsel and outside accountants unless Purchaser has signed a customary agreement relating to access to such

accounting work papers in form and substance reasonably acceptable to Seller, Seller Parent, or the Subject Companies, as applicable, and their respective accountants, as applicable.

(d) Disputes. If Purchaser disputes the statements delivered by Seller pursuant to Section 2.5(c), the Closing shall proceed based on the statements delivered by Seller and such dispute thereafter shall be resolved as follows. Seller and Purchaser shall first attempt to reconcile their differences, and any resolution by them as to any disputed amounts or calculations shall be final, binding and conclusive on the parties hereto. If Seller and Purchaser are unable to reach a resolution with such effect within 10 Business Days, Seller and Purchaser shall submit the items remaining in dispute for resolution to the Accounting Firm, which shall, within 15 Business Days after such submission, determine and report to Seller and Purchaser upon such remaining disputed items or calculations, and such report shall be final, binding and conclusive on Seller and Purchaser; provided that in no event shall the Accounting Firm's determination of such remaining disputed items or calculations be for an amount that is outside the range of the Purchaser's and Seller's disagreement. Purchaser and Seller shall make reasonably available to the Accounting Firm all relevant books and records, any work papers (including those of the parties' respective accountants, to the extent applicable) and supporting documentation relating to the determination of the Aggregate Closing Advisory Revenue Run-Rate and the reduction in the Purchase Price, if any; provided, however, that the parties' outside accountants shall not be obligated to make work papers available to the Accounting Firm unless the Accounting Firm has signed a customary agreement relating to access to such work papers in

form and substance reasonably acceptable to such accountants. The fees and disbursements of the Accounting Firm shall be borne by Purchaser and Seller in proportion to the relative differences between their respective calculations of the remaining disputed items or calculations and the aggregate amount of such remaining disputed items or calculations as determined by the Accounting Firm.

(e) Purchase Price Adjustment. The reduction in the Purchase Price, if any, shall be deemed final for purposes of this Section 2.5 upon the earliest of (i) the failure of Purchaser to notify Seller of a dispute within 45 days following the Closing Date, (ii) the resolution of all disputes, pursuant to Section 2.5(d), by Seller and Purchaser or (iii) the resolution of all disputes, pursuant to Section 2.5(d), by the Accounting Firm. Any amount that is disputed by Purchaser but paid to Seller at Closing and thereafter resolved in favor of Purchaser shall be promptly paid by Seller to Purchaser. Any payments required to be made by Seller pursuant to Section 2.5 shall be accompanied by cash interest thereon calculated from the Closing through the date of payment at the prime lending rate prevailing during such period as published in The Wall Street Journal. The provisions in this Section 2.5 relating to resolutions of disputes by an Accounting Firm are not intended to and shall not be interpreted to require that the parties refer to such a firm (i) any dispute arising out of a breach by one of the parties of its obligations under this Agreement or (ii) any dispute the resolution of which requires the construction or interpretation of this Agreement (apart from the mathematical calculation of the reduction in the Purchase Price pursuant to this Section 2.5).

2.6 Make-Whole Purchase Price Adjustment. The Purchase Price shall be subject to further adjustment after the Closing as specified in this Section 2.6.

(a) Make-Whole Calculation. As promptly as practicable, but in any event within 60 days following the end of each of the Make-Whole Years, Purchaser shall deliver to Seller a calculation (the "Make-Whole Calculation"), with reasonable supporting documentation, of the following items for such period: Selected AUM; Selected Annual Fee Revenue; Purchaser's Retail Mutual Fund AUM; Purchaser's Retail Mutual Fund Annual Fee Revenue; and the Make-Whole Payment, if any. In addition, Purchaser shall deliver to Seller a preliminary, quarterly calculation of such amounts within 45 days after the end of each of the first three quarterly periods during each of the Make-Whole Years; provided, that such quarterly calculations shall be for information purposes only. The Selected AUM and the Purchaser's Retail Mutual Fund AUM shall be derived from the books and records of Purchaser and its Subsidiaries for the relevant periods of determination. Seller and Seller Parent shall assist and cooperate with Purchaser in all commercially reasonable respects in the calculation of such items, including by providing Purchaser with reasonable access to any relevant personnel, books and records in the possession of Seller, Seller Parent or any of their Affiliates.

(b) Disputes. (i) Seller and its accountants shall be provided with reasonable access to the work papers of Purchaser and its accountants and to the books and records of the Purchaser and its Subsidiaries in connection with its review of the Make-Whole Calculation delivered by Purchaser pursuant to Section 2.6(a); provided, however, that Purchaser's outside accountants shall not be obligated to make work papers available to Seller or its accountants unless Seller and its outside accountants have signed a customary agreement relating to access to

such work papers in form and substance reasonably acceptable to Purchaser and Purchaser's outside accountants.

(ii) Seller may dispute any amounts on the Make-Whole Calculation by notifying Purchaser in writing of any such disputed amounts or calculations and setting forth, in reasonable detail, the basis for such dispute within 30 days of Seller's receipt of the Make-Whole Calculation from Purchaser. In the event of such a dispute, Seller and Purchaser shall attempt to reconcile their differences, and any resolution by them as to any disputed amounts or calculations shall be final, binding and conclusive on the parties hereto. If Seller and Purchaser are unable to reach a resolution with such effect within 30 days after the receipt by Purchaser of Seller's written notice of dispute, Seller and Purchaser shall submit the items remaining in dispute for resolution to the Accounting Firm, which shall, within 45 days after such submission, determine and report to Seller and Purchaser upon such remaining disputed items or calculations, and such report shall be final, binding and conclusive on Seller and Purchaser; provided that in no event shall the Accounting Firm's determination of such remaining disputed items or calculations be for an amount that is outside the range of the Purchaser's and Seller's disagreement. Purchaser and Seller shall make reasonably available to the Accounting Firm all relevant books and records, any work papers (including those of the parties' respective accountants, to the extent applicable) and supporting documentation relating to the Make-Whole Calculation; provided, however, that the parties' outside accountants shall not be obligated to make work papers available to the Accounting Firm unless the Accounting Firm has signed a customary agreement relating to access to such work papers in form and substance reasonably acceptable to such accountants. The fees and disbursements of the Accounting Firm shall be borne by Purchaser and Seller in proportion to the relative differences between their respective calculations of the remaining disputed items or calculations and the aggregate amount of such remaining disputed items or calculations as determined by the Accounting Firm.

(c) Make-Whole Purchase Price Adjustment. The calculation of the amount of the Make-Whole Payment shall be deemed final for the purposes of this Section 2.6 upon the earliest of (i) the failure of Seller to notify Purchaser of a dispute within 30 days of Seller's receipt of the Make-Whole Calculation for the applicable period from Purchaser, (ii) the resolution of all disputes, pursuant to Section 2.6(b), by Seller and Purchaser or (iii) the resolution of all disputes, pursuant to Section 2.6(b), by the Accounting Firm. Within three Business Days of any calculation of the amount of the Make-Whole Payment being deemed final, Seller shall pay to Purchaser an amount equal to the finally determined Make-Whole Payment in cash by wire transfer of immediately available federal funds to such bank account(s) as shall be designated in writing by Purchaser.

(d) Make-Whole Reconciliation Amount. If any Make-Whole Payment is paid by Seller to Purchaser pursuant to Section 2.6(c) above in respect of any Make-Whole Year, then within 10 Business Days following the date on which the Make-Whole Payment for the Make-Whole Year ending on the fourth anniversary of Closing becomes final as provided in Section 2.6(c), Purchaser shall deliver to Seller a calculation of the Make-Whole Reconciliation

---

Amount. The calculation of the Make-Whole Reconciliation Amount shall use the final calculations for each Make-Whole Payment and related items as finally determined pursuant to Section 2.6(c) above. Within three Business Days of the delivery of the calculation of the Make-Whole Reconciliation Amount, Purchaser shall pay to Seller an amount equal to the finally determined Make-Whole Reconciliation Amount, if any, in cash by wire transfer of immediately available federal funds to such bank account(s) as shall be designated in writing by Seller.

2.7 Post-Closing True-Up. (a) If (i) (x) Fund Shareholder Approval was not obtained with respect to any Sponsored Fund or (solely to the extent that approval of the shareholders of a Sub-Advised Fund is required under Section 15 of the Investment Company Act, as determined by the sponsor of such Sub-Advised Fund) Sub-Advised Fund, or (y) any Separate Account Consent was not obtained prior to Closing, (ii) the Purchase Price was adjusted at Closing pursuant to Section 2.5 as a result of the failure to obtain such Fund Shareholder Approval or Separate Account Consent, as the case may be, and (iii) on or prior to the 120th day after the Closing Date any such Fund Shareholder Approval or Separate Account Consent is obtained and in full force and effect as of the 120th day after the Closing Date, then Purchaser shall pay to Seller, on the 130th day after the Closing Date, an amount equal to the excess, if any, of (I) the Purchase Price that would have been paid if the Aggregate Closing Advisory Revenue Run-Rate had been calculated as provided in Section 2.7(b) and assuming that such Fund Shareholder Approval or Separate Account Consent, as the case may be, had been obtained prior to Closing over (II) the Purchase Price that was paid at Closing, provided that in no event shall Purchaser be obligated to pay Seller, in respect of any Fund Shareholder Approval or Special Client Consent, an amount in excess of the lesser of (s) the reduction of the Purchase Price pursuant to Section 2.5 attributable to the relevant Sponsored Fund, Sub-Advised Fund or Special Account Client, as the case may be, and (t) the amount of the increase in the Purchase Price pursuant to this Section 2.7 that is attributable to the specific Sponsored Fund, Sub-Advised Fund or Special Account Client, as the case may be.

(b) For purposes of calculating the Aggregate Closing Advisory Revenue Run-Rate in respect of the relevant Sponsored Funds, Sub-Advised Funds and Separate Account Clients to which this Section 2.7 applies: (A) references to the Closing and the Closing Date in the definitions of Aggregate Closing Advisory Revenue Run-Rate and Closing Adjusted Assets Under Management shall be deemed to be references to the Business Day immediately following the date that the relevant Fund Shareholder Approval or Separate Account Consent is obtained; and (B) references to the Closing in the definition of Adjusted Closing Fee Rate shall be deemed to be references to the Business Day immediately following the later of (u) the date that the relevant Fund Shareholder Approval or Separate Account Consent is obtained and (v) the date that any new Advisory Contract or merger, as the case may be, takes effect.

(c) The procedures for resolving disputes between Seller and Purchaser set forth in Section 2.5(d) shall apply, *mutatis mutandis*, to any disputes arising under this Section 2.7.

Article III
CLOSING DATE

3.1 Closing Date. Unless this Agreement shall have theretofore been terminated and the transactions herein abandoned pursuant to Section 9.1, subject to the provisions of Article VIII, the closing (the "Closing") of the purchase and sale of the Stock provided for in Article II shall take place at the offices of Simpson Thacher & Bartlett LLP, 425 Lexington Avenue, New York, New York, as of 4:01 p.m., New York City time, on the last Business Day of the first calendar month during which all conditions set forth in Sections 8.1, 8.2 and 8.3 (other than conditions relating to delivery of certificates at the Closing) are satisfied or waived at least two (2) Business Days prior to such calendar month-end, or at such other place and time and on such other date as the parties may agree in writing, in either such case provided that all conditions set forth in Sections 8.1, 8.2 and 8.3 remain satisfied or waived as of the Closing. The date on which the Closing occurs is herein called the "Closing Date".

Article IV
REPRESENTATIONS AND WARRANTIES OF SELLER

Except as set forth in the Seller Disclosure Letter, Seller and Seller Parent, jointly and severally, represent and warrant to Purchaser and Purchaser Parent, as of the date hereof and as of the Closing Date, that:

4.1 Organization, Power, etc. (a) Each of Seller and Seller Parent is a corporation duly incorporated, validly existing and in good standing under the laws of its jurisdiction of incorporation.

(b) Each of the Subject Companies has been duly incorporated or organized and is validly existing and in good standing under the laws of its jurisdiction of incorporation or organization. Where applicable, each of the Subject Companies is duly qualified or licensed as a foreign corporation or other entity to do business and is in good standing in each jurisdiction in which the nature of its business or properties makes such qualification or license necessary, and each of the Subject Companies has full power and authority necessary to own all of its properties and assets and to carry on its business as it is now being conducted, except where failure to be so qualified, licensed or in good standing or to have such power or authority (as applicable) would not reasonably be

expected to have a Material Adverse Effect. True and complete copies of the certificate of incorporation and bylaws of the Company and each of its Subsidiaries, as in effect as of the date hereof, have heretofore been delivered or made available to Purchaser.

4.2 Authority Relative to Agreements. Each of Seller, Seller Parent and any Affiliate of Seller which is to be a party to an Ancillary Agreement, as applicable, has the corporate power and authority to execute and deliver this Agreement and the Ancillary Agreements, to perform its obligations hereunder and thereunder, and to consummate the transactions contemplated hereby and thereby. The execution and delivery by each of Seller, Seller Parent and any Affiliate of Seller which is to be a party to an Ancillary Agreement, as applicable, of this Agreement and the Ancillary Agreements, the performance of its obligations hereunder and thereunder and its consummation of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action. This Agreement has been,

and the Ancillary Agreements upon their execution and delivery at Closing will have been, duly and validly executed and delivered by Seller, Seller Parent and any Affiliate of Seller which is to be a party to an Ancillary Agreement, as applicable, and, assuming the due authorization, execution and delivery by Purchaser or its Affiliates party thereto, constitute their legal and binding obligations, enforceable against them in accordance with their terms, except as may be affected by bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium and other similar laws relating to or affecting creditors' rights generally and general equitable principles.

4.3 Non-Contravention. The execution and delivery of this Agreement by Seller and Seller Parent do not, and the execution and delivery of the Ancillary Agreements by Seller, Seller Parent and any Affiliate of Seller which is to be a party to an Ancillary Agreement, as applicable, will not, and their consummation of the transactions contemplated hereby and thereby, and their performance of the obligations which they are obligated to perform or cause to be performed hereunder and thereunder will not: (a) violate any provision of the certificate of incorporation or by-laws or other organizational documents of any of them or of any Subject Company or Sponsored Fund; or (b) assuming that all consents, authorizations, orders or approvals of, filings or registrations with, and notices to, any national, state or local government or political subdivision thereof, any entity, authority or body exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government, any court, tribunal or arbitrator, and any self-regulatory organization ("Governmental Authority") referred to in Section 4.4(a), all Third Party Consents referred to in Section 4.4(b) of the Seller Disclosure Letter, and all Client Consents of Advisory Clients contemplated by Section 6.3 have been obtained or, in the case of filings, registrations and notices, made, (i) conflict with or violate any law, regulation, rule, order, judgment or decree of any Governmental Authority ("Applicable Law"), (ii) except as set forth in Section 4.3 of the Seller Disclosure Letter, require the consent of or other action by any Person under, violate, result in the termination or acceleration of or of any right under, give rise to or modify any right or obligation under (whether or not in combination with any other event or circumstance), or conflict with, breach or constitute a default under (in each case with or without notice, the passage of time or both), any mortgage, indenture, lease, license, note, contract, agreement, commitment, Benefit Plan or other instrument or arrangement (each a "Contract") to which any of them or any Subject Company or Sponsored Fund is a party or by which any of their respective properties or other assets is bound or (iii) result in the creation of any Lien on the Stock or any of the stock, assets or properties of any Subject Company or any Sponsored Fund, except, in the case of clauses (ii) and (iii), for any such violation, termination, acceleration, conflict, default or Lien as would not reasonably be expected to have a Material Adverse Effect.

4.4 Consents, etc. (a) Except for (i) the filing of notice under the Hart-Scott-Rodino Antitrust Improvements Act of 1976 ("HSR Act"), and the expiration or early termination of the applicable waiting period, and (ii) as described in Section 4.4(a) of the Seller Disclosure Letter, no consent, authorization, order or approval of, filing or registration with, or notice to, any Governmental Authority (collectively, "Governmental Approvals") is required for the execution and delivery of this Agreement and the Ancillary Agreements by Seller, Seller Parent or any Affiliate of Seller, as applicable, the performance by them of their respective obligations hereunder and thereunder and their consummation of the transactions contemplated hereby and thereby, except in any such case for any such Governmental Approvals the failure of

which to be obtained or, in the case of filings, registrations and notices, made would not, individually or in the aggregate, reasonably be expected to have a Material Adverse Effect.

(b) Except as described in Section 4.4(b) of the Seller Disclosure Letter or as contemplated by Section 6.3 hereof, no consent, authorization, approval or waiver from or notice to any party (other than a Governmental Authority) to any Contract (collectively, "Third Party Consents") to which Seller, Seller Parent, any Affiliate of Seller or any Sponsored Fund is a party or by which any of their respective properties are bound is required for the execution and delivery of this Agreement and the Ancillary Agreements by Seller, Seller Parent or any Affiliate of Seller, as applicable, the performance by them of their respective obligations hereunder and thereunder and their consummation of the transactions contemplated hereby and thereby, except in any such case for any such Third Party Consent the failure of which to be obtained or made would not reasonably be expected to have a Material Adverse Effect.

4.5 Title to Stock. Upon the delivery and payment for the Stock as contemplated herein, Seller will transfer to Purchaser good and valid title to the Stock, free and clear of any Liens (other than Liens created or incurred by Purchaser or any of its Affiliates). The Stock has been duly authorized and validly issued and is fully paid and nonassessable.

4.6 Capital Stock of the Subject Companies. (a) The authorized capital stock of the Company consists of 10,000 shares of common stock, par value $0.25 per share, of which 3,974 shares are issued and outstanding and owned, beneficially and of record, by Seller, free and clear of any Liens. There are no outstanding obligations, warrants, options or other rights to subscribe for or purchase from the Company, Seller or Seller Parent, or any of their Affiliates, or other contracts or commitments providing for the issuance of or granting any Person the right to acquire, shares of any class of stock of the Company, or any securities or other instruments convertible into or exchangeable or exercisable for shares of any class of stock of the Company. There are no outstanding (i) voting trusts, proxies or other similar agreements or understandings to which the Company or any of its Subsidiaries is a party or by which the Company or any of its Subsidiaries is bound with respect to the voting of any shares of capital stock of or other voting or equity interests in the Company or any of its Subsidiaries or (ii) contractual obligations or commitments of any character restricting the transfer of, or requiring the registration for sale of, any shares of capital stock of or other voting or equity interests in the Company or any of its Subsidiaries.

(b) Section 4.6(b) of the Seller Disclosure Letter sets forth, as to each Subsidiary of the Company, its jurisdiction of organization. All of the outstanding shares of capital stock of each Subsidiary of the Company are validly issued, fully paid and non-assessable and are wholly-owned by the Company, free and clear of any Liens, except as otherwise set forth in Section 4.6(b) of the Seller Disclosure Letter. There are no outstanding obligations, warrants, options or other rights to subscribe for or purchase from any such Subsidiary, or other contracts or commitments providing for the issuance of or granting any Person the right to acquire, shares of any class of stock of any Subsidiary of the Company, or any securities or other instruments convertible into or exchangeable or exercisable for shares of any class of stock of any Subsidiary of the Company.

(c) Except as set forth in Section 4.6(c) of the Seller Disclosure Letter, neither the Company nor any of its Subsidiaries owns any shares of capital stock of or other voting or equity interests in (including any securities exercisable or exchangeable for or convertible into capital stock of or other voting or equity interests in) any other Person.

4.7 Company Financial Statements; Accounting Controls. (a) The Company's consolidated statements of financial condition and the related consolidated statements of operations and comprehensive income, retained earnings and cash flows (including, in each case, any related notes thereto and the reports of the Company's independent auditors thereon) for fiscal periods commencing on or after January 1, 2003 set forth in Section 4.7 of the Seller Disclosure Letter (collectively, the "Company Financial Statements") were prepared in accordance with GAAP applied on a consistent basis throughout the periods involved (except as may be set forth in the notes thereto, and except for the absence of footnotes in financial statements for interim periods), and fairly present in all material respects the consolidated financial position of the Company and its Subsidiaries at the respective dates thereof and the consolidated results of their operations and cash flows at and for the periods indicated (subject, in the case of financial statements for interim periods, to normal year-end adjustments which will not be material to the Company and its Subsidiaries, taken as a whole).

(b) The Company and its Subsidiaries have devised and maintained systems of internal accounting controls with respect to the Business sufficient to provide reasonable assurances that (i) all transactions are executed in accordance with management's general or specific authorization, (ii) all transactions are recorded as necessary to permit the preparation of financial statements in conformity with GAAP and to maintain proper accountability for items, (iii) access to their property and assets is permitted only in accordance with management's general or specific authorization and (iv) the recorded accountability for items is compared with the actual levels at reasonable intervals and appropriate action is taken with respect to any differences.

(c) The Company Financial Statements accurately reflect in the aggregate all amounts charged to the Subject Companies for services provided by Seller, Seller Parent or any of their Affiliates (other than the Subject Companies) to the Subject Companies (including, without limitation, any migration of information technology systems to systems of the the Seller or Seller Parent or any of their Affiliates (other than the Subject Companies)), whether in connection with the operation of the Business or otherwise, including all amounts charged that relate to the individuals listed on Section 4.7(c)(i) of the Seller Disclosure Letter. Section 4.7(c)(ii) of the Seller Disclosure Letter contains an accurate list of all such services. Such amounts charged were not less than the actual costs incurred by Seller, Seller Parent and their Affiliates in providing such services.

(d) The reports set forth in Section 4.7(d) of the Seller Disclosure Letter are accurate in all material respects and all of the data set forth therein have been derived from the books and records of the Subject Companies.

4.8 Litigation. Except as set forth in Section 4.8 of the Seller Disclosure Letter, there is no action, suit or proceeding pending or, to the Knowledge of Seller, threatened against any Subject Company or Registered Fund Client before any Governmental Authority or

arbitrator that would reasonably be expected to be material to the Subject Companies, taken as a whole, or prohibit or materially impair the ability of Seller Parent or Seller to consummate the transactions contemplated hereby or perform their respective obligations hereunder on a timely basis. Except as set forth in Section 4.8 of the Seller Disclosure Letter, there are no settlement agreements or similar written agreements with any Governmental Authority and there are no outstanding judgments, decrees, injunctions or orders of any Governmental Authority to which any of the Subject Companies, any of the Sponsored Funds or, to the Knowledge of Seller, any of the Sub-Advised Funds is subject or by which any of their respective assets or properties is bound or affected that would reasonably be expected to have a Material Adverse Effect.

4.9 Compliance with Laws; Permits and Licenses. The operations of each of the Subject Companies are being and, since January 1, 2003, have been, conducted in compliance with all Applicable Laws, except where the failure to so comply would not reasonably be expected to have a Material Adverse Effect, and, to the Knowledge of Seller, none of the Subject Companies has been charged or is or has been since January 1, 2003 under investigation with respect to any material violations of any Applicable Laws. Each of the Subject Companies holds all permits, certificates, licenses, approvals, orders and other authorizations ("Permits") of each Governmental Authority which are necessary for the operation of the Business, except where the failure to hold any such Permit would not reasonably be expected to have a Material Adverse Effect. Except as set forth in Section 4.9 of the Seller Disclosure Letter, (i) the material Permits are valid and in full force and effect, (ii) neither the Company nor any of its Subsidiaries is in default under, and no condition exists that with notice or lapse of time or both would constitute a default under, the material Permits and (iii) none of the material Permits will be terminated or impaired or become terminable, in whole or in part, as a result of the transactions contemplated hereby. Except as set forth in Section 4.9 of the Seller Disclosure Letter, since January 1, 2004, none of the Subject Companies has received any written or, to the Knowledge of Seller, oral notification from any Governmental Authority asserting that any Person is not in compliance with any of the statutes, regulations or ordinances that such Governmental Authority enforces or that such Governmental Authority intends to revoke or suspend any Permit, except where such noncompliance, revocation or suspension would not reasonably be expected to have a Material Adverse Effect.

4.10 Absence of Certain Changes; No Undisclosed Liabilities. (a) Since December 31, 2005, there has been no change, event or development affecting the Subject Companies which has had or would reasonably be expected to have a Material Adverse Effect. Since December 31, 2005, no event or circumstance has occurred or arisen that, if it occurred or arose between the date hereof and Closing, would constitute a breach of Section 6.1.

(b) Except as contemplated by this Agreement or as set forth in Section 4.10(b) of the Seller Disclosure Letter, and except to the extent of (i) liabilities disclosed or reserved for in the Company Financial Statements and (ii) liabilities incurred by the Subject Companies after December 31, 2005 in the ordinary course of business consistent with past practice that have not had and would not reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, the Subject Companies do not have any liabilities or obligations (known, unknown, accrued, absolute, contingent or otherwise).

4.11 Personnel and Employee Benefits Matters. (a) Section 4.11(a) of the Seller Disclosure Letter sets forth a complete and correct list of all employees of and consultants to any of the Subject Companies (identified separately as employees or consultants, as appropriate, and indicating each employee who is on an approved leave of absence) as of the Business Day before the date hereof. As of the date of this Agreement, no officer of any of the Subject Companies has provided any of the Subject Companies with notice of termination of employment or, to the Knowledge of Seller, intends to terminate employment with any of the Subject Companies. Each employee of the Subject Companies has been properly classified as "exempt" or "non-exempt" for all purposes under Applicable Law (including, but not limited to, the Fair Labor Standards Act).

(b) Section 4.11(b) of the Seller Disclosure Letter sets forth a list of each (i) "employee benefit plan" (within the meaning of Section 3(3) of ERISA), (ii) severance, deferred compensation, change in control and employment plan, program or agreement and (iii) vacation, incentive, bonus, stock option, stock purchase, deferred compensation and restricted stock plan, program or policy sponsored, maintained or contributed to by any of the Subject Companies, Seller Parent, Seller or any of their Affiliates, in which present or former employees of the Subject Companies participate or are eligible to participate (collectively, "Benefit Plans").

(c) With respect to each Benefit Plan, to the extent applicable to any such Benefit Plan, Seller has provided or made available to Purchaser (i) true and complete copies of all written Benefit Plans; (ii) written descriptions of all unwritten Benefit Plans; (iii) any and all trust agreements; insurance contracts or other funding arrangements; (iv) the most recent IRS determination letter; (v) the current summary plan description; (vi) all material communications received from or sent to the Internal Revenue Service ("IRS"), the Pension Benefit Guaranty Corporation or the Department of Labor (including a written description of any oral communication); and (vii) any and all amendments and modifications to any such document.

(d) The Benefit Plans are in compliance with all applicable requirements of ERISA, the Code, and other Applicable Laws and have been administered in accordance with their terms and such laws, in each case in all material respects. Each Benefit Plan that is intended to be qualified within the meaning of Section 401 of the Code has received a favorable determination letter as to its qualification, and nothing has occurred that would reasonably be expected to adversely affect such qualification.

(e) Except for ordinary and usual claims for benefits by participants and beneficiaries, there are no pending or, to the Knowledge of Seller, threatened claims and no pending or, to the Knowledge of Seller, threatened litigation with respect to any Benefit Plan.

(f) Except as expressly provided in this Agreement or as set forth in Section 4.11(f) of the Seller Disclosure Letter, none of the Seller, the Seller Parent or any of the Subject Companies has any commitment, intention or understanding to create, modify or terminate any Benefit Plan prior to the Closing Date. All contributions required to be made to or in respect of each Benefit Plan have been made on a timely basis and in accordance with the terms of such plan or Applicable Law, and all liabilities in respect of any such Benefit Plan have been accrued in accordance with GAAP. No Subject Company has incurred or would reasonably be expected to incur any material liability (other than with respect to the payment of premiums) under Title

---

IV of ERISA in connection with any Benefit Plan. No asset of the Subject Companies is subject to any Lien arising under Section 302(f) of ERISA or Section 412(n) of the Code and no event has occurred and no condition or circumstance has existed that could give rise to any such lien. None of the Subject Companies is required to provide any security under Section 307 of ERISA or Section 401(a)(29) or 412(f) of the Code and, to the Knowledge of Seller, no event has occurred and no condition or circumstance has existed that could reasonably be expected to give rise to any such requirement to provide any such security.

(g) Except as set forth in Section 4.11(g) of the Seller Disclosure Letter or as accrued or disclosed in the books and records of the Subject Companies, none of the Seller, Seller Parent, or any of the Subject Companies maintains any Benefit Plan providing for post-employment or retiree health, life insurance and/or other welfare benefits having unfunded liabilities, and none of the Seller, Seller Parent, or any of the Subject Companies has any obligation to provide any such benefits to any retired or former employees of the Subject Companies following such employees' retirement or termination of service, except to the extent provided by Part 6 of Subtitle I of ERISA or Section 4980B of the Code.

(h) Except as set forth in Section 4.11(h) of the Seller Disclosure Letter, the execution of this Agreement and the Ancillary Agreements and the consummation of the transactions contemplated hereby and thereby do not and will not constitute a triggering event under any Benefit Plan or otherwise that (either alone or upon the occurrence of any additional or subsequent event) will or may result in any payment (whether of severance pay or otherwise), acceleration, vesting or increase in benefit to any employee or former employee or director of the Subject Companies.

4.12 Taxes. Except as set forth in Section 4.12 of the Seller Disclosure Letter: (a)(i) all material Tax Returns required to be filed by or with respect to each Subject Company have been timely filed and all such Tax Returns are true and complete in all material respects; (ii) all material Taxes required to be paid by or with respect to each Subject Company have been timely paid; and (iii) there are no pending or, to the Knowledge of Seller, threatened actions or proceedings for the assessment or collection of any material Taxes against or with respect to any of the Subject Companies.

(b) Since January 1, 2000, each Subject Company has been a member of the affiliated group (within the meaning of Section 1504(a) of the Code) of which Seller Parent is the common parent.

(c) All Taxes required to be withheld by or with respect to any of the Subject Companies have been timely withheld and paid to the proper taxing authority.

(d) There are no Liens for Taxes (other than Permitted Liens) on any assets of the Subject Companies.

(e) (i) None of the Subject Companies is a party to or has any obligations or liabilities arising pursuant to any Tax sharing, allocation, indemnification or similar agreement, and (ii) since January 1, 2000, none of the Subject Companies has been a member of a

consolidated, combined or other affiliated group for the purposes of filing any Tax Return or has been subject to any transferee liabilities.

(f) No extension or waiver of the statute of limitations has been granted for any Tax Return relating to any Subject Company, that (after giving effect to such extension or waiver) has not yet expired.

(g) (i) None of the Tax Returns relating to any Subject Company is currently under any audit or examination by any taxing authority, (ii) no notification has been received that such an audit or examination is pending or threatened, (iii) since January 1, 2000, no issues have been raised in writing by any taxing authority with respect to Taxes relating to any Subject Company, (iv) no power of attorney that is currently in force has been granted by or with respect to any Subject Company with respect to any matter relating to Taxes, and (v) there is no advance ruling from or similar agreement with, a taxing authority that would affect the Tax liability of any of the Subject Companies after the Closing.

(h) To the Knowledge of Seller, all contracts sold, distributed, issued or administered by any Subject Company in connection with any plan described in Sections 401, 403, 408, or 457 or any similar provision of the Code or an employee benefit plan within the meaning of ERISA are in compliance in all material respects with all applicable Code and ERISA requirements and the terms of such contracts and selling or offering documents relating thereto.

(i) To the Knowledge of Seller, all financial products, life insurance, annuity or other contracts sold, distributed, issued or administered by any Subject Company have been sold, distributed, issued, and administered by the Subject Company and its Affiliates in accordance in all material respects with all Applicable Laws, including, without limitation, the Code and ERISA, and the terms of such products, insurance, annuity or contracts and selling or offering documents relating thereto.

(j) None of the Subject Companies has participated (within the meaning of Treasury Regulation Section 1.6011-4(c)) in or has been a "material advisor" (within the meaning of Section 6111 of the Code and the Treasury Regulations promulgated thereunder) with respect to any "reportable transaction" (within the meaning of Section 6707A(c) of the Code and the Treasury Regulations promulgated under Section 6011 of the Code).

4.13 Properties.

(a) Title to Assets, Etc. The Company and its Subsidiaries have good and valid title to, or otherwise have the right to use pursuant to a valid and enforceable lease, license or similar contractual arrangement or, to the extent set forth on Section 4.13 of the Seller Disclosure Letter or so indicated in Section 4.7(c) of the Seller Disclosure Letter, an administrative services agreement, all of the assets (real and personal, tangible and intangible, including all Intellectual Property) that are used or held for use in connection with the Business or are reflected on the balance sheet included in the most recent Company Financial Statements (collectively, the "Assets"), except for accounts receivable collected since the date of such

balance sheet in the ordinary course of business consistent with past practice, in each case free and clear of any Lien other than Permitted Liens.

(b) Sufficiency of Assets, Etc. The Assets constitute all of the assets required for or used in the conduct of the Business. The Assets are in good repair and operating condition, subject only to ordinary wear and tear, and are adequate and suitable for the purposes for which they are presently being used or held for use. To the Knowledge of Seller, there are no facts or conditions affecting any material Assets that would reasonably be expected, individually or in the aggregate, to interfere with the use, occupancy or operation of such Assets.

(c) Real Property. A Subject Company has a valid and enforceable leasehold interest in each of the leased premises in which the Subject Companies currently conduct the Business (the "Leased Real Property"), except as may be affected by bankruptcy, insolvency, reorganization, moratorium and other similar laws relating to or affecting creditors' rights generally or general equitable principles. As of the date hereof, there is no material default (or event or circumstance which, with the giving of notice or lapse of time, would constitute such a default) by the lessee or, to the Knowledge of Seller, the lessor under any such lease. The use and operation of the Leased Real Property in the conduct of the Business do not violate in any material respect any Applicable Law, covenant, condition, restriction, easement, Permit or agreement. None of the Subject Companies owns any real property in fee simple.

4.14 Certain Labor Matters. None of the Subject Companies is a party to any collective bargaining agreement and there are no labor unions or other organizations representing, purporting to represent or, to the Knowledge of Seller, attempting to represent any employees of the Subject Companies. There is no pending or, to the Knowledge of Seller, threatened strike, slowdown, picketing, work stoppage, concerted refusal to work overtime or other similar labor activity with respect to any employees of the Subject Companies. To the Knowledge of Seller, there are no labor controversies pending against any of the Subject Companies which would reasonably be expected to have a Material Adverse Effect.

4.15 Material Agreements. Section 4.15 of the Seller Disclosure Letter identifies each Material Contract to which any Subject Company or Sponsored Fund is a party or by which any of their assets or properties are bound or affected as of the date of this Agreement (provided that Seller need not so identify a Distribution Agreement described in clause (ii) of the definition of Material Contract or any agreement described in the second proviso of the definition of Material Contract unless such Distribution Agreement or such other agreement required aggregate payments by the Subject Companies in excess of $100,000 (excluding "adviser paid fees" and 12b-1 fees) for the 12 months ended March 31, 2006) and Seller has made available to Purchaser prior to the date of this Agreement a true and correct copy of each Material Contract identified in Section 4.15 of the Seller Disclosure Letter. The Material Contracts required to be identified in Section 4.15 of the Seller Disclosure Letter (without limitation to what constitutes a Material Contract for any

other purpose hereof) include Distribution Agreements relating to at least 90% of the revenue sharing payments (excluding "adviser paid fees" and 12b-1 fees) for the twelve months ended March 31, 2006 and at least sixty percent (60%) of the assets under management by the Subject Companies and the Sponsored Funds as of the date hereof. Except as would not reasonably be expected to have a Material Adverse Effect, each such Material Contract to which any of the Subject Companies or

---

Sponsored Funds is a party or by which any of their assets or properties are bound or affected as of the date of this Agreement is in full force and effect, is a legal and binding obligation of the applicable Subject Company or Sponsored Fund and, to the Knowledge of Seller, each of the other parties thereto, in each case enforceable in accordance with its terms, except as may be affected by bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium and other similar laws relating to or affecting creditors' rights generally or general equitable principles. No condition exists or event has occurred which (whether with or without notice or lapse of time or both) would constitute a breach or default (or is alleged to constitute a breach or default) by any of the Subject Companies or Sponsored Funds or, to the Knowledge of Seller, any other party thereto under, or result in a right of termination of (and no notice of any intent to terminate has been received by any of the Subject Companies, Seller or Seller Parent), or give rise to any right to accelerate or otherwise modify any other right or obligation under, any such Material Contract to which any of the Subject Companies or Sponsored Funds is a party or by which any of their assets or properties are bound or affected as of the date of this Agreement, except as would not reasonably be expected to have a Material Adverse Effect.

4.16 Intellectual Property. (a) Section 4.16(a) of the Seller Disclosure Letter lists and separately identifies according to the following categories all Intellectual Property owned (the "Owned Intellectual Property") by any of the Subject Companies or the Sponsored Funds that is registered or subject to an application for registration or that is otherwise material to the Business, all Intellectual Property provided to any Subject Company or Sponsored Fund by Seller, Seller Parent or any of their Affiliates (other than the Subject Companies and the Sponsored Funds) and all agreements to which any of the Subject Companies or Sponsored Funds is a party or by which any of them is otherwise bound or affected that relate to Intellectual Property, including (i) licenses of Intellectual Property to a Subject Company or Sponsored Fund by any other Person, (ii) licenses of Intellectual Property to any other Person by a Subject Company or Sponsored Fund, (iii) agreements otherwise granting or restricting the right to use Intellectual Property and (iv) agreements transferring, assigning, indemnifying with respect to or otherwise relating to Intellectual Property used or held for use in the Business, in each case to the extent material to the Business. Except as set forth in Section 4.16(a) of the Seller Disclosure Letter, as contemplated by Section 6.6, or as would not reasonably be expected to be material to the Business: (a) the Subject Companies own or have the right to use all the Intellectual Property used or held for use in the Business and (b) (i) such Intellectual Property that is registered in the name of any of the Subject Companies is valid and enforceable; (ii) to the Knowledge of Seller, such Intellectual Property is not being infringed or violated by any other Person; and (iii) to the Knowledge of Seller, the conduct of the Business and the use by the Subject Companies or Sponsored Funds of such Intellectual Property do not infringe, conflict with or violate the Intellectual Property of any other Person. To the Knowledge of Seller, none of the Owned Intellectual Property is being infringed or otherwise used or being made available for use by any Person without a license or permission from the Subject Companies, except as set forth in Section 4.16(a) of the Seller Disclosure Letter. The Subject Companies are the exclusive owners of the Owned Intellectual Property set forth in Section 4.16(a) of the Seller Disclosure Letter, free and clear of any Liens other than Permitted Liens. Without limitation, Seller owns or has the right to use any websites maintained or operated in connection with the Business, and, as of Closing, such websites shall be separated from the websites of Seller and Seller Parent and all rights and assets relating thereto shall be transferred to the Company.

(b) Except as set forth in Section 4.16(b) of the Seller Disclosure Letter, the Subject Companies have taken all actions reasonably necessary to ensure full protection of the material Intellectual Property under any Applicable Law (including making and maintaining in full force and effect all necessary filings, registrations and issuances). Each of the Subject Companies has taken all actions reasonably necessary to maintain the secrecy of all confidential Intellectual Property used in the Business. To the Knowledge of Seller, none of the Subject Companies is using any material Intellectual Property in a manner that would reasonably be expected to result in the cancellation or unenforceability of such Intellectual Property.

4.17 Brokers. No broker, investment banker, financial advisor or other Person, other than Morgan Stanley & Co., Incorporated, the fees and expenses of which will be paid by Seller Parent, is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Seller Parent or Seller or any of their Affiliates.

4.18 Regulatory Reports, Registrations and Agreements. (a) Each of the Subject Companies has filed all regulatory reports, schedules, forms, registrations, financial statements, sales literature, statements, notices, filings and other documents, together with any amendments required to be made with respect thereto, that it was required under Applicable Law to file since January 1, 2003 with any Governmental Authority. Except as set forth in Section 4.18(a) of the Seller Disclosure Letter, such filings complied in all material respects with Applicable Law and did not at the time they were filed contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were or are made, not misleading. Except as set forth in Section 4.18(a) of the Seller Disclosure Letter, Seller has made available to Purchaser complete and correct copies of (i) all such filings, (ii) all audit or inspection reports provided by any Governmental Authority in respect of the Subject Companies and all written responses thereto made by the Subject Companies since January 1, 2003 and (iii) all non-routine correspondence relating to any investigation of the Subject Companies by any Governmental Authority since January 1, 2003.

(b) Section 4.18(b) of the Seller Disclosure Letter identifies each Subject Company which is registered or licensed as of the date of this Agreement as (i) a broker-dealer under the Exchange Act or under any similar state or foreign laws, (ii) an investment adviser under the Investment Advisers Act or under any similar state or foreign laws, or (iii) a transfer agent under the Exchange Act or under any similar state or foreign laws, in each case together with a listing of all such registrations and licenses held with all applicable Governmental Authorities. Seller has made available to Purchaser prior to the date of this Agreement a true and correct copy of the Form BD, Form ADV, Form TA-1 or other applicable registration forms of each Subject Company registered in any of the capacities described in the immediately preceding sentence as in effect on the date of this Agreement.

(c) Section 4.18(c) of the Seller Disclosure Letter identifies each no-action letter and exemptive order issued to any of the Subject Companies or Sponsored Funds that remains applicable to its business as conducted on the date of this Agreement. Prior to the date of this Agreement, Seller has made available to Purchaser a true and correct copy of each such no-action letter and exemptive order. The Subject Companies or Sponsored Funds, as

applicable, have complied with all representations, terms and conditions of such no-action letters and exemptive orders necessary to rely on the relief granted thereby.

(d) Each of the Subject Companies that is required to be is, and at all times required by the Investment Advisers Act has been, duly registered as an investment adviser under the Investment Advisers Act. Each of the Subject Companies that is required to be is, and at all times required by Applicable Law (other than the Investment Advisers Act) has been, duly registered, licensed or qualified as an investment adviser in each state or any other jurisdiction where the conduct of its business requires such registration, licensing or qualification. No Subject Company not identified in Section 4.18(b) of the Seller Disclosure Letter (i) is or has been an "investment adviser" within the meaning of the Investment Advisers Act or any other Applicable Law or (ii) is subject to any material liability or disability by reason of any failure to be so registered, licensed or qualified.

(e) Each of the Subject Companies that is required to be is, and at all times required by Applicable Law has been, duly registered, licensed or qualified as a broker or dealer in each jurisdiction where the conduct of its business requires such registration, licensing or qualification. Each such Subject Company is a member in good standing of the NASD Inc. (the "NASD") and such other organizations in which its membership is required by Applicable Law in order to conduct its business as now conducted. No Subject Company that is required to be registered, licensed or qualified as a broker or dealer under any Applicable Law is subject to any material liability or disability by reason of any failure to be so registered, licensed and qualified. No Subject Company not identified in Section 4.18(b) of the Seller Disclosure Letter (i) is or has been a "broker" or "dealer" within the meaning of the Exchange Act or any other Applicable Law or (ii) is subject to any material liability or disability by reason of any failure to be so registered, licensed or qualified.

(f) Each of the Subject Companies that is required to be is, and at all times required by Applicable Law has been, duly registered, licensed or qualified as a transfer agent in each jurisdiction where the conduct of its business requires such registration, licensing or qualification. No Subject Company not identified in Section 4.18(b) of the Seller Disclosure Letter (i) is or has been a "transfer agent" within the meaning of the Exchange Act or any other Applicable Law or (ii) is subject to any material liability or disability by reason of any failure to be so registered, licensed or qualified.

(g) No Subject Company is required to be registered, licensed or qualified as a commodity pool operator, futures commission agent, commodity trading advisor, bank, trust company, real estate broker, insurance company or insurance broker under any Applicable Law or is subject to any liability or disability by reason of any failure to be so registered, licensed or qualified. No Subject Company has received notice of any proceeding concerning any failure to obtain any commodity pool operator, futures commission merchant, commodity trading advisor, bank, trust company, real estate broker, insurance company, insurance broker or transfer agent registration, license or qualification.

(h) The officers and employees of the Subject Companies who are required by Applicable Law to be licensed or registered for the activities conducted by them in respect of the Subject Companies are and at all times since January 1, 2003 have been duly licensed or

registered in each state or jurisdiction in which and with each Governmental Authority with which such licensing or registration is so required. Each such registration or license is in full force and effect. Except as may be disclosed in Forms ADV or BD filed by the Subject Companies and made available to Purchaser prior to the date of this Agreement or set forth in Section 4.18(h) of the Seller Disclosure Letter, none of these individuals is or, since January 1, 2003, has been, subject to any material disciplinary or other material regulatory compliance action or material complaint by a Governmental Authority, a Subject Company, a client or customer.

(i) None of the Subject Companies or, to the Knowledge of Seller, any "affiliated person" (as defined in the Investment Company Act) of any of them is ineligible pursuant to Section 9(a) or 9(b) of the Investment Company Act to serve as an investment adviser (or in any other capacity contemplated in the Investment Company Act) to a registered investment company, and there is no proceeding pending or, to the Knowledge of Seller, threatened that could result in the ineligibility of any of the Subject Companies or any affiliated persons of any of them to serve in any such capacities.

(j) None of the Subject Companies or, to the Knowledge of Seller, any Person who is "associated with" any Subject Company for purposes of the Investment Advisers Act has during the ten years prior to the date of this Agreement been convicted of any crime (other than a misdemeanor traffic violation or similar misdemeanor) or is, or has been during such period subject to, any disqualification that, in either case, would be a basis for denial, suspension or revocation of registration of an investment adviser under Section 203(e) of the Investment Advisers Act or Rule 206(4)-4(b) thereunder, and as of the date of this Agreement, there are no proceedings or investigations pending or, to the Knowledge of Seller, threatened that could result in any such disqualification, denial, suspension or revocation.

(k) None of the Subject Companies or, to the Knowledge of Seller, their associated Persons are ineligible pursuant to Section 15(b) of the Exchange Act to serve as a broker-dealer, and there is no proceeding pending or, to the Knowledge of Seller, threatened which would result in the ineligibility of any of the Subject Companies or any affiliated Person to serve in any such capacities.

(l) None of the Subject Companies or, to the Knowledge of Seller, their associated Persons are ineligible pursuant to Section 17A of the Exchange Act to serve as a transfer agent, as applicable, and there is no proceeding pending or, to the Knowledge of Seller, threatened which would result in the ineligibility of any of the Subject Companies or any affiliated Person to serve in any such capacities.

(m) No Governmental Authority has initiated or, to the Knowledge of Seller, threatened any proceeding against a Subject Company with respect to a violation of Applicable Law. No examination (other than routine examinations in the ordinary course of business that will not result in any material expense for or liability of the Purchaser, any Subject Company or any of their Affiliates) conducted by any Governmental Authority into the Subject Companies' business is ongoing, unresolved or, to the Knowledge of Seller, threatened by any Governmental Authority. None of the Subject Companies has received any notice or communication of any unresolved violation or exception by any Governmental Authority with respect to any report or

statement by any Governmental Authority relating to any examination of any Subject Company, threatening to revoke or condition the continuation of any permit, or restricting or disqualifying their activities. Except as set forth in Section 4.19(m) of the Seller Disclosure Letter, none of the Subject Companies or their associated persons is, or at any time during the past three years has been, (i) subject to any cease and desist, censure or other disciplinary or similar order issued by, (ii) a party to any written agreement, consent agreement, memorandum of understanding or disciplinary agreement with, (iii) a party to any commitment letter or similar undertaking to, (iv) subject to any order or directive by or (v) a recipient of any supervisory letter from, any Governmental Authority.

(n) Each Subject Company that is registered as an investment adviser with the SEC has in effect, and at all times required by Applicable Law has had in effect (i) a written policy regarding insider trading and the protection of material non-public information, (ii) a written code of ethics, as required by Rule 204A-1 under the Investment Advisers Act and, to the extent required, Rule 17j-1 under the Investment Company Act, (iii) policies and procedures with respect to the protection of nonpublic personal information about customers, clients and other third parties designed to assure compliance with Applicable Law ("Privacy Policies"), (iv) a proxy voting policy as required by Rule 206(4)-6 under the Investment Advisers Act, (v) policies and procedures with respect to business continuity plans in the event of business disruptions and (vi) all such other policies and procedures required by Rule 206(4)-7 under the Investment Advisers Act (collectively, "Adviser Compliance Policies"), and has designated and approved an appropriate chief compliance officer in accordance with Rule 206(4)-7. Copies of all such Adviser Compliance Policies have been provided or made available to Purchaser. All such Adviser Compliance Policies comply in all material respects with Applicable Law, including Sections 204A and 206 of the Investment Advisers Act and Section 17(j) of the Investment Company Act, and there have been no material violations or allegations by any employee or client of Seller Parent or any of its Affiliates or any Governmental Authority of material violations of such Adviser Compliance Policies. The policies of each Subject Company with respect to avoiding conflicts of interest, to the extent they are required to be disclosed pursuant to Applicable Law, are as set forth in its most recent Form ADV. Each Subject Company that is registered as a broker or dealer with the SEC has in place, and at all times required by Applicable Law has had in place processes to establish, maintain, review, test and modify written compliance policies and written supervisory procedures reasonably designed to achieve compliance with applicable NASD rules, the rules of any domestic or foreign securities or broker-dealer industry self-regulatory organization ("SRO") of which such Subject Company is a member, and federal securities laws and regulations ("Broker-Dealer Compliance Policies"). Copies of all such Broker-Dealer Compliance Policies have been provided or made available to Purchaser. All such Broker-Dealer Compliance Policies comply in all material respects with Applicable Law, and there have been no material violations or, to the Knowledge of Seller, allegations by any employee or client of Seller Parent or any of its Affiliates or any Governmental Authority of material violations of such Broker-Dealer Compliance Policies.

(o) Each Subject Company has complied with Applicable Law governing the receipt, use or provision of "brokerage and research services" (as such term is defined in Section 28(e) of the Exchange Act) through "soft dollar" arrangements or otherwise.

(p) Each Subject Company has complied in all material respects with all Applicable Law regarding the privacy of clients, customers and other Persons and, to the extent required by Applicable Law, has established and complied with its Privacy Policies.

(q) Each Subject Company, to the extent required by Applicable Law, has adopted and maintains a written anti-money laundering program and a written customer identification program in compliance with Applicable Law and has complied with the terms of such programs in all material respects.

(r) All performance information provided, presented or made available by a Subject Company to any client or potential client or with respect to any Registered Fund Client has complied in all material respects with Applicable Law. Each Subject Company maintains all documentation necessary to form the basis for, demonstrate or recreate the calculation of the performance or rate of return of all accounts that are included in a composite (current and historical performance results) as required by Applicable Law. Any investment performance earned by any Person at a firm other than the Subject Companies and presented by a Subject Company as its business performance has complied in all material respects with Applicable Law.

(s) Since January 1, 2003, there has existed no material unremedied pricing error or similar condition with respect to any Sponsored Fund or Separate Account Client or, to the Knowledge of Seller, any Sub-Advised Fund.

(t) Each Subject Company that is a registered investment adviser has adopted and implemented procedures or practices for the allocation of securities purchased for its clients that comply in all material respects with Applicable Laws, including procedures or practices relating to the allocation between Sponsored Funds and Sub-Advised Funds or other accounts in which Seller Parent, a Subject Company or any other Affiliate of Seller Parent has an interest.

(u) No Subject Company has caused a securities transaction to be effected on behalf of a Registered Fund Client that involved a directed brokerage arrangement that did not comply in all material respects with Applicable Law.

(v) No Subject Company has participated in or facilitated a revenue sharing arrangement based on the distribution of interests in, or on the assets of, a registered investment company that did not comply in all material respects with Applicable Law.

4.19 Certain Fund and Client Matters. (a) Section 4.19(a)(i) of the Seller Disclosure Letter identifies each company, trust, or other entity (or series thereof) registered under the Investment Company Act that is sponsored by any of the Subject Companies, Seller or any of their respective Affiliates as of the date of this Agreement (collectively, the "Sponsored Funds"); Section 4.19(a)(ii) of the Seller Disclosure Letter identifies each investment company (or series thereof) registered under the Investment Company Act that is an Advisory Client as of the date of this Agreement and is sponsored by a Person other than the Subject Companies, Seller or any of their respective Affiliates (collectively, the "Sub-Advised Funds" and, together with the Sponsored Funds, the "Registered Fund Clients"); and Section 4.19(a)(iii) of the Seller Disclosure Letter identifies each Advisory Client as of the date of this Agreement that is not a Registered Fund Client (collectively, the "Separate Account Clients"). Seller has provided or

made available to Purchaser (i) each Advisory Contract between a Subject Company and a Registered Fund Client or that relates to a Registered Fund Client; (ii) the prospectuses, statements of additional information and similar selling or offering documents distributed since January 1, 2003 in connection with offering interests in a Registered Fund Client; (iii) the charter, by-laws and other organizational documents of each Sponsored Fund, including all amendments thereto; (iv) the corporate minutes of the board of directors or trustees of each Sponsored Fund (including any committees thereof) for the period January 1, 2003 through the date of this Agreement; (v) each Administration Contract and Distribution Agreement to which a Sponsored Fund is a party or that relates to a Sponsored Fund; and (vi) any other agreements, contracts and commitments material to a Sponsored Fund's business or operations, except for documents relating to the purchase of specific portfolio investments by or for a Sponsored Fund. Each Sponsored Fund and, to the Knowledge of Seller, each Sub-Advised Fund is, and at all times required under Applicable Law has been, duly registered with all applicable Governmental Authorities as an investment company or a regulated fund or for the purpose of marketing in the applicable jurisdiction. No Separate Account Client is a pooled investment vehicle that relies on an exemption from registration under either Section 3(c)(1) or 3(c)(7) of the Investment Company Act or is a foreign investment company that is not required to register under the Investment Company Act. The Subject Companies have not, since January 1, 2003, sponsored, advised or been involved in the distribution of any pooled investment vehicles that rely on an exemption from registration under either Section 3(c)(1) or 3(c)(7) of the Investment Company Act or are foreign investment companies that are not required to register under the Investment Company Act.

(b) The audited balance sheet of each Sponsored Fund as of December 31, 2005 or October 31, 2005, as applicable, and the related financial statements for the year ended December 31, 2005 or October 31, 2005, as applicable, as reported on by such Sponsored Fund's independent auditors, have been prepared in accordance with GAAP, which has been consistently applied except as otherwise disclosed therein, and present fairly, in all material respects in accordance with GAAP, the financial position and other financial results of such Sponsored Fund at the dates and for the periods stated therein. The unaudited semi-annual financial statements for each Sponsored Fund for its semi-annual period, if any, ended after the date of the most recent annual financial statements for such Sponsored Fund and prior to the date hereof fairly present in all material respects (subject to normal year-end adjustments) the financial position and statement of net assets of such Sponsored Fund for the period then ended in accordance with GAAP applied on a consistent basis except as otherwise disclosed therein. The Subject Companies and the Sponsored Funds have established and maintained disclosure controls and procedures (as defined in Rule 30a-3(c) under the Investment Company Act) and internal control over financial reporting (as defined in Rule 30a-3(d) under the Investment Company Act) for the Sponsored Funds. Such disclosure controls and procedures are designed (i) to ensure that material information relating to the Sponsored Funds is made known to appropriate officers of the Sponsored Funds and (ii) to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements of the Sponsored Funds in accordance with GAAP. Seller has disclosed to Purchaser, and to the Sponsored Funds' auditors and audit committees (i) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect any Sponsored Fund's ability to record, process, summarize, and report financial information; and (ii) any fraud, whether or not material, that involves management or other

employees who have a significant role in any Sponsored Fund's internal control over financial reporting.

(c) Each Sponsored Fund has all Permits and has made all filings, applications and registrations with, Governmental Authorities that are required by Applicable Law in order to permit it to carry on its respective business as presently conducted, and such Permits are in full force and effect. Except as set forth on Section 4.19(c) of the Seller Disclosure Letter, the conduct of its respective business by each Sponsored Fund or, to the Knowledge of Seller, Sub-Advised Fund does not violate or infringe any Applicable Law.

(d) Since January 1, 2003, each Sponsored Fund and, to the Knowledge of Seller, each Sub-Advised Fund has filed all material registrations reports, prospectuses, proxy statements, statements of additional information, financial statements, sales literature, notices and other filings required to be filed with any Governmental Authority, including all amendments and supplements to any of the above ("Fund Filings") in compliance in all material respects with Applicable Law. The Fund Filings of each Sponsored Fund and, to the Knowledge of Seller, the Fund Filings of each Sub-Advised Fund, did not at the time they were filed, and did not during any period of authorized use, contain any untrue statement of a material fact or omit to state a material fact required to be stated therein or necessary in order to make the statements therein, in the light of the circumstances under which they were made, not misleading. Seller has made available to Purchaser complete and correct copies of (i) all such Fund Filings, (ii) all audit or inspection reports received by any Sponsored Fund or by Seller or any Affiliate of Seller with respect to a Registered Fund Client from any Governmental Authority and all written responses thereto made by any Registered Fund Client, Seller or any Affiliate of Seller since January 1, 2003, and (iii) all non-routine correspondence relating to any investigation or examination provided to or by any Sponsored Fund or by Seller or any Affiliate of Seller with respect to a Registered Fund Client by any Governmental Authority since January 1, 2003.

(e) Since January 1, 2003, (i) each Sponsored Fund has been operated in compliance in all material respects with its respective investment objectives, investment policies and offering document descriptions, (ii) the Subject Companies have provided investment advisory services to each of the Sub-Advised Funds in compliance in all material respects with its respective investment objectives, investment policies and offering document descriptions from time to time provided to the Subject Companies by the sponsor of such fund, and (iii) the Subject Companies have provided investment advisory services to each of the Separate Account Clients in compliance in all material respects with such client's Advisory Contract with the Subject Companies.

(f) Except as otherwise identified in Section 4.19(f) of the Seller Disclosure Letter, for all taxable years since its inception, each Sponsored Fund (and, to the Knowledge of Seller, each Sub-Advised Fund) has elected to be treated, and has qualified, as a "regulated investment company" under Subchapter M of Chapter 1 of Subtitle A of the Code and has complied with all applicable provisions of law necessary to preserve and retain such fund's election and status as a regulated investment company under such Subchapter M. Section 4.19(f) of the Seller Disclosure Letter identifies each Registered Fund Client that pays "exempt-interest dividends" (within the meaning of Section 852(b)(5) of the Code) (a "Tax-Exempt Municipal Bond Fund"). For all taxable years since its inception, each Sponsored Fund (and, to the

Knowledge of Seller, each Sub-Advised Fund) identified in Section 4.19(f) of the Seller Disclosure Letter as a Tax-Exempt Municipal Bond Fund has satisfied the requirements of Section 852(b)(5) of the Code and has been qualified to pay exempt-interest dividends as defined therein. Section 4.19(f) of the Seller Disclosure Letter identifies each Registered Fund Client that serves as an underlying investment for an insurance company separate account which is registered as an investment company under the Investment Company Act (a "Registered Separate Account") and that funds variable annuity or variable life insurance products (a "Variable Insurance Products Fund"). Each Sponsored Fund (and, to the Knowledge of Seller, each Sub-Advised Fund) identified in Section 4.19(f) of the Seller Disclosure Letter as a Variable Insurance Products Fund has at all times since its inception been operated in manner that permits each Registered Separate Account investing in it to meet the requirements of Section 817(h) of the Code and Section 1.817-5 of the Treasury Regulations. Each Sponsored Fund (and, to the Knowledge of Seller, each Sub-Advised Fund) has timely filed all material Tax Returns required to be filed by it with any taxing authority and has timely paid, or timely withheld and paid over, all material Taxes required to be paid or withheld by it to the proper taxing authority. All such Tax Returns are true, correct and complete in all material respects. No Sponsored Fund (and, to the Knowledge of Seller, no Sub-Advised Fund) has received a written notice from any taxing authority proposing an audit of such Tax Return, no assessment of material Taxes has been asserted with respect to such Tax Returns, and no requests for waivers of the time to make any such assessment are pending. Except as set forth on Section 4.19(f) of the Seller Disclosure Letter, none of the Sponsored Funds (and, to the Knowledge of Seller, none of the Sub-Advised Funds) is delinquent in the payment of any material Taxes. None of the Sponsored Funds or, to the Knowledge of Seller, Subadvised Funds has participated (within the meaning of Treasury Regulation Section 1.6011-4(c)) in or has been a "material advisor" (within the meaning of Section 6111 of the Code and the Treasury Regulations promulgated thereunder) with respect to any "reportable transaction" (within the meaning of Section 6707A(c) of the Code and the Treasury Regulations promulgated under Section 6011 of the Code).

(g) Each Sponsored Fund that is a juridical entity is duly organized, validly existing and, with respect to jurisdictions that recognize the concept of "good standing," in good standing under the laws of the jurisdiction of its organization and has the requisite corporate, trust, company or partnership power and authority to own its properties and to carry on its business as currently conducted. Each Sponsored Fund is qualified to do business in each jurisdiction where it is required to be so qualified under Applicable Law and in which failure to be so qualified could be material to such Sponsored Fund. No Sponsored Fund is in default in performing, observing or fulfilling the terms or conditions of its declaration of trust, bylaws or other organizational documents and these documents are in full force and effect and there does not exist under any fund Contract any event of default or event or condition that, after notice of lapse of time or both would constitute an event of default thereunder on the part of a Subject Company or Sponsored Fund, or, to the Knowledge of Seller, on the part of any other party thereto.

(h) The shares or units of each Sponsored Fund (i) have been issued and sold by the applicable Subject Companies in compliance in all material respects with Applicable Law, (ii) are qualified for public offering and sale in each jurisdiction where offers by the applicable Sponsored Fund have been or are made to the extent required under Applicable Law; and (iii) have been duly authorized and validly issued and are fully paid and non-assessable.

(i) Except as set forth on Section 4.19(i) of the Seller Disclosure Letter, no proceeding, investigation, examination (other than routine examinations in the ordinary course of business that will not result in any material expense for or liability of the Purchaser, any Subject Companies or any of their Affiliates), audit or review with respect to any Sponsored Fund or, to the Knowledge of Seller, Sub-Advised Fund has been initiated or is ongoing, unresolved or, to the Knowledge of Seller, threatened by any Governmental Authority. No Sponsored Fund or, to the Knowledge of Seller, Sub-Advised Fund has received any notice or communication of any unresolved violation or exception from any Governmental Authority with respect to any report or statement by any Governmental Authority relating to any examination or any notice or communication threatening to revoke or condition the continuation of any permit or restricting or disqualifying such Sponsored Fund's or Sub-Advised Fund's activities.

(j) Each Sponsored Fund and, to the Knowledge of Seller, each Sub-Advised Fund has implemented and maintains in force one or more formal codes of ethics, personal trading policies, a written policy regarding the protection of material non-public information and other material policies as required by Applicable Law, a complete and correct copy of each of which has been made available to the Purchaser. The codes of ethics, personal trading policies, policy regarding the protection of material non-public information and other material policies of the Sponsored Funds comply in all material respects with Applicable Law. Since January 1, 2003, there have been no material violations by any officer or investment professional of any Subject Company, Sponsored Fund or, to the Knowledge of Seller, Sub-Advised Fund, of such codes of ethics or policies.

(k) Each Sponsored Fund has complied in all material respects with all Applicable Laws regarding the privacy of customers and other Persons and has established and complied with its Privacy Policies.

(l) Each Sponsored Fund, to the extent required by Applicable Law, has implemented and maintained in force a written anti-money laundering program and a written customer identification program in compliance with Applicable Law and has complied with the terms of such programs in all material respects.

(m) Each Subject Company that acts as investment adviser or sub-adviser to a Registered Fund Client has a written Advisory Contract pursuant to which such Subject Company serves as investment adviser or sub-adviser to such Registered Fund Client. None of the Subject Companies nor any "interested persons" (as such term is defined in the Investment Company Act) of any Subject Company receive or are entitled to receive any compensation directly or indirectly (i) from any Person in connection with the purchase or sale of securities or other property to, from or on behalf of any Sponsored Fund or Sub-Advised Fund, other than bona fide ordinary compensation as principal underwriter, distributor or sponsor for such Sponsored Fund or Sub-Advised Fund or other compensation permitted by Applicable Laws or (ii) from the Sponsored Fund or Sub-Advised Fund or their respective security holders for other than bona fide investment advisory, sub-advisory, accounting and shareholder servicing, securities lending, transfer agency, administrative or similar services. There does not exist under any Advisory Contract to which a Subject Company is party relating to a Registered Fund Client an event of default or any event or condition that, after notice or lapse of time or both, would

---

constitute an event of default under such Advisory Contract on the part of a Subject Company, or, to Knowledge of Seller, on the part of any other party to it.

(n) Each Sponsored Fund's board of directors or trustees, as applicable, and to the Knowledge of Seller, each Sub-Advised Fund's board of directors or trustees, as applicable, has been established and operated in conformity with the requirements and restrictions of Sections 10 and 16 of the Investment Company Act and satisfies the fund governance standards as defined in Rule 0-1 under the Investment Company Act. No director or trustee of a Sponsored Fund who has been identified as an "independent" or "non-interested" director or trustee in such Sponsored Fund's most recent registration statement on Form N-1A is an "interested person" of such Sponsored Fund, as that term is defined in Section 2(a)(19) of the Investment Company Act, or has had at any time since January 1, 2003 a material business or professional relationship with such Sponsored Fund's investment adviser or principal underwriter or with the principal executive officer or any controlling person of such investment adviser or principal underwriter other than as set forth in such Sponsored Fund's registration statement on Form N-1A. There has been no conduct that would reasonably be expected to give rise to any allegation of a violation of Section 36 of the Investment Company Act in respect of any Sponsored Fund or, to the Knowledge of Seller, any Sub-Advised Fund. The compensation that each director or trustee of a Sponsored Fund receives for serving as such is as set forth in such Form N-1A and, to the Knowledge of Seller, no proposal has been made to modify such compensation.

(o) Section 4.19(o) of the Seller Disclosure Letter lists each insurance policy, including each directors' and officers' and errors and omissions insurance policy and fidelity bond that has been obtained with respect to a Sponsored Fund under which claims may still be made. Each Sponsored Fund has in full force and effect such insurance as is required by the Investment Company Act and such directors' and officers' and errors and omissions insurance policies as are listed in Section 4.19(o) of the Seller Disclosure Letter. All premiums that are due and payable under such policies have been paid.

(p) Each Sponsored Fund has (i) duly adopted written policies and procedures required by Rule 38a-1 under the Investment Company Act and (ii) designated and approved an appropriate chief compliance officer in accordance with such Rule. Copies of all such policies and procedures have been provided or made available to Purchaser. All such policies and procedures comply in all material respects with Applicable Law and there have been no material violations or allegations of material violations of such policies and procedures. All such policies have been reviewed for the period ended March 22, 2006 as required by Rule 38a-1, and the most recent annual report of the Sponsored Funds' chief compliance officer required by Rule 38a-1 has been provided to Purchaser and to the board of directors or trustees, as applicable, of each Sponsored Fund.

(q) All payments by a Sponsored Fund relating to the distribution of its shares (other than payments that were not when made required by Applicable Law to be paid pursuant to a 12b-1 Plan) have been made in compliance in all material respects with the related 12b-1 Plan, if applicable, and each 12b-1 Plan adopted by a Sponsored Fund, and the operation of each such 12b-1 Plan, currently complies in all material respects with Rule 12b-1 of the Investment Company Act and other Applicable Law. No Sponsored Fund has paid or is paying, directly or indirectly, any amount to any Person for the purpose of financing the distribution of its shares

except in accordance with a 12b-1 Plan, and no Sponsored Fund or Subject Company has made or is making any other payments in respect of the distribution of the shares of any Sponsored Fund that violated or violate Applicable Law in any respect. Any payments for distribution or shareholder servicing activities in excess of the amounts provided under the 12b-1 Plans have been paid out of past profits or other available resources of Subject Companies and not by any Sponsored Fund, and the nature of such payments has been disclosed, to the extent required by Applicable Law, to the board of directors or trustees of the applicable Sponsored Fund and in the Fund Filings of the applicable Sponsored Fund with respect to which such payments were made. No such payments are obligations of or have been borne by any of the Sponsored Funds.

(r) The Sponsored Funds have maintained a market timing policy in force at all times since January 1, 2003 with respect to the purchase and sale of any Sponsored Fund shares. Such policies, as they have been in effect at any applicable time, have been enforced consistently by the Subject Companies or other entities and are consistent with the disclosure relating thereto contained in the applicable Sponsored Fund prospectus or statement of additional information, and no arrangements involving any of the Subject Companies or any of their respective directors, officers, employees, agents or representatives exist or have existed to permit any party (including any such officer, employee, agent or representative) to trade shares of any Sponsored Fund in a manner that is inconsistent with such policy.

(s) Since January 1, 2003, no Subject Company has taken any action pursuant to any arrangements or accommodations whereby (i) a Subject Company or any of its officers or employees has permitted any Person to enter orders to purchase or redeem shares or to cancel previously entered orders of any Sponsored Fund; or (ii) a Subject Company or its officers or employees facilitates the entering by any Person of orders to purchase or redeem shares or to cancel previously entered orders of any Sponsored Fund, in either case at a time and in a manner not consistent with the requirements of Rule 22c-1 under the Investment Company Act.

(t) All written information provided by the Seller, Seller Parent or any of their Affiliates, including the Subject Companies, for use by the Registered Fund Clients in connection with the transactions contemplated by this Agreement at the time such information is provided or used, and any such written information provided by the Seller, Seller Parent or any of their Affiliates, including Subject Companies, disseminated in respect of the transactions contemplated hereby at the time such information is disseminated, in each case, will be accurate and complete in all material respects and will not contain any untrue statement of a material fact, or omit to state any material fact (A) required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading or (B) necessary to correct any statement in any earlier communication that has become false or misleading.

(u) No director, trustee or employee of any Sponsored Fund is ineligible pursuant to Section 9(a) or 9(b) of the Investment Company Act to serve as such, and there is no proceeding pending or, to the Knowledge of Seller, threatened which would result in the ineligibility of any such Person to serve in any such capacities. No managing director or officer or, to the Knowledge of Seller, trustee or employee of any Subject Company or any Sponsored Fund is, or at any time during the past three years has been, (i) subject to any cease and desist, censure or other disciplinary or similar order issued by, (ii) a party to any written agreement,

consent agreement, memorandum of understanding or disciplinary agreement with, (iii) a party to any commitment letter or similar undertaking to, (iv) subject to any order or directive by or (v) a recipient of any supervisory letter from, any Governmental Authority.

(v) Neither Seller nor any Subject Company has any express or implied understanding or arrangement that would reasonably be expected to impose an "unfair burden" (as defined in the Investment Company Act) on any of the Registered Fund Clients for purposes of Section 15(f) of the Investment Company Act as a result of the transactions contemplated by this Agreement.

(w) Section 4.19(w) of the Seller Disclosure Letter lists each investment adviser that is not an Affiliate of a Subject Company that provides investment advisory services to a Sponsored Fund ("Third Party Adviser"). Each Third Party Adviser serves as such pursuant to a written Advisory Contract that has been approved by the Sponsored Fund's board of directors or trustees and, if required by Applicable Law, shareholders. Each Subject Company that is an investment adviser to such Sponsored Fund has adopted policies and procedures that are designed to provide for reasonable supervision by the Subject Company of the Third Party Adviser with a view to preventing violations of the provisions of Applicable Law.

(x) Except for the Sponsored Funds, Sub-Advised Funds, Separate Account Clients and New Advisory Clients listed in Section 4.19(x) of the Seller Disclosure Letter, none of the Sponsored Funds, Separate Account Clients, New Advisory Clients or, to the Knowledge of Seller, Sub-Advised Funds is or may be deemed to contain "plan assets" within the meaning of U.S. Department of Labor Regulation 2510.3.101. With respect to each Sponsored Fund, Sub-Advised Fund, Separate Account Client and New Advisory Client that is or may be deemed to so contain "plan assets," such Sponsored Fund, Separate Account Client, New Advisory Client and, to the Knowledge of Seller, Sub-Advised Fund has been operated in compliance with ERISA, and no Subject Company has any liability for any non-exempt prohibited transaction within the meaning of Section 406 of ERISA or Section 4975 of the Code. At all relevant times, including immediately prior to the Closing, each Subject Company providing services to a Sponsored Fund, Sub-Advised Fund, Separate Account Client or New Advisory Client that is or may be deemed to contain "plan assets" has been a "Qualified Professional Asset Manager" within the meaning of U.S. Department of Labor Prohibited Transaction Class Exemption 84-14.

(y) To the Knowledge of Seller, as of the date hereof, the Sponsored Funds, the Sub-Advised Funds and the Separate Account Clients do not intend to terminate their respective Advisory Contracts with the Subject Companies, or to enter into negotiations to amend the terms and conditions of any Advisory Contracts.

4.20 Assets Under Management; Investment Management Revenues. (a) As of the Base Date, the aggregate amount of assets under management for which any of the Subject Companies provided investment advisory services or investment sub-advisory services pursuant to Advisory Contracts was not less than the amount specified as "Aggregate Base Assets Under Management" on Schedule 1, and the fee rate for each Sponsored Fund, Sub-Advised Fund and Separate Account Client was as shown on Schedule 1. As of the Base Date, the Registered Fund Clients and Separate Account Clients were the only Advisory Clients of the Subject Companies. The Base Advisory Revenue Run-Rate for each such Advisory Client is as shown on Schedule 1.

As of the Base Date, the aggregate amount of the Selected AUM was not less than the amount specified therefor in Section 4.20(a) of the Seller Disclosure Letter.

(b) Except as set forth (i) in Section 4.20(b) of the Seller Disclosure Letter, (ii) in an Advisory Contract relating to a Registered Fund Client or Separate Account Client (as applicable), or (iii) in the case of a Registered Fund Client, in its offering documents, none of the material Advisory Contracts relating to any Registered Fund Client or Separate Account Client to which any Subject Company is a party as of the date of this Agreement (or any related arrangements or understandings relating to the Subject Companies' rendering of investment advisory, administration, distribution or shareholder servicing services to such Registered Fund Client or Separate Account Client (as applicable) pursuant to any such Advisory Contract) contains any undertaking by any of the Subject Companies or their Affiliates to waive or reimburse fees thereunder resulting in an effective fee rate lower than that stated in such Advisory Contract.

4.21 Intercompany Accounts; Transactions with Affiliates.

(a) Section 4.21(a) of the Seller Disclosure Letter lists all balances (the "Intercompany Balances") as of June 30, 2006 owed between Seller, Seller Parent or any of their Affiliates (other than the Subject Companies), on the one hand, and any of the Subject Companies, on the other hand. Since June 30, 2006 there has not been any accrual of liability by any of the Subject Companies to Seller, Seller Parent or any of their Affiliates (other than the Subject Companies) or other transaction between the Subject Companies and the Seller, Seller Parent or any of their Affiliates (other than the Subject Companies), except in the ordinary course of business of the Subject Companies consistent with past practice and, in respect of any fiscal period covered by the Company Financial Statements, as reflected on the Company Financial Statements.

(b) Section 4.21(b) of the Seller Disclosure Letter lists all agreements, arrangements and other commitments or transactions (including the provision of any Assets or services) to or by which any of the Subject Companies, on the one hand, and Seller, Seller Parent or any of their Affiliates (other than the Subject Companies), on the other hand, are or have been a party or otherwise bound or affected and that (i) were entered into since January 1, 2003, (ii) are currently pending or in effect or (iii) involve continuing liabilities or obligations that, individually or in the aggregate, have been or will be material to any of the Subject Companies (each, an "Affiliate Transaction"). The Affiliate Transactions were, taken as a whole, on terms and conditions no more favorable to the Subject Companies than as would have been obtainable by them at the time in a comparable arm's-length transaction with a Person other than Seller, Seller Parent or any of their Affiliates. Except as set forth in Section 4.7(c)(ii) of the Seller Disclosure Letter, no stockholder or Affiliate of the Subject Companies owns, directly or indirectly, any interest in any material asset or other property used in or held for use in the Business. For purposes of this Section 4.21(b), and without limitation, Affiliates of the Seller or Seller Parent shall be deemed to include (A) any Person directly or indirectly beneficially owning or controlling 10% or more of the outstanding voting securities of Seller, Seller Parent or any of their Affiliates, (B) any Person 10% or more of whose outstanding voting securities are directly or indirectly beneficially owned or controlled by Seller, Seller Parent or any of their Affiliates or (C) any current director of Seller, Seller Parent or any of their Affiliates or any

"associates" or members of the "immediate family" (as such terms are respectively defined in Rule 12b-2 and Rule 16a-1 of the Exchange Act) of any such director.

4.22 Insurance. Section 4.22 of the Seller Disclosure Letter lists all insurance policies (including fidelity bonds and other similar instruments) relating to the Assets, the Business or the employees, officers or directors of the Subject Companies. There is no claim by or with respect to any Subject Company pending under any of such policies as to which coverage has been questioned, denied or disputed by the underwriters of such policies or in respect of which such underwriters have reserved their rights. All premiums payable under such policies have been timely paid, and Seller, Seller Parent and each of the Subject Companies have otherwise complied fully with the terms and conditions of such policies. Such policies (or other policies providing substantially similar insurance coverage) have been in effect continuously since January 1, 2003 and remain in full force and effect. Such policies are of the type and in amounts customarily carried by Persons conducting businesses similar to those of the Subject Companies. The Seller, Seller Parent and the Subject Companies do not know of any threatened termination of, premium increase with respect to, or alteration of coverage under, any of such policies to the extent such termination, increase or alteration relates to the Subject Companies.

Article V
REPRESENTATIONS AND WARRANTIES OF PURCHASER

Purchaser and Purchaser Parent, jointly and severally, represent and warrant to Seller, as of the date hereof and as of the Closing Date, that:

5.1 Organization. Each of Purchaser and Purchaser Parent is a corporation duly incorporated, validly existing and in good standing under the laws of its jurisdiction of incorporation.

5.2 Authority Relative to Agreement. Each of Purchaser and Purchaser Parent has the corporate power and authority to execute and deliver this Agreement and the Ancillary Agreements to which it is a party, to perform its obligations hereunder and thereunder, and to consummate the transactions contemplated hereby and thereby. The execution and delivery by each of Purchaser and Purchaser Parent of this Agreement and the Ancillary Agreements to which it is a party, the performance by each of Purchaser and Purchaser Parent of its obligations hereunder and thereunder, and the consummation by each of Purchaser and Purchaser Parent of the transactions contemplated hereby and thereby have been duly authorized by all necessary corporate action. This Agreement has been, and the Ancillary Agreements to which each is a party upon their execution and delivery at Closing will have been, duly and validly executed and delivered by Purchaser and Purchaser Parent and, assuming the due authorization, execution and delivery by Seller, Seller Parent and any Affiliate of Seller, as applicable, constitute legal and binding obligations of Purchaser and Purchaser Parent, enforceable against Purchaser and Purchaser Parent in accordance with their terms, except as may be affected by bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium and other similar laws relating to or affecting creditors' rights generally or general equitable principles.

5.3 Non-Contravention. The execution and delivery of this Agreement by Purchaser and Purchaser Parent do not, and the execution and delivery by Purchaser and

---

Purchaser Parent of the Ancillary Agreements to which each is a party will not, and their consummation of the transactions contemplated hereby and thereby and their performance of the obligations which they are obligated to perform hereunder and thereunder will not: (a) violate any provision of the certificate of incorporation or by-laws of Purchaser or Purchaser Parent; or (b) assuming that all consents, authorizations, orders or approvals of, filings or registrations with, and notices to, each Governmental Authority referred to in Section 5.4(a) and all Third Party Consents referred to in Section 5.4(b) have been obtained or made, (i) violate any law, regulation, rule, order, judgment or decree of any Governmental Authority to which Purchaser or Purchaser Parent is subject or (ii) violate, result in the termination or the acceleration of, or conflict with or constitute a default under, any Contract to which Purchaser or Purchaser Parent is a party or by which any of its property is bound, except, in the case of clauses (i) and (ii), for any such violation, termination, acceleration, conflict or default as would not prohibit or materially impair Purchaser's or Purchaser Parent's ability to consummate the transactions contemplated hereby or perform its obligations hereunder on a timely basis.

5.4 Consents, etc. (a) Except for (i) the filing of notice under the HSR Act, and the expiration or early termination of the applicable waiting period, and (ii) as described in Section 5.4(a) of the Purchaser Disclosure Letter, no Governmental Approval is required for the execution and delivery by Purchaser or Purchaser Parent of this Agreement or the Ancillary Agreements to which either is a party, the performance by them of their obligations hereunder and thereunder and their consummation of the transactions contemplated hereby and thereby, except in any such case for any such Governmental Approval the failure of which to be obtained or made would not reasonably be expected to have an effect on Purchaser or Purchaser Parent that is either, individually or in the aggregate, materially adverse to the business, operations or financial condition of Purchaser and Purchaser Parent, taken as a whole ("Purchaser Material Adverse Effect") or prohibit or materially impair Purchaser's or Purchaser Parent's ability to consummate the transactions contemplated hereby or thereby or perform their obligations hereunder or thereunder on a timely basis.

(b) Except as described in Section 5.4(b) of the Purchaser Disclosure Letter, no Third Party Consents with respect to any material Contract to which Purchaser or Purchaser Parent is a party or by which any of their property is bound is required for the execution and delivery by Purchaser or Purchaser Parent of this Agreement and the Ancillary Agreements to which either is a party, the performance by them of their respective obligations hereunder and thereunder and their consummation of the transactions contemplated hereby and thereby, except in any such case for any such Third Party Consent, the failure of which to be obtained or made would not reasonably be expected to have a Purchaser Material Adverse Effect or prohibit or materially impair Purchaser's or Purchaser Parent's ability to consummate the transactions contemplated hereby or thereby or perform their obligations hereunder or thereunder on a timely basis.

5.5 Litigation. As of the Business Day before the date of this Agreement and, for purposes of Section 8.3(a) only, as of the Closing Date, there is no action, suit or proceeding pending or, to the knowledge of Purchaser or Purchaser Parent, threatened against Purchaser or Purchaser Parent before any Governmental Authority or arbitrator that would reasonably be expected to have a Purchaser Material Adverse Effect or prohibit or materially impair

Purchaser's or Purchaser Parent's ability to consummate the transactions contemplated hereby or perform their obligations hereunder on a timely basis.

5.6 Regulatory Reports. Except as would not reasonably be expected to have a Purchaser Material Adverse Effect, Purchaser Parent has filed all material regulatory reports, schedules, forms, registrations and other documents, together with any material amendments required to be made with respect thereto, that it was required under any Applicable Law to file since January 1, 2004 with Governmental Authorities.

5.7 Absence of Certain Changes. Since December 31, 2005, there has been no change, event or development affecting Purchaser which has resulted in or would reasonably be expected to result in a Purchaser Material Adverse Effect.

5.8 Information Supplied. All written information provided by Purchaser or Purchaser Parent for use by the Registered Fund Clients in connection with the transactions contemplated by this Agreement at the time such information is provided or used, and any such written information provided by Purchaser or Purchaser Parent disseminated in respect of the transactions contemplated hereby at the time such information is disseminated, in each case, will be accurate and complete in all material respects and will not contain any untrue statement of a material fact, or omit to state any material fact (A) required to be stated therein or necessary to make the statements therein, in the light of the circumstances under which they were made, not misleading or (B) necessary to correct any statement in any earlier communication that has become false or misleading.

5.9 Brokers. No broker, investment banker, financial advisor or other Person, other than Goldman, Sachs & Co., the fees and expenses of which will be paid by Purchaser, is entitled to any broker's, finder's, financial advisor's or other similar fee or commission in connection with the transactions contemplated by this Agreement based upon arrangements made by or on behalf of Purchaser or Purchaser Parent or any of their Affiliates.

5.10 Available Funds. Purchaser has or will have as of the Closing available to it all funds necessary to satisfy all of its obligations hereunder and in connection with the transactions contemplated hereby, and its ability to consummate such transactions is not conditional upon the receipt of financing (whether debt or equity) from any Third Party.

5.11 Investment Intent. Purchaser is acquiring the Stock for its own account, for investment purposes only and not with a view to, or for resale in connection with, the distribution thereof. Purchaser understands that the Stock may not be sold, transferred or otherwise disposed of without registration under the Securities Act, except pursuant to an exemption from such registration available under the Securities Act.

5.12 Certain Regulatory Matters. Neither Purchaser nor, to the knowledge of Purchaser, any Person "associated" (as defined under the Investment Advisers Act) with Purchaser, has during the five years prior to the date hereof been convicted of any crime or is or has been subject to any disqualification that would be a basis for denial, suspension or revocation of registration of an investment adviser under Section 203(e) of the Investment Advisers Act or Rule 206(4)-4(b) thereunder or of a broker-dealer under Section 15 of the Exchange Act, or for

---

disqualification as an investment adviser for any registered investment company pursuant to Section 9(a) of the Investment Company Act, and to the knowledge of Purchaser, as of the date of this Agreement, there are no proceedings or investigations pending or threatened that would reasonably be expected to result in any such disqualification, denial, suspension or revocation.

Article VI
COVENANTS

6.1 Conduct of Business. During the period from the date hereof to the Closing Date, without the prior written consent of Purchaser (which shall not be unreasonably withheld or delayed) or except as permitted or contemplated by this Agreement, or as set forth in Section 6.1 of the Seller Disclosure Letter, Seller Parent and Seller shall ensure that:

(a) the respective businesses of the Subject Companies will be operated in all material respects in the ordinary course consistent with past practice;

(b) no amendment shall be made in the certificate of incorporation, by-laws or other organizational documents of any Subject Company, other than to the extent contemplated by Section 6.6;

(c) no Subject Company shall issue or agree to issue any shares of its capital stock or securities convertible into or exchangeable or exercisable for such capital stock;

(d) no change shall be made by any Subject Company in its accounting methods, principles or practices, except as required by changes in GAAP, Applicable Law or official interpretations thereof after the date hereof;

(e) other than in the ordinary course of business, none of the Subject Companies shall enter into any Contract that would constitute a Material Contract or any transaction which is material to such Subject Company;

(f) other than in the ordinary course of business, none of the Subject Companies shall transfer or otherwise dispose of or encumber any of its material properties or assets, other than sales of "Receivables" and "Collections", each as defined in and pursuant to the CDSC Financing Agreements (which includes "sales charges" within the meaning of Section 2830 of the rules of the NASD and contingent deferred sales charges payable (either directly or by withholding from the proceeds of redemptions) on redemptions of related shares), in any case subject to Section 6.4;

(g) other than in the ordinary course of business, none of the Subject Companies shall cancel any debts, waive or compromise any claims or rights which are material to the Subject Companies, taken as a whole, or settle or otherwise compromise any material litigation;

(h) none of the Subject Companies shall make or commit to make any material capital expenditures in excess of $75,000 annually and $250,000 in the aggregate;

(i) none of Seller, Seller Parent or the Subject Companies shall grant any increase in the compensation of officers or employees of the Subject Companies, except for increases to base compensation in the ordinary course of business that do not exceed $75,000 on an annual basis individually or $750,000 on an annual basis in the aggregate or as required by any Benefit Plan listed in Section 4.11(b) of the Seller Disclosure Letter or by Applicable Law; provided, that, at Purchaser's option and expense, Seller and Seller Parent shall cause the Subject Companies to adopt promptly such additional retention programs and bonuses as Purchaser may reasonably specify;

(j) none of Seller, Seller Parent, or the Subject Companies shall establish or announce any intention to establish any new Benefit Plan in which employees of the Subject Companies will participate or modify any Benefit Plan as it applies to the Subject Companies or any of their employees unless Seller, Seller Parent or the Subject Companies provide evidence reasonably satisfactory to the Purchaser that none of Purchaser or the Subject Companies will incur any increase in liability under the relevant Benefit Plan from that in effect as of the date hereof resulting from such modification;

(k) none of the Subject Companies shall incur or assume indebtedness for borrowed money, except to the extent such indebtedness is reflected in the Working Capital Amount at Closing;

(l) none of the Subject Companies shall merge or consolidate with, or acquire substantially all of the assets or equity securities of, any other entity;

(m) none of the Subject Companies shall declare, set aside, make or pay any dividend or other distribution on or in respect of its capital stock, or repurchase, redeem or otherwise reacquire any of its capital stock, other than (i) any dividends or other distributions on any capital stock of any Subject Company paid or made solely to another Subject Company or (ii) any cash dividends or other distributions paid or made by the Company to the Seller and taken into account in the calculation of the Working Capital Amount (provided, that no such dividend or other distribution shall be made if it would reasonably be expected to cause the Working Capital Amount to be less than the Target Working Capital Amount at Closing);

(n) there shall be no (i) material Tax election, (ii) change in any material Tax accounting method, (iii) settlement or compromise of any material Tax liabilities or (iv) amendment of any material Tax Return, in each case, with respect to any Subject Company or Sponsored Fund, except as required by Applicable Law or to comply with the requirements of Subchapter M of Chapter 1 of Subtitle A of the Code;

(o) none of the Subject Companies shall amend or revise (i) any Advisory Contract to reduce, waive or agree to offset any fee or reimburse any expenses payable under such Advisory Contract to the Subject Company or offer or promise to any Advisory Client any reduced fee, fee waiver or expense reimbursement, (ii) any Distribution Agreement; provided, that this subclause shall not limit any amendment or revision of a Distribution Agreement if such Distribution Agreement does not involve payments by a party thereto in excess of $100,000 in the twelve month period prior to the

date hereof and prompt notice of any such amendment or revision is provided to Purchaser pursuant to Section 6.3(i)(c), or (iii) any compensation arrangement with any wholesaler other than as contemplated by Section 6.3(k);

(p) none of the Subject Companies shall renew, terminate or otherwise modify the Seattle Sublease;

(q) subject to their fiduciary duties under Applicable Law, none of the Subject Companies shall change the investment policies of any of the Sponsored Funds;

(r) the Subject Companies shall, subject to their fiduciary duties to the Sponsored Funds under Applicable Law, use their reasonable best efforts to cause each Sponsored Fund to carry on its business in the ordinary course consistent with past practices, and shall not encourage or propose to any Sponsored Fund that it (i) amend its charter, by-laws or other organization documents; (ii) enter into or assume any contract or enter into or permit any amendment, supplement, waiver or other modification in respect thereof, except (in the case of contracts other than Advisory Contracts, Distribution Agreements and Administration Contracts) in the ordinary course of business consistent with past practice; or (iii) merge or consolidate with, or agree to merge or consolidate with, or purchase any material amount of the assets of, or otherwise acquire or make any equity investment in, any other Person (other than in connection with investment activities consistent with such Sponsored Fund's investment objectives and policies);

(s) none of the Subject Companies commences providing investment advisory services or otherwise enters into any Contract with a New Advisory Client that is an investment company (or series thereof) registered under the Investment Company Act;

(t) the Tangible Net Worth of the Subject Companies does not fall below $11,575,000;

(u) they and their Affiliates use reasonable best efforts to ensure that the Working Capital Amount at Closing does not exceed the Target Working Capital Amount;

(v) they and their Affiliates use reasonable best efforts to ensure that Persons which have any material contractual relationship with a Subject Company or any material contractual or investor relationship with a Sponsored Fund preserve such relationships, in the aggregate, so that they may be continued, in the ordinary course in all material respects consistent with past practice, after the Closing; and

(w) none of the Subject Companies shall agree, whether in writing or otherwise, to take any of the actions prohibited pursuant to subsections (a) through (v) above.

6.2 Access; Confidentiality Upon reasonable notice, Seller and Seller Parent agree to permit Purchaser and its accountants, counsel and other authorized representatives to have, during the period from the date of this Agreement to the Closing Date, reasonable access to the premises, books and records of each Subject Company that relate to its business upon

---

reasonable advance notice during normal business hours, provided that such access does not interfere with the normal operations of the Subject Companies. Seller and Seller Parent agree to cause the Subject Companies to furnish Purchaser with such financial and operational data and other information with respect to their respective businesses and properties as Purchaser may from time to time reasonably request, provided, however, that (i) the auditors and outside accountants of Seller, Seller Parent and the Subject Companies shall not be obligated to make work papers available to Purchaser unless Purchaser has signed a customary agreement relating to access to such work papers in form and substance reasonably acceptable to such auditors or accountants, as applicable, and (ii) none of Seller, Seller Parent or the Subject Companies shall be obligated to make any information available to Purchaser that would, in the reasonable judgment of Seller or Seller Parent, violate or jeopardize any applicable attorney-client or other privilege or any applicable contractual confidentiality obligation. Any information concerning the Subject Companies obtained by Purchaser or its representatives pursuant to this Section 6.2 shall be subject to the terms of the Confidentiality Agreement, and such information shall be held by Purchaser and its representatives in accordance with the terms of the Confidentiality Agreement.

6.3 Reasonable Best Efforts; Taking of Necessary Action; Notices of Certain Events. (a) Each of Seller, Seller Parent, Purchaser and Purchaser Parent shall use its reasonable best efforts to take or cause to be taken all action and promptly to do or cause to be done all things necessary, proper or advisable to consummate and make effective the transactions contemplated by this Agreement (including any actions required of, or with respect to, the Sponsored Funds).

(b) Each of Seller, Seller Parent, Purchaser and Purchaser Parent shall (i) as soon as practicable after the date hereof, (A) file such applications, notices, registrations and requests as may be required or advisable to be filed by it with any Governmental Authority (including without limitation applicable filings under the HSR Act and with the NASD) in order to consummate the transactions contemplated hereby, (B) use its reasonable best efforts to obtain all consents, authorizations, orders and approvals of all such Governmental Authorities referred to in the preceding clause (A), and (C) use its reasonable best efforts to satisfy all conditions, undertakings and requirements as may be necessary or appropriate to obtain all such consents, authorizations, orders and approvals or as may be set forth therein, (ii) furnish the other parties hereto with copies of all documents (except documents or portions thereof for which confidential treatment has been requested or given) and correspondence (A) prepared by or on behalf of such party for submission to any Governmental Authority and (B) received by or on behalf of such party from any Governmental Authority, in each case in connection with the transactions contemplated hereby and (iii) use its reasonable best efforts to consult with and keep the other parties hereto informed as to the status of such matters. To the extent that any application, notice, registration or request so filed by any party contains any significant information relating to the other parties hereto or any of the Subject Companies, prior to submitting such application, notice, registration or request to any Governmental Authority, such party will permit the other parties to review such information and will consider in good faith the suggestions of such other parties with respect thereto.

(c) Each of Seller, Seller Parent, Purchaser and Purchaser Parent shall use its reasonable best efforts to cooperate with the other parties hereto in the preparation and filing

---

of any applications, notices, registrations and responses to requests for additional information from Governmental Authorities in connection with the transactions contemplated by this Agreement, including providing such information as may be reasonably necessary for inclusion in such applications, notices, registrations and responses.

(d) To the extent that any Third Party Consent is required under any Contract to which one of the Subject Companies is a party, or (in the case of Advisory Contracts relating to Registered Fund Clients) for the approval of a new Advisory Contract, in either such case in connection with the consummation of the transactions contemplated by this Agreement, Seller and Seller Parent will use their reasonable best efforts to obtain such Third Party Consent on or prior to the Closing Date. Upon the request of Seller, Purchaser and Purchaser Parent will provide reasonable assistance to Seller and Seller Parent in obtaining such Third Party Consents, including providing such financial and other information as shall be reasonably requested by the other parties to such Contracts. To the extent that any consent is required under any Contract to which Purchaser Parent or any of its Affiliates is a party in connection with the merger of any Sponsored Fund into a fund sponsored by Purchaser Parent or any of its Affiliates, Purchaser and Purchaser Parent will use their reasonable best efforts to obtain such consent on or prior to the Closing Date. Upon the request of Purchaser, Seller and Seller Parent will provide reasonable assistance to Purchaser and Purchaser Parent in obtaining such consents referred to in the preceding sentence, including providing such financial and other information as shall be reasonably requested by the other parties to such Contracts. Notwithstanding the foregoing provisions of this Section 6.3 and paragraphs (e) and (f) below, none of the parties hereto nor any of their Affiliates shall have any obligation under this Agreement to pay any money or other consideration to any Person or to initiate any claim or proceeding against any Person in order to obtain any such Third Party Consent or such other consents (other than the bearing of fees and expenses pursuant to Section 12.6 hereof).

(e) In furtherance (and without limitation) of Section 6.3(d) above, with respect to each Registered Fund Client, Seller shall use its reasonable best efforts to obtain, as promptly as practicable following the date hereof, the due consideration and approval by the board of directors or trustees (as applicable) of such Registered Fund Client (its "Fund Board Approval") of (i) in accordance with Section 15 of the Investment Company Act, a new Advisory Contract with the Company, its applicable Subsidiary, Purchaser or its Affiliate to be in effect as of, and subject to, the Closing, in all material respects on the same terms and conditions as the terms of the Company's or its applicable Subsidiary's existing Advisory Contract relating to such Registered Fund Client, with the exception of its effective and termination dates, or which is otherwise in form and substance reasonably satisfactory to Purchaser, provided that in the case of a Sponsored Fund, such new Advisory Contract shall terminate upon the effectiveness of the merger (if approved) of such Sponsored Fund referred to in clause (iii) below; (ii) in accordance with Section 15 of the Investment Company Act, an interim advisory contract with the Company, its applicable Subsidiary, Purchaser or its applicable Affiliate that contains the provisions required by Rule 15a-4(b)(2) under the Investment Company Act, to be in effect as of, and subject to, the Closing, and otherwise in all material respects on the same terms and conditions as the terms of the Company's or its applicable Subsidiary's existing Advisory Contract relating to such Registered Fund Client, with the exception of its effective and

termination dates, or which is otherwise in form and substance reasonably satisfactory to Purchaser, provided that such interim contract shall become effective only if the Fund

---

Shareholder Approval of the new Advisory Contract referred to in clause (i) above of such Registered Fund Client is not received by the Closing; and (iii) in the case of a Sponsored Fund, the merger of such Sponsored Fund with a fund sponsored by Purchaser or any of its Affiliates, as set forth on Schedule 6.3(e), provided that, notwithstanding Schedule 6.3(e), Purchaser may elect to request Fund Board Approval of the merger of a Sponsored Fund into any reasonably comparable fund sponsored by Purchaser or any of its Affiliates that does not have a higher aggregate expense ratio or an investment performance record materially worse than that of the fund sponsored by Purchaser or any of its Affiliates proposed for such merger on Schedule 6.3(e) (or may elect not to request Fund Board Approval of one or more mergers (in which event Fund Board Approval of such merger or mergers shall not be required for purposes of Section 8.2(f) or the definition of Client Consent) or may elect to request Fund Board Approval of a different merger with Seller's consent not to be unreasonably withheld or delayed), except that if a Sponsored Fund is shown on Schedule 6.3(e) of the Purchaser Disclosure Letter as merging into a newly-formed "shell" fund sponsored by Purchaser or any of its Affiliates, Purchaser may not elect to request Fund Board Approval of the merger of such Sponsored Fund into an existing fund sponsored by Purchaser or any of its Affiliates without the prior written consent of Seller, which consent shall not be unreasonably withheld or delayed. To the extent Fund Board Approval has been obtained with respect to a Sponsored Fund in accordance with the first sentence of this Section 6.3(e), Seller shall use its reasonable best efforts to obtain, as promptly as practicable following the date of such Fund Board Approval, the due consideration and approval by the shareholders of such Sponsored Fund (its "Sponsored Fund Shareholder Approval") of the new Advisory Contract referred to in clause (i) of the first sentence of this Section 6.3(e) in accordance with Section 15 of the Investment Company Act and the applicable merger described in clause (iii) of the first sentence of this Section 6.3(e), provided that Seller shall be afforded a reasonable time to solicit proxies and to coordinate the date or dates for shareholders meetings of the Sponsored Funds. In the event that a Sponsored Fund Shareholder Approval of the new Advisory Contract referred to in clause (i) of the first sentence of this Section 6.3(e) and the merger of a Sponsored Fund referred to in clause (iii) of the first sentence of this Section 6.3(e) is not received prior to the Closing Date, Seller shall, at the request of Purchaser, use its reasonable best efforts to obtain or assist the Purchaser in its efforts to obtain, as promptly as practicable and at Seller's expense, Sponsored Fund Shareholder Approval of such new Advisory Contract and merger. In the event that such Sponsored Fund Shareholder Approval of such new Advisory Contract is not obtained within 120 days after the Closing Date, Seller shall use its reasonable best efforts to assist the Board of Directors of such Sponsored Fund in seeking an alternative investment advisory arrangement for such Sponsored Fund. To the extent Fund Board Approval has been obtained with respect to a new Advisory Contract relating to a Sub-Advised Fund in accordance with this Section 6.3(e), Seller shall (solely in the event that shareholder approval of such new Advisory Contract is required under Section 15 of the Investment Company Act, as determined by the sponsor of such Sub-Advised Fund) use its reasonable best efforts to cause the sponsor of such Sub-Advised Fund to obtain in accordance with Section 15 of the Investment Company Act, as promptly as practicable following the date of such Fund Board Approval, the due consideration and approval by the shareholders of such Sub-Advised Fund (its "Sub-Advised Fund Shareholder Approval" and, together with the Sponsored Fund Shareholder Approvals, the "Fund Shareholder Approvals") of such new Advisory Contract described above. Purchaser shall use its reasonable best efforts to assist Seller in obtaining the Fund Board Approvals and Fund Shareholder Approvals to the extent so requested

---

by Seller. Nothing in this Agreement shall require Seller or any of its Affiliates or Purchaser or any of its Affiliates to make any proposal regarding or otherwise seek in any manner to influence or affect the director or trustee composition or any other governance matter with respect to any fund sponsored by Purchaser or any of its Affiliates (collectively, "Board Governance Matters"). Purchaser and Seller acknowledge and agree that Board Governance Matters are within the sole purview of and are under the consideration of the respective boards of directors or trustees of the Sponsored Funds and the relevant funds sponsored by Purchaser and its Affiliates. In furtherance (and without limitation) of Section 6.3(d) above, Purchaser shall use its reasonable best efforts to obtain, as promptly as practicable following the date hereof, the due consideration and approval by the board of directors or trustees (as applicable) of the funds sponsored by Purchaser or an Affiliate of Purchaser of the merger of the Sponsored Funds into funds sponsored by Purchaser or any of its Affiliates, as contemplated by clause (iii) above ("Purchaser Fund Board Approvals"). Seller shall use its reasonable best efforts to assist Purchaser in obtaining the Purchaser Fund Board Approvals and related shareholder approvals to the extent so requested by Purchaser.

(f) In furtherance (and without limitation) of Section 6.3(d) above, with respect to each Separate Account Client, Seller shall use its reasonable best efforts to obtain, as promptly as practicable following the date hereof, such consent of such Separate Account Client to the "assignment" of its Advisory Contract resulting from the consummation of the transactions contemplated hereby as is required by the terms of such Advisory Contract and the Investment Advisers Act, such Advisory Contract to provide for the same terms and conditions in all material respects as exist as of the date hereof or as are otherwise in form and substance reasonably satisfactory to Purchaser (its "Separate Account Consent"). The parties hereto agree that the Separate Account Consent for any such Advisory Contract shall be deemed given for all purposes of this Agreement as follows: (i) for those Advisory Contracts set forth on Schedule 6.3(f), upon receipt of written consent prior to the Closing Date, (ii) for all other such Advisory Contracts, (A) if written consent is required pursuant to the Applicable Law or the applicable Advisory Contract, upon receipt of written consent prior to the Closing Date or (B) if consent other than written consent is sufficient under Applicable Law and the applicable Advisory Contract, (x) upon receipt of a written consent prior to the Closing Date or (y) if no such written consent is received, if 60 days shall have passed since the sending of a notice of the transactions contemplated by this Agreement and related assignment (which notice must be sent at least 60 days prior to the Closing Date); provided, however, that any Advisory Client who has informed any Subject Company whether orally or in writing of its intention to terminate or seek a material modification of the terms of its Advisory Contract with the Subject Company, withdraw assets under management by the Subject Companies (other than in the ordinary course of business consistent with past practice), put its account up for bid or refuse or delay its consent prior to the Closing shall be deemed not to have provided its Separate Account Consent for any purpose under this Agreement unless, as of the Closing Date, such notice shall have been rescinded or withdrawn. All notices and related materials distributed to such Advisory Clients shall be in form and substance reasonably acceptable to Purchaser, and Purchaser shall be provided the opportunity to review and comment on all such notices within a reasonable period of time prior to distribution.

(g) Seller shall, and shall cause the Subject Companies and their respective Affiliates to, use reasonable best efforts to obtain in accordance with Section 15 of the

Investment Company Act, as promptly as practicable following the date hereof, the approval of the board of directors or trustees of the Sponsored Funds of new Distribution Agreements between the Sponsored Funds and a Subject Company or such other Affiliate of Purchaser as Purchaser may designate (effective as of the Closing) on substantially the same terms as the terms of the existing Distribution Agreement with such Sponsored Fund or on terms which are otherwise in form and substance reasonably satisfactory to Purchaser. Purchaser shall use its reasonable best efforts to assist Seller in obtaining such approvals to the extent so requested by Seller.

(h) Seller shall, and shall cause the Subject Companies and their respective Affiliates to, use reasonable best efforts to obtain, as promptly as practicable following the date hereof, to the extent required, the approval of the board of directors or trustees of each Sponsored Fund of new Administration Contracts and other Contracts with a Subject Company, if and to the extent that existing Administration Contracts and other Contracts between such Sponsored Fund and Subject Company would terminate automatically upon the consummation of the transactions contemplated by this Agreement.

(i) From the date hereof until the Closing, Seller shall promptly notify Purchaser in writing upon becoming aware of: (a) any circumstance which (i) has had or would reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect, (ii) would reasonably be expected to result in any representation or warranty made by Seller or Seller Parent hereunder not being true and correct in any material respect or (iii) would reasonably be expected to result in the failure of any of the conditions set forth in Article VIII to be satisfied; (b) any notice or other communication from any Person alleging that the consent of such Person is or may be required in connection with the transactions contemplated by this Agreement; (c) the amendment, termination, renewal of or entry into any new Distribution Agreement, except in the ordinary course of business consistent with past practice; (d) other than in the ordinary course of business, the hiring or termination of any employee of any of the Subject Companies; and (e) any litigation commenced or, to the Knowledge of Seller, threatened, that, if pending on the date of this Agreement, would have been required to have been disclosed pursuant to Section 4.8 or that relates to the consummation of the transactions contemplated by this Agreement; provided, however, that any noncompliance with the foregoing clauses (a) through (e) shall not constitute a failure of any condition to Closing set forth in Article VIII or give rise to any right of termination under Article IX unless the underlying breach shall independently constitute such a failure or give rise to such a right. Purchaser's receipt of information pursuant to this Section 6.3(i) or otherwise shall not operate as a waiver or otherwise affect any representation, warranty or agreement given or made by Seller or Seller Parent in this Agreement.

(j) From the date hereof until the Closing, Seller shall provide to Purchaser: (i) weekly sales data in the format and detail that Purchaser may reasonably request, promptly following the end of each week; (ii) unaudited monthly financial statements of the Subject Companies, within 21 days of the end of each month; (iii) copies of all regularly prepared management reports, promptly following their preparation; and (iv) such other information as Purchaser may reasonably request promptly following such request.

(k) Each of Seller, Seller Parent, Purchaser and Purchaser Parent shall use its reasonable best efforts to cooperate with the other parties hereto to obtain the agreements referred to in Section 8.2(g) from all of the parties listed on Schedule 8.2(g), to the extent requested by Purchaser. Seller Parent and Seller shall pay up to the amount set forth in Section 6.3(k)(i) of the Seller Disclosure Letter to secure such agreements, and, the Subject Companies shall pay the amount set forth in Section 6.3(k)(ii) of the Seller Disclosure Letter to secure such agreements, <u>provided</u> that the amount set forth in Section 6.3(k)(ii) of the Seller Disclosure Letter shall be accrued as a current liability on the Closing Date Balance Sheet. Such payments shall be allocated in accordance with the determinations of the officer named on Section 6.3(k) of the Seller Disclosure Letter.

6.4 <u>CDSC Financing Agreements</u>. Prior to the Closing, Seller shall cause the Subject Companies to either (i) terminate the Subject Companies obligation to transfer receivables and collections under or otherwise utilize the CDSC Financing Agreements or (ii) amend the CDSC Financing Agreements so that such obligation of the Subject Companies to transfer receivables and collections (other than in respect of receivables previously transferred) can be terminated by the Subject Companies no later than 30 days after the Closing without payment or penalty. Subject to the preceding sentence, from and after the Closing, Purchaser shall cause the Company and its Subsidiaries (a) to comply in all material respects with their respective obligations under the CDSC Financing Agreements, and (b) not to amend or otherwise modify any of the CDSC Financing Agreements without the prior written consent of Seller.

6.5 <u>Insurance</u>. Seller Parent shall cause to be maintained through the Closing the insurance with respect to the Company and its Subsidiaries referred to in Section 4.22 or Section 4.19(o) of the Seller Disclosure Letter. If Purchaser requests, Seller shall cause to be purchased, at Purchaser's expense, an extended reporting period with respect to such insurance. Following the Closing, Seller Parent shall and shall cause its Affiliates to (i) not seek to change any rights or obligations of any of Subject Companies under such insurance, (ii) cooperate with the Subject Companies in making claims under such insurance, and (iii) promptly pay over to the Subject Companies any amounts that Seller Parent or any such Affiliate may receive under such insurance in respect of losses experienced by any of the Subject Companies.

6.6 <u>Names of Subject Companies and Sponsored Funds; Websites</u>. (a) Within the later of (i) 180 days following Closing and (ii) at Purchaser's option, 270 days following Closing, or such greater number of days upon which the parties hereto shall agree, following Closing, the names of the Subject Companies and the Sponsored Funds shall be changed to names that do not include the names "Washington Mutual" or the acronym "WM" or any name confusingly similar thereto, and from and after such date, Purchaser shall not use (and shall cause the Subject Companies not to use, including, without limitation, in connection with the Sponsored Funds or other financial products) the names "Washington Mutual", the acronym "WM", or any other names, trademarks, service marks, trade names, corporate names, domain names, logos, trade dress or other source indicators ("<u>Trademarks</u>") that contain or comprise any Trademark owned or used by Seller Parent or any of its Affiliates prior to the Closing or any Trademark confusingly similar thereto (other than for purposes of prospectus and similar disclosures describing the historical relationship of the Subject Companies and the Sponsored Funds with Seller Parent and its Affiliates and such continuing service relationships as may be in

effect with them from time to time following the Closing, and other than as provided for in Section 6.6(b) below).

(b) Purchaser and Seller agree that, effective as of the Closing and until May 31, 2008, (i) all Internet websites operated by Seller or any of its Affiliates which previously made reference to the ownership of the Subject Companies by Seller shall display prominently on their home pages (in such form as is mutually agreed upon by Purchaser and Seller in writing prior to the Closing, such agreement not to be unreasonably withheld) (A) a statement as to the new ownership of the Subject Companies and (B) a direct hyperlink to Purchaser's home page, and (ii) all Internet websites operated by Purchaser or any of its Affiliates (including without limitation the Subject Companies) in connection with the businesses of the Subject Companies shall display prominently on their home pages (in such form as is mutually agreed upon by Purchaser and Seller in writing prior to the Closing, such agreement not to be unreasonably withheld) (A) a statement as to the new ownership of the Subject Companies and (B) if so requested by Seller in writing, a direct hyperlink to Seller Parent's home page. Purchaser and Seller shall cooperate in all commercially reasonable respects prior to the Closing in connection with the implementation of the provisions of the immediately preceding sentence.

(c) Seller Parent shall grant Purchaser and the Subject Companies a limited license commencing on the Closing and ending on the later of (i) the 180th day following Closing and (ii) at Purchaser's option, the 270th day following Closing or such greater number of days upon which the parties hereto shall agree, following Closing, to use the term "Washington Mutual" or the acronym "WM" in connection with the operation of the Subject Companies.

(d) Purchaser acknowledges that Seller Parent would be irreparably harmed by any breach of this Section 6.6 and that there would be no adequate remedy at law or in damages to compensate Seller Parent for any such breach. Purchaser agrees that Seller Parent shall be entitled to injunctive relief requiring specific performance of this Section 6.6, and consents to the entry of such injunctive relief in the event of any such breach. If the final judgment of a court of competent jurisdiction declares that any term or provision of this Section 6.6 is invalid or unenforceable, the parties hereto agree that the court making the determination of invalidity or unenforceability shall have the power to replace any invalid or unenforceable term or provision with a term or provision that is valid and enforceable and that comes closest to expressing the intention of the invalid or unenforceable term or provision, and this Agreement shall be enforceable as so modified.

6.7 Post-Closing Cooperation; Retention of Records and Confidentiality. (a) Following the Closing, each party hereto shall use reasonable efforts to, and Purchaser shall use reasonable efforts to cause the Subject Companies to, (i) preserve and keep all records relating to the Subject Companies (and their predecessors) and the Sponsored Funds in their possession for so long as and to the extent required by Applicable Law (but in no event less than six years after the Closing Date) and (ii) to the extent permitted by Applicable Law, make such records available to the other parties hereto (and their auditors and professional advisors) and provide them with reasonable access thereto, subject to customary confidentiality commitments reasonable under the circumstances, as may be reasonably required by their other parties hereto or their Affiliates, including in connection with any insurance claims by, legal proceedings against or investigations by any Governmental Authority or similar matters or to enable any

party or any Subject Company to comply with its obligations under Applicable Law and this Agreement or otherwise reasonably necessary for the conduct of any party's or any Subject Company's business and operations.

(b) Following the Closing, each party hereto shall use reasonable efforts to, and Purchaser shall use reasonable efforts to cause the Subject Companies to, make available to the other parties hereto and their Affiliates (and their auditors and professional advisors) the reasonable assistance and cooperation of the appropriate personnel in the review of the records described in Section 6.7(a) consistent with the assistance and cooperation furnished during the period prior to the Closing. In addition, following the Closing, each party hereto shall use reasonable efforts to, and Purchaser shall use reasonable efforts to cause the Subject Companies to, make available to the other parties hereto and to the Subject Companies such party's employees whose assistance, expertise, testimony, notes, recollections or presence (including participation as a witness in a deposition, hearing or trial) is necessary or appropriate to assist the other parties and their Affiliates in the defense or prosecution of any legal action or proceeding or similar matter relating to the business of the Subject Companies or the Sponsored Funds, provided that the requesting party bears all reasonable expenses and pays reasonable compensation for the assisting employee's time.

(c) Following the Closing, Seller and Seller Parent shall, and shall cause their Affiliates to, hold and use their reasonable best efforts to cause their respective officers, directors, employees, accountants, counsel, consultants, advisors and agents to hold in confidence, unless compelled to disclose by judicial or administrative process or by other requirements of law, all confidential documents and information concerning the Subject Companies, except to the extent that such information can be shown to have been (i) in the public domain through no fault of any such Person or (ii) later lawfully acquired by any such Person from sources that to such Person's knowledge are not under any legal or contractual duty of confidentiality with respect to such documents or information.

(d) From and after the Closing, Seller and Seller Parent shall, or shall cause their Affiliates to, at the direction and expense of Purchaser, use reasonable best efforts to enforce its or their rights under any confidentiality, non-solicitation and similar agreements with any Person entered into in connection with the proposed sale of the Subject Companies.

6.8 Public Announcements. Upon execution and delivery of this Agreement, the parties shall jointly issue a press release in the form approved by the parties prior to the date hereof, such approval not to be unreasonably withheld or delayed. Except for such press release, prior to the Closing Date, no news release or other public announcement pertaining to the transactions contemplated by this Agreement shall be made by or on behalf of any party hereto without the prior approval, not to be unreasonably withheld or delayed, of the other parties, unless the party making such public announcement or disclosure shall give prior written notice to the other parties and consider in good faith their suggestions with respect thereto, to the extent possible and legally permissible.

6.9 Section 15 of the Investment Company Act. Prior to the Closing, Seller shall use its best efforts to ensure compliance with Section 15(f) of the Investment Company Act, so that the transactions contemplated by this Agreement will be in compliance at the Closing

with Section 15(f) of the Investment Company Act, including using such efforts to ensure that at the time of the Closing at least 75% of the members of the board of directors or trustees (as applicable) of each Sponsored Fund are not "interested persons" (as such term is defined in the Investment Company Act) of Seller or any Affiliate thereof or Purchaser or any Affiliate thereof. Purchaser will use its best efforts to ensure compliance with the conditions of Section 15(f) of the Investment Company Act as it applies to the transactions contemplated by this Agreement. Without limitation of the foregoing, but without interfering with any Sponsored Fund's compliance with clause (ii) of the fund governance standards as defined in Rule 0-1 under the Investment Company Act, from and after the Closing Purchaser shall use its best efforts to conduct the business of Purchaser and its Affiliates (including, from and after the Closing, the Subject Companies) so as to ensure that (i) for a period of at least three years after the Closing Date, at least 75% of the members of the board of directors or trustees (as applicable) of each such Sponsored Fund (and of any fund sponsored by Purchaser or any of its Affiliates into which any Sponsored Fund is merged) are not "interested persons" of the Seller or any Affiliate thereof or Purchaser or any Affiliate thereof, and (ii) for a period of at least two years after the Closing Date, there is not imposed on any Sponsored Fund (or any fund sponsored by Purchaser or any of its Affiliates into which a Sponsored Fund is merged) an "unfair burden" (within the meaning of Section 15(f) of the Investment Company Act) as a result of the transactions contemplated by this Agreement, or any express or implied terms, conditions or understandings applicable thereto. Notwithstanding anything to the contrary contained herein, the covenants of the parties contained in this Section 6.9 are intended only for the benefit of the parties to this Agreement and for no other Person.

6.10 Non-Competition; Non-Solicitation. (a) Seller and Seller Parent agree that during the Seller Restricted Period, within the Territory, Seller and Seller Parent shall not, and shall cause each of their controlled Affiliates (other than the Subject Companies) not to, (i) engage in the Seller Restricted Activities, provided that nothing in this Section 6.10(a) shall restrict Seller, Seller Parent or their Affiliates from conducting or engaging in the Seller Permitted Activities or any other business of any kind or nature other than the Seller Restricted Activities, or (ii) directly or indirectly, hire, employ, solicit or receive the performance of services by any employee of any of the Subject Companies, other than (A) pursuant to a bona fide general advertisement of employment opportunities that is not specifically targeted to any employees of the Subject Companies, (B) pursuant to head-hunter inquiries (provided that the employee and the Subject Companies were not identified to the headhunter by Seller Parent or any of its Affiliates), and (C) employees who contact Seller Parent or any of its Affiliates on their own initiative, provided that during the Seller Restricted Period in no event shall Seller Parent or any of its Affiliates hire, employ or receive the performance of services by any of the individuals listed in Section 6.10(a) of the Seller Disclosure Letter.

(b) Seller and Seller Parent acknowledge that Purchaser would be irreparably harmed by any breach of this Section 6.10 and that there would be no adequate remedy at law or in damages to compensate Purchaser for any such breach. Seller and Seller Parent agree that Purchaser shall be entitled to injunctive relief requiring specific performance of this Section 6.10, and Seller and Seller Parent consent to the entry of such injunctive relief in the event of any such breach. If the final judgment of a court of competent jurisdiction declares that any term or provision of this Section 6.10 is invalid or unenforceable, the parties hereto agree that the court making the determination of invalidity or unenforceability shall have the power to

reduce the duration, or area of the term or provision, to delete specific words or phrases, or to replace any invalid or unenforceable term or provision with a term or provision that is valid and enforceable and that comes closest to expressing the intention of the invalid or unenforceable term or provision, and this Agreement shall be enforceable as so modified.

(c) Notwithstanding the provisions of Section 6.10(a), nothing contained in this Section 6.10 shall be construed as precluding Seller Parent from (i) acquiring direct or indirect control of another entity that engages directly or indirectly in the Seller Restricted Activities as a secondary part of such entity's business, provided that (A) Seller Parent's primary purpose in effecting such acquisition is not to acquire a business that engages in the Seller Restricted Activities, and (B) if after giving effect to such acquisition or at any time thereafter so long as this covenant is in effect assets under management or annual revenues in connection with the engagement by Seller Parent and its controlled Affiliates in the Seller Restricted Activities exceed $2.5 billion or $50 million, respectively, Seller Parent shall within six months either cause all of the business that engages in such Seller Restricted Activities to be sold or cease to conduct such business, provided that if Seller Parent elects to cause such business to be sold, it shall extend to Purchaser Parent in good faith equivalent access to information and an equivalent opportunity to bid on the purchase of such business to be sold as that offered to any other Person; or (ii) merging or combining with or being acquired by an entity that engages directly or indirectly in the Seller Restricted Activities (in which case the restrictions of Section 6.10(a)(i) shall not apply to the surviving parent company of such transaction or any of its controlled Affiliates), provided that Seller Parent may only avail itself of this clause (ii) if (A) immediately following such acquisition directors of Seller Parent at the time such acquisition is announced no longer constitute a majority of directors of Seller Parent and do not constitute a majority of the directors of the surviving parent company of such transaction, (B) holders of equity securities having the right to elect the directors of Seller Parent immediately prior to the consummation of such acquisition do not own directly or indirectly a majority of the equity securities having the right to elect the directors of Seller Parent or of the surviving parent company of such transaction immediately following such consummation, and (C) such transaction has not been structured or entered into principally for the purpose of avoiding the obligations of Seller Parent under this Section 6.10.

(d) Notwithstanding the provisions of Section 6.10(a), nothing contained in this Section 6.10 shall be construed as precluding Seller Parent from directly or indirectly acquiring and holding publicly traded equity interests representing less than five percent of the outstanding voting equity securities of companies that engage directly or indirectly in the Seller Restricted Activities; provided that securities owned by Seller Parent and its Affiliates shall not include, for purposes of this Section 6.10, any securities held: by Seller Parent and its Affiliates in trust, managed, brokerage, custodial, nominee or other customer accounts; in mutual funds, open or closed end investment funds or other pooled investment vehicles sponsored, managed and/or advised or subadvised by Seller Parent or its Affiliates to the extent otherwise permitted by the terms of this Section 6.10; or by Affiliates of Seller Parent which are broker-dealers or otherwise engaged in the securities business, provided that in each case, such securities were acquired in the ordinary course of their respective banking and securities business and not with the intent or purpose on the part of Seller Parent or its Affiliates of avoiding the provisions of this Section 6.10.

6.11 401(k) Plans. Subject to Applicable Law (including, for the avoidance of doubt, Section 406 of ERISA and Section 4975 of the Code), Seller Parent shall not, and shall cause its Affiliates not to, take any action (i) to eliminate any of the Sponsored Funds (or any fund with which such

Sponsored Fund merges) as an investment option under any of its Benefit Plans which are participant individual account plans and under which any such Fund is such an investment option on the date hereof, or (ii) to restrict or otherwise limit the ability of plan participants to select any such Sponsored Fund as such an investment option under any such individual account Benefit Plan (unless such limitation or restriction applies generally to all available investment options), provided, however, that Seller Parent shall not be obligated to take any action that would interfere with or prevent the free exercise by the trustees or the named fiduciary that has the authority and discretion to manage and control the assets of any such Benefit Plan, of their fiduciary duties under the Benefit Plan and ERISA, or otherwise impose requirements, restrictions or limitations on any such trustees or named fiduciary that could give rise to liability under Section 406 of ERISA or Section 4975 of the Code or otherwise.

6.12 Further Assurances. Until the Closing, each party shall cooperate with the others, and execute and deliver, or use its reasonable best efforts to cause to be executed and delivered, all such other instruments, including instruments of conveyance, assignment and transfer, and take all such other actions as such party may reasonably be requested to take by the other parties hereto from time to time, consistent with the terms of this Agreement, in order to effectuate the provisions and purposes of this Agreement and the transactions contemplated hereby. Seller and Purchaser shall work together in good faith and use their respective reasonable best efforts to agree, as soon as practicable following the date hereof, on additions or modifications to Exhibit A-1 to the Transition Services Agreement (including Schedule 1 thereto) so that (i) the Transition Services Agreement may be entered into at Closing with such Exhibit (and Schedule) completed and will cover all services that are either listed on Section 4.7(c) of the Seller Disclosure Letter (other than the services set forth on Exhibit A-2 to the form of Transition Services Agreement attached hereto as Exhibit B) or that constitute an “Omitted Service” (as such term is used in Section 1.2 of the form of Transition Services Agreement attached hereto as Exhibit B), in each case at rates as set forth in Section 2.1 of the form of Transition Services Agreement attached hereto as Exhibit B, and (ii) such Exhibit (and Schedule) are otherwise complete in all material respects. Prior to Closing, Seller will use its reasonable best efforts to assist Purchaser in order that Purchaser or the Subject Companies are able to provide the services set forth on Section 6.12 of the Seller Disclosure Letter to the Subject Companies.

6.13 Settlement of Intercompany Accounts. Seller Parent and its Affiliates shall use their reasonable best efforts to reduce or eliminate the Intercompany Balances of the Subject Companies that will remain outstanding at Closing, including by eliminating any Intercompany Balances that are included in the long term assets or liabilities of the Subject Companies and netting or otherwise settling and repaying any Intercompany Balances as soon as practicable following each month end after the date hereof and prior to Closing. Seller Parent shall deliver a statement of all Intercompany Balances within 15 days after each month end following the date hereof and prior to Closing. Within 15 days following the Closing Date, the Subject Companies, on the one hand, and Seller Parent and its Affiliates (other than the Subject Companies), on the other hand, shall settle and repay all Intercompany Balances (including intercompany loans, notes, advances, payables and receivables) between them, in each case that

---

were outstanding on the Closing Date, without any interest thereon from and after the Closing Date. Purchaser and Purchaser Parent shall cause the Subject Companies to comply with their obligations under the preceding sentence. All payments made pursuant to this Section 6.13 shall be made in immediately available funds to an account designated by the receiving party, and may be made on a net basis.

Article VII
EMPLOYEE MATTERS

7.1 General. Except as otherwise provided in this Article VII, for the twelve-month period following the Closing Date, Purchaser shall, or shall cause its Affiliates to, provide each Affected Employee with salary or wages, incentive compensation opportunity and employee benefits (excluding any change in control or similar arrangements) that are no less favorable in the aggregate than the salary or wages provided to such Affected Employee immediately prior to the Closing Date, and the incentive compensation opportunity and employee benefits provided to such Affected Employee immediately prior to the date hereof, provided that nothing contained herein, expressed or implied, is intended to interfere with the right of Purchaser to terminate the employment of any Affected Employee at any time, with or without cause.

(a) Effective as of the Closing Date, Purchaser and its Affiliates shall give Affected Employees full credit for all purposes, except for purposes of benefit accrual under any qualified or non-qualified defined benefit pension plan, under such employee benefit plans or arrangements maintained by Purchaser or any of its Affiliates (including, without limitation, any welfare plan, pension plan, vacation program or severance program) in which any such Affected Employees participate for such Affected Employees’ service with Seller, Seller Parent, any of the Subject Companies, any of their respective Affiliates and/or any predecessor entities to the same extent recognized by Seller, Seller Parent and/or any of the Subject Companies immediately prior to the Closing Date, except to the extent such credit would result in an unintended duplication of benefits. Notwithstanding the foregoing, effective as of the Closing Date, Purchaser and its Affiliates shall give Affected Employees full credit, for all purposes (including, without limitation, for purposes of eligibility to participate, vesting benefit accrual and determination of benefits) under all post-retirement health plans maintained by Purchaser or any of its Affiliates, if any, in which any such Affected Employees participate for such Affected Employees’ service with Seller, Seller Parent, any of the Subject Companies, any of their respective Affiliates and/or any predecessor entities to the same extent recognized by Seller, Seller Parent and/or any of the Subject Companies immediately prior to the Closing Date; provided, however, that nothing contained in this sentence shall obligate Purchaser or any Affiliates thereof to establish or maintain any post-retirement health plan. Notwithstanding anything in this section to the contrary, Affected Employees shall not be eligible to participate in any employee benefit plan or portion thereof to the extent eligibility for such benefit is conditioned (under the terms and conditions of such benefit) upon employment with Purchaser as of a specified date occurring prior to the Closing Date.

(b) Purchaser shall, or shall cause its Affiliates to, (i) waive all limitations as to preexisting conditions, exclusions and waiting periods with respect to participation and coverage requirements applicable to the Affected Employees under any welfare benefit plans in

---

which such Affected Employees may be eligible to participate on or after the Closing Date to the extent waived under the applicable Seller’s corresponding Benefit Plan immediately prior to the Closing and (ii) to the extent not prohibited by Applicable Law, provide each Affected Employee with credit for any co-payments and deductibles paid prior to the Closing Date for Seller Parent’s then-current plan year in satisfying any applicable deductible or out-of-pocket requirements under any welfare plans in which any such Affected Employee is eligible to participate on or after the Closing Date.

(c) Prior to the Closing Date, Seller or Seller Parent shall cause the Subject Companies to assign and delegate to Seller or Seller Parent, and Seller or Seller Parent shall assume, any and all liability arising under the agreement listed in Section 7.1 of the Seller Disclosure Letter.

7.2 Termination and Severance. Notwithstanding the foregoing, if the employment of an Affected Employee is terminated on or prior to the date that is twelve months after the Closing Date under circumstances under which such Affected Employee would have received severance benefits from Purchaser or its Affiliates under the Washington Mutual, Inc. Special Severance Plan, effective August 1, 2004 (as set forth in Section 7.2(a) of the Seller Disclosure Letter) (the "Seller Severance Plan"), such Affected Employee shall be entitled to severance benefits from Purchaser or its Affiliates that are equal to the severance benefits that would have been paid under the Seller Severance Plan had such plan remained applicable to such Affected Employee. Prior to the Closing Date, Seller shall cause the Company to assign and delegate to Seller any severance obligations, and Seller shall assume any severance obligations, arising under the change in control and employment plans, programs or agreements listed on Section 7.2(b) of the Seller Disclosure Letter.

7.3 Closing Payments. As of immediately prior to the Closing, Seller shall pay to each Affected Employee who is a participant in the transaction bonus plan sponsored by the Company or Seller described in Section 7.3 of the Seller Disclosure Letter (the "Transaction Bonus Plan") that amount (if any) owed to such Affected Employee pursuant to the Transaction Bonus Plan (as reasonably determined by Seller) (each payment a "Closing Payment").

7.4 Welfare Plans. Seller Parent shall retain responsibility for and continue to pay all medical, life insurance, disability and other welfare plan expenses and benefits for each Affected Employee with respect to claims incurred by such Affected Employees or their covered dependents prior to the Closing Date. Subject to the terms and conditions of and to the extent provided under Purchaser's welfare plans, expenses and benefits with respect to claims incurred by Affected Employees or their covered dependents on or after the Closing Date shall be the responsibility of Purchaser and its Affiliates. For purposes of this paragraph, (i) except as otherwise provided in subclauses (ii), (iii) and (iv) of this Section 7.4, a claim is deemed incurred when the services that are the subject of the claim are performed; (ii) in the case of life insurance, a claim is deemed incurred when the death occurs; (iii) in the case of long-term disability benefits, a claim is deemed incurred when the disability first occurs; and (iv) in the case of a hospital stay, a claim is deemed incurred when the employee or covered dependent first enters the hospital (regardless of the length of such stay).

7.5 Accrued Vacation. With respect to any accrued but unused vacation time to which any Affected Employee is entitled pursuant to the vacation policy applicable to such Affected Employee immediately prior to the Closing Date (the "Vacation Policy") (as set forth in Section 7.5 of the Seller Disclosure Letter), the Subject Companies shall retain such liabilities, and Purchaser and its Affiliates shall allow, or cause the Subject Companies to allow, such Affected Employee to use such accrued vacation in a manner consistent with the terms and conditions of the Vacation Policy. To the extent that, at the time of his termination an Affected Employee still has accrued and unused vacation time outstanding in accordance with the Vacation Policy, Purchaser shall, or shall cause the Subject Companies to, pay in cash an amount equal to such accrued and unused vacation days. Notwithstanding anything else in this Section to the contrary, Purchaser shall have no obligation with respect to accrued vacation days of the Affected Employees to the extent that such accrued vacation days have not been properly accrued on the financial statements of the Subject Companies in accordance with GAAP.

7.6 Seller Parent Benefit Plans. On or prior to the Closing, Seller Parent shall cause the Subject Companies to cease participating in any Benefit Plan sponsored by the Seller Parent or any of its Affiliates (other than the Subject Companies) and, except as otherwise expressly set forth herein, assume any and all obligations of each of the Subject Companies with respect to or arising under any such Benefit Plan. Except as otherwise expressly provided herein, Purchaser and its Affiliates shall have no obligations with respect to any Benefit Plan, whether with respect to any Affected Employee or for any other employee or former employee of the Subject Companies. Notwithstanding the foregoing, to the extent that any of the Affected Employees participated in any nonqualified plan of deferred compensation maintained by Seller, Seller Parent or any Subject Company in respect of services for the Subject Companies prior to the date hereof (a list of which is set forth in Section 7.6 of the Seller Disclosure Letter) (such plans, the "Deferred Compensation Plans"), and to the extent permitted by the terms of such plan and by Section 409A of the Code, the liabilities as of the Closing Date arising under each such plan with respect to such services (the "Deferred Compensation Liabilities") shall remain with or be assumed by the Subject Companies, provided that, and only so long as, such Deferred Compensation Liabilities are reflected as current liabilities on the Closing Date Balance Sheet. In connection with the foregoing, Seller, Seller Parent and the Subject Companies shall cooperate in good faith to take all actions that are reasonably necessary to effectuate the foregoing, including the spin-off to and assumption by the Subject Companies of any Deferred Compensation Plans that are maintained by Seller or Seller Parent (but only to the extent of the amount of the Deferred Compensation Liabilities). Seller will cause all Deferred Compensation Liabilities (pro rated through the Closing Date and including in any event the amount of contributions or other accruals that would otherwise have been made for the benefit of the relevant Affected Employees that are attributable to the period January 1, 2006 through the Closing Date) to be reflected as current liabilities on the Closing Date Balance Sheet. With respect to any Deferred Compensation Liabilities that arise under any actuarially determined defined benefit plan, for purposes of this Section 7.6, such liabilities shall be determined using the assumptions that would apply with respect to an assumption of liabilities from a qualified plan subject to the provisions of Section 414(l) of the Code.

7.7 Administration. (a) Following the date of this Agreement, Seller, Seller Parent, the Subject Companies and Purchaser shall reasonably cooperate in all matters reasonably necessary to effect the transactions contemplated by this Article VII, including,

---

without limitation, exchanging information and data relating to workers' compensation, employee payroll data, employee files, employee benefits and employee benefit plan coverages (except to the extent prohibited by Applicable Law), and in obtaining any Governmental Approvals required hereunder.

(b) The Closing Date Balance Sheet shall reflect an accrual as a current liability for the amount reasonably estimated to be payable (the "Estimated Accruals") as of the Closing Date pursuant to the variable pay plans listed in Section 7.7 of the Seller Disclosure Letter (the "Variable Pay Plans"). As soon as practicable following the Closing Date, Seller Parent and/or Seller shall, at their own expense, calculate, in a manner consistent with Seller Parent's, Seller's and the Subject Companies' past practices, the amount payable through the Closing Date (such an amount, a "Variable Pay Plan Amount") under each of the Variable Pay Plans in respect of the bonus payments described in this Section 7.7 for any Affected Employee (each, a "Variable Pay Plan Participant") who was a participant in one or more of the Variable Pay Plans, and who is employed on the Closing Date. Seller Parent or Seller shall

promptly notify Purchaser in writing and in a format reasonably acceptable to Purchaser of the Variable Pay Plan Amounts calculated for each Variable Pay Plan Participant and Purchaser shall pay or cause to be paid the Variable Pay Plan Amounts to each Variable Pay Plan Participant promptly following receipt of such notice from Seller Parent or Seller (but in no event shall Purchaser be obligated to make such payments earlier than 30 days following the Closing Date). If the Variable Pay Plan Amounts, in the aggregate, are greater than the Estimated Accruals, Seller Parent or Seller shall remit the difference to Purchaser at the time Seller Parent or Seller notifies Purchaser of the Variable Pay Plan Amounts. If the Variable Pay Plan Amounts, in the aggregate, are less than the Estimated Accruals, Purchaser shall remit the difference to the Seller within 30 days after the payment of the Variable Pay Plan Amounts to the Variable Pay Plan Participants. Except as otherwise expressly provided in this Section 7.7(b), Purchaser shall have no obligation with respect to the Variable Pay Plan bonuses payable to the Variable Pay Plan Participants.

Article VIII
CONDITIONS TO THE CLOSING

8.1 Conditions to Obligations of Each Party. The respective obligations of Purchaser, Seller and Seller Parent to consummate the transactions contemplated by this Agreement are subject to the satisfaction (or waiver in writing by Purchaser and Seller) as of the Closing of the following conditions:

(a) No Injunction. At the Closing Date, there shall be no (i) injunction, restraining order or decree of any nature of any Governmental Authority of competent jurisdiction in effect that restrains or prohibits the purchase of the Stock hereunder or the consummation of the other transactions contemplated hereby or (ii) pending action, suit or proceeding brought by any Governmental Authority which seeks to restrain or prohibit the purchase of the Stock hereunder or the consummation of the other transactions contemplated hereby.

(b) Regulatory Authorizations. All Governmental Approvals required for the execution and delivery of this Agreement and the Ancillary Agreements by Seller, Seller

---

Parent, Purchaser, Purchaser Parent and any of their respective Affiliates party thereto, for the performance by any of them of their respective obligations hereunder and thereunder and for their consummation of the transactions contemplated hereby and thereby shall have been obtained and be in full force and effect, and the applicable HSR Act waiting period shall have expired.

(c) Section 15 Compliance. No more than 25% of the members of the board of directors or trustees (as applicable) of any Sponsored Fund (or of any fund sponsored by Purchaser or any of its Affiliates into which any Sponsored Fund's shareholders have prior to the Closing approved the merger of such Sponsored Fund pursuant to Section 6.3 of this Agreement) shall be "interested persons" (as defined in the Investment Company Act) of Seller or any Affiliate thereof or Purchaser or any Affiliate thereof for purposes of Section 15(f)(1)(A) of the Investment Company Act.

8.2 Additional Conditions to the Obligations of Purchaser. The obligation of Purchaser to consummate the transactions contemplated by this Agreement is subject to the satisfaction (or waiver in writing by Purchaser) as of the Closing of each of the following additional conditions:

(a) Representations and Warranties. The representations and warranties of Seller contained in Article IV of this Agreement shall be true and correct as of the date hereof and as of the Closing Date as though made at and as of the Closing Date, except to the extent that any representation and warranty is made as of a specified date other than the Closing Date, in which case such representation and warranty shall be true and correct as of such specified date, without taking into account any qualification of such representation or warranty by reference to Material Adverse Effect or other materiality, except, in each case, for such failures to be true and correct that individually or in the aggregate would not reasonably be expected to have a Material Adverse Effect.

(b) Performance of Covenants. Seller and Seller Parent shall have performed in all material respects all obligations and agreements, and complied in all material respects with all covenants and conditions, contained in this Agreement to be performed or complied with by them prior to or at the Closing Date.

(c) Certificate. Purchaser shall have received a certificate of Seller and Seller Parent, dated the Closing Date, executed on behalf of Seller and Seller Parent, to the effect that the conditions specified in paragraphs (a) and (b) above have been fulfilled.

(d) Ancillary Agreements. The Ancillary Agreements shall have been executed and delivered by Seller Parent or its Affiliate or Affiliates party thereto.

(e) Aggregate Closing Advisory Revenue Run-Rate. The Aggregate Closing Advisory Revenue Run-Rate shall be equal to at least 80.0% of the Aggregate Base Advisory Revenue Run-Rate.

(f) Third Party Consents; Fund Board Approval; Fund Shareholder Approvals. The following shall have been obtained: (i) all Third Party Consents under the Material Contracts set forth in Schedule 8.2(f)(i) and (ii) (A) Fund Board Approvals

---

and Purchaser Fund Board Approvals with respect to all Sponsored Funds and (B) Fund Shareholder Approvals with respect to all of the Sponsored Funds specified in Schedule 8.2(f)(ii). Fund Board Approvals shall not be subject to any requirements or conditions that are not reasonably acceptable to Purchaser, provided that if a Fund Board Approval is subject to any requirements or conditions, Seller shall be entitled to require (by written request describing such requirements or conditions in reasonable detail) that Purchaser acknowledge in writing, within ten Business Days after receipt of such written request, whether or not such requirements and conditions are acceptable to it; and if Purchaser acknowledges that such

requirements and conditions are acceptable to it, the condition described in this sentence shall be deemed satisfied (whether or not any such requirements or conditions set forth in or accompanying such Fund Board Approval are themselves satisfied). If Purchaser accepts a Fund Board Approval for purposes of Closing, such Fund Board Approval shall also be deemed sufficient for purposes of the definition of Client Consent.

(g) Section 8.2(g) Agreements. Purchaser shall have received agreements, substantially in the form of Exhibit 8.2(g), executed and delivered as specified on Schedule 8.2(g).

(h) Third Party Distributors. For the third party distributors listed on Schedule 8.2(h), no more than the percentage indicated on such Schedule 8.2(h) (such percentage to be calculated as a percentage of sales for the 12 months prior to the Base Date) shall have given Seller Parent, Purchaser or any of their respective Affiliates notice of their election or intention to terminate or make any material adverse changes to the terms and conditions of the Contracts between such distributors and the Subject Companies, as such terms existed on the Base Date, provided that the foregoing shall not require Seller or Seller Parent to obtain an affirmative consent from any third party distributor.

(i) FIRPTA. Seller shall have delivered to Purchaser a certificate in form and substance reasonably satisfactory to Purchaser, duly executed and acknowledged, certifying any facts that would exempt the transactions contemplated hereby from withholding under Section 1445 of the Code.

(j) Election Forms. Seller Parent shall have delivered to Purchaser Parent the Election Forms described in Section 10.6.

8.3 Additional Conditions to the Obligations of Seller and Seller Parent. The obligation of Seller and Seller Parent to consummate the transactions contemplated by this Agreement is subject to the satisfaction (or waiver in writing by Seller) as of the Closing of each of the following additional conditions:

(a) Representations and Warranties. The representations and warranties of Purchaser and Purchaser Parent contained in Article V of this Agreement shall be true and correct as of the date hereof and as of the Closing Date as though made at and as of the Closing Date, except to the extent that any representation and warranty is made as of a specified date other than the Closing Date, in which case such representation and

---

warranty shall be true and correct as of such specified date, without taking into account any qualification of such representation or warranty by reference to Material Adverse Effect or other materiality, except, in each case, for such failures to be true and correct that individually or in the aggregate would not reasonably be expected to have a Purchaser Material Adverse Effect.

(b) Performance of Covenants. Purchaser and Purchaser Parent shall have performed in all material respects all obligations and agreements, and complied in all material respects with all covenants and conditions, contained in this Agreement to be performed or complied with by it prior to or at the Closing Date.

(c) Certificate. Seller and Seller Parent shall have received a certificate of Purchaser and Purchaser Parent, dated the Closing Date, executed on behalf of Purchaser and Purchaser Parent, to the effect that the conditions specified in paragraphs (a) and (b) above have been fulfilled.

(d) Ancillary Agreements. The Ancillary Agreements shall have been executed and delivered by Purchaser Parent or its Affiliate or Affiliates party thereto.

Article IX
TERMINATION, AMENDMENT AND WAIVER

9.1 Termination. This Agreement may be terminated and the transactions contemplated hereby abandoned at any time prior to the Closing Date:

(a) By mutual written consent of Seller and Purchaser;

(b) By either Seller or Purchaser upon written notice to the other in the event that any Governmental Authority (including any court of competent jurisdiction) shall have issued an order, decree or ruling or taken any other official action enjoining or otherwise prohibiting the transactions contemplated by this Agreement, and such order, decree, ruling or other action shall have become final and non-appealable; or

(c) By either Seller or Purchaser upon written notice given to the other in the event that the Closing shall not have taken place on or before February 28, 2007, provided that the failure of the Closing to occur on or before such date is not the result of a breach of any covenant or agreement hereunder by the party seeking such termination (or, in the case of a termination by Seller, by Seller Parent, or, in the case of a termination by Purchaser, by Purchaser Parent).

9.2 Effect of Termination. In the event of the termination of this Agreement as provided above, this Agreement (other than this Section) shall become void and of no further force and effect, and there shall be no duties, liabilities or obligations of any kind or nature whatsoever on the part of any party hereto to the other parties based either upon this Agreement or the transactions contemplated hereby, except (a) that the obligations of the parties referred to in the last sentence of Section 6.2 and in Sections 12.6 through 12.12 shall continue to apply following any such termination of this Agreement and (b) no party shall be relieved or released

---

from any liabilities or damages arising out of or caused by the willful breach by such party of its obligations under this Agreement.

Article X
TAX MATTERS

10.1 Indemnification for Taxes. From and after the Closing Date and to the extent the amount of such Taxes or Damages has not been taken into account in determining the Working Capital Amount pursuant to Section 2.4 of this Agreement (provided that, for this purpose, any amount of Taxes or Damages shall be treated as having not been taken into account in determining the Working Capital Amount if such amount has been paid or settled pursuant to Section 6.13), Seller Parent and Seller shall be responsible for, and shall jointly and severally indemnify and hold harmless Purchaser, Purchaser Parent and each of the Subject Companies and each of their Affiliates (and any successor thereto) from (A) any Damages suffered, paid or incurred by any Indemnified Purchaser Entity resulting from or caused by any breach of (i) any of the representations and warranties made by Seller and Seller Parent in Sections 4.12 and 4.19(f) of this Agreement or (ii) any covenant set forth in Section 6.1(n) of this Agreement and (B) any and all Taxes (i) imposed on any member of the Seller Parent's Group (other than the Subject Companies) for any taxable year, (ii) imposed on any of the Subject Companies or for which any of the Subject Companies may otherwise be liable for any taxable year that ends on or before the Closing Date and, with respect to any taxable year beginning before and ending after the Closing Date, the portion of such taxable year ending on (and including) the Closing Date (such portion being referred to hereinafter as the "Interim Period") (the Interim Period and any taxable year that ends on or before the Closing Date being referred to collectively hereinafter as the "Pre-Closing Period"), (iii) imposed on another Person for which any Subject Company is liable pursuant to Section 1.1502-6 of the Treasury Regulations (or any similar provision of state, local or foreign Tax law), or pursuant to rules imposing transferee liability, or by virtue of such Subject Company's having been affiliated with, or being a transferee of, such other Person prior to the Closing or (iv) arising from any of the Elections described in Section 10.6 below, in each case, together with interest, penalties, reasonable attorney's fees and other reasonable expenses relating thereto; provided that the foregoing shall not include any Taxes described in clause (ii) of the following sentence. From and after the Closing Date, except with respect to Taxes for which Seller Parent and Seller are responsible pursuant to the immediately preceding sentence, Purchaser, Purchaser Parent and each of the Subject Companies shall be responsible for, and shall jointly and severally indemnify and hold harmless Seller Parent and Seller Parent's Group (or any successor thereto) from, any and all Taxes imposed on the Subject Companies, Purchaser, Purchaser Parent or Purchaser's Affiliated Group (or any successor thereto) for (i) any taxable year that begins after the Closing Date and, with respect to any taxable year beginning before and ending after the Closing Date, the portion of such taxable year commencing on the day after the Closing Date, and (ii) any transfer of assets by the Subject Companies (other than any transfer in the ordinary course of business and any transfer or deemed transfer arising from any of the Elections) after the Closing on the Closing Date.

10.2 Apportionment of Taxes. In order to appropriately apportion any Taxes relating to any taxable year that includes the Interim Period, the parties hereto shall (and shall cause their respective Affiliates to), to the extent permitted by applicable Tax law, elect with the relevant taxing authority to treat for all purposes the Closing Date as the last day of the taxable

year of the Subject Companies, and such Interim Period shall be treated as a short taxable year and a Pre-Closing Period for purposes of this Agreement. In any case where applicable Tax law does not permit the Subject Companies to treat the Closing Date as the last day of the taxable year of the Subject Companies, then, in the case of a Tax that is not property or other periodic tax (such as Tax based on gross or net income) such Tax shall be apportioned for an Interim Period as if such Interim Period were a short taxable year. All property or other periodic Taxes that are attributable to a taxable year that includes an Interim Period shall be apportioned to the period to which they legally relate, or, if not capable of being so apportioned, shall be apportioned based upon a fraction, the numerator of which is the number of days in the Interim Period, and the denominator of which is the number of days in such taxable year.

10.3 Tax Returns and Payment of Taxes. (a) Seller Parent or Seller Parent's Group shall (and shall cause its Affiliates to), to the extent permitted by applicable Tax law and consistent with prior year practice, include the Subject Companies in the consolidated federal income Tax Returns and any combined or consolidated state and local Tax Returns filed by Seller Parent for any Pre-Closing Period. With respect to state and local and other Tax Returns required to be filed by the Subject Companies after the Closing Date for Tax periods beginning before and ending after the Closing Date, Seller Parent or Seller Parent's Group, or Purchaser, Purchaser Parent or the Subject Companies, as the case may be, shall cause the Subject Companies to, when permitted, elect to file a short-period Tax Return for the portion of such period which ends on the Closing Date. Seller Parent or Seller Parent's Group shall prepare and file, or cause to be prepared and filed all such Tax Returns for any such short period, and shall pay, or cause to be paid, all Taxes due on such Tax Returns to the proper taxing authority.

(b) Except to the extent that an election has been made to prepare a short-period Tax Return described in Section 10.3(a), Purchaser or Purchaser Parent shall, or shall cause the Subject Companies to, prepare, submit to Seller (at least sixty days prior to the extended due date) for its review and approval (such approval not to be unreasonably withheld), and thereafter file all state and local and other Tax Returns required to be filed by the Subject Companies after the Closing Date for all Interim Periods, and the Seller Parent and the Seller shall timely pay to Purchaser, Purchaser Parent or the relevant Subject Company the amount of Taxes with respect to such Tax Returns as determined and apportioned to a Pre-Closing Period pursuant to Section 10.2 above. All such Tax Returns shall be prepared on a basis consistent with the Tax Returns filed by or on behalf of the Subject Companies for the preceding Tax period unless otherwise required by applicable Tax law.

(c) Purchaser Parent shall, or shall cause the Subject Companies to, prepare and file all Tax Returns (other than those referred to in Section 10.3(a) or Section 10.3(b)) required to be filed by the Subject Companies after the Closing Date for all Tax periods beginning after the Closing Date.

(d) Seller Parent and Seller shall cause any tax sharing, allocation, indemnity or similar agreement between Seller Parent, Seller or any of their Affiliates (other than the Subject Companies) on the one hand and any of the Subject Companies on the other hand to terminate prior to the Closing Date and have no further effect, and no Subject Company shall have any further liability thereunder after the Closing.

(e) Seller Parent and Purchaser Parent shall not (and shall cause their Affiliates not to) amend any Tax Return relating to any Subject Company for any Pre-Closing Period without the prior written consent of the other party (which consent shall not be unreasonably withheld) if such amendment would adversely affect Tax obligations of such other party under this Agreement.

10.4 Cooperation; Audits. In connection with the preparation of Tax Returns and audit examinations relating to the Subject Companies by any taxing authority or administrative or judicial proceedings resulting therefrom, Seller, Seller Parent, Purchaser, Purchaser Parent and the Subject Companies shall cooperate fully with one another, including but not limited to the furnishing or making available of records, personnel (as reasonably required), books of account, powers of attorney or other materials necessary or helpful for the preparation of Tax Returns, the conduct of audit examinations or the defense of claims by taxing authorities as to the imposition of Taxes. After the Closing Date, Seller Parent shall control the conduct of all stages of any audit or other administrative or judicial proceeding with respect to Taxes for any Pre-Closing Period (other than any Interim Period with respect to which a short-period Tax Return described in Section 10.3(a) has not been filed), and Purchaser Parent shall control the conduct of all other audits or other administrative or judicial proceedings with respect to the Tax liability of the Subject Companies; provided, however, that if, with respect to any such audit or other proceeding which is controlled by Purchaser Parent or Seller Parent, as the case may be, any Tax adjustment is proposed which would be for the account of Seller Parent or Purchaser Parent, as the case may be, pursuant to this Article X, Purchaser Parent or Seller Parent, as the case may be, (i) shall give prompt notice to Seller Parent or Purchaser Parent, as the case may be, of such proposed adjustment, (ii) shall afford Seller Parent or Purchaser Parent, as the case may be, and its counsel a reasonable opportunity to participate in such proceeding including, without limitation, the right to participate in conferences with Tax authorities and to submit pertinent material in support of Seller Parent's or Purchaser Parent's, as the case may be, position and (iii) shall not, and shall not permit their respective Affiliates to, accept such proposed adjustment or enter into any settlement or agreement which would be for Seller Parent's or Purchaser Parent's, as the case may be, account under this Article X without Seller Parent's or Purchaser Parent's, as the case may be, written consent (which consent shall not be unreasonably withheld).

10.5 Transfer Taxes. Notwithstanding any provision of this Agreement to the contrary, all transfer, documentary, sales, use, stamp, registration, valued added, real property transfer Taxes and other similar Taxes, and all conveyance fees, recording charges and other similar fees and charges, and any penalties and interest associated with such Taxes, fees and charges, incurred in connection with this Agreement or the transactions contemplated hereby, shall be paid by Seller Parent and Seller when due, and Seller Parent and Seller shall, at their own expense, file all necessary Tax Returns and other documentation with respect to all such Taxes, fees and charges, and, if required by applicable Tax law, the parties shall, and shall cause their Affiliates to, join in the execution of any such Tax Returns and other documentation.

10.6 Section 338(h)(10) Election. (a) Seller, Seller Parent, Purchaser and Purchaser Parent agree that they shall take all steps necessary to make a timely, effective and irrevocable election under Section 338(h)(10) of the Code and analogous state and local tax provisions, arising out of the purchase and sale of the Stock and, at Purchaser Parent's election,

---

for any eligible Subsidiary that is a corporation, pursuant to this Agreement (collectively, the "Elections"), and to file the Elections in accordance with applicable Tax law. At least 10 days prior to the Closing Date, Seller Parent and Purchaser Parent shall agree on the form and content of the IRS Form 8023 and analogous state and local tax forms on which the Elections shall be made (collectively, the "Election Forms"). At or prior to the Closing, Seller Parent shall deliver to Purchaser Parent properly executed and mutually agreed upon Election Forms containing information then available, which Purchaser Parent shall be entitled to file, or cause to be filed, at any time after the Closing.

(b) Purchaser Parent shall, within 120 days after the Closing Date, prepare and deliver to Seller Parent for its review and consent, the allocation of the deemed sales price of the assets of the Company (and any eligible Subsidiary for which an Election is made) resulting from the Elections (as required pursuant to Section 338(h)(10) of the Code and regulations promulgated thereunder) among such assets (the "Section 338 Allocation"). In the event that no election is made with respect to an eligible Subsidiary, the purchase price allocated to such Subsidiary shall be an amount at least sufficient to prevent realization of a loss for U.S. federal income tax purposes with respect to the capital stock of such Subsidiary. Seller Parent and Purchaser Parent shall negotiate in good faith to resolve any disputed items. If Seller Parent and Purchaser Parent are unable to agree on the Section 338 Allocation within 60 days after Purchaser Parent provides the Section 338 Allocation, they shall request an appraisal firm selected by Seller and reasonably acceptable to Purchaser Parent (the "Appraiser") to decide any disputed items. The costs of the Appraiser shall be borne equally by Seller Parent and Purchaser Parent. The Section 338 Allocation shall be used in preparing Internal Revenue Service Form 8883, and any similar forms under applicable Tax law. Seller Parent and Purchaser Parent shall (and shall cause their Affiliates to) report and file all Tax Returns (including amended Tax Returns and claims for refund) consistent with the Section 338 Allocation, and shall (and shall cause their Affiliates to) take no position contrary thereto or inconsistent therewith (including, without limitation, in any audits or examinations by any taxing authority or any other proceeding). All allocations made pursuant to this Section 10.6(b) shall be binding upon the parties hereto and upon each of their successors and assigns, and the parties hereto shall (and shall cause their Affiliates to) report the transactions contemplated by this Agreement in accordance with such allocations and use reasonable efforts to sustain such reporting of the transaction in any subsequent Tax dispute to the extent consistent with applicable Tax law.

10.7 Allocation of Closing Payments. Seller Parent, Seller, Purchaser and Purchaser Parent recognize and agree that the Closing Payments are properly allocable to the portion of the Company's day prior to the Closing for all federal, state and local income tax purposes, including, without limitation, the allocation of any corresponding deductions. Seller Parent, Seller, Purchaser and Purchaser Parent shall report and file all Tax Returns (including amended Tax Returns and claims for refund) consistent with this allocation, and shall take no position contrary thereto or inconsistent therewith (including, without limitation, in any audits or examinations by any taxing authority or any other proceeding). All allocations made pursuant to this Section 10.7 shall be binding upon the parties hereto and upon each of their successors and assigns, and the parties hereto shall report the transactions contemplated by this Agreement in accordance with such allocations and use reasonable efforts to sustain such reporting of the transaction in any subsequent tax dispute to the extent consistent with applicable Tax law.

Article XI
INDEMNIFICATION

11.1 Indemnification by Seller and Seller Parent. (a) In addition to, and not in limitation of, the indemnities provided in Article X (which Article shall control the matters covered thereby in the case of any inconsistencies), from and after the Closing Date, subject to the other provisions of this Article XI, Seller and Seller Parent, jointly and severally, agree to indemnify Purchaser and its officers, directors, employees and Affiliates (collectively,

the "Indemnified Purchaser Entities") and to hold each of them harmless from and against, any and all actions, suits, proceedings, demands, assessments, judgments, claims, liabilities, losses, costs, damages, expenses or penalties, and reasonable attorneys' fees, expenses and disbursements in connection with any action, suit or proceeding against such Person whether or not arising out of or resulting from any Third Party claim (but excluding, in any case, damages that were not reasonably foreseeable and punitive or other exemplary damages, except in each case to the extent that such damages have been awarded to a Third Party against an Indemnified Entity) (collectively, "Damages"), suffered, paid or incurred by such Indemnified Purchaser Entity resulting from or caused by: (i) any breach of any of the representations and warranties made by Seller and Seller Parent to Purchaser in Article IV of this Agreement other than a breach of the representations and warranties in Sections 4.12 and 4.19(f) of this Agreement which shall be governed by Article X; (ii) any breach by Seller or Seller Parent of any covenant or agreement of Seller or Seller Parent contained in this Agreement, other than a breach of the covenants in Section 6.1(n) of this Agreement, which shall be governed by Article X; or (iii) the matters described in Section 11.1 of the Seller Disclosure Letter.

(b) Notwithstanding anything to the contrary contained in this Section 11.1, the Indemnified Purchaser Entities shall be entitled to indemnification pursuant to Section 11.1(a) with respect to any claim for indemnification pursuant to Section 11.1(a)(i):

(A) only if, and then only to the extent that, the aggregate Damages to all Indemnified Purchaser Entities (without duplication), with respect to all such claims, exceed $6 million (the "Deductible"), whereupon (subject to the provisions of clause (B) below) Seller and Seller Parent shall be obligated to pay in full all such amounts but only to the extent such aggregate Damages are in excess of the amount of the Deductible; and provided that the Indemnified Purchaser Entities shall not be entitled to aggregate Damages in excess of 50 percent of the Base Purchase Price as adjusted pursuant to Section 2.5 (the "Cap"); provided, further, that the Deductible and the Cap shall not apply to claims for indemnification arising out of, resulting from or caused by a breach of the representations and warranties in Section 4.11 of this Agreement; and

(B) only with respect to claims for indemnification made on or before the date that is three years after the Closing Date; provided that with respect to claims for indemnification arising out of, resulting from or caused by a breach of the representations and warranties made in Section 4.11 of this Agreement, the Indemnified Purchaser Entities shall be entitled to indemnification pursuant to Section 11.1(a)(i) with respect to any such claim made on or before 30 days after the expiration of the applicable statute of limitations; provided further, that with

---

respect to claims for indemnification arising out of, resulting from or caused by a breach of the representations and warranties made in Section 4.1(a), the first sentence of Section 4.1(b) or Sections 4.2, 4.6(a), 4.6(b) or 4.17, the Indemnified Purchaser Entities shall be entitled to indemnification pursuant to Section 11.1(a)(i) with respect to any such claim indefinitely or until the latest date permitted by Applicable Law.

(c) Notwithstanding anything contained in Article IV or any other provision of this Agreement to the contrary, Purchaser and Purchaser Parent understand and agree that Seller and Seller Parent have not made, and are not making, any representation or warranty whatsoever, express or implied, with respect to Seller, Seller Parent, the Subject Companies, the Registered Fund Clients, the Separate Account Clients or the New Advisory Clients, the respective businesses and properties of any of the foregoing Persons, the transactions contemplated hereby or any other matter, other than those representations and warranties of Seller and Seller Parent expressly set forth in this Agreement and the Ancillary Agreement, provided that nothing in this Agreement shall relieve any party from liability for fraud.

11.2 Indemnification by Purchaser. (a) In addition to, and not in limitation of, the indemnities provided in Article X (which Article shall control the matters covered thereby in the case of any inconsistencies), from and after the Closing Date, subject to the other provisions of this Article XI, Purchaser and Purchaser Parent, jointly and severally, agree to indemnify Seller and Seller Parent and their respective officers, directors, employees and Affiliates (collectively, the "Indemnified Seller Entities") and to hold each of them harmless from and against any and all Damages suffered, paid or incurred by such Indemnified Seller Entity resulting from or caused by: (i) any breach of any of the representations and warranties made by Purchaser and Purchaser Parent to Seller in Article V of this Agreement; or (ii) any breach by Purchaser or Purchaser Parent of any covenant or agreement of Purchaser or Purchaser Parent contained in this Agreement.

(b) Notwithstanding anything to the contrary contained in this Section 11.2, the Indemnified Seller Entities shall be entitled to indemnification pursuant to Section 11.2(a) with respect to any claim for indemnification pursuant to Section 11.2(a)(i):

(A) only if, and then only to the extent that, the aggregate Damages to all Indemnified Seller Entities (without duplication), with respect to all claims for indemnification pursuant to Section 11.2(a)(i), exceed the amount of the Deductible, whereupon (subject to the provisions of clause (B) below) Purchaser and Purchaser Parent shall be obligated to pay in full all such amounts but only to the extent such aggregate Damages are in excess of the amount of the Deductible; and provided that the Indemnified Seller Entities shall not be entitled to aggregate Damages in excess of $100,000,000; and

(B) only with respect to claims for indemnification made on or before the date that is three years after the Closing Date, provided that with respect to claims for indemnification arising out of, resulting from or caused by a breach of the representations and warranties made in Sections 5.1, 5.2 and 5.9, the Indemnified Seller Entities shall be entitled to indemnification pursuant to Section

---

11.2(a)(i) with respect to any such claim indefinitely or until the latest date permitted by Applicable Law.

(c) Notwithstanding anything contained in Article V or any other provision of this Agreement to the contrary, Seller and Seller Parent understand and agree that Purchaser and Purchaser Parent have not made, and are not making, any representation or warranty whatsoever, express or implied, with respect to Purchaser or Purchaser Parent, the transactions contemplated hereby or any other matter, other than those representations and warranties of

Purchaser and Purchaser Parent expressly set forth in this Agreement and the Ancillary Agreements, provided that nothing in this Agreement shall relieve any party from liability for fraud.

11.3 Indemnification Procedures. (a) If an Indemnified Purchaser Entity or an Indemnified Seller Entity (each, an "Indemnified Entity") believes that a claim, demand or other circumstance exists that has given or may reasonably be expected to give rise to a right of indemnification under this Article XI (whether or not the amount of Damages relating thereto is then quantifiable), such Indemnified Entity shall assert its claim for indemnification by giving written notice thereof (a "Claim Notice") to Seller (if indemnification is sought from Seller and/or Seller Parent) or Purchaser (if indemnification is sought from Purchaser or Purchaser Parent) (in either such case, the "Indemnifying Party") (i) if the event or occurrence giving rise to such claim for indemnification is, or relates to, a claim, suit, action or proceeding brought by a Person not a party to this Agreement or affiliated with any such party (a "Third Party"), within ten Business Days following receipt of notice of such claim, suit, action or proceeding by such Indemnified Entity, or (ii) if the event or occurrence giving rise to such claim for indemnification is not, or does not relate to, a claim, suit, action or proceeding brought by a Third Party, within 30 days after the discovery by the Indemnified Entity of the circumstances giving rise to such claim for indemnity, provided in any case that failure to give notice as specified herein shall not relieve the Indemnifying Party of its indemnification obligation hereunder unless and to the extent that such failure results in a lack of actual notice to the Indemnifying Party and the Indemnifying Party is materially prejudiced by such failure. Each Claim Notice shall describe the claim in reasonable detail.

(b) If any claim or demand by an Indemnified Entity under this Article XI relates to an action or claim filed or made against an Indemnified Entity by a Third Party (a "Third Party Claim"), the Indemnifying Party may elect at any time within 30 days of receipt of notice of such claim to negotiate a settlement or a compromise of such action or claim or to defend such action or claim, in each case at its sole cost and expense and with its own counsel. Except with the prior written consent of the Indemnified Entity (which consent shall not be unreasonably withheld or delayed), no Indemnifying Party, in the defense of any such Third Party Claim, shall consent to entry of any judgment or enter into any settlement that provides for injunctive or other nonmonetary relief affecting the Indemnified Entity, that would reasonably be expected to affect adversely the Indemnified Entity's Tax liability (unless such Tax liability is fully indemnified and paid by the Indemnifying Party) or the ability of the Company or any of its Subsidiaries to conduct its business or that does not include as an unconditional term thereof the giving by each claimant or plaintiff to such Indemnified Entity of an irrevocable release from all liability with respect to such Third Party Claim. If the Indemnifying Party elects to defend any such Third Party Claim, then the Indemnified Entity shall be entitled to participate in such defense with its own counsel, at such Indemnified Entity's sole cost and expense unless the

Indemnified Entity in good faith determines that it may have available to it one or more defenses or counterclaims that are inconsistent with one or more of those that may be available to the Indemnifying Party in respect of such Third Party Claim, in which case the Indemnifying Party shall be liable for the fees and expenses hereunder of one law firm for all the Indemnified Entities, in addition to local counsel in each applicable jurisdiction, with respect to such Third Party Claim or group of related Third Party Claims. In no event shall any Indemnified Entity settle any Third Party Claim without the written consent of the Indemnifying Party, such consent not to be unreasonably withheld or delayed. If, within thirty days of receipt from an Indemnified Entity of any Claim Notice with respect to a Third Party Claim, the Indemnifying Party (i) advises such Indemnified Entity in writing that the Indemnifying Party will not elect to defend, settle or compromise such action or claim or (ii) fails to make such an election in writing, such Indemnified Entity may (subject to the Indemnifying Party's continuing right of election in the preceding sentence), at its option, defend, settle or otherwise compromise or pay such action or claim; provided that any such settlement or compromise shall be permitted hereunder only with the written consent of the Indemnifying Party, which consent shall not be unreasonably withheld. Unless and until the Indemnifying Party makes an election in accordance with this Section 11.3(b) to defend, settle or compromise such action, all of the Indemnified Entity's reasonable costs and expenses arising out of the defense, settlement or compromise of any such action or claim shall be Damages subject to indemnification hereunder to the extent provided herein. Each Indemnified Entity shall make available to the Indemnifying Party all information reasonably available to such Indemnified Entity relating to such action or claim. In addition, the parties shall render to each other such assistance as may reasonably be requested in order to help ensure the proper and adequate defense of any such action or claim. The party in charge of the defense shall keep the other parties reasonably apprised at all times as to the status of the defense or any settlement negotiations with respect thereto. If the Indemnifying Party elects to defend any such action or claim, then the Indemnified Entity shall be entitled to participate in such defense with counsel reasonably acceptable to the Indemnifying Party, at such Indemnified Entity's sole cost and expense.

11.4 General. (a) An Indemnified Entity shall have no obligation in connection with any claim for indemnification under this Article XI to seek to recover any insurance proceeds available in connection with such claim. The amount which the Indemnifying Party is or may be required to pay to any Indemnified Entity pursuant to this Article XI shall be reduced (retroactively, if necessary) by any insurance proceeds, tax benefits or other amounts actually recovered by or on behalf of such Indemnified Entity in reduction of the related Damages and shall be increased by any Tax cost incurred by such Indemnified Entity or its Affiliates in connection with such indemnity payment. If an Indemnified Entity shall have received the payment required by this Agreement from the Indemnifying Party in respect of Damages and shall subsequently receive insurance proceeds, tax benefits or other amounts in respect of such Damages, then such Indemnified Entity shall promptly repay to the Indemnifying Party a sum equal to the amount of such insurance proceeds, tax benefits or other amounts actually received (net of any Tax cost or other expenses incurred by such Indemnified Entity or its Affiliates relating thereto and in no event in excess of the amount of such payment received from the Indemnifying Party). In determining for purposes of this Article XI whether a representation or warranty has been breached and in calculating Damages hereunder with respect to such breach, any limitations set forth in such representation and warranty as to "materiality",

"Material Adverse Effect" or "Purchaser Material Adverse Effect" (except with respect to the first sentence of Section 4.10(a) and Section 5.7) shall be disregarded.

(b) In addition to the requirements of Section 11.4(a), each Indemnified Entity shall be obligated in connection with any claim for indemnification under this Article XI to use all commercially reasonable efforts to mitigate Damages upon and after becoming aware of any event which would reasonably be expected to give rise to such Damages.

(c) The Indemnifying Party shall not be subrogated to any right of action (whether pursuant to contract, arising under Applicable Law or otherwise) which the Indemnified Entity may have against any other Person with respect to any matter giving rise to a claim for indemnification hereunder, without the prior written consent of Purchaser (which shall not be unreasonably withheld and may in any case be withheld if the Purchaser has an ongoing business relationship with such other Person).

(d) The indemnification provided in this Article XI shall be the exclusive monetary remedy available to any party hereto after the Closing with respect to any breach of any representation, warranty, covenant or agreement in this Agreement, except in the case of fraud or intentional misconduct and as otherwise provided in this Agreement.

(e) The rights and remedies of any party in respect of any inaccuracy or breach of any representation, warranty, covenant or agreement of any other party contained in this Agreement shall in no way be limited by the fact that the act, omission, occurrence or other state of facts or circumstances upon which any claim of any such inaccuracy or breach is based may also be the subject matter of any other representation, warranty, covenant or agreement as to which there is no inaccuracy or breach. The representations, warranties and covenants of each party hereto and any Person's rights to indemnification with respect thereto shall not be affected or deemed waived by reason of any investigation made by or on behalf of such Person (including by any of its advisors, consultants or representatives) or by reason of the fact that such Person or any of such advisors, consultants or representatives knew or should have known that any such representation or warranty is, was or might be inaccurate or by reason of any waiver by any party hereto of any condition set forth in Article VIII.

(f) The parties agree that any payment (other than interest) under Section 2.4, 2.5, 2.6 or 2.7 and any indemnity payment under this Agreement shall be treated as an adjustment to the Purchase Price for all Tax purposes, unless otherwise required by applicable Tax law.

Article XII
GENERAL PROVISIONS

12.1 Survival. Except for the representations and warranties contained in Section 4.1(a), the first sentence of Section 4.1(b) and Sections 4.2, 4.6(a), 4.6(b), 4.11, 4.12, 4.17, 4.19(f), 5.1, 5.2 and 5.9 of this Agreement, each of the representations and warranties of the parties hereunder shall survive the Closing to and until the date which is three years from the Closing Date, at which date they shall terminate and be of no further force or effect. The representations and warranties of Seller contained in Sections 4.11, 4.12 and 4.19(f) of this

---

Agreement shall survive the Closing to and until 30 days after the expiration of the applicable statute of limitations. The representations and warranties in Section 4.1(a), the first sentence of Section 4.1(b) and Sections 4.2, 4.6(a), 4.6(b), 4.17, 5.1, 5.2 and 5.9 shall survive indefinitely or until the latest date permitted by Applicable Law. Notwithstanding the foregoing, any representation or warranty in respect of which indemnity may be sought under Article XI of this Agreement shall survive the time at which it would otherwise terminate pursuant to Section 11.1 or 11.2 or this Section 12.1 if a Claim Notice for indemnification in respect of such representation or warranty shall have been duly given prior to such time, in which event such representation or warranty shall survive solely with respect to such claim until the final resolution thereof.

12.2 Notices. All notices and other communications required or permitted to be given hereunder shall be in writing and shall be deemed given if delivered personally, transmitted by facsimile (and telephonically confirmed), mailed by registered or certified mail with postage prepaid and return receipt requested, or sent by commercial overnight courier, courier fees prepaid (if available; otherwise, by the next best class of service available), to the parties at the following addresses:

(a) if to Purchaser, to it at:

Principal Financial Group, Inc.
711 High Street
Des Moines, IA 50392
Attn: General Counsel
Telecopy: (515) 235-9852
Confirmation: (515) 248-3254

with a copy to:

Debevoise & Plimpton LLP
919 Third Avenue
New York, NY 10022
Attn: Robert F. Quaintance, Jr.
Telecopy: (212) 909-6836
Confirmation: (212) 909-6000

(b) if to Seller or Seller Parent, to it at:

Washington Mutual, Inc.
1201 3rd Avenue
Seattle, WA 98101
Attn: Carey Brennan
Richard Sohn
Telecopy: (206) 377-6244
Confirmation: (206) 461-2000

with a copy to:

Simpson Thacher & Bartlett LLP
425 Lexington Avenue
New York, New York 10017-3909
Attn: Lee Meyerson
Robert Goldbaum
Telecopy: (212) 455-2502
Confirmation: (212) 455-2500

or to such other Person or address as any party shall specify by notice in writing to the other parties in accordance with this Section 12.2. All such notices or other communications shall be deemed to have been received on the date of the personal delivery or on the third Business Day after the mailing or dispatch thereof; provided that notice of change of address shall be effective only upon receipt.

12.3 Interpretation. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement. The words “include”, “includes” and “including” shall be deemed to be followed by the phrase “without limitation”. Unless otherwise expressly provided herein, any statute defined or referred to herein means such statute as from time to time amended, modified or supplemented. When this Agreement provides that Seller Parent or Seller has “made available” information to Purchaser (or similar wording), Seller shall have included such information in the electronic data room maintained by Intralinks and given Purchaser and Purchaser’s representatives customary notice of such inclusion or shall have sent such information to a responsible officer or representative of Purchaser, in each case at least one Business Day before the date hereof.

12.4 Amendment and Modification; Waiver. (a) This Agreement may not be amended except by an instrument or instruments in writing signed and delivered on behalf of each of the parties hereto.

(b) At any time prior to the Closing Date, any party hereto which is entitled to the benefits hereof may (i) extend the time for the performance of any of the obligations or other acts of the other parties, (ii) waive any inaccuracy in the representations and warranties of any other party contained herein or in any schedule hereto or in any document delivered pursuant hereto, and (iii) waive compliance with any of the agreements of any other party or conditions contained herein. Any agreement on the part of a party hereto to any such extension or waiver shall be valid only if set forth in an instrument in writing signed and delivered on behalf of such party.

12.5 Entire Agreement. This Agreement (including the Disclosure Letters and other documents and instruments referred to herein) and, until the Closing, the Confidentiality Agreement constitute the entire agreement and supersede all other prior agreements and understandings, both written and oral, between the parties with respect to the subject matter hereof. Effective upon Closing, the Confidentiality Agreement and all obligations of the parties thereto thereunder shall terminate and be of no further force or effect.

12.6 Fees and Expenses. Except as set forth in Section 10.5, whether or not the transactions contemplated hereby are consummated, all fees and expenses incurred in connection with this Agreement, and the transactions contemplated hereby, shall be paid by the party incurring such expenses; provided, however, that each of Seller and Purchaser shall pay fifty percent (50%) of the document preparation (including reasonable attorneys’ fees), printing, mailing and other costs and expenses associated with any board approvals sought and proxy solicitations (including the solicitation of voting instructions from owners of variable annuity and variable life insurance products) conducted in connection with the transactions contemplated hereby, including amounts reimbursed to Sponsored Funds and funds sponsored by Purchaser or any of its Affiliates. All references to “$” or “dollars” set forth in this Agreement are to U.S. dollars.

12.7 Disclosure Letters. Seller Parent, Seller and Purchaser agree that, for purposes of the representations and warranties of Seller and Purchaser in this Agreement, items disclosed in one Section of the Seller Disclosure Letter shall be considered to be made for purposes of all other Sections of the Seller Disclosure Letter to the extent that the relevance of any such disclosure to any other Section of the Seller Disclosure Letter is reasonably apparent from the text of such disclosure and items disclosed in one Section of the Purchaser Disclosure Letter shall be considered to be made for purposes of all other Sections of the Purchaser Disclosure Letter to the extent that the relevance of any such disclosure to any other Section of the Purchaser Disclosure Letter is reasonably apparent from the text of such disclosure. The disclosure of any item or matter in the Seller Disclosure Letter or the Purchaser Disclosure Letter shall not be construed as an admission, representation or indication that such item or other matter is “material” or would have a Material Adverse Effect or Purchaser Material Adverse Effect (as applicable) or that such item or other matter is required to be referred to or disclosed in the Seller Disclosure Letter or the Purchaser Disclosure Letter (as applicable). The disclosure of any item or matter relating to any possible breach or violation of any law or contract shall not be construed as an admission or indication that any such breach or violation exists or has actually occurred.

12.8 Third Party Beneficiaries. Except for Indemnified Entities (who shall only claim through a party hereto), nothing in this Agreement, express or implied, is intended to confer upon any Person other than the parties hereto or their respective successors and permitted assigns any rights, remedies, obligations or liabilities under or by reason of this Agreement.

12.9 Specific Performance. The parties agree that if any of the provisions of this Agreement were not performed by the parties hereto in accordance with their specific terms or were otherwise breached thereby, irreparable damage would occur, no adequate remedy at law would exist and damages would be difficult to determine, and that each party hereto will be entitled to specific performance to prevent breaches of the provisions of this Agreement and to enforce specifically the terms and provisions hereof, in addition to any other remedy to which it may be entitled at law or in equity.

12.10 Performance by Seller and Purchaser. (a) Seller Parent will cause to be performed and hereby guarantees the performance of all actions, agreements and obligations set forth herein to be performed by Seller. Subject to the terms and conditions of this Agreement,

this guarantee is an absolute, unconditional and continuing guarantee of the performance of such obligations of Seller.

(b) Purchaser Parent will cause to be performed and hereby guarantees the performance of all actions, agreements and obligations set forth herein to be performed by Purchaser. Subject to the terms and conditions of this Agreement, this guarantee is an absolute, unconditional and continuing guarantee of the performance of such obligations of Purchaser.

12.11 Assignment; Binding Effect. This Agreement shall not be assigned by any party hereto without the prior written consent of the other parties; provided that no consent shall be required for Purchaser or Purchaser Parent to assign any or all of their respective rights and obligations hereunder to a directly or indirectly wholly owned Subsidiary of Purchaser Parent, provided, further, that any such assignment pursuant to the preceding proviso shall not relieve Purchaser or Purchaser Parent, as the case may be, from any obligation under this Agreement. This Agreement shall inure to the benefit of and be binding upon the parties hereto and their respective successors and assigns.

12.12 Governing Law. THIS AGREEMENT AND THE RIGHTS AND DUTIES OF THE PARTIES HEREUNDER SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAW OF THE STATE OF NEW YORK.

12.13 Jurisdiction; Waiver of Jury Trial. The parties hereby irrevocably and unconditionally consent to submit to the exclusive jurisdiction of the courts of the State of New York and of the United States of America located in the State of New York with respect to any actions, suits or proceedings arising out of or relating to this Agreement and the transactions contemplated hereby. The parties hereby irrevocably and unconditionally waive any objection to the laying of venue of any action, suit or proceeding arising out of this agreement or the transactions contemplated hereby, in the courts of the State of New York and of the United States of America located in the State of New York, and hereby further irrevocably and unconditionally waive and agree not to plead or claim in any such court that any such action, suit or proceeding brought in any such court has been brought in an inconvenient forum. EACH PARTY HEREBY IRREVOCABLY AND UNCONDITIONALLY WAIVES ANY RIGHT SUCH PARTY MAY HAVE TO A TRIAL BY JURY IN RESPECT OF ANY LITIGATION DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE TRANSACTIONS CONTEMPLATED HEREBY.

12.14 Severability. If any term, provision, covenant or restriction of this Agreement is held by a court of competent jurisdiction or other authority to be invalid, void or unenforceable, the remainder of the terms, provisions, covenants and restrictions of this Agreement shall remain in full force and effect and shall in no way be affected, impaired or invalidated so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party. Upon such a determination, the parties shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in an acceptable manner in order that the transactions contemplated hereby be consummated as originally contemplated to the fullest extent possible.

12.15 Counterparts. This Agreement may be executed in two or more counterparts, each of which shall be deemed an original, and all of which together shall constitute one and the same instrument.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed on their behalf by their respective officers hereunto duly authorized all as of the date first written above.

WASHINGTON MUTUAL, INC.

By: /s/ Kerry K. Killinger
Name: Kerry K. Killinger
Title: Chairman and Chief Executive Officer

NEW AMERICAN CAPITAL, INC.

By: /s/ Kerry K.Killinger
Name: Kerry K. Killinger
Title: Chairman and Chief Executive Officer

PRINCIPAL FINANCIAL GROUP, INC.

By: /s/ Larry D. Zimpleman
Name: Larry D. Zimpleman
Title: President and CEO

PRINCIPAL MANAGEMENT CORPORATION

By: /s/ Ralph C. Eucher
Name: Ralph C. Eucher
Title: President

Exhibit 12

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

		For the nine months ended September 30,		For the years ended December 31,				
		2006	2005	2005	2004	2003	2002	2001
					(in millions)			
1.	Income from continuing operations before income taxes	**$ 1,001.6**	$ 848.9	$ 1,124.3	$ 879.1	$ 820.3	$ 371.5	$ 249.9
2.	Interest expense	**63.9**	60.6	81.1	96.9	117.5	99.7	97.2
3.	Interest factor of rental expense	**5.2**	3.4	7.0	4.6	4.8	8.0	9.4
4.	Undistributed (income) loss from equity investees	**(45.9)**	(26.1)	(34.1)	(19.4)	(18.3)	4.3	(17.4)
5.	Earnings before interest credited on investment products	**1,024.8**	886.8	1,178.3	961.2	924.3	483.5	339.1
6.	Interest credited on investment products	**664.8**	619.0	832.2	763.7	735.7	743.4	773.1
7.	Earnings	**$ 1,689.6**	$ 1,505.8	$ 2,010.5	$ 1,724.9	$ 1,660.0	$ 1,226.9	$ 1,112.2
8.	Interest expense	**$ 63.9**	$ 60.6	$ 81.1	$ 96.9	$ 117.5	$ 99.7	$ 97.2
9.	Interest factor of rental expense	**5.2**	3.4	7.0	4.6	4.8	8.0	9.4
10.	Preferred stock dividends by registrant	**24.7**	9.4	17.7	—	—	—	—
11.	Preferred stock dividend requirements of majority-owned subsidiaries (non-intercompany)	**—**	—	—	—	1.2	0.4	—
12.	Fixed charges before interest credited on investment products	**93.8**	73.4	105.8	101.5	123.5	108.1	106.6
13.	Interest credited on investment products	**664.8**	619.0	832.2	763.7	735.7	743.4	773.1
14.	Fixed charges	**$ 758.6**	$ 692.4	$ 938.0	$ 865.2	$ 859.2	$ 851.5	$ 879.7
15.	Ratio of earnings to fixed charges before interest credited on investment products (Line item 5/Line item 12)	**10.9**	12.1	11.1	9.5	7.5	4.5	3.2
16.	Ratio of earnings to fixed charges (Line item 7/Line item 14)	**2.2**	2.2	2.1	2.0	1.9	1.4	1.3

Exhibit 31.1

CERTIFICATIONS

I, J. Barry Griswell, 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 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: November 1, 2006

/s/ J. Barry Griswell
J. Barry Griswell
Chairman and Chief Executive Officer

Exhibit 31.2

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 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: November 1, 2006

/s/ Michael H. Gersie

Michael H. Gersie
Executive Vice President and Chief Financial Officer

Exhibit 32.1

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

I, J. Barry Griswell, Chairman, President and Chief Executive Officer of Principal Financial Group, Inc., certify that (i) the Form 10-Q for the quarter ended September 30, 2006 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 September 30, 2006 fairly presents, in all material respects, the financial condition and results of operations of Principal Financial Group, Inc.

/s/ J. Barry Griswell
J. Barry Griswell
Chairman and Chief Executive Officer
Date: November 1, 2006

Exhibit 32.2

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 September 30, 2006 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 September 30, 2006 fairly presents, in all material respects, the financial condition and results of operations of Principal Financial Group, Inc.

/s/ Michael H. Gersie
Michael H. Gersie
Executive Vice President and Chief Financial Officer
Date: November 1, 2006