SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2005

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☒ No o

The total number of shares of the registrant's Common Stock, $0.01 par value, outstanding as of July 27, 2005 was 279,701,355.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.
Consolidated Statements of Financial Position

	June 30, 2005 (Unaudited)	December 31, 2004 (Note 1)
	(in millions)	
Assets		
Fixed maturities, available-for-sale	**$ 42,115.4**	$ 40,916.3
Fixed maturities, trading	**91.3**	93.0
Equity securities, available-for-sale	**767.3**	762.6
Mortgage loans	**11,691.7**	11,714.5
Real estate	**1,023.3**	982.9
Policy loans	**813.0**	814.5
Other investments	**1,207.0**	1,585.7
Total investments	**57,709.0**	56,869.5
Cash and cash equivalents	**1,171.6**	451.9
Accrued investment income	**672.8**	678.0
Premiums due and other receivables	**719.6**	628.5
Deferred policy acquisition costs	**1,969.1**	1,837.6
Property and equipment	**419.3**	429.4
Goodwill	**275.7**	232.9
Other intangibles	**211.5**	196.5
Separate account assets	**53,007.9**	51,507.9
Assets of discontinued operations	**—**	50.1
Other assets	**1,036.1**	915.8
Total assets	**$ 117,192.6**	$ 113,798.1
Liabilities		
Contractholder funds	**$ 33,322.9**	$ 32,183.3
Future policy benefits and claims	**16,212.9**	16,042.6
Other policyholder funds	**746.6**	734.9
Short-term debt	**456.3**	281.7
Long-term debt	**839.5**	843.5
Income taxes payable	**—**	277.1
Deferred income taxes	**1,197.3**	1,131.7
Separate account liabilities	**53,007.9**	51,507.9
Liabilities of discontinued operations	**—**	1.3
Other liabilities	**3,557.1**	3,249.8
Total liabilities	**109,340.5**	106,253.8
Stockholders' equity		
Series A preferred stock, par value $.01 with liquidation preference of $100 per share – 3.0 million shares authorized, issued and outstanding in 2005	**—**	—
Series B preferred stock, par value $.01 with liquidation preference of $25 per share – 10.0 million shares authorized, issued and outstanding in 2005	**0.1**	—
Common stock, par value $.01 per share – 2,500.0 million shares authorized, 380.1 million and 379.1 million shares issued, and 279.4 million and 300.6 million shares outstanding in 2005 and 2004, respectively	**3.8**	3.8
Additional paid-in capital	**7,860.5**	7,269.4
Retained earnings	**1,733.9**	1,289.5
Accumulated other comprehensive income	**1,453.9**	1,313.3

Treasury stock, at cost (100.7 million and 78.5 million common shares in 2005 and 2004, respectively)	**(3,200.1)**	(2,331.7)
Total stockholders' equity	**7,852.1**	7,544.3
Total liabilities and stockholders' equity	**$ 117,192.6**	$ 113,798.1

See accompanying notes.

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions, except per share data)			
Revenues				
Premiums and other considerations	**$ 948.9**	$ 892.6	**$ 1,883.0**	$ 1,813.0
Fees and other revenues	**405.3**	364.2	**822.5**	696.8
Net investment income	**836.3**	789.2	**1,630.4**	1,574.5
Net realized/unrealized capital gains (losses)	**10.2**	(66.3)	**8.7**	(108.8)
Total revenues	**2,200.7**	1,979.7	**4,344.6**	3,975.5
Expenses				
Benefits, claims and settlement expenses	**1,264.5**	1,221.1	**2,498.8**	2,407.2
Dividends to policyholders	**72.2**	74.4	**145.1**	147.7
Operating expenses	**580.8**	521.1	**1,137.7**	1,050.6
Total expenses	**1,917.5**	1,816.6	**3,781.6**	3,605.5
Income from continuing operations before income taxes	**283.2**	163.1	**563.0**	370.0
Income taxes	**59.4**	34.2	**134.2**	78.3
Income from continuing operations, net of related income taxes	**223.8**	128.9	**428.8**	291.7
Income (loss) from discontinued operations, net of related income taxes	**15.1**	(9.2)	**15.6**	27.3
Income before cumulative effect of accounting change	**238.9**	119.7	**444.4**	319.0
Cumulative effect of accounting change, net of related income taxes	**—**	—	**—**	(5.7)
Net income	**$ 238.9**	$ 119.7	**$ 444.4**	$ 313.3
Earnings per common share				
Basic earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.78**	$ 0.41	**$ 1.45**	$ 0.91
Income (loss) from discontinued operations, net of related income taxes	**0.05**	(0.03)	**0.05**	0.09
Income before cumulative effect of accounting change	**0.83**	0.38	**1.50**	1.00
Cumulative effect of accounting change, net of related income taxes	**—**	—	**—**	(0.02)
Net income	**$ 0.83**	$ 0.38	**$ 1.50**	$ 0.98
Diluted earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.77**	$ 0.40	**$ 1.44**	$ 0.91
Income (loss) from discontinued operations, net of related income taxes	**0.05**	(0.03)	**0.05**	0.09
Income before cumulative effect of accounting change	**0.82**	0.37	**1.49**	1.00
Cumulative effect of accounting change, net of related income taxes	**—**	—	**—**	(0.02)
Net income	**$ 0.82**	$ 0.37	**$ 1.49**	$ 0.98

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, 2004	$ —	$ —	$ 3.8	$ 7,153.2	$ 630.4	$ 1,171.3	$ (1,559.1)	$ 7,399.6
Shares issued	—	—	—	14.1	—	—	—	14.1

Capital transactions of equity method investee, net of related income taxes	—	—	—	13.1	—	—	—	13.1
Stock-based compensation and additional related tax benefits	—	—	—	22.7	—	—	—	22.7
Tax benefits related to initial public offering	—	—	—	8.8	—	—	—	8.8
Treasury stock acquired	—	—	—	—	—	—	(222.3)	(222.3)
Comprehensive loss:								
Net income	—	—	—	—	313.3	—	—	313.3
Net unrealized losses	—	—	—	—	—	(596.2)	—	(596.2)
Provision for deferred income tax benefits	—	—	—	—	—	228.9	—	228.9
Foreign currency translation adjustment, net of related income taxes	—	—	—	—	—	(42.9)	—	(42.9)
Comprehensive loss								(96.9)
Balances at June 30, 2004	$ —	$ —	$ 3.8	$ 7,211.9	$ 943.7	$ 761.1	$ (1,781.4)	$ 7,139.1
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	**—**	**—**	**—**	**25.8**	**—**	**—**	**—**	**25.8**
Capital transactions of equity method investee, net of related income taxes	**—**	**—**	**—**	**0.4**	**—**	**—**	**—**	**0.4**
Stock-based compensation and additional related tax benefits	**—**	**—**	**—**	**23.0**	**—**	**—**	**—**	**23.0**
Treasury stock acquired, common	—	—	—	—	—	—	**(868.4)**	**(868.4)**
Comprehensive income:								
Net income	**—**	**—**	**—**	**—**	**444.4**	**—**	**—**	**444.4**
Net unrealized gains	**—**	**—**	**—**	**—**	**—**	**164.7**	**—**	**164.7**
Provision for deferred income taxes	**—**	**—**	**—**	**—**	**—**	**(41.0)**	**—**	**(41.0)**
Foreign currency translation adjustment, net of related income taxes	**—**	**—**	**—**	**—**	**—**	**16.9**	**—**	**16.9**
Comprehensive income								**585.0**
Balances at June 30, 2005	**$ —**	**$ 0.1**	**$ 3.8**	**$ 7,860.5**	**$ 1,733.9**	**$ 1,453.9**	**$ (3,200.1)**	**$ 7,852.1**

See accompanying notes.

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

	For the six months ended June 30,	
	2005	**2004**
	(in millions)	
Operating activities		
Net income	**$ 444.4**	$ 313.3
Adjustments to reconcile net income to net cash provided by operating activities:		
Income from discontinued operations, net of related income taxes	**(15.6)**	(27.3)
Cumulative effect of accounting change, net of related income taxes	**—**	5.7
Amortization of deferred policy acquisition costs	**126.7**	92.4
Additions to deferred policy acquisition costs	**(249.4)**	(215.0)
Accrued investment income	**5.2**	22.9
Premiums due and other receivables	**(20.4)**	33.8
Contractholder and policyholder liabilities and dividends	**932.3**	680.4
Current and deferred income tax benefits	**(415.9)**	(4.9)
Net realized/unrealized capital losses (gains)	**(8.7)**	108.8
Depreciation and amortization expense	**48.1**	52.9
Mortgage loans held for sale, acquired or originated	**(1,077.3)**	(423.9)
Mortgage loans held for sale, sold or repaid, net of gain	**1,108.2**	449.5
Real estate acquired through operating activities	**(26.7)**	(16.1)
Real estate sold through operating activities	**4.8**	56.4
Stock-based compensation	**22.9**	20.9
Other	**(73.3)**	(220.2)
Net adjustments	**360.9**	616.3
Net cash provided by operating activities	**805.3**	929.6
Investing activities		
Available-for-sale securities:		
Purchases	**(4,753.5)**	(5,137.1)
Sales	**961.7**	1,477.3
Maturities	**3,046.6**	2,802.0
Mortgage loans acquired or originated	**(444.0)**	(949.6)
Mortgage loans sold or repaid	**435.5**	783.4
Real estate acquired	**(161.1)**	(105.7)
Real estate sold	**267.2**	131.7
Net purchases of property and equipment	**(18.1)**	(24.4)
Net proceeds from sales of subsidiaries	**—**	14.9
Purchases of interest in subsidiaries, net of cash acquired	**(54.4)**	(106.2)
Net change in other investments	**(41.2)**	(65.5)
Net cash used in investing activities	**(761.3)**	(1,179.2)

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

	For the six months ended June 30,	
	2005	2004
	(in millions)	
Financing activities		
Issuance of common stock	$ **25.8**	$ 14.1
Issuance of preferred stock	**542.0**	—
Acquisition of treasury stock	**(868.4)**	(222.3)
Proceeds from financing element derivatives	**83.0**	94.0
Payments for financing element derivatives	**(55.6)**	(41.1)
Issuance of long-term debt	**12.2**	7.8
Principal repayments of long-term debt	**(11.5)**	(221.1)
Net proceeds of short-term borrowings	**172.4**	49.6
Investment contract deposits	**4,072.6**	3,805.3
Investment contract withdrawals	**(3,319.5)**	(2,938.2)
Net increase (decrease) in banking operation deposits	**22.7**	(13.9)
Net cash provided by financing activities	**675.7**	534.2
Net increase in cash and cash equivalents	**719.7**	284.6
Cash and cash equivalents at beginning of period	**451.9**	1,190.2
Cash and cash equivalents at end of period	$ **1,171.6**	$ 1,474.8

See accompanying notes.

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
June 30, 2005
(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 months and six months ended June 30, 2005, are not necessarily indicative of the results that may be expected for the year ended December 31, 2005. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2004, included in our Form 10-K for the year ended December 31, 2004, filed with the United States Securities and Exchange Commission (“SEC”). The accompanying consolidated statement of financial position at December 31, 2004, 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 December 31, 2004, and June 30, 2004 financial statements to conform to the June 30, 2005 presentation.

Recent Accounting Pronouncements

On May 30, 2005, the Financial Accounting Standards Board (the “FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* (“SFAS 154”), which changes the requirements for the accounting and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principles and also to changes required by an accounting pronouncement that does not contain specific transition provisions. SFAS 154 carries forward without change the guidance contained in Accounting Principles Board (“APB”) Opinion No. 20, *Accounting Changes*, for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will be adopting SFAS 154 effective January 1, 2006. SFAS 154 does not change the transition provisions of any existing accounting pronouncements.

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 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 FASB Statement 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 will be adopting SFAS 123R effective January 1, 2006. This Statement will 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 have already fully vested. We applied the prospective method of transition as prescribed by SFAS 123.

In May 2005, we learned of discussions between several major accounting firms, the FASB and the SEC concluding it is appropriate to recognize compensation cost 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 has been 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 we adopt SFAS 123R on January 1, 2006, we will 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.

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

Separate Accounts

At June 30, 2005 and December 31, 2004, the separate accounts included a separate account valued at $698.9 million and $782.8 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 the 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.

Stock-Based Compensation

At June 30, 2005, we have four stock-based compensation plans. We applied the fair value method to all stock-based awards granted subsequent to January 1, 2002. For stock-based awards granted prior to this date, we used the intrinsic value method.

Awards under our plans vest over periods ranging from one year to three years. Therefore, the cost related to stock-based compensation included in the determination of net income for the three months and six months ended June 30, 2004, is less than that which would have been recognized if the fair value based method had been applied to all awards since the inception of our stock-based compensation plans. Had compensation expense for our stock option awards and employees' purchase rights been determined based upon fair values at the grant dates for awards under the plans in accordance with SFAS 123, our net income and earnings per share would have been reduced to the pro forma amounts indicated below. For the purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period.

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions, except per share data)			
Net income, as reported	**$ 238.9**	$ 119.7	**$ 444.4**	$ 313.3
Add: Stock-based compensation expense included in reported net income, net of related tax effects	**8.2**	9.2	**13.5**	12.6
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	**8.2**	10.1	**13.5**	14.3
Pro forma net income	**$ 238.9**	$ 118.8	**$ 444.4**	$ 311.6
Basic earnings per share:				
As reported	**$ 0.83**	$ 0.38	**$ 1.50**	$ 0.98
Pro forma	**0.83**	0.37	**1.50**	0.98
Diluted earnings per share:				
As reported	**$ 0.82**	$ 0.37	**$ 1.49**	$ 0.98
Pro forma	**0.82**	0.37	**1.49**	0.97

2. Discontinued Operations

Real Estate Investment

On May 25, 2005, we entered into a definitive agreement for the sale of a real estate property previously held for investment purposes. This property qualifies 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 and cash flows for all periods presented. The gain on disposal is reported as an other after-tax adjustment in our Corporate and Other segment.

Selected financial information for the discontinued operation is as follows:

	June 30, 2005	December 31, 2004
	(in millions)	
Assets		
Real estate	$ —	$ 49.1
All other assets	—	1.0
Total assets	$ —	$ 50.1
Liabilities		
Liabilities	$ —	$ 1.3
Total liabilities	$ —	$ 1.3

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Total revenues	$ **0.7**	$ —	$ **1.4**	$ 0.9
Income from discontinued operations:				
Income before income taxes	$ **0.7**	$ —	$ **1.4**	$ 0.9
Income taxes	**0.3**	—	**0.5**	0.3
Income from discontinued operations, net of related income taxes	**0.4**	—	**0.9**	0.6
Gain on disposal of discontinued operations, net of related income taxes	**14.7**	—	**14.7**	—
Net income	$ **15.1**	$ —	$ **15.6**	$ 0.6

3. Consolidated Variable Interest Entities

Synthetic Collateralized Debt Obligation. 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.

We have determined that this grantor trust is a variable interest entity and that we are the primary beneficiary of the trust due to our sole interest in the variable interest entity and management of the synthetic reference portfolios. Upon consolidation of the trust, as of June 30, 2005, our consolidated statements of financial position include $130.0 million of available-for-sale fixed maturity securities, which represented the collateral held by the trust. As of June 30, 2005, the credit default swap entered into by the trust has an outstanding notional amount of $130.0 million and a change in fair value of a $2.2 million pre-tax loss that is recorded in earnings and is reflected on the consolidated statements of financial position as an other liability. The creditors of the grantor trusts have no recourse to our assets.

4. Securitization Transactions

We, along with other contributors, sell commercial mortgage loans to trusts that, in turn, securitize the assets. We retain primary servicing responsibilities and may retain other immaterial interests. We receive annual servicing fees approximating 0.01%, which approximates cost. The investors and the securitization entities have no recourse to our other assets for failure of debtors to pay when due. The value of our retained interests is subject primarily to credit risk.

As these trusts are classified as qualifying special purpose entities ("QSPE") pursuant to the guidance of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities - A Replacement of FASB Statement 125* ("SFAS 140"), we recognize the gain on the sale of the loans to the trust and the trusts are not required to be consolidated under the provisions of FIN 46R. There is significant judgment used to determine whether a trust is a qualifying special purpose entity. To maintain QSPE status, the trust must continue to meet the QSPE criteria both initially and in subsequent periods. We have analyzed the governing pooling and servicing agreements for each of our securitizations and believe that the terms are industry standard and are consistent with the QSPE criteria. If at any time we determine a trust no longer qualifies as a qualifying special purpose entity, each trust will need to be reviewed to determine if there is a need to recognize the commercial mortgage loan asset in the statement of financial position along with the offsetting liability.

5. Federal Income Taxes

The effective income tax rate on income from continuing operations for the three months and six months ended June 30, 2005 is lower than the prevailing corporate federal income tax rate primarily due to income tax deductions allowed for corporate dividends received and Section 29 tax credits received on our investment in a synthetic fuel production facility. The effective income tax rate on income from continuing operations for the three months and six months

ended June 30, 2004 is lower than the prevailing corporate federal income tax rate primarily due to income tax deductions allowed for corporate dividends received.

The Internal Revenue Service (the "Service") has completed examinations of the U.S. consolidated federal income tax returns for 2001 and prior years. The Service has also started to examine returns for 2002 and 2003. The Service's completion of the examinations for the years 1999 - 2001 resulted in notices of deficiency dated December 29, 2004, and March 1, 2005. We paid the deficiencies (approximately $444.0 million for 1999 and 2000, and $1.3 million for 2001, including interest) in the first quarter of 2005 and plan to file claims for refund relating to the disputed adjustments. The majority of the deficiency is attributable to the disallowance of carrybacks of capital losses, net operating losses and foreign tax credits arising in years after 2001. We expect the Service to allow some (if not all) of the carrybacks upon completion of the audit of the returns for the years in which the losses and credits arose. The remainder of the deficiency is attributable to both contested issues and adjustments that we have accepted. We believe that we have adequate defenses against, or sufficient provisions for, the contested issues. Consequently, we do not expect the ultimate resolution of issues in tax years 1999 – 2001 to have a material impact on our net income. Similarly, we believe that there are adequate defenses against, or sufficient provisions for, any challenges that might arise in tax years subsequent to 2001.

6. Employee and Agent Benefits

Components of net periodic benefit cost (income):

	Pension benefits For the three months ended June 30,		Other postretirement benefits For the three months ended June 30,	
	2005	**2004**	**2005**	**2004**
	(in millions)			
Service cost	**$ 12.4**	$ 12.8	**$ 2.5**	$ 2.3
Interest cost	**19.4**	18.3	**4.2**	3.9
Expected return on plan assets	**(24.1)**	(21.5)	**(7.3)**	(6.8)
Amortization of prior service cost (benefit)	**0.4**	0.5	**(0.6)**	(0.7)
Recognized net actuarial loss	**4.1**	4.0	**0.1**	0.1
Net periodic benefit cost (income)	**$ 12.2**	$ 14.1	**$ (1.1)**	$ (1.2)

	Pension benefits For the six months ended June 30,		Other postretirement benefits For the six months ended June 30,	
	2005	**2004**	**2005**	**2004**
	(in millions)			
Service cost	**$ 24.8**	$ 25.6	**$ 5.0**	$ 4.5
Interest cost	**38.7**	36.6	**8.4**	7.7
Expected return on plan assets	**(48.1)**	(43.1)	**(14.7)**	(13.6)
Amortization of prior service cost (benefit)	**0.7**	0.9	**(1.3)**	(1.4)
Recognized net actuarial loss	**8.2**	8.2	**0.3**	0.3
Net periodic benefit cost (income)	**$ 24.3**	$ 28.2	**$ (2.3)**	$ (2.5)

Contributions

We anticipate contributing between $0.6 million and $1.5 million in 2005 to fund our other postretirement benefit plans. We contributed $0.2 million during the three months ended June 30, 2005, and $0.3 million during the six months ended June 30, 2005.

Our funding policy for the qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act ("ERISA") and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2005 will be zero so we will not be required to fund the qualified pension plan during 2005. However, it is possible that we may fund the qualified and nonqualified plans in 2005 in the range of $20 million to $50 million. During the three months and six months ended June 30, 2005, $8.4 million was contributed to the plans.

7. Comprehensive Income (Loss)

Comprehensive income (loss) is as follows:

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Comprehensive income (loss):				
Net income	**$ 238.9**	$ 119.7	**$ 444.4**	$ 313.3
Net change in unrealized gains and losses on fixed maturities, available-for-sale	**691.0**	(1,411.7)	**158.5**	(773.4)
Net change in unrealized gains and losses on equity securities, available-for-sale	**10.1**	(19.7)	**3.8**	(10.5)
Net change in unrealized gains and losses on equity method subsidiaries and minority interest adjustments	**(17.3)**	5.6	**(17.0)**	(8.1)
Adjustments for assumed changes in amortization patterns:				
Deferred policy acquisition costs	**(36.8)**	122.9	**6.8**	80.3
Sales inducements	**(3.8)**	6.2	**(0.2)**	3.1
Unearned revenue reserves	**(9.5)**	(6.1)	**(2.4)**	(4.8)
Net change in unrealized gains and losses on derivative instruments	**0.6**	36.4	**25.2**	39.0
Adjustments to unrealized gains and losses for Closed Block policyholder dividend obligation	**(62.9)**	133.1	**(10.0)**	78.2
Provision for deferred income tax benefit (expense)	**(188.1)**	401.4	**(39.3)**	228.6
Change in net foreign currency translation adjustment	**24.2**	(46.6)	**15.2**	(42.6)
Comprehensive income (loss)	**$ 646.4**	$ (658.8)	**$ 585.0**	$ (96.9)

8. 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, and 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 others 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. We received a subpoena on March 3, 2005, from the Office of the Attorney General of the State of New York seeking information on compensation agreements associated with the sale of retirement products. We are cooperating fully with the inquiry. We have received requests from regulators and other governmental authorities relating to industry issues and may receive such requests 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 new 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.

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, financial position or net income. 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 2005 through 2019. The maximum exposure under these agreements as of June 30, 2005, was approximately $222.0 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, minimizing the impact to net income. The fair value of such guarantees issued after January 1, 2003, was determined to be insignificant.

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. $190.0 million as of June 30, 2005). 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 ("the Commission") opined that such late filings would result in certain New Zealand investors having a right to return of their investment plus interest at 10% per annum from the date of investment.

8. Contingencies, Guarantees and Indemnifications (continued)

This technical issue affected many in the industry. On April 15, 2004, the New Zealand government enacted legislation that will provide issuers, including BT Financial Group, the opportunity for retroactive relief from such late filing violations. The law allows issuers to apply for judicial validation of non-compliant issuances resulting from late filings. The law further provides that judicial relief is mandatory and unconditional unless an investor was materially prejudiced by the late filing. Such judicial relief has been granted to BT Financial Group and Westpac with regard to the vast majority of affected investors. As a result, we do not believe that this matter will result in a material adverse effect on our business or financial position. It is possible, however, that it could have a material adverse effect on net income in a particular quarter or annual period.

On December 24, 2004, Westpac lodged several warranty and indemnification claims related to the sale of BT Financial Group. Under the sale agreements, certain warranty claims were required to be lodged by December 31, 2004. The claims aggregate approximately A$50.0 million Australian dollars (approximately U.S. $38.0 million) with the majority of the claims (approximately A$45.0 million Australian dollars, or U.S. $34.0 million) 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 claims 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. We intend to vigorously defend against these claims. Although we cannot predict the outcome of this matter or reasonably estimate possible losses, we do not believe that it would result in a material adverse effect on our business or financial position. It is possible, however, that it could have a material adverse effect on net income in a particular quarter or annual period.

We are also subject to various other indemnification obligations issued in conjunction with certain transactions, primarily the sale of BT Financial Group, 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, financial position or net income. The fair value of such indemnifications issued after January 1, 2003, was determined to be insignificant.

9. 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 Mortgage Banking segment (discontinued operations) and 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 savings 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 offers retirement products and services, annuities, long-term mutual funds and life insurance through operations in Brazil, Chile, Mexico, Hong Kong, India, Japan and Malaysia. On July 2, 2004, we closed the sale of all the stock of our Argentine companies. Consequently, the results of operations (excluding corporate overhead) for Principal International Argentina S.A. are reported as other after-tax adjustments for all periods presented.

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.

On July 1, 2004, we closed the sale of Principal Residential Mortgage, Inc. to CitiMortgage, Inc. The results of operations (excluding corporate overhead) for our Mortgage Banking segment, which includes Principal Residential Mortgage, Inc., are reported as other after-tax adjustments for all periods presented.

9. Segment Information (continued)

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, intersegment 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 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 and sales inducement costs, recognition of front-end fee revenues for sales charges on pension 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. 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 capital allocation and income tax allocation. The Corporate and Other segment functions to absorb the risk inherent in interpreting and applying tax law. The segments are allocated tax adjustments consistent with the positions we took on tax returns. The Corporate and Other segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

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

	June 30, 2005	December 31, 2004
	(in millions)	
Assets:		
U.S. Asset Management and Accumulation	**$ 97,258.2**	$ 94,394.6
International Asset Management and Accumulation	**3,854.6**	3,642.0
Life and Health Insurance	**13,764.7**	13,185.4
Corporate and Other	**2,315.1**	2,576.1
Total consolidated assets	**$ 117,192.6**	$ 113,798.1

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating revenues by segment:				
U.S. Asset Management and Accumulation	**$ 971.1**	$ 906.8	**$ 1,928.4**	$ 1,800.1
International Asset Management and Accumulation	**158.2**	122.3	**291.0**	235.3
Life and Health Insurance	**1,089.5**	1,030.7	**2,158.1**	2,066.0
Corporate and Other	**(28.0)**	(11.9)	**(38.1)**	(10.3)
Total segment operating revenues	**2,190.8**	2,047.9	**4,339.4**	4,091.1
Add:				
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**10.6**	(68.2)	**6.6**	(114.7)
Subtract:				
Operating revenues from discontinued real estate	**0.7**	—	**1.4**	0.9
Total revenue per consolidated statements of operations	**$ 2,200.7**	$ 1,979.7	**$ 4,344.6**	$ 3,975.5

9. Segment Information (continued)

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating earnings (loss) by segment:				
U.S. Asset Management and Accumulation	**$ 130.5**	$ 121.7	**$ 269.1**	$ 241.2
International Asset Management and Accumulation	**19.1**	9.3	**28.6**	17.9
Life and Health Insurance	**76.3**	56.9	**145.8**	131.7
Mortgage Banking	**—**	(5.4)	**—**	(10.3)
Corporate and Other	**(4.9)**	(9.1)	**(13.3)**	(20.6)
Total segment operating earnings	**221.0**	173.4	**430.2**	359.9
Net realized/unrealized capital gains (losses), as adjusted	**3.2**	(44.5)	**(0.5)**	(67.6)
Other after-tax adjustments (1)	**14.7**	(9.2)	**14.7**	21.0
Net income per consolidated statements of operations	**$ 238.9**	$ 119.7	**$ 444.4**	$ 313.3

(1) For the three months ended June 30, 2005, other after-tax adjustments reflect a $14.7 million gain on sale of a real estate property that qualifies for discontinued operations treatment under SFAS 144.

For the three months ended June 30, 2004, other after-tax adjustments of $(9.2) million included the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($9.5 million); and the positive effect of income from discontinued operations of Argentina ($0.3 million).

For the six months ended June 30, 2005, other after-tax adjustments reflect a $14.7 million gain on sale of a real estate property that qualifies for discontinued operations treatment under SFAS 144.

For the six months ended June 30, 2004, other after-tax adjustments of $21.0 million included the positive effects of: (1) income from discontinued operations of Principal Residential Mortgage ($26.5 million) and (2) income from discontinued operations of Argentina ($0.2 million); and the negative effect from a cumulative change in accounting principle related to the implementation of Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* ($5.7 million).

10. Stockholders' Equity

Preferred Stock

As of June 30, 2005, we had 13.0 million shares of perpetual preferred stock authorized, issued and outstanding under the two series described below. Preferred stockholders have dividend and liquidation priority over common stockholders.

Series A
On June 16, 2005, we issued 3.0 million shares of fixed rate, non-cumulative, Series A Perpetual Preferred Stock ("Series A Preferred Stock"), at an initial offering price of $100 per share. We received net proceeds of $296.0 million after offering costs. Dividends on the Series A Preferred Stock are non-cumulative and are payable quarterly when, and if, declared by our Board of Directors. Dividends commence on September 30, 2005, at a rate of 5.563% per annum of the liquidation preference. On or after the dividend payment date in June 2015, the Series A initial distribution rate will become a floating rate, subject to reset, at our option, subject to certain conditions and parameters. If reset, the rate may be at fixed or floating rates. On or after the dividend payment date in June 2015, we may, at our option, redeem the shares at a price of $100 per share, or $300.0 million in the aggregate, plus accrued and unpaid dividends for the then current dividend period to the date of redemption, if any.

10. Stockholders' Equity (continued)

The Series A Preferred Stock has no stated maturity and is not convertible in to any other of our securities. Series A Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the shares and in the case of certain dividend non-payments.

Series B
On June 16, 2005, we issued 10.0 million shares of fixed rate, non-cumulative, Series B Perpetual Preferred Stock ("Series B Preferred Stock"), at an initial offering price of $25 per share. We received net proceeds of $246.0 million after offering costs. Dividends on the Series B Preferred Stock are non-cumulative and are payable quarterly when, and if, declared by the Board of Directors. Dividends commence on September 30, 2005, at a rate of 6.518% per annum of the liquidation preference. On or after the dividend payment date in June 2035, the Series B initial distribution rate will become a floating rate, subject to reset, at our option, subject to certain conditions and parameters. If reset, the rate may be at fixed or floating rates. On or after the dividend payment date in June 2015, we may, at our option, redeem the shares at a price of $25 per share, or $250.0 million in the aggregate, plus accrued and unpaid dividends for the then current dividend period to the date of redemption, if any.

The Series B Preferred Stock has no stated maturity and is not convertible in to any other of our securities. Series B Preferred Stock will have no voting rights, except with respect to certain fundamental changes in the terms of the shares and in the case of certain dividend non-payments.

Dividend Restrictions

The certificates of designations for the Series A and B Preferred Stock restrict the declaration of preferred dividends if we fail to meet specified capital adequacy, net income or stockholders' equity levels. As of June 30, 2005, we have no preferred dividend restrictions.

Common Stock

In June 2005, following our Board of Directors' share repurchase authorization of up to 15.0 million shares, we entered into an accelerated stock repurchase agreement with a third party investment bank for approximately 13.7 million shares of our common stock with an initial payment of $542.3 million, using cash proceeds from the preferred stock issuance. The transaction is subject to a market price adjustment provision based on the volume weighted average market price over the execution period, which can be settled in shares or cash.

In March 2005, our Board of Directors authorized the repurchase of up to $250.0 million of our outstanding common stock. This program was completed in May 2005.

Reconciliation of Outstanding Shares

	Series A preferred stock	Series B preferred stock	Common stock
		(in millions)	

Outstanding shares at January 1, 2004	—	—	320.7
Shares issued	—	—	0.5
Treasury stock acquired	—	—	(6.3)
Outstanding shares at June 30, 2004	—	—	314.9
Outstanding shares at January 1, 2005	**—**	**—**	**300.6**
Shares issued	**3.0**	**10.0**	**1.0**
Treasury stock acquired	**—**	**—**	**(22.2)**
Outstanding shares at June 30, 2005	**3.0**	**10.0**	**279.4**

11. Earnings Per Common Share

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions, except per share data)			
Income from continuing operations, net of related income taxes	**$ 223.8**	$ 128.9	**$ 428.8**	$ 291.7
Weighted-average shares outstanding:				
Basic	**288.9**	317.9	**295.8**	319.4
Dilutive effect:				
Stock options	**1.5**	1.1	**1.5**	1.1
Restricted stock units	**0.4**	0.2	**0.3**	0.1
Long term performance plan	**0.1**	—	**0.1**	—
Accelerated stock repurchase agreement	**0.5**	—	**0.5**	—
Diluted	**291.4**	319.2	**298.2**	320.6
Income from continuing operations per share:				
Basic	**$ 0.78**	$ 0.41	**$ 1.45**	$ 0.91
Diluted	**$ 0.77**	$ 0.40	**$ 1.44**	$ 0.91

The calculation of diluted earnings per share for the three months and six months ended June 30, 2005 and 2004, excludes the incremental effect related to certain stock-based compensation grants due to their anti-dilutive effect.

12. Condensed Consolidating Financial Information

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

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.

12. Condensed Consolidating Financial Information (continued)

The following tables set forth condensed consolidating financial information of Principal Life and PFG as of June 30, 2005 and December 31, 2004, and for the six months ended June 30, 2005 and 2004.

Condensed Consolidating Statements of Financial Position
June 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

	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					
Investments, excluding investment in unconsolidated entities	$ —	$ 52,868.0	$ 6,267.6	$ (1,665.5)	$ 57,470.1
Investment in unconsolidated entities	7,828.1	291.3	6,222.9	(14,103.4)	238.9
Cash and cash equivalents	23.3	902.4	374.1	(128.2)	1,171.6
Other intangibles	—	5.1	206.4	—	211.5
Separate account assets	—	52,153.1	871.7	(16.9)	53,007.9
All other assets	1.9	4,492.0	817.1	(218.4)	5,092.6
Total assets	$ 7,853.3	$ 110,711.9	$ 14,759.8	$ (16,132.4)	$ 117,192.6
Liabilities					
Contractholder funds	$ —	$ 33,500.5	$ 10.5	$ (188.1)	$ 33,322.9
Future policy benefits and claims	—	14,360.0	1,852.9	—	16,212.9
Other policyholder funds	—	743.5	3.1	—	746.6
Short-term debt	—	—	587.5	(131.2)	456.3
Long-term debt	—	275.9	1,114.1	(550.5)	839.5
Deferred income taxes	—	1,018.1	191.7	(12.5)	1,197.3
Separate account liabilities	—	52,153.1	871.7	(16.9)	53,007.9
Other liabilities	1.2	1,476.7	2,300.2	(221.0)	3,557.1
Total liabilities	1.2	103,527.8	6,931.7	(1,120.2)	109,340.5
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	7,860.5	5,168.3	6,882.9	(12,051.2)	7,860.5
Retained earnings (deficit)	1,733.9	657.5	(508.7)	(148.8)	1,733.9
Accumulated other comprehensive income	1,453.9	1,355.8	1,453.9	(2,809.7)	1,453.9
Treasury stock, at cost	(3,200.1)	—	—	—	(3,200.1)
Total stockholders' equity	7,852.1	7,184.1	7,828.1	(15,012.2)	7,852.1
Total liabilities and stockholders' equity	$ 7,853.3	$ 110,711.9	$ 14,759.8	$ (16,132.4)	$ 117,192.6

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2004

	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					
Investments, excluding investment in unconsolidated entities	$ —	$ 52,199.1	$ 5,716.8	$ (1,260.7)	$ 56,655.2
Investment in unconsolidated entities	7,469.0	277.3	5,961.3	(13,493.3)	214.3
Cash and cash equivalents	75.4	31.2	410.0	(64.7)	451.9
Other intangibles	—	5.5	191.0	—	196.5
Separate account assets	—	50,722.4	785.5	—	51,507.9
All other assets	1.6	4,263.7	687.3	(180.3)	4,772.3
Total assets	$ 7,546.0	$ 107,499.2	$ 13,751.9	$ (14,999.0)	$ 113,798.1
Liabilities					
Contractholder funds	$ —	$ 32,353.1	$ 8.4	$ (178.2)	$ 32,183.3
Future policy benefits and claims	—	14,284.8	1,757.8	—	16,042.6
Other policyholder funds	—	731.2	3.7	—	734.9
Short-term debt	—	—	527.4	(245.7)	281.7
Long-term debt	—	215.0	929.9	(301.4)	843.5
Income taxes currently payable	—	246.5	48.3	(17.7)	277.1
Deferred income taxes	—	937.5	207.8	(13.6)	1,131.7
Separate account liabilities	—	50,722.4	785.5	—	51,507.9
Liabilities of discontinued operations	—	1.3	—	—	1.3
Other liabilities	1.7	1,351.1	2,014.1	(117.1)	3,249.8
Total liabilities	1.7	100,842.9	6,282.9	(873.7)	106,253.8
Stockholders' equity					
Common stock	3.8	2.5	—	(2.5)	3.8
Additional paid-in capital	7,269.4	5,112.7	6,860.9	(11,973.6)	7,269.4
Retained earnings (deficit)	1,289.5	238.3	(705.3)	467.0	1,289.5

Accumulated other comprehensive income	1,313.3	1,302.8	1,313.4	(2,616.2)	1,313.3
Treasury stock, at cost	(2,331.7)	—	—	—	(2,331.7)
Total stockholders' equity	7,544.3	6,656.3	7,469.0	(14,125.3)	7,544.3
Total liabilities and stockholders' equity	$ 7,546.0	$ 107,499.2	$ 13,751.9	$ (14,999.0)	$ 113,798.1

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
June 30, 2005
(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the six months ended June 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	$ —	$ 1,726.0	$ 157.0	$ —	$ 1,883.0
Fees and other revenues	—	572.0	376.9	(126.4)	822.5
Net investment income	1.1	1,494.2	127.6	7.5	1,630.4
Net realized/unrealized capital gains	—	2.4	3.5	2.8	8.7
Total revenues	1.1	3,794.6	665.0	(116.1)	4,344.6
Expenses					
Benefits, claims, and settlement expenses	—	2,293.5	210.5	(5.2)	2,498.8
Dividends to policyholders	—	145.1	—	—	145.1
Operating expenses	5.4	877.6	366.1	(111.4)	1,137.7
Total expenses	5.4	3,316.2	576.6	(116.6)	3,781.6
Income (loss) from continuing operations before income taxes	(4.3)	478.4	88.4	0.5	563.0
Income taxes (benefits)	(2.1)	125.4	10.0	0.9	134.2
Equity in the net income of subsidiaries, excluding discontinued operations and cumulative effect of accounting change	431.0	50.7	352.6	(834.3)	—
Income from continuing operations, net of related income taxes	428.8	403.7	431.0	(834.7)	428.8
Income from discontinued operations, net of related income taxes	15.6	15.6	15.6	(31.2)	15.6
Net income	$ 444.4	$ 419.3	$ 446.6	$ (865.9)	$ 444.4

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the six months ended June 30, 2004

	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	$ —	$ 1,694.1	$ 118.9	$ —	$ 1,813.0
Fees and other revenues	—	493.2	321.2	(117.6)	696.8
Net investment income	1.2	1,415.9	144.5	12.9	1,574.5
Net realized/unrealized capital losses	—	(100.2)	(14.1)	5.5	(108.8)
Total revenues	1.2	3,503.0	570.5	(99.2)	3,975.5
Expenses					

Benefits, claims, and settlement expenses	—	2,249.2	163.1	(5.1)	2,407.2
Dividends to policyholders	—	147.7	—	—	147.7
Operating expenses	4.8	786.2	360.9	(101.3)	1,050.6
Total expenses	4.8	3,183.1	524.0	(106.4)	3,605.5
Income (loss) from continuing operations before income taxes	(3.6)	319.9	46.5	7.2	370.0
Income taxes (benefits)	(1.3)	72.5	4.8	2.3	78.3
Equity in the net income of subsidiaries, excluding discontinued operations and cumulative effect of accounting change	294.0	53.3	252.3	(599.6)	—
Income from continuing operations, net of related income taxes	291.7	300.7	294.0	(594.7)	291.7
Income (loss) from discontinued operations, net of related income taxes	27.3	(2.7)	27.3	(24.6)	27.3
Income before cumulative effect of accounting change	319.0	298.0	321.3	(619.3)	319.0
Cumulative effect of accounting change, net of related income taxes	(5.7)	(2.5)	(5.7)	8.2	(5.7)
Net income	$ 313.3	$ 295.5	$ 315.6	$ (611.1)	$ 313.3

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the six months ended June 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)		
Operating activities					
Net cash provided by (used in) operating activities	$ (2.6)	$ 540.5	$ 325.6	$ (58.2)	$ 805.3
Investing activities					
Available-for-sale securities:					
Purchases	—	(3,106.3)	(1,760.5)	113.3	(4,753.5)
Sales	—	878.7	83.0	—	961.7
Maturities	—	1,747.0	1,299.6	—	3,046.6
Mortgage loans acquired or originated	—	(324.9)	(234.1)	115.0	(444.0)
Mortgage loans sold or repaid	—	415.0	125.5	(105.0)	435.5
Real estate acquired	—	(125.7)	(35.4)	—	(161.1)
Real estate sold	—	213.7	53.5	—	267.2
Net purchases of property and equipment	—	(13.3)	(4.8)	—	(18.1)
Purchases of interest in subsidiaries, net of cash acquired	—	—	(54.4)	—	(54.4)
Dividends received (contributions to) from unconsolidated entities	251.1	(226.4)	(35.0)	10.3	—
Net change in other investments	—	(4.6)	(45.0)	8.4	(41.2)
Net cash provided by (used in) investing activities	251.1	(546.8)	(607.6)	142.0	(761.3)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows (continued)
For the six months ended June 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 common stock	**$ 25.8**	**$ —**	**$ —**	**$ —**	**$ 25.8**
Issuance of preferred stock	**542.0**	**—**	**—**	**—**	**542.0**
Acquisition of treasury stock	**(868.4)**	**—**	**—**	**—**	**(868.4)**
Proceeds from financing element derivatives	**—**	**83.0**	**—**	**—**	**83.0**
Payments for financing element derivatives	**—**	**(55.6)**	**—**	**—**	**(55.6)**
Issuance of long-term debt	**—**	**68.6**	**83.6**	**(140.0)**	**12.2**
Principal repayments of long-term debt	**—**	**(7.8)**	**(3.8)**	**0.1**	**(11.5)**
Net proceeds of short-term borrowings	**—**	**1.1**	**168.3**	**3.0**	**172.4**
Capital received from (dividends paid to) parent	**—**	**35.0**	**(24.7)**	**(10.3)**	**—**
Investment contract deposits	**—**	**4,072.6**	**—**	**—**	**4,072.6**
Investment contract withdrawals	**—**	**(3,319.5)**	**—**	**—**	**(3,319.5)**
Net increase in banking operation deposits	**—**	**—**	**22.7**	**—**	**22.7**
Net cash provided by (used in) financing activities	**(300.6)**	**877.4**	**246.1**	**(147.2)**	**675.7**
Net increase (decrease) in cash and cash equivalents	**(52.1)**	**871.2**	**(35.9)**	**(63.5)**	**719.7**
Cash and cash equivalents at beginning of period	**75.4**	**31.2**	**410.0**	**(64.7)**	**451.9**
Cash and cash equivalents at end of period	**$ 23.3**	**$ 902.4**	**$ 374.1**	**$ (128.2)**	**$ 1,171.6**

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the six months ended June 30, 2004

	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	$ (2.2)	$ 895.6	$ (83.5)	$ 119.7	$ 929.6
Investing activities					
Available-for-sale securities:					
Purchases	—	(4,335.7)	(810.9)	9.5	(5,137.1)
Sales	—	750.8	726.5	—	1,477.3
Maturities	—	2,222.5	579.5	—	2,802.0
Mortgage loans acquired or originated	—	(967.5)	(18.3)	36.2	(949.6)
Mortgage loans sold or repaid	—	806.0	57.2	(79.8)	783.4
Real estate acquired	—	(87.2)	(18.5)	—	(105.7)
Real estate sold	—	83.0	48.7	—	131.7
Net purchases of property and equipment	—	(20.2)	(4.2)	—	(24.4)
Net proceeds from sale of subsidaries	—	—	14.9	—	14.9
Purchases of interest in subsidiaries, net of cash acquired	—	—	(106.2)	—	(106.2)
Dividends received from unconsolidated entities	300.0	26.0	557.2	(883.2)	—
Net change in other investments	0.3	(171.7)	45.7	60.2	(65.5)
Net cash provided by (used in) investing activities	300.3	(1,694.0)	1,071.6	(857.1)	(1,179.2)

Condensed Consolidating Statements of Cash Flows (continued)
For the six months ended June 30, 2004

	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	$ 14.1	$ —	$ —	$ —	$ 14.1
Acquisition of treasury stock	(222.3)	—	—	—	(222.3)
Proceeds from financing element derivatives	—	94.0	—	—	94.0
Payments for financing element derivatives	—	(41.1)	—	—	(41.1)
Issuance of long-term debt	—	4.7	3.1	—	7.8
Principal repayments of long-term debt	—	(218.1)	(50.7)	47.7	(221.1)
Net proceeds (repayments) of short-term borrowings	—	—	56.0	(6.4)	49.6
Dividends paid to parent	—	(494.0)	(300.0)	794.0	—
Investment contract deposits	—	3,805.3	—	—	3,805.3
Investment contract withdrawals	—	(2,938.2)	—	—	(2,938.2)
Net decrease in banking operation deposits	—	—	(13.9)	—	(13.9)
Net cash provided by (used in) financing activities	(208.2)	212.6	(305.5)	835.3	534.2
Net increase (decrease) in cash and cash equivalents	89.9	(585.8)	682.6	97.9	284.6
Cash and cash equivalents at beginning of period	173.8	638.2	684.2	(306.0)	1,190.2
Cash and cash equivalents at end of period	$ 263.7	$ 52.4	$ 1,366.8	$ (208.1)	$ 1,474.8

12. Condensed Consolidating Financial Information (continued)

On June 30, 2004, our shelf registration statement with the Securities and Exchange Commission 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 $2.45 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. 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 Principal Financial Group, Inc. as of June 30, 2005 and December 31, 2004, and for the six months ended June 30, 2005 and 2004.

Condensed Consolidating Statements of Financial Position
June 30, 2005

	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
Assets					
Investments, excluding investment in unconsolidated entities	**$ —**	**$ 24.3**	**$ 57,445.8**	**$ —**	**$ 57,470.1**
Investment in unconsolidated entities	**7,828.1**	**8,265.7**	**238.8**	**(16,093.7)**	**238.9**
Cash and cash equivalents	**23.3**	**581.5**	**1,350.3**	**(783.5)**	**1,171.6**
Other intangibles	**—**	**—**	**211.5**	**—**	**211.5**
Separate account assets	**—**	**—**	**53,007.9**	**—**	**53,007.9**
All other assets	**1.9**	**151.3**	**4,954.0**	**(14.6)**	**5,092.6**
Total assets	**$ 7,853.3**	**$ 9,022.8**	**$ 117,208.3**	**$ (16,891.8)**	**$ 117,192.6**

Notes to Consolidated Financial Statements (continued)
June 30, 2005
(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position (continued)
June 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)		
Liabilities					
Contractholder funds	$ —	$ —	$ 33,322.9	$ —	$ 33,322.9
Future policy benefits and claims	—	—	16,212.9	—	16,212.9
Other policyholder funds	—	—	746.6	—	746.6
Short-term debt	—	275.0	759.4	(578.1)	456.3
Long-term debt	—	464.3	375.2	—	839.5
Income taxes currently payable	—	5.1	(8.6)	3.5	—
Deferred income taxes	—	4.2	1,209.5	(16.4)	1,197.3
Separate account liabilities	—	—	53,007.9	—	53,007.9
Other liabilities	1.2	446.1	3,316.8	(207.0)	3,557.1
Total liabilities	1.2	1,194.7	108,942.6	(798.0)	109,340.5
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	7,860.5	6,883.0	6,014.1	(12,897.1)	7,860.5
Retained earnings (deficit)	1,733.9	(508.7)	784.2	(275.5)	1,733.9
Accumulated other comprehensive income	1,453.9	1,453.8	1,452.7	(2,906.5)	1,453.9
Treasury stock, at cost	(3,200.1)	—	(2.1)	2.1	(3,200.1)
Total stockholders' equity	7,852.1	7,828.1	8,265.7	(16,093.8)	7,852.1
Total liabilities and stockholders' equity	$ 7,853.3	$ 9,022.8	$ 117,208.3	$ (16,891.8)	$ 117,192.6

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2004

	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					
Investments, excluding investment in unconsolidated entities	$ —	$ 24.0	$ 56,631.2	$ —	$ 56,655.2
Investment in unconsolidated entities	7,469.0	7,668.4	214.3	(15,137.4)	214.3
Cash and cash equivalents	75.4	551.9	520.4	(695.8)	451.9
Other intangibles	—	—	196.5	—	196.5
Separate account assets	—	—	51,524.5	(16.6)	51,507.9
All other assets	1.6	17.4	4,785.5	(32.2)	4,772.3
Total assets	$ 7,546.0	$ 8,261.7	$ 113,872.4	$ (15,882.0)	$ 113,798.1
Liabilities					
Contractholder funds	$ —	$ —	$ 32,183.3	$ —	$ 32,183.3
Future policy benefits and claims	—	—	16,042.6	—	16,042.6
Other policyholder funds	—	—	734.9	—	734.9
Short-term debt	—	75.0	753.7	(547.0)	281.7
Long-term debt	—	464.2	379.3	—	843.5
Income taxes currently payable	—	9.1	273.6	(5.6)	277.1
Deferred income taxes	—	12.4	1,130.7	(11.4)	1,131.7
Separate account liabilities	—	—	51,524.5	(16.6)	51,507.9
Liabilities of discontinued operations	—	—	1.3	—	1.3

Other liabilities	1.7	232.0	3,180.1	(164.0)	3,249.8
Total liabilities	1.7	792.7	106,204.0	(744.6)	106,253.8
Stockholders' equity					
Series A preferred stock	—	—	—	—	—
Series B preferred stock	—	—	—	—	—
Common stock	3.8	—	16.8	(16.8)	3.8
Additional paid-in capital	7,269.4	6,860.9	5,950.6	(12,811.5)	7,269.4
Retained earnings (deficit)	1,289.5	(705.3)	389.2	316.1	1,289.5
Accumulated other comprehensive income	1,313.3	1,313.4	1,311.8	(2,625.2)	1,313.3
Treasury stock, at cost	(2,331.7)	—	—	—	(2,331.7)
Total stockholders' equity	7,544.3	7,469.0	7,668.4	(15,137.4)	7,544.3
Total liabilities and stockholders' equity	$ 7,546.0	$ 8,261.7	$ 113,872.4	$ (15,882.0)	$ 113,798.1

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
June 30, 2005
(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the six months ended June 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	$ —	$ —	$ 1,883.0	$ —	$ 1,883.0
Fees and other revenues	—	—	822.6	(0.1)	822.5
Net investment income	1.1	4.5	1,624.8	—	1,630.4
Net realized/unrealized capital gains	—	0.2	8.5	—	8.7
Total revenues	1.1	4.7	4,338.9	(0.1)	4,344.6
Expenses					
Benefits, claims, and settlement expenses	—	—	2,498.8	—	2,498.8
Dividends to policyholders	—	—	145.1	—	145.1
Operating expenses	5.4	23.2	1,109.2	(0.1)	1,137.7
Total expenses	5.4	23.2	3,753.1	(0.1)	3,781.6
Income (loss) from continuing operations before income taxes	(4.3)	(18.5)	585.8	—	563.0
Income taxes (benefits)	(2.1)	(2.1)	138.4	—	134.2
Equity in the net income of subsidiaries, excluding discontinued operations and cumulative effect of accounting change	431.0	447.4	—	(878.4)	—
Income from continuing operations, net of related income taxes	428.8	431.0	447.4	(878.4)	428.8
Income from discontinued operations, net of related income taxes	15.6	15.6	15.6	(31.2)	15.6
Net income	$ 444.4	$ 446.6	$ 463.0	$ (909.6)	$ 444.4

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
June 30, 2005
(Unaudited)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the six months ended June 30, 2004

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and	Eliminations	Principal Financial Group, Inc. Consolidated

			Other Subsidiaries Combined		
			(in millions)		
Revenues					
Premiums and other considerations	$ —	$ —	$ 1,813.0	$ —	$ 1,813.0
Fees and other revenues	—	—	698.8	(2.0)	696.8
Net investment income	1.2	6.6	1,566.1	0.6	1,574.5
Net realized/unrealized capital losses	—	(25.0)	(83.8)	—	(108.8)
Total revenues	1.2	(18.4)	3,994.1	(1.4)	3,975.5
Expenses					
Benefits, claims, and settlement expenses	—	—	2,407.2	—	2,407.2
Dividends to policyholders	—	—	147.7	—	147.7
Operating expenses	4.8	30.0	1,017.2	(1.4)	1,050.6
Total expenses	4.8	30.0	3,572.1	(1.4)	3,605.5
Income (loss) from continuing operations before income taxes	(3.6)	(48.4)	422.0	—	370.0
Income taxes (benefits)	(1.3)	(18.4)	98.0	—	78.3
Equity in the net income of subsidiaries, excluding discontinued operations and cumulative effect of accounting change	294.0	324.0	—	(618.0)	—
Income from continuing operations, net of related income taxes	291.7	294.0	324.0	(618.0)	291.7
Income from discontinued operations, net of related income taxes	27.3	27.3	10.9	(38.2)	27.3
Income before cumulative effect of accounting change	319.0	321.3	334.9	(656.2)	319.0
Cumulative effect of accounting change, net of related income taxes	(5.7)	(5.7)	(5.7)	11.4	(5.7)
Net income	$ 313.3	$ 315.6	$ 329.2	$ (644.8)	$ 313.3

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the six months ended June 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	$ (2.6)	$ 70.2	$ 812.6	$ (74.9)	$ 805.3
Investing activities					
Available-for-sale securities:					
Purchases	—	139.2	(4,892.7)	—	(4,753.5)
Sales	—	(141.2)	1,102.9	—	961.7
Maturities	—	—	3,046.6	—	3,046.6
Mortgage loans acquired or originated	—	—	(444.0)	—	(444.0)
Mortgage loans sold or repaid	—	—	435.5	—	435.5
Real estate acquired	—	—	(161.1)	—	(161.1)
Real estate sold	—	—	267.2	—	267.2
Net purchases of property and equipment	—	—	(18.1)	—	(18.1)
Purchases of interest in subsidiaries, net of cash acquired	—	—	(54.4)	—	(54.4)
Dividends received from (contributions to) unconsolidated entities	251.1	13.3	(66.1)	(198.3)	—
Net change in other investments	—	(0.8)	(40.9)	0.5	(41.2)
Net cash provided by (used in) investing activities	251.1	10.5	(825.1)	(197.8)	(761.3)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows (continued)
For the six months ended June 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)				
Financing activities					
Issuance of common stock	$ 25.8	$ —	$ —	$ —	$ 25.8
Issuance of preferred stock	542.0	—	—	—	542.0
Acquisition of treasury stock	(868.4)	—	—	—	(868.4)
Proceeds from financing element derivatives	—	—	83.0	—	83.0
Payments for financing element derivatives	—	—	(55.6)	—	(55.6)
Issuance of long-term debt	—	—	12.2	—	12.2
Principal repayments of long-term debt	—	—	(11.5)	—	(11.5)
Net proceeds of short-term borrowings	—	200.0	3.5	(31.1)	172.4
Contributions received from (dividends paid to) parent	—	(251.1)	35.0	216.1	—
Investment contract deposits	—	—	4,072.6	—	4,072.6
Investment contract withdrawals	—	—	(3,319.5)	—	(3,319.5)
Net increase in banking operation deposits	—	—	22.7	—	22.7
Net cash provided by (used in) financing activities	(300.6)	(51.1)	842.4	185.0	675.7
Net increase (decrease) in cash and cash equivalents	(52.1)	29.6	829.9	(87.7)	719.7
Cash and cash equivalents at beginning of period	75.4	551.9	520.4	(695.8)	451.9
Cash and cash equivalents at end of period	$ 23.3	$ 581.5	$ 1,350.3	$ (783.5)	$ 1,171.6

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the six months ended June 30, 2004

	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	$ (2.2)	$ (160.8)	$ 1,393.2	$ (300.6)	$ 929.6
Investing activities					
Available-for-sale securities:					
Purchases	—	(218.0)	(4,919.1)	—	(5,137.1)
Sales	—	168.8	1,308.5	—	1,477.3
Maturities	—	—	2,802.0	—	2,802.0
Mortgage loans acquired or originated	—	—	(949.6)	—	(949.6)
Mortgage loans sold or repaid	—	—	783.4	—	783.4
Real estate acquired	—	—	(105.7)	—	(105.7)
Real estate sold	—	—	131.7	—	131.7
Net purchases of property and equipment	—	—	(24.4)	—	(24.4)
Net proceeds from sale of subsidiaries	—	9.3	5.6	—	14.9
Purchases of interest in subsidiaries, net of cash acquired	—	(25.7)	(80.5)	—	(106.2)
Capital contributed to unconsolidated entities	—	—	—	—	—

Dividends received from unconsolidated entities	300.0	527.9	—	(827.9)	—
Net change in other investments	0.3	155.1	(202.3)	(18.6)	(65.5)
Net cash provided by (used in) investing activities	300.3	617.4	(1,250.4)	(846.5)	(1,179.2)

12. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows (continued)
For the six months ended June 30, 2004

	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	$ 14.1	$ —	$ —	$ —	$ 14.1
Issuance of preferred stock	—	—	—	—	—
Acquisition of treasury stock	(222.3)	—	—	—	(222.3)
Proceeds from financing element derivatives	—	—	94.0	—	94.0
Payments for financing element derivatives	—	—	(41.1)	—	(41.1)
Issuance of long-term debt	—	—	7.8	—	7.8
Principal repayments of long-term debt	—	—	(221.1)	—	(221.1)
Net proceeds of short-term borrowings	—	75.0	105.4	(130.8)	49.6
Dividends paid to parent	—	(300.0)	(504.9)	804.9	—
Investment contract deposits	—	—	3,805.3	—	3,805.3
Investment contract withdrawals	—	—	(2,938.2)	—	(2,938.2)
Net decrease in banking operation deposits	—	—	(13.9)	—	(13.9)
Net cash provided by (used in) financing activities	(208.2)	(225.0)	293.3	674.1	534.2
Net increase in cash and cash equivalents	89.9	231.6	436.1	(473.0)	284.6
Cash and cash equivalents at beginning of period	173.8	872.7	1,028.0	(884.3)	1,190.2
Cash and cash equivalents at end of period	$ 263.7	$ 1,104.3	$ 1,464.1	$ (1,357.3)	$ 1,474.8

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

The following analysis discusses our financial condition as of June 30, 2005, compared with December 31, 2004, and our consolidated results of operations for the three and six months ended June 30, 2005 and 2004, 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, 2004, filed with the United States Securities and Exchange Commission 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 Principal Life Insurance Company's ("Principal Life") financial strength 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; (10) we may need to fund deficiencies in our closed block ("Closed Block") assets which benefit only the holders of Closed Block policies; (11) changes in laws, regulations or accounting standards may reduce our profitability; (12) litigation and regulatory investigations may harm our financial strength and reduce our profitability; (13) fluctuations in foreign currency exchange rates could reduce our profitability; (14) applicable laws and our stockholder rights plan, certificate of incorporation and by-laws may discourage takeovers and business combinations that our stockholders might consider in their best interests; and (15) a downgrade in our debt ratings may adversely affect our ability to secure funds and cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations.

Overview

We provide financial products and services through the following segments:

- U.S. Asset Management and Accumulation, which consists of our asset accumulation operations, including retirement savings and related financial 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 products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans and non-qualified executive benefit plans to businesses. We also offer annuities, mutual funds and bank products and services to the employees of our business customers and other individuals.

- 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 Brazil, Chile, Mexico, Hong Kong, India, Japan, 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, intersegment 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 2005:

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.

Columbus Circle Investors. On October 14, 2004, we agreed to purchase a 70% interest in Columbus Circle Investors ("Columbus Circle"). The acquisition of Columbus Circle increased our assets under management by $3.9 billion. Columbus Circle has specialized expertise in the management of growth equities. We closed the transaction on January 3, 2005. The operations of Columbus Circle are reported in our U.S. Asset Management and Accumulation segment.

Dispositions

Real Estate Investment. On May 25, 2005, we entered into a definitive agreement for the sale of a real estate property previously held for investment purposes. This property qualifies 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 and cash flows for all periods presented. The gain on disposal is reported as an other after-tax adjustment in our Corporate and Other segment.

Selected financial information for the discontinued operation is as follows:

	June 30, 2005	December 31, 2004
	(in millions)	
Assets		
Real estate	$ —	$ 49.1
All other assets	—	1.0
Total assets	$ —	$ 50.1
Liabilities		
All other liabilities	$ —	$ 1.3
Total liabilities	$ —	$ 1.3

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	**2005**	2004
	(in millions)			
Total revenues	**$ 0.7**	$ —	**$ 1.4**	$ 0.9
Income from discontinued operations:				
Income before income taxes	**$ 0.7**	$ —	**$ 1.4**	$ 0.9
Income taxes	**0.3**	—	**0.5**	0.3
Income from discontinued operations, net of related income taxes	**0.4**	—	**0.9**	0.6
Gain on disposal of discontinued operations, net of related income taxes	**14.7**	—	**14.7**	—
Net income	**$ 15.1**	$ —	**$ 15.6**	$ 0.6

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. We plan to complete the liquidation process by December 31, 2005.

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

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

Foreign currency exchange rate fluctuations create variances in our financial statement line items but have not had a material impact on our consolidated net income. Our consolidated net income was positively impacted $1.1 million and $0.5 million for the three months ended June 30, 2005 and 2004, respectively, and positively impacted $1.4 million and $1.1 million for the six months ended June 30, 2005 and 2004, 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."

Pension and Other Postretirement Benefit Expense

The 2005 annual pension benefit expense for substantially all of our employees and certain agents is expected to be approximately $48.6 million pre-tax, which is an $8.8 million increase from the 2004 pre-tax pension expense of $39.8 million. Of the $39.8 million of 2004 pre-tax expense, $51.8 million of expense ran through operating earnings and $12.1 million in pre-tax gains ran through discontinued operations due to the mid-year remeasurement for the Principal Residential Mortgage, Inc. divestiture. Approximately $12.2 million and $24.3 million of pre-tax pension expense was reflected in the determination of net income for the three and six months ended June 30, 2005, respectively. In addition, approximately $12.2 million of pre-tax pension expense is expected to be reflected in each of the following two quarters for 2005. The discount rate used to determine the 2005 expense was 6.0%, which is down from the 6.25% and 6.5% discount rates used to calculate the 2004 expense. Two discount rates were used in 2004 due to the mid-year remeasurement for the Principal Residential Mortgage, Inc. divestiture. The expected long-term return on assets assumption used for the 2005 pension expense remained at 8.5%.

Recent Accounting Pronouncements

On May 30, 2005, the Financial Accounting Standards Board (the "FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 154, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* ("SFAS 154"), which changes the requirements for the accounting and reporting of a change in accounting principle. SFAS 154 applies to all voluntary changes in accounting principles and also to changes required by an accounting pronouncement that does not contain specific transition provisions. SFAS 154 carries forward without change the guidance contained in Accounting Principles Board ("APB") Opinion No. 20, *Accounting Changes*, for reporting the correction of an error in previously issued financial statements and a change in accounting estimate. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. We will be adopting SFAS 154 effective January 1, 2006. SFAS 154 does not change the transition provisions of any existing accounting pronouncements.

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 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 will be adopting SFAS 123R effective January 1, 2006. This Statement will 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 have already vested. We applied the prospective method of transition as prescribed by SFAS 123.

In May 2005, we learned of discussions between several major accounting firms, the FASB and the SEC concluding it is appropriate to recognize compensation cost immediately for 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 has been 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 we adopt SFAS 123R on January 1, 2006, we will 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.

Results of Operations

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Income Statement Data:				
Revenues:				
Premiums and other considerations	$ **948.9**	$ 892.6	$ **1,883.0**	$ 1,813.0
Fees and other revenues	**405.3**	364.2	**822.5**	696.8
Net investment income	**836.3**	789.2	**1,630.4**	1,574.5
Net realized/unrealized capital gains (losses)	**10.2**	(66.3)	**8.7**	(108.8)
Total revenues	**2,200.7**	1,979.7	**4,344.6**	3,975.5
Expenses:				
Benefits, claims and settlement expenses	**1,264.5**	1,221.1	**2,498.8**	2,407.2
Dividends to policyholders	**72.2**	74.4	**145.1**	147.7
Operating expenses	**580.8**	521.1	**1,137.7**	1,050.6
Total expenses	**1,917.5**	1,816.6	**3,781.6**	3,605.5
Income from continuing operations before income taxes	**283.2**	163.1	**563.0**	370.0
Income taxes	**59.4**	34.2	**134.2**	78.3
Income from continuing operations, net of related income taxes	**223.8**	128.9	**428.8**	291.7
Income (loss) from discontinued operations, net of related income taxes	**15.1**	(9.2)	**15.6**	27.3
Income before cumulative effect of accounting change	**238.9**	119.7	**444.4**	319.0
Cumulative effect of accounting change, net of related income taxes	—	—	—	(5.7)
Net income	$ **238.9**	$ 119.7	$ **444.4**	$ 313.3

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Premiums and other considerations increased $56.3 million, or 6%, to $948.9 million for the three months ended June 30, 2005, from $892.6 million for the three months ended June 30, 2004. The increase reflected a $46.1 million increase from the Life and Health segment primarily due to strong sales and retention in our specialty benefits business, higher premium per member and an increase in insured medical members in our health insurance business, partially offset by a decline in premiums resulting from the continuation of a shift in marketing emphasis from individual traditional life insurance products to individual universal and individual variable universal life insurance products. In addition, the increase was due to a $12.0 million increase from the International Asset Management and Accumulation segment, primarily due to an increase in Chile, a result of increased sales of single premium annuities with life contingencies.

Fees and other revenues increased $41.1 million, or 11%, to $405.3 million for the three months ended June 30, 2005, from $364.2 million for the three months ended June 30, 2004. The increase was largely due to a $31.2 million increase from the U.S. Asset Management and Accumulation segment primarily related to increased fees from our separate accounts related to our pension business, increased revenue from our commercial real estate business and our acquisitions of Columbus Circle and Principal Services Trust Company. In addition, Life and Health Insurance fees and other revenues increased $7.5 million primarily due to growth in our fee-based individual universal life and individual variable universal life insurance business.

Net investment income increased $47.1 million, or 6%, to $836.3 million for the three months ended June 30, 2005, from $789.2 million for the three months ended June 30, 2004. The increase was primarily related to a $3,448.8 million, or 6%, increase in average invested assets and cash. The annualized yield on average investments and cash was 5.8% for the three months ended June 30, 2005 and 2004.

Net realized/unrealized capital gains increased $76.5 million to $10.2 million of net realized/unrealized capital gains for the three months ended June 30, 2005, from $66.3 million of net realized/unrealized capital losses for the three months ended June 30, 2004. The increase in net realized/unrealized gains was primarily due to fewer other than temporary impairments of fixed maturity securities including a $52.0 million recovery of previously impaired securities received as the result of a

litigation settlement, fewer losses on commercial mortgage loans, unrealized gains versus unrealized losses on the mark to market of certain seed money investments, and the non-recurrence of a loss on the sale of a foreign investment in 2004 offset in part by increased unrealized losses on the mark to market of derivatives activity.

The following table highlights the contributors to net realized/unrealized capital gains and losses for the three months ended June 30, 2005:

	For the three months ended June 30, 2005			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	$ **41.8**	$ **7.8**	$ **92.1**	$ **141.7**
Equity securities(2)	**(1.1)**	**1.7**	**—**	**0.6**
Mortgage loans on real estate(3)	**0.9**	**—**	**—**	**0.9**

Derivatives	—	—	(133.7)	(133.7)
Other(4)	—	0.9	(0.2)	0.7
Total(5)	$ 41.6	$ 10.4	$ (41.8)	$ 10.2

(1) Impairments include $3.1 million of impairment write-downs and $56.8 million in realized recoveries on the sales of previously impaired assets and the impact of a $52.0 million litigation settlement. Credit losses include $11.9 million in realized losses related to credit triggered sales. Other gains (losses) includes gross realized gains of $10.6 million and gross realized losses of $2.8 million.

(2) Impairments include $1.1 million of impairment write-downs. Other gains (losses) includes gross realized gains of $2.6 million and gross realized losses of $0.9 million.

(3) Impairments include $0.6 million in realized losses due to the sale of commercial mortgage loans and a $1.6 million decrease in commercial mortgage valuation allowance.

(4) Other gains (losses) include $2.8 million in mark to market of net realized/unrealized gains on certain seed money investments.

(5) We enter into economic hedges that do not qualify for hedge accounting treatment. At June 30, 2005, the mark to market of the instruments not designated as accounting hedges contributed to the net loss due to hedging. We do not get hedge accounting treatment for swaptions and those instruments used to hedge our short-term interest rate exposure including futures, mortgage-backed securities forwards, and certain interest rate swaps. We report the mark to market of these items in realized/unrealized capital gains/losses.

Benefits, claims and settlement expenses increased $43.4 million, or 4%, to $1,264.5 million for the three months ended June 30, 2005, from $1,221.1 million for the three months ended June 30, 2004. The increase resulted from a $27.0 million increase in the International Asset Management and Accumulation segment, primarily due to an increase in Chile related to higher reserve expenses due to increased sales of single premium annuities with life contingencies along with higher interest credited to customers. In addition, the increase resulted from a $26.1 million increase in the U.S. Asset Management and Accumulation segment due to an increase in cost of interest credited and amortization related to sale inducements, higher benefit payments and an increase in life payout annuity reserves. Partially offsetting these increases was a $10.1 million decrease in the Life and Health Insurance segment primarily the result of methodology improvements related to reinsurance values and a change in the estimate of reinsurance benefits in the individual life insurance business partly offset by growth in the specialty benefits business.

Dividends to policyholders decreased $2.2 million, or 3%, to $72.2 million for the three months ended June 30, 2005, from $74.4 million for the three months ended June 30, 2004. The decrease primarily resulted from a $1.8 million decrease in dividends to policyholders for the Life and Health Insurance segment due to a decrease in the individual life insurance dividend interest crediting rates resulting from a declining interest rate environment.

Operating expenses increased $59.7 million, or 11%, to $580.8 million for the three months ended June 30, 2005, from $521.1 million for the three months ended June 30, 2004. The increase was due to a $43.0 million increase from the Life and Health Insurance segment due to growth in our specialty benefits, health insurance, and individual life insurance businesses as well as a change in the estimate of reinsurance benefits in the individual life insurance business. In addition, the increase resulted from a $31.4 million increase from the U.S Asset Management and Accumulation segment due to an increase in

compensation costs, and our acquisitions of Principal Services Trust Company and Columbus Circle.

Income taxes increased $25.2 million, or 74%, to $59.4 million for the three months ended June 30, 2005 from $34.2 million for the three months ended June 30, 2004. The effective income tax rate was 21% for the three months ended June 30, 2005 and 2004. The effective income tax rate for the three months ended June 30, 2005 was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and Section 29 tax credits received on our investment in a synthetic fuel production facility. The effective income tax rate for the three months ended June 30, 2004 was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received.

As a result of the foregoing factors and the inclusion of income (loss) from discontinued operations, net income increased $119.2 million, or 100%, to $238.9 million for the three months ended June 30, 2005, from $119.7 million for the three months ended June 30, 2004. The income from discontinued operations was related to a gain on the sale and operating revenues of a real estate property that qualifies for discontinued operations treatment under SFAS 144 in 2005. The loss from discontinued operations was related to our sale of Principal Residential Mortgage, Inc., our sale of our Argentine companies, and operating revenues of a real estate property that qualifies for discontinued treatment under SFAS 144 in 2004.

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Premiums and other considerations increased $70.0 million, or 4%, to $1,883.0 million for the six months ended June 30, 2005, from $1,813.0 million for the six months ended June 30, 2004. The increase reflected a $65.5 million increase from the Life and Health segment primarily due to strong sales and retention in our specialty benefits business and higher premium per member in our health insurance business partially offset by a decline in premiums resulting from the continuation of a shift in marketing emphasis from individual traditional life insurance products to individual universal and individual variable universal life insurance products. The increase was also due to a $35.3 million increase from the International Asset Management and Accumulation segment, primarily due to an increase in Chile, a result of increased sales of single premium annuities with life contingencies. These increases were partially offset by a $33.3 million decrease from the U.S. Asset Management and Accumulation segment, primarily a result of a decrease in pension full-service payout sales of single premium group 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.

Fees and other revenues increased $125.7 million, or 18%, to $822.5 million for the six months ended June 30, 2005, from $696.8 million for the six months ended June 30, 2004. The increase was largely due to a $98.9 million increase from the U.S. Asset Management and Accumulation segment primarily related to increased fees from our separate accounts related to our pension business, increased revenue from our commercial mortgage-backed securities and commercial real estate businesses and our acquisitions of Columbus Circle and Principal Services Trust Company. In addition, Life and Health Insurance fees and other revenues increased $21.8 million primarily due to growth in our fee-based individual universal life and individual variable universal life insurance business.

Net investment income increased $55.9 million, or 4%, to $1,630.4 million for the six months ended June 30, 2005, from $1,574.5 million for the six months ended June 30, 2004. The increase was primarily related to a $3,861.8 million, or 7%, increase in average invested assets and cash. The increase was partially offset by a decrease in the annualized investment yields. The annualized yield on average investments and cash was 5.6% for the six months ended June 30, 2005, compared to 5.8% for the six months ended June 30, 2004. This reflects lower yields on newly invested assets in comparison to the current portfolio yields.

Net realized/unrealized capital gains increased $117.5 million to $8.7 million of net realized/unrealized capital gains for the six months ended June 30, 2005, from $108.8 million of net realized/unrealized capital losses for the six months ended June 30, 2004. The increase in net realized/unrealized gains was primarily due to fewer other than temporary impairments of fixed maturity securities including a $52.0 million recovery of previously impaired securities received as the result of a litigation settlement, fewer losses on commercial mortgage loans, and the non-recurrence of a loss on the sale of a foreign investment in 2004 offset in part by increased unrealized losses on the mark to market of certain seed money investments versus unrealized gains in 2004.

The following table highlights the contributors to net realized/unrealized capital gains and losses for the six months ended June 30, 2005:

	For the six months ended June 30, 2005			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	$ 37.2	$ 15.4	$ 45.6	$ 98.2
Equity securities(2)	(1.1)	2.4	—	1.3
Mortgage loans on real estate(3)	(1.6)	—	—	(1.6)
Derivatives	—	—	(82.9)	(82.9)
Other(4)	—	(1.8)	(4.5)	(6.3)
Total(5)	$ 34.5	$ 16.0	$ (41.8)	$ 8.7

(1) Impairments include $7.4 million of impairment write-downs and $59.7 million in realized recoveries on the sales of previously impaired assets and the impact of a $52.0 million litigation settlement. Credit losses include $1.2 million in realized gains and $16.3 million in realized losses related to credit triggered sales. Other gains (losses) includes gross realized gains of $21.7 million and gross realized losses of $6.3 million.

(2) Impairments include $1.1 million of impairment write-downs. Other gains (losses) includes gross realized gains of $4.8 million and gross realized losses of $2.4 million.

(3) Impairments include $2.5 million in realized losses due to the sale of commercial mortgage loans and a $1.3 million decrease in commercial mortgage valuation allowance.

(4) Other gains (losses) include $1.7 million in mark to market of net realized/unrealized losses on certain seed money investments.

(5) We enter into economic hedges that do not qualify for hedge accounting treatment. At June 30, 2005, the mark to market of the instruments not designated as accounting hedges contributed to the net loss due to hedging. We do not get hedge accounting treatment for swaptions and those instruments used to hedge our short-term interest rate exposure including futures, mortgage-backed securities forwards, and certain interest rate swaps. We report the mark to market of these items in realized/unrealized capital gains/losses.

Benefits, claims and settlement expenses increased $91.6 million, or 4%, to $2,498.8 million for the six months ended June 30, 2005, from $2,407.2 million for the six months ended June 30, 2004. The increase resulted from a $47.3 million increase in the International Asset Management and Accumulation segment, primarily due to an increase in Chile related to higher reserve expenses due to increased sales of single premium annuities with life contingencies along with higher interest credited to customers. In addition, the increase resulted from a $27.3 million increase in the U.S. Asset Management and Accumulation segment due to an increase in cost of interest credited and amortization related to sale inducements associated with our deferred annuity business, higher benefit payments and an increase in life payout annuity reserves.

Dividends to policyholders decreased $2.6 million, or 2%, to $145.1 million for the six months ended June 30, 2005, from $147.7 million for the six months ended June 30, 2004. The decrease primarily resulted from a $1.9 million decrease in dividends to policyholders for the Life and Health Insurance segment due to a decrease in the individual life insurance dividend interest crediting rates resulting from a declining interest rate environment.

Operating expenses increased $87.1 million, or 8%, to $1,137.7 million for the six months ended June 30, 2005, from $1,050.6 million for the six months ended June 30, 2004. The increase was largely due to a $73.6 million increase from the U.S Asset Management and Accumulation segment due to an increase in amortization of deferred policy acquisition costs ("DPAC"), including DPAC unlocking, an increase in compensation costs, and due to our acquisitions of Principal Services Trust Company and Columbus Circle. The increase was also due to a $58.9 million increase from the Life and Health Insurance segment due to growth in our specialty benefits and individual life insurance businesses, a change in the estimate of reinsurance benefits in the individual life insurance business, as well as revenue growth in the insured medical and wellness businesses. These increases were partially offset by a $28.9 million decrease in the Corporate and Other segment due to a decrease in interest related to federal income tax audit activities, a decrease in interest expense primarily related to the reduction of corporate debt, as well as a prior year prepayment penalty recognized on redemption of our surplus notes due in 2024.

Income taxes increased $55.9 million, or 71%, to $134.2 million for the six months ended June 30, 2005 from $78.3 million for the six months ended June 30, 2004. The effective income tax rate was 24% for the six months ended June 30, 2005 and 21% for the six months ended June 30, 2004. The effective income tax rate for the six months ended June 30, 2005 was

lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and Section 29 tax credits received on our investment in a synthetic fuel production facility. The effective income tax rate for the six months ended June 30, 2004 was lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received. The increase in the effective tax rate to 24% for the six months ended June 30, 2005, from 21% for the six months ended June 30, 2004, was primarily due to the tax benefit of capital losses in 2004.

As a result of the foregoing factors, the inclusion of income from discontinued operations and the cumulative change in accounting principle, net income increased $131.1 million, or 42%, to $444.4 million for the six months ended June 30, 2005, from $313.3 million for the six months ended June 30, 2004. The income from discontinued operations was related to a gain on the sale and operating revenues of a real estate property that qualifies for discontinued operations treatment under SFAS 144 in 2005. The income from discontinued operations was related to our sale of Principal Residential Mortgage, Inc., our sale of our Argentine companies, and operating revenues of a real estate property that qualifies for discontinued operations treatment under SFAS 144 in 2004. The cumulative change in accounting principle was related to our implementation of Statement of Position 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts* ("SOP 03-1"), in 2004.

Results of Operations by Segment

We use operating earnings, which exclude the effect of net realized/unrealized capital gains and losses, as adjusted, and other after-tax adjustments, 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 for net realized/unrealized capital gains and losses, as adjusted, and other after-tax adjustments we believe are not indicative of overall operating trends. Other 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 June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating revenues by segment:				
U.S. Asset Management and Accumulation	$ **971.1**	$ 906.8	$ **1,928.4**	$ 1,800.1
International Asset Management and Accumulation	**158.2**	122.3	**291.0**	235.3
Life and Health Insurance	**1,089.5**	1,030.7	**2,158.1**	2,066.0
Corporate and Other (1)	**(28.0)**	(11.9)	**(38.1)**	(10.3)
Total segment operating revenues	**2,190.8**	2,047.9	**4,339.4**	4,091.1
Add:				
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues(2)	**10.6**	(68.2)	**6.6**	(114.7)
Subtract:				
Operating revenues from discontinued real estates to fee revenues(2)	**0.7**	—	**1.4**	0.9
Total revenue per consolidated statements of operations	$ **2,200.7**	$ 1,979.7	$ **4,344.6**	$ 3,975.5
Operating earnings (loss) by segment:				
U.S. Asset Management and Accumulation	$ **130.5**	$ 121.7	$ **269.1**	$ 241.2
International Asset Management and Accumulation	**19.1**	9.3	**28.6**	17.9
Life and Health Insurance	**76.3**	56.9	**145.8**	131.7
Mortgage Banking(3)	**—**	(5.4)	**—**	(10.3)
Corporate and Other	**(4.9)**	(9.1)	**(13.3)**	(20.6)
Total segment operating earnings	**221.0**	173.4	**430.2**	359.9
Net realized/unrealized capital gains (losses), as adjusted(2)	**3.2**	(44.5)	**(0.5)**	(67.6)
Other after-tax adjustments(4)	**14.7**	(9.2)	**14.7**	21.0
Net income per consolidated statements of operations	$ **238.9**	$ 119.7	$ **444.4**	$ 313.3

	June 30, 2005	December 31, 2004
	(in millions)	
Total assets by segment:		
U.S. Asset Management and Accumulation (5)	$ **97,258.2**	$ 94,394.6
International Asset Management and Accumulation	**3,854.6**	3,642.0
Life and Health Insurance	**13,764.7**	13,185.4
Corporate and Other (6)	**2,315.1**	2,576.1
Total consolidated assets	$ **117,192.6**	$ 113,798.1

(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 of 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 pension products and services and certain market value adjustments to fee revenues.

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Net realized/unrealized capital gains (losses)	**$ 10.2**	$ (66.3)	**$ 8.7**	$ (108.8)
Certain market value adjustments to fee revenues	**(1.0)**	(2.9)	**(3.9)**	(5.8)
Recognition of front-end fee revenues	**1.4**	1.0	**1.8**	(0.1)
Net realized/unrealized capital gains (losses), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**10.6**	(68.2)	**6.6**	(114.7)
Amortization of deferred policy acquisition and sales inducement costs related to net realized/unrealized capital gains (losses)	**(4.4)**	0.5	**(3.9)**	2.6
Capital losses (gains) distributed	**0.2**	0.8	**(1.2)**	(1.2)
Minority interest capital gains	**(0.2)**	(0.1)	**(0.2)**	(0.2)
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 and sales inducement costs, capital losses (gains) distributed and minority capital gains	**6.2**	(67.0)	**1.3**	(113.5)
Income tax effect	**(3.0)**	22.5	**(1.8)**	45.9
Net realized/unrealized capital gains (losses), as adjusted	**$ 3.2**	$ (44.5)	**$ (0.5)**	$ (67.6)

(3) Corporate overhead allocated to our Mortgage Banking segment does not qualify for discontinued operations treatment under SFAS 144 and was included in our results of continuing operations and segment operating earnings prior to July 1, 2004.

(4) For the three months ended June 30, 2005, other after-tax adjustments reflect a $14.7 million gain on sale of a real estate property that qualifies for discontinued operations treatment under SFAS 144.

For the three months ended June 30, 2004, other after-tax adjustments of $9.2 million included the negative effect of a loss from discontinued operations of Principal Residential Mortgage, Inc. ($9.5 million); and the positive effect of income from discontinued operations of Argentina ($0.3 million).

For the six months ended June 30, 2005, other after-tax adjustments reflect a $14.7 million gain on sale of a real estate property that qualifies for discontinued operations treatment under SFAS 144.

For the six months ended June 30, 2004, other after-tax adjustments of $21.0 million included the positive effects of: (1) income from discontinued operations of Principal Residential Mortgage ($26.5 million) and (2) income from discontinued operations of Argentina ($0.2 million); and the negative effect from a cumulative change in accounting principle related to the implementation of SOP 03-1 ($5.7 million).

(5) U.S. Asset Management and Accumulation separate account assets include shares of Principal Financial Group stock allocated to a separate account, a result of our demutualization. The value of the separate account was $698.9 million at June 30, 2005, and $782.8 million at December 31, 2004. Changes in fair value of the separate account are reflected in both separate account assets and separate account liabilities.

(6) Includes inter-segment elimination amounts related to an internal line of credit, internally generated mortgage loans, and long-term borrowings. The Corporate and Other segment managed a revolving line of credit used by another segment. The U.S. Asset Management and Accumulation segment and the 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. In prior years, the U.S. Asset Management and Accumulation segment provided a source of funding for the Mortgage Banking segment's mortgage servicing rights.

U.S. Asset Management and Accumulation Segment

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 June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Premiums and other considerations	**$ 74.1**	$ 77.1	**$ 132.7**	$ 166.0
Fees and other revenues	**284.1**	255.2	**580.1**	485.0
Net investment income	**612.9**	574.5	**1,215.6**	1,149.1
Total operating revenues	**971.1**	906.8	**1,928.4**	1,800.1
Expenses:				
Benefits, claims and settlement expenses, including dividends to policyholders	**529.5**	504.1	**1,029.1**	1,002.7
Operating expenses	**270.8**	241.5	**550.1**	479.9
Total expenses	**800.3**	745.6	**1,579.2**	1,482.6
Pre-tax operating earnings	**170.8**	161.2	**349.2**	317.5

Income taxes	**40.3**	39.5	**80.1**	76.3
Operating earnings	**130.5**	121.7	**269.1**	241.2
Net realized/unrealized capital losses, as adjusted	**(2.5)**	(20.3)	**(0.1)**	(57.5)
Other after-tax adjustments	**—**	(6.0)	**—**	(5.0)
U. S. GAAP Reported:				
Net income	**$ 128.0**	$ 95.4	**$ 269.0**	$ 178.7

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

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Premiums and other considerations decreased $3.0 million, or 4%, to $74.1 million for the three months ended June 30, 2005, from $77.1 million for the three months ended June 30, 2004. The decrease primarily resulted from an $18.7 million decrease in pension full-service payout sales of single premium group annuities with life contingencies, which are typically used to fund defined benefit plan terminations. 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. Offsetting the overall decrease was a $15.7 million increase in individual payout annuity premiums and other considerations primarily due to an increase in larger sized contract sales, along with an increase in overall sales during the current quarter.

Fees and other revenues increased $28.9 million, or 11%, to $284.1 million for the three months ended June 30, 2005, from $255.2 million for the three months ended June 30, 2004. Pension full-service accumulation fees and other revenue increased $17.9 million primarily due to an increase in fees from our separate accounts, due to improvements in the equity markets and net cash flow from customers, which have led to higher account values, and increased fees from our acquisition of Principal Services Trust Company. In addition, Principal Global Investors fees and other revenues increased $11.0 million primarily due to increased fee revenue from our commercial real estate business, our acquisition of Columbus Circle and an increase in assets under management.

Net investment income increased $38.4 million, or 7%, to $612.9 million for the three months ended June 30, 2005, from $574.5 million for the three months ended June 30, 2004. The increase primarily resulted from a $2,430.7 million, or 6%, increase in average invested assets and cash. The average annualized yield on invested assets and cash was 5.7% for the three months ended June 30, 2005 compared to 5.6% for the three months June 30, 2004.

Benefits, claims and settlement expenses, including dividends to policyholders, increased $25.4 million, or 5%, to $529.5 million for the three months ended June 30, 2005, from $504.1 million for the three months ended June 30, 2004. The increase primarily related to a $23.9 million increase in our individual fixed annuity benefits, claims and settlement expenses due to an increase in cost of interest credited and amortization related to sale inducements associated with our deferred annuity business, higher benefit payments and an increase in reserves stemming from an increase in sales related to our life payout annuity business. In addition, our pension investment-only business benefits, claims and settlement expenses increased $22.1 million primarily due to an increase in cost of interest credited on this block of business as a result of an increase in account values. Partially offsetting the overall increase was a $16.0 million decrease in our pension full-service payout business as a result of decreased sales of single premium group annuities with life contingencies.

Operating expenses increased $29.3 million, or 12%, to $270.8 million for the three months ended June 30, 2005, from $241.5 million for the three months ended June 30, 2004. The increase resulted from a $13.5 million increase in pension full-service accumulation primarily due to our acquisition of Principal Services Trust Company and an increase in regular compensation costs. In addition, Principal Global Investors operating expenses increased $12.4 million primarily due to an increase in incentive compensation costs, due to our acquisition of Columbus Circle and an increase in allocated expenses.

Income taxes increased $0.8 million, or 2%, to $40.3 million for the three months ended June 30, 2005, from $39.5 million for the three months ended June 30, 2004. The effective income tax rate for this segment was 24% for the three months ended June 30, 2005, and 25% for the three months ended June 30, 2004. The effective income tax rates for the three months ended June 30, 2005 and 2004, were lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

As a result of the foregoing factors, operating earnings increased $8.8 million, or 7%, to $130.5 million for the three months ended June 30, 2005 from $121.7 million for the three months ended June 30, 2004.

Net realized/unrealized capital losses, as adjusted, decreased $17.8 million, or 88%, to $2.5 million for the three months ended June 30, 2005, from $20.3 million for the three months ended June 30, 2004. The decrease primarily related to fewer other than temporary impairments of fixed maturity securities including a $24.3 million recovery of previously impaired securities received as the result of a litigation settlement offset in part by increased unrealized losses on the mark to market of derivatives activity.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $32.6 million, or 34%, to $128.0 million for the three months ended June 30, 2005, from $95.4 million for the three months ended June 30, 2004. For the three months ended June 30, 2004, net income included the negative effect of other after-tax adjustments totaling $6.0 million related to a loss from discontinued operations associated with the sale of Principal Residential Mortgage.

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Premiums and other considerations decreased $33.3 million, or 20%, to $132.7 million for the six months ended June 30, 2005, from $166.0 million for the six months ended June 30, 2004. The decrease primarily resulted from a $45.2 million decrease in pension full-service payout sales of single premium group annuities with life contingencies, which are typically used to fund defined benefit plan terminations. 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. Partially offsetting the decrease was an $11.9 million increase in individual payout annuity premiums and other

considerations primarily due to an increase in larger sized contract sales, along with an increase in overall sales.

Fees and other revenues increased $95.1 million, or 20%, to $580.1 million for the six months ended June 30, 2005, from $485.0 million for the six months ended June 30, 2004. Pension full-service accumulation fees and other revenue increased $55.6 million primarily due to an increase in fees from our separate accounts, due to improvements in the equity markets and net cash flow from customers, which have led to higher account values, and increased fees from our acquisition of Principal Services Trust Company. In addition, Principal Global Investors fees and other revenues increased $41.6 million primarily due to increased revenue stemming from our commercial mortgage-backed securities business, growth in our commercial real estate fees, our acquisition of Columbus Circle and an increase in assets under management.

Net investment income increased $66.5 million, or 6%, to $1,215.6 million for the six months ended June 30, 2005, from $1,149.1 million for the six months ended June 30, 2004. The increase primarily resulted from a $2,772.0 million, or 7%, increase in average invested assets and cash. The average annualized yield on invested assets and cash was 5.6% for the six months ended June 30, 2005 compared to 5.7% for the six months June 30, 2004.

Benefits, claims and settlement expenses, including dividends to policyholders, increased $26.4 million, or 3%, to $1,029.1 million for the six months ended June 30, 2005, from $1,002.7 million for the six months ended June 30, 2004. The increase primarily related to a $43.4 million increase in our pension investment-only business due to an increase in cost of interest credited on this block of business as a result of an increase in account values. In addition, our individual annuity benefits, claims and settlement expenses increased $28.7 million due to an increase in cost of interest credited and amortization related to sale inducements associated with our deferred annuity business, higher benefit payments and an increase in reserves stemming from an increase in sales related to our life payout annuity business. Partially offsetting the overall increase was a $34.5 million decrease in our pension full-service payout business as a result of decreased sales of single premium group annuities with life contingencies. Further offsetting the overall increase was a $10.5 million decrease in our pension full-service accumulation business primarily due to lower interest credited on our non-participating deposit type business and to a lesser extent due to decreases in cost of interest credited on business from our participating block.

Operating expenses increased $70.2 million, or 15%, to $550.1 million for the six months ended June 30, 2005, from $479.9 million for the six months ended June 30, 2004. The increase resulted from a $40.1 million increase in pension full-service accumulation primarily due to an increase in amortization of DPAC, including DPAC unlocking, an increase in compensation costs and due to our acquisition of Principal Services Trust Company. In addition, Principal Global Investors operating expenses increased $25.2 million primarily due to an increase in incentive compensation costs and due to our acquisition of Columbus Circle.

Income taxes increased $3.8 million, or 5%, to $80.1 million for the six months ended June 30, 2005, from $76.3 million for the six months ended June 30, 2004. The effective income tax rate for this segment was 23% for the six months ended June 30, 2005, and 24% for the six months ended June 30, 2004. The effective income tax rates for the six months ended June 30, 2005 and 2004, were lower than the corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

As a result of the foregoing factors, operating earnings increased $27.9 million, or 12%, to $269.1 million for the six months ended June 30, 2005 from $241.2 million for the six months ended June 30, 2004.

Net realized/unrealized capital losses, as adjusted, decreased $57.4 million to $0.1 million for the six months ended June 30, 2005, from $57.5 million for the six months ended June 30, 2004. The decrease was primarily due to fewer other than temporary impairments of fixed maturity securities including a $24.3 million recovery of previously impaired securities received as the result of a litigation settlement and fewer losses on commercial mortgage loans.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $90.3 million, or 51%, to $269.0 million for the six months ended June 30, 2005, from $178.7 million for the six months ended June 30, 2004. For the six months ended June 30, 2004, net income included the negative effect of other after-tax adjustments totaling $5.0 million related to: (1) a loss from discontinued operations associated with the sale of Principal Residential Mortgage ($3.5 million) and (2) a cumulative effect of accounting change related to our implementation of SOP 03-1 ($1.5 million).

International Asset Management and Accumulation Segment

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	**2004**	**2005**	**2004**
	(in millions)			
Operating Earnings Data:				
Operating revenues (1):				
Premiums and other considerations	**$ 64.3**	$ 52.3	**$ 146.4**	$ 111.1
Fees and other revenues	**24.1**	21.2	**46.7**	42.2
Net investment income	**69.8**	48.8	**97.9**	82.0
Total operating revenues	**158.2**	122.3	**291.0**	235.3
Expenses:				
Benefits, claims and settlement expenses, including dividends to policyholders	**111.0**	84.0	**205.6**	158.3
Operating expenses	**25.7**	26.2	**51.9**	51.7
Total expenses	**136.7**	110.2	**257.5**	210.0

Pre-tax operating earnings	**21.5**	12.1	**33.5**	25.3
Income taxes	**2.4**	2.8	**4.9**	7.4
Operating earnings	**19.1**	9.3	**28.6**	17.9
Net realized/unrealized capital gains (losses), as adjusted	**—**	0.2	**(0.7)**	4.0
Other after-tax adjustments	**—**	0.3	—	(3.1)
U. S. GAAP Reported:				
Net income	**$ 19.1**	$ 9.8	**$ 27.9**	$ 18.8

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

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Premiums and other considerations increased $12.0 million, or 23%, to $64.3 million for the three months ended June 30, 2005, from $52.3 million for the three months ended June 30, 2004. An increase of $15.1 million in Chile was primarily a result of increased sales of single premium annuities with life contingencies. Partially offsetting this increase was a decrease of $3.1 million in Mexico primarily due to a decrease in sales of single premium annuities with life contingencies.

Fees and other revenues increased $2.9 million, or 14%, to $24.1 million for the three months ended June 30, 2005, from $21.2 million for the three months ended June 30, 2004. An increase of $2.5 million in Mexico was primarily due to improved net transfers of pension customers from competitors in the last half of 2004 and the first half of 2005. In addition, an increase of $0.5 million in Hong Kong was primarily a result of an increase in fees caused by growth in assets under management.

Net investment income increased $21.0 million, or 43%, to $69.8 million for the three months ended June 30, 2005, from $48.8 million for the three months ended June 30, 2004. The increase was primarily due to an increase of $ 425.4 million, or 21%, in average invested assets and cash, excluding our equity investment in subsidiaries. In addition, the increase was due to an increase in the annualized yield on average invested assets and cash, excluding our equity investment in subsidiaries, which was 10.4% for the three months ended June 30, 2005, compared to 9.1% for the three months ended June 30, 2004.

Benefits, claims and settlement expenses increased $27.0 million, or 32%, to $111.0 million for the three months ended June 30, 2005, from $84.0 million for the three months ended June 30, 2004. An increase of $29.3 million in Chile was primarily related to higher reserve expenses due to an increase in sales of single premium annuities with life contingencies along with higher interest credited to customers.

Operating expenses decreased $0.5 million, or 2%, to $25.7 million for the three months ended June 30, 2005, from $26.2 million for the three months ended June 30, 2004. A decrease of $2.6 million in Mexico is primarily due to lower distribution expense and professional fees. Partially offsetting the decrease in operating expense is an increase of $1.5 million

in Chile due to higher commission and interest costs. In addition, an increase of $0.3 million in India was due to the expenses of PNB Principal Insurance Advisory Company Pvt. Ltd. that began operations in February 2005, and an increase of $0.2 million in Hong Kong was partially due to higher investment management expenses caused by an increase in assets under management.

Income taxes decreased $0.4 million, or 14%, to $2.4 million for the three months ended June 30, 2005, from $2.8 million for the three months ended June 30, 2004. A decrease of $1.1 million was due to a tax benefit from the American Jobs Creation Act in 2005. In addition, a decrease of $0.9 million in Brazil was primarily a result of a decrease in deferred taxes in 2005 related to our Brazilian equity method investment. Partially offsetting this decrease was an increase of $1.8 million in Mexico due to an increase in pre-tax operating earnings.

As a result of the foregoing factors, operating earnings increased $9.8 million to $19.1 million for the three months ended June 30, 2005, from $9.3 million for the three months ended June 30, 2004.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $9.3 million, or 95%, to $19.1 million for the three months ended June 30, 2005, from $9.8 million for the three months ended June 30, 2004. For the three months ended June 30, 2004, net income included the positive effect of other after-tax adjustments totaling $0.3 million due to income from discontinued operations related to the sale of our Argentine companies.

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Premiums and other considerations increased $35.3 million, or 32%, to $146.4 million for the six months ended June 30, 2005, from $111.1 million for the six months ended June 30, 2004. An increase of $36.0 million in Chile was primarily a result of increased sales of single premium annuities with life contingencies.

Fees and other revenues increased $4.5 million, or 11%, to $46.7 million for the six months ended June 30, 2005, from $42.2 million for the six months ended June 30, 2004. An increase of $3.3 million in Mexico was primarily due to improved net transfers of pension customers from competitors. An increase of $0.9 million in India was primarily a result of an increase in fees from PNB Principal Insurance Advisory Company Pvt. Ltd. that began operations in February 2005, along with an increase in fees caused by a growth in assets under management.

Net investment income increased $15.9 million, or 19%, to $97.9 million for the six months ended June 30, 2005, from $82.0 million for the six months ended June 30, 2004. The increase was primarily due to an increase of $483.2 million, or 25%, in average invested assets and cash, excluding our equity investment in subsidiaries. The increase was partially offset by a decrease in the annualized yield on average invested assets and cash, excluding our equity investment in subsidiaries, which was 7.1% for the six months ended June 30, 2005, compared to 7.5% for the six months ended June 30, 2004.

Benefits, claims and settlement expenses increased $47.3 million, or 30%, to $205.6 million for the six months ended June 30, 2005, from $158.3 million for the six months ended June 30, 2004. An increase of $50.6 million in Chile was primarily related to higher reserve expenses due to an increase in sales of single premium annuities with life contingencies along with higher interest credited to customers.

Operating expenses increased $0.2 million to $51.9 million for the six months ended June 30, 2005, from $51.7 million for the six months ended June 30, 2004. An increase of $1.9 million in Chile is primarily due to higher commission and compensation expenses. An increase of $0.7 million in India is primarily due to the expenses of PNB Principal Insurance Advisory Company Pvt. Ltd. that began operations in February 2005. In addition, an increase of $0.4 million in Hong Kong is primarily a result of increased management fees caused by an increase in assets under management, and an increase in Brazil of $0.2 million was primarily a result of higher marketing expenses. These increases are partially offset by a decrease of $3.1 million in Mexico primarily due to a lower distribution expenses and professional fees in 2005.

Income taxes decreased $2.5 million, or 34%, to $4.9 million for the six months ended June 30, 2005, from $7.4 million for the six months ended June 30, 2004. A decrease of $3.8 million in Brazil was primarily a result of a decrease in deferred taxes related to our Brazilian equity method investment. A decrease of $1.1 million was due to a tax benefit from the American Jobs Creation Act in 2005. Partially offsetting this decrease was an increase of $2.4 million in Mexico related to an increase in pre-tax earnings.

As a result of the foregoing factors, operating earnings increased $10.7 million, or 60%, to $28.6 million for the six months ended June 30, 2005, from $17.9 million for the six months ended June 30, 2004.

Net realized/unrealized capital losses, as adjusted, increased $4.7 million to $0.7 million of net realized/unrealized capital losses for the six months ended June 30, 2005, from $4.0 million of net realized/unrealized capital gains for the six months ended June 30, 2004. An increase of $2.5 million in India was primarily due to a 2004 realized gain on recovery of a

previously impaired fixed maturity security. An increase of $2.0 million in Chile was primarily due to sale of fixed maturities securities and derivative losses.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $9.1 million, or 48%, to $27.9 million for the six months ended June 30, 2005, from $18.8 million for the six months ended June 30, 2004. For the six months ended June 30, 2004, net income included the effect of other after-tax adjustments totaling $3.1 million, related to: (1) the negative cumulative effect of an accounting change related to the implementation of SOP 03-1 ($3.3 million) and (2) the positive effect of income from discontinued operations related to the sale of our Argentine companies ($0.2 million).

Life and Health Insurance Segment

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating Earnings Data:				
Operating revenues(1):				
Premiums and other considerations	$ **809.3**	$ 763.2	$ **1,601.4**	$ 1,535.9
Fees and other revenues	**110.7**	103.2	**222.6**	200.8
Net investment income	**169.5**	164.3	**334.1**	329.3
Total operating revenues	**1,089.5**	1,030.7	**2,158.1**	2,066.0
Expenses:				
Benefits, claims and settlement expenses, including dividends to policyholders	**626.4**	636.5	**1,269.4**	1,252.6
Dividends to policy holders	**71.3**	73.1	**143.2**	145.1
Operating expenses	**276.5**	236.0	**525.6**	469.6
Total expenses	**974.2**	945.6	**1,938.2**	1,867.3
Pre-tax operating earnings	**115.3**	85.1	**219.9**	198.7
Income taxes	**39.0**	28.2	**74.1**	67.0
Operating earnings	**76.3**	56.9	**145.8**	131.7
Net realized/unrealized capital gains (losses), as adjusted	**1.2**	(5.9)	**0.5**	(7.8)
Other after-tax adjustments	**—**	—	**—**	(0.9)
U. S. GAAP Reported:				
Net income	$ **77.5**	$ 51.0	$ **146.3**	$ 123.0

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

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Premiums and other considerations increased $46.1 million, or 6%, to $809.3 million for the three months ended June 30, 2005, from $763.2 million for the three months ended June 30, 2004. Specialty benefits insurance premiums increased $31.9 million primarily due to strong sales and persistency. In addition, health insurance premiums increased $26.0 million, primarily due to higher premium per member and an increase in insured medical members. Partially offsetting these increases was a decrease of $11.8 million in individual life insurance premiums, primarily a result of the continuation of a shift in marketing emphasis to universal and variable universal life insurance products from traditional life insurance products. Unlike traditional premium-based products, individual universal life and variable life insurance deposits are not reported as U.S. GAAP revenue.

Fees and other revenues increased $7.5 million, or 7%, to $110.7 million for the three months ended June 30, 2005, from $103.2 million for the three months ended June 30, 2004. Fee revenues from our individual life insurance business increased $8.7 million, primarily due to growth in our fee-based universal and variable universal life insurance business.

Net investment income increased $5.2 million, or 3%, to $169.5 million for the three months ended June 30, 2005, from $164.3 million for the three months ended June 30, 2004. The increase primarily relates to a $646.0 million, or 6%, increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 6.3% for the three months ended June 30, 2005, compared to 6.5% for the three months ended June 30, 2004.

Benefits, claims and settlement expenses decreased $10.1 million, or 2%, to $626.4 million for the three months ended June 30, 2005, from $636.5 million for the three months ended June 30, 2004. Individual life insurance benefits, claims and settlement expenses decreased $22.0 million primarily the result of methodology improvements related to reinsurance values and a change in the estimate of reinsurance benefits. The change in the estimate of reinsurance benefits is negated by a corresponding increase in operating expenses and thus has no impact on earnings. Partially offsetting this decrease was a $9.0 million increase in specialty benefit insurance benefits, claims and settlement expenses, primarily driven by growth in the business.

Dividends to policyholders decreased $1.8 million, or 2%, to $71.3 million for the three months ended June 30, 2005, from $73.1 million for the three months ended June 30, 2004. The decrease is primarily related to a decrease in the individual life insurance dividend interest crediting rates resulting from a declining interest rate environment.

Operating expenses increased $40.5 million, or 17%, to $276.5 million for the three months ended June 30, 2005, from $236.0 million for the three months ended June 30, 2004. Individual life insurance operating expenses increased $14.7 million, primarily due to growth in the business and a change in the estimate of reinsurance benefits. The change in the estimate of reinsurance benefits is negated by a corresponding decrease in benefits, claims, and settlement expenses and thus has no impact on earnings. Specialty benefits operating expenses increased $14.1 million primarily resulting from growth in the business. Health insurance operating expenses increased $11.7 million, primarily due to growth in the insured medical and wellness businesses.

Income taxes increased $10.8 million, or 38%, to $39.0 million for the three months ended June 30, 2005, from $28.2 million for the three months ended June 30, 2004. The effective income tax rate for the segment was 34% and 33% for the three months ended June 30, 2005 and 2004, respectively. The effective income tax rates for the three months ended June 30, 2005 and 2004 were lower than the corporate income tax rate of 35% primarily due to the interest exclusion from taxable income.

As a result of the foregoing factors, operating earnings increased $19.4 million, or 34%, to $76.3 million for the three months ended June 30, 2005, from $56.9 million for the three months ended June 30, 2004.

Net realized/unrealized capital gains, as adjusted, increased $7.1 million to $1.2 million of net realized/unrealized capital gains for the three months ended June 30, 2005, from $5.9 million of net realized/unrealized capital losses for the three months ended June 30, 2004. The increase is primarily the result of fewer other than temporary impairments of certain fixed maturity securities including a $7.4 million recovery of previously impaired securities received as the result of a litigation settlement offset in part by a software impairment and increased losses as the result of fixed maturity securities sales.

As a result of the foregoing factors, net income increased $26.5 million, or 52%, to $77.5 million for the three months ended June 30, 2005, from $51.0 million for the three months ended June 30, 2004.

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Premiums and other considerations increased $65.5 million, or 4%, to $1,601.4 million for the six months ended June 30, 2005, from $1,535.9 million for the six months ended June 30, 2004. Specialty benefits insurance premiums increased $51.5 million primarily due to strong sales and persistency. In addition, health insurance premiums increased $35.5 million, primarily due to higher premium per member. Partially offsetting these increases was a decrease of $21.5 million in individual life insurance premiums, primarily a result of the continuation of a shift in marketing emphasis to universal and variable universal life insurance products from traditional life insurance products and an increase in ceded reinsurance premium. Unlike traditional premium-based products, individual universal life and variable life insurance deposits are not reported as U.S. GAAP revenue.

Fees and other revenues increased $21.8 million, or 11%, to $222.6 million for the six months ended June 30, 2005, from $200.8 million for the six months ended June 30, 2004. Fee revenues from our individual life insurance business increased $24.3 million, primarily due to growth in our fee-based universal and variable universal life insurance business.

Net investment income increased $4.8 million, or 1%, to $334.1 million for the six months ended June 30, 2005, from $329.3 million for the six months ended June 30, 2004. The increase primarily relates to a $773.0 million, or 8%, increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 6.2% for the six months ended June 30, 2005, compared to 6.6% for the six

months ended June 30, 2004.

Benefits, claims and settlement expenses increased $16.8 million, or 1%, to $1,269.4 million for the six months ended June 30, 2005, from $1,252.6 million for the six months ended June 30, 2004. Despite lower loss ratios, specialty benefits insurance benefits, claims and settlement expenses increased $23.2 million, primarily due to growth in the business. Health insurance benefits, claims and settlement expenses increased $10.5 million primarily due to insured medical cost trend. Partially offsetting these increases was a decrease of $16.9 million in individual life insurance benefits, claims and settlement expenses, primarily a result of methodology improvements related to reinsurance values and a change in the estimate of reinsurance benefits, partially offset by higher

death benefit costs. The change in the estimate of reinsurance benefits is negated by a corresponding increase in operating expenses and thus has no impact to earnings.

Dividends to policyholders decreased $1.9 million, or 1%, to $143.2 million for the six months ended June 30, 2005, from $145.1 million for the six months ended June 30, 2004. The decrease is primarily related to a decrease in the individual life insurance dividend interest crediting rates resulting from a declining interest rate environment.

Operating expenses increased $56.0 million, or 12%, to $525.6 million for the six months ended June 30, 2005, from $469.6 million for the six months ended June 30, 2004. Specialty benefits operating expenses increased $23.4 million primarily resulting from growth in the business. Individual life insurance operating expenses increased $19.7 million, primarily due to growth in the business and a change in the estimate of reinsurance benefits. The change in the estimate of reinsurance benefits is negated by a corresponding decrease in benefits, claims, and settlement expenses and thus has no impact on earnings. In addition, health insurance operating expenses increased $12.9 million, primarily due to revenue growth in the insured medical and wellness businesses.

Income taxes increased $7.1 million, or 11%, to $74.1 million for the six months ended June 30, 2005, from $67.0 million for the six months ended June 30, 2004. The effective income tax rate for the segment was 34% for the six months ended June 30, 2005 and 2004. The effective income tax rates for the six months ended June 30, 2005 and 2004 were lower than the corporate income tax rate of 35% primarily due to the interest exclusion from taxable income.

As a result of the foregoing factors, operating earnings increased $14.1 million, or 11%, to $145.8 million for the six months ended June 30, 2005, from $131.7 million for the six months ended June 30, 2004.

Net realized/unrealized capital gains, as adjusted, increased $8.3 million to $0.5 million of net realized/unrealized capital gains for the six months ended June 30, 2005, from $7.8 million of net realized/unrealized capital losses for the six months ended June 30, 2004. The increase is primarily the result of fewer other than temporary impairments of certain fixed maturity securities including a $7.4 million recovery of previously impaired securities received as the result of a litigation settlement, more losses as the result of sales of securities offset in part by a software impairment.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $23.3 million, or 19%, to $146.3 million for the six months ended June 30, 2005, from $123.0 million for the six months ended June 30, 2004. For the six months ended June 30, 2004, net income included the negative effect of other after-tax adjustments totaling $0.9 million, due to a cumulative effect of accounting change, a result of our implementation of SOP 03-1.

Corporate and Other Segment

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

	For the three months ended June 30,		For the six months ended June 30,	
	2005	2004	2005	2004
	(in millions)			
Operating Earnings Data:				
Operating revenues (1):				
Total operating revenues	**$ (28.0)**	$ (11.9)	**$ (38.1)**	$ (10.3)
Expenses:				
Total expenses	**1.9**	7.6	**1.4**	30.1
Pre-tax operating loss	**(29.9)**	(19.5)	**(39.5)**	(40.4)
Income tax benefits	**(25.0)**	(10.4)	**(26.2)**	(19.8)
Operating loss	**(4.9)**	(9.1)	**(13.3)**	(20.6)
Net realized/unrealized capital gains (losses), as adjusted	**4.5**	(18.5)	**(0.2)**	(6.3)
Other after-tax adjustments	**14.7**	—	**14.7**	—
U. S. GAAP Reported:				
Net income (loss)	**$ 14.3**	$ (27.6)	**$ 1.2**	$ (26.9)

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

Three Months Ended June 30, 2005 Compared to Three Months Ended June 30, 2004

Total operating revenues decreased $16.1 million to a negative $28.0 million for the three months ended June 30, 2005, from a negative $11.9 million for the three months ended June 30, 2004. Net investment income decreased $15.3 million primarily due to the increase in investment expenses related to the acquisition of a significant variable interest in a coal-based synthetic fuel production facility in June 2004. The increase in investment expense from this investment is more than offset by a decrease in income taxes due to Section 29 tax credits generated from the fuel production.

Total expenses decreased $5.7 million, or 75%, to $1.9 million for the three months ended June 30, 2005, from $7.6 million for the three months ended June 30, 2004. The decrease in total expenses was partially due to a $4.8 million decrease in interest related to federal income tax audit activities as well as a $2.6 million decrease in interest expense primarily related to the reduction in corporate debt.

Income tax benefits increased $14.6 million to $25.0 million for the three months ended June 30, 2005, from $10.4 million for the three months ended June 30, 2004. The increase was primarily due to Section 29 tax credits on our investment in a synthetic fuel production facility.

As a result of the foregoing factors, operating loss decreased $4.2 million, or 46%, to $4.9 million for the three months ended June 30, 2005, from $9.1 million for the three months ended June 30, 2004.

Net realized/unrealized capital gains, as adjusted, increased $23.0 million to $4.5 million of net realized/unrealized capital gains for the three months ended June 30, 2005, from $18.5 million of net realized/unrealized capital losses for the three months ended June 30, 2004. The increase was primarily due to the loss on sale of a foreign investment in 2004. In addition, the increase was due to less mark to market losses of certain seed money investments as well as fewer other than temporary declines in value of certain fixed maturity securities.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $41.9 million to $14.3 million for the three months ended June 30, 2005 from $27.6 million of net loss for the three months ended June 30, 2004. For the three months ended June 30, 2005, net income included the positive effect of an other after-tax adjustment totaling $14.7 million, due to a gain on sale of real estate property that qualifies for discontinued operations treatment under SFAS 144.

Six Months Ended June 30, 2005 Compared to Six Months Ended June 30, 2004

Total operating revenues decreased $27.8 million to a negative $38.1 million for the six months ended June 30, 2005, from a negative $10.3 million for the six months ended June 30, 2004. Net investment income decreased $26.5 million primarily due to a decrease in average annualized investment yields for the segment. Contributing to the decline in yields is the increase in investment expenses related to the acquisition of a significant variable interest in a coal-based synthetic fuel production facility in June 2004. The increase in investment expense from this investment is more than offset by a decrease in income taxes due to Section 29 tax credits generated from the fuel production. In addition, the decrease in total revenues was partially due to a $3.8 million increase in inter-segment eliminations included in this segment, which is offset by a corresponding change in total expenses. Partially offsetting the decrease in total revenue was an increase of $3.5 million in fee revenue for transitional services that are provided to CitiMortgage, Inc. on a temporary basis that are related to the sale of Principal Residential Mortgage, Inc., which is mostly offset by a corresponding change in total expenses.

Total expenses decreased $28.7 million, or 95%, to $1.4 million for the six months ended June 30, 2005, from $30.1 million for the six months ended June 30, 2004. The decrease in total expenses was partially due to a $12.2 million decrease in interest related to federal income tax audit activities as well as $11.7 million decrease in interest expense primarily related to the reduction in corporate debt. In addition, a decrease in total expense of $7.2 million was related to a prior year prepayment penalty recognized on redemption of our surplus notes due 2024. Furthermore, inter-segment eliminations included in this segment increased $3.8 million, resulting in a decrease in total expenses. The decrease in total expense was partially offset by a $3.4 million increase in transitional service agreement expenses that are provided to CitiMortgage, Inc. on a temporary basis that are related to the sale of Principal Residential Mortgage, Inc., which is mostly offset in total revenue.

Income tax benefits increased $6.4 million, or 32%, to $26.2 million for the six months ended June 30, 2005, from $19.8 million for the six months ended June 30, 2004. The increase was primarily due to Section 29 tax credits on our investment in a synthetic fuel production facility. Partially offsetting the increase in income tax benefits is an increase in 2005 in income tax reserves established for contested IRS tax audit matters as well as a tax benefit associated with the sale of a foreign investment in 2004.

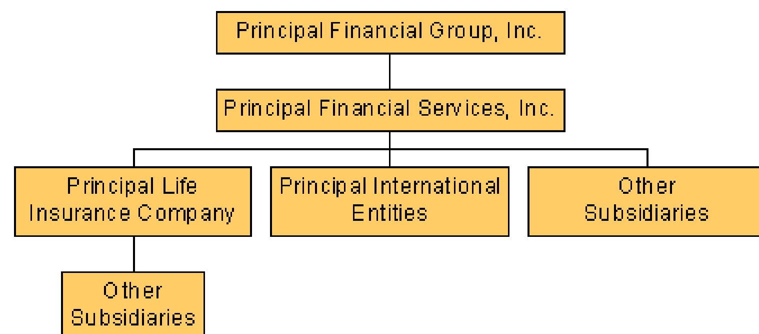
As a result of the foregoing factors, operating loss decreased $7.3 million, or 35%, to $13.3 million for the six months ended June 30, 2005, from $20.6 million for the six months ended June 30, 2004.

Net realized/unrealized capital losses, as adjusted, decreased $6.1 million, or 97%, to $0.2 million for the six months ended June 30, 2005, from $6.3 million for the six months ended June 30, 2004. The decrease was primarily due to the loss on sale of a foreign investment in 2004 offset in part by the mark to market of certain seed money investments.

As a result of the foregoing factors and the inclusion of other after-tax adjustments, net income increased $28.1 million to $1.2 million of net income for the six months ended June 30, 2005, from $26.9 million of net loss for the six months ended June 30, 2004. For the six months ended June 30, 2005, net income included the positive effect of an other after-tax adjustment totaling $14.7 million, due to a gain on sale of real estate property that qualifies 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 as of June 30, 2005.



Sources and Uses of Cash of Consolidated Operations

Net cash provided by operating activities was $805.3 million and $929.6 million for the six months ended June 30, 2005 and 2004, respectively. The decrease in cash provided by operations between periods primarily related to the payment of an Internal Revenue Service deficiency related to the examination for 1999 – 2001, offset by an increase in fees and a decrease in cash paid for benefits, claims and settlement expenses.

Net cash used in investing activities was $761.3 million and $1,179.2 million for the six months ended June 30, 2005 and 2004, respectively. The decrease in cash used in investing activities between periods was primarily related to a reduction in purchases of available-for-sale fixed maturity securities and mortgage loans as well as an increase in net real estate sales.

Net cash provided by financing activities was $675.7 million and $534.2 million for the six months ended June 30, 2005 and 2004, respectively. The increase in net cash provided by financing activities reflects the issuance of preferred stock in 2005 as well as a decrease in payments of long term debt, primarily due to the early extinguishment of surplus notes in the prior year, with no corresponding activity in the current year. Also contributing were increases in short term borrowings and bank deposits. Offsetting these increases was an increase in treasury stock acquired, partially funded from the preferred stock issuance as well as a decrease in net deposits of investment contracts.

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.

Impacts of Income Taxes

The Internal Revenue Service (the “Service”) completed the examination for 1999 - 2001 and issued notices of deficiency dated December 29, 2004 and March 1, 2005. We paid the deficiencies (approximately $444.0 million for 1999 and 2000, and $1.3 million for 2001, including interest) in the first quarter of 2005 and plan to file claims for refund relating to the disputed adjustments. The majority of the deficiency is attributable to the disallowance of carry-backs of capital losses, net operating losses and foreign tax credits arising in years after 2001. We expect the Service to allow some (if not all) of the carry-backs upon completion of the audit of the returns for the years in which the losses and credits arose. The remainder of the deficiency is attributable to both contested issues and adjustments that we have accepted. We believe that we have adequate defenses against, or sufficient provisions for, the contested issues. Consequently, we do not expect the ultimate resolution of issues in tax years 1999 - 2001 to have a material impact on our net income. In order to make the January 2005 payment, we utilized some of our short-term debt capacity as a funding source. While the amount representing the disallowed carry-backs should be refunded within the next year, final settlement on the contested issues could take several years while legal remedies are pursued.

On October 22, 2004, the American Jobs Creation Act of 2004 (“the “Act”) was signed into law. The Act includes a repatriation provision granting U.S. corporations a special deduction of 85% of certain qualifying dividends from their foreign subsidiaries. A company may elect to apply this provision to qualifying earnings that are repatriated in its 2005 tax year. While we continue to evaluate the effects of this provision, whether we will ultimately elect to utilize this repatriation provision depends on a number of factors. Based on the interpretive guidance issued to date by the Service, we currently believe that we will elect to utilize this repatriation provision in our 2005 tax year. This includes the Service’s release of Notice 2005-38, which explicitly provides that a Code section 78 gross-up does not apply to any foreign tax for which a foreign tax credit is disallowed under Code section 965. Consequently, a domestic reinvestment plan was implemented including the required chief executive officer approval. Ultimately, the Board of Directors will also be approving this plan. The range of possible amounts that we are considering for application under this provision is between approximately $35.0 and $54.0 million. Our current tax accrual reflects application of the provisions of the Act .

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 Securities and Exchange Commission, which became effective on June 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

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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. Following our issuance of perpetual preferred stock, we now have the ability to issue up to $2.45 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.

Preferred Stock Dividend Restrictions. 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 June 30, 2005, we have no preferred dividend restrictions.

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.

In June 2005, following our Board of Directors authorization of the repurchase of up to 15.0 million shares of our outstanding common stock, we entered into an accelerated stock repurchase agreement with a third party investment banker for approximately 13.7 million shares of our common stock with an initial payment of $542.3 million. This transaction is subject to a market pricing adjustment provision based on the volume weighted average market price over the execution period, which can be settled in shares or cash.

In March 2005, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. This program began after the completion of the May 2004 repurchase program, which authorized the repurchase of up to $700.0 million of our outstanding common stock. Under the May 2004 and March 2005 repurchase programs, we acquired 8.4 million shares in the open market at an aggregate cost of $325.0 million during the six months ended June 30, 2005. Of that amount, $75.0 million was acquired under the May 2004 repurchase program and $250.0 million was acquired under the March 2005 repurchase program. As of June 30, 2005, the share repurchase program announced in March 2005 has been completed.

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 2004 statutory results, Principal Life could pay approximately $591.1 million in stockholder dividends in 2005 without exceeding the statutory limitation. As of June 30, 2005, there have been no dividends declared by Principal Life.

International Operations

Our Brazilian, Hong Kong, Chilean and Mexican operations produced positive cash flow from operations for the six months ended June 30, 2005 and 2004. These cash flows have been historically maintained at the local country level for strategic expansion purposes and local capital requirements. Our international operations have required infusions of capital primarily to fund acquisitions and to a lesser extent, to meet the cash outflow 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, we have repatriated and will continue to repatriate a portion of the capital from certain countries in 2005.

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) and dividends on majority-owned subsidiary redeemable preferred securities (non-intercompany) (D). The formula for this ratio is: (BT+I+IF-E)/(I+IF+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), 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+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 six months ended June 30,		For the year ended December 31,		
	2005	**2004**	**2004**	**2003**	**2002**
Ratio of earnings to fixed charges before interest credited on investment products (1)	**16.0**	6.9	9.5	7.4	4.2
Ratio of earnings to fixed charges	**2.2**	1.9	2.0	1.9	1.4

(1) For the six months ended June 30, 2005, increased primarily due to lower long-term borrowing costs and the effects of tax-related interest.

Contractual Obligations and Commercial Commitments

As of June 30, 2005, we had $839.5 million of long-term debt outstanding compared to $843.5 million at December 31, 2004. There have been no significant changes to contractual obligations and commitments since December 31, 2004.

Short-Term Debt

As of June 30, 2005, we had credit facilities with various financial institutions in an aggregate amount of $1.1 billion. As of June 30, 2005 we had $456.3 million of outstanding borrowings related to our credit facilities with $179.4 million of assets pledged as support, compared to $281.7 million of outstanding borrowings at December 31, 2004 with $221.3 million of assets pledged as support. Assets pledged consisted primarily of commercial mortgages and

mortgage-backed 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 June 30, 2005.

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 2005 through 2019. The maximum exposure under these agreements as of June 30, 2005, was approximately $222.0 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, minimizing the impact to net income. The fair value of such guarantees issued after January 1, 2003, was determined to be insignificant.

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. $190.0 million as of June 30, 2005). 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 (“the Commission”) opined that such late filings would result in certain New Zealand investors having a right to return of their investment plus interest at 10% per annum from the date of investment. This technical issue affected many in the industry. On April 15, 2004, the New Zealand government enacted legislation that will provide issuers, including BT Financial Group, the opportunity for retroactive relief from such late filing violations. The law allows issuers to apply for judicial validation of non-compliant issuances resulting from late filings. The law further provides that judicial relief is mandatory and unconditional unless an investor was materially prejudiced by the late filing. Such judicial relief has been granted to BT Financial Group and Westpac with regard to the vast majority of affected investors. As a result, we do not believe that this matter will result in a material adverse effect on our business or financial position. It is possible, however, that it could have a material adverse effect on net income in a particular quarter or annual period.

On December 24, 2004, Westpac lodged several warranty and indemnification claims related to the sale of BT Financial Group. Under the sale agreements, certain warranty claims were required to be lodged by December 31, 2004. The claims aggregate approximately A$50.0 million Australian dollars (approximately U.S. $38.0 million) with the majority of the claims (approximately A$45.0 million Australian dollars, or U.S. $34.0 million) 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 claims 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. We intend to vigorously defend against these claims. Although we cannot predict the outcome of this matter or reasonably estimate possible losses, we do not believe that it would result in a material adverse effect on our business or financial position. It is possible, however, that it could have a material adverse effect on net income in a particular quarter or annual period.

We are also subject to various other indemnification obligations issued in conjunction with certain transactions, primarily the sale of BT Financial Group, 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, financial position or net income. The fair value of such indemnifications issued after January 1, 2003, was determined to be insignificant.

Investments

We had total consolidated assets as of June 30, 2005, of $117.2 billion, of which $57.7 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, $55.1 billion were held by our U.S. operations and the remaining $2.6 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 reviewing and approving all investments. As of June 30, 2005, there are ten members on the Investment Committee, one of

whom is a member 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 1.9 times as of June 30, 2005.

We have limited exposure to equity risk in our common stock portfolio. Equity securities accounted for only 1% of our U.S. invested assets as of June 30, 2005.

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

Overall Composition of U.S. Invested Assets

U.S. invested assets as of June 30, 2005, 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

	June 30, 2005		December 31, 2004	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
Fixed maturity securities				
Public	**$ 27,482.8**	**50%**	$ 26,477.1	49%
Private	**12,832.8**	**23**	12,749.6	23
Equity securities	**735.6**	**1**	725.9	1
Mortgage loans				

Commercial	**10,127.5**	**18**	10,224.7	19
Residential	**1,148.8**	**2**	1,104.0	2
Real estate held for sale	**161.3**	**—**	136.1	—
Real estate held for investment	**852.0**	**2**	836.0	2
Policy loans	**813.0**	**2**	814.5	2
Other investments	**907.6**	**2**	1,339.7	2
Total invested assets	**55,061.4**	**100%**	54,407.6	100%
Cash and cash equivalents	**1,147.7**		368.9	
Total invested assets and cash	**$ 56,209.1**		$ 54,776.5	

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 5.5% for the three months ended June 30, 2005, compared to 5.7% for the three months ended June 30, 2004. The annualized yield on U.S. invested assets and on cash and cash equivalents was 5.5% for the six months ended June 30, 2005, compared to 5.7% for the six months ended June 30, 2004. 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 June 30,			
	2005		2004	
	Yield	Amount	Yield	Amount
	($ in millions)			
Fixed maturity securities	**5.8%**	**$ 575.3**	5.9%	$ 537.5
Equity securities	**6.8**	**12.4**	6.3	10.4
Mortgage loans — Commercial	**6.6**	**169.0**	6.9	167.8
Mortgage loans — Residential	**4.5**	**12.8**	3.5	10.7
Real estate	**5.9**	**14.6**	7.3	21.7
Policy loans	**6.2**	**12.6**	6.3	12.6
Cash and cash equivalents	**2.8**	**5.6**	1.9	4.8
Other investments	**(0.3)**	**(0.7)**	4.1	11.1
Total before investment expenses	**5.8**	**801.6**	6.0	776.6
Investment expenses	**0.3**	**35.1**	0.3	36.1
Net investment income	**5.5%**	**$ 766.5**	5.7%	$ 740.5

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

	For the six months ended June 30,			
	2005		2004	
	Yield	Amount	Yield	Amount
	($ in millions)			
Fixed maturity securities	**5.8%**	**$ 1,145.4**	5.9%	$ 1,073.3
Equity securities	**6.6**	**24.1**	6.7	22.0
Mortgage loans — Commercial	**6.6**	**336.9**	7.0	337.5
Mortgage loans — Residential	**4.5**	**25.4**	3.8	23.6
Real estate	**5.4**	**26.8**	9.0	55.1
Policy loans	**6.2**	**25.1**	6.3	25.4
Cash and cash equivalents	**2.7**	**10.3**	1.3	8.3
Other investments	**1.1**	**6.2**	2.4	13.5
Total before investment expenses	**5.8**	**1,600.2**	6.0	1,558.7
Investment expenses	**0.3**	**67.7**	0.3	66.2
Net investment income	**5.5%**	**$ 1,532.5**	5.7%	$ 1,492.5

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 73% and 72% of total U.S. invested assets as of June 30, 2005 and December 31, 2004, 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 June 30, 2005 and 67% in publicly traded fixed maturity securities and 33% in privately placed fixed maturity securities as of December 31, 2004. Included in the privately placed category as of June 30, 2005, and December 31, 2004, were $6.3 billion and $5.8 billion, respectively, of securities eligible for resale to qualified institutional buyers under Rule 144A under the Securities Act of 1933. Fixed maturity securities were diversified by category of issuer as of June 30, 2005, and December 31, 2004, as shown in the following table:

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

	June 30, 2005		December 31, 2004	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
U.S. Government and agencies	**$ 260.4**	**1%**	$ 274.2	1%
States and political subdivisions	**1,137.9**	**3**	947.0	2

Non-U.S. governments	**483.0**	**1**	490.3	1
Corporate — public	**19,822.7**	**49**	19,572.4	50
Corporate — private	**10,517.3**	**26**	10,549.4	27
Residential pass-through securities	**1,558.9**	**4**	1,536.2	4
Commercial mortgage-backed securities	**3,950.6**	**10**	3,472.7	9
Residential collateralized mortgage obligations	**680.9**	**1**	652.4	2
Asset-backed securities	**1,903.9**	**5**	1,732.1	4
Total fixed maturities	**$ 40,315.6**	**100%**	$ 39,226.7	100%

We held $8,094.3 million of mortgage-backed and asset-backed securities as of June 30, 2005, and $7,393.4 million as of December 31, 2004.

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 $6,172.9 million, or 15% of total fixed maturity securities, as of June 30, 2005, comprised of corporate and foreign government fixed maturity securities. Of the $6,172.9 million as of June 30, 2005, investments totaled $1,671.5 million in the continental European Union, $1,434.2 million in the United Kingdom, $754.9 million in Asia, $539.6 million in Australia, $529.3 million in South America, $321.4 million in Mexico and $16.4 million in Japan. The remaining $905.6 million is invested in 13 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 June 30, 2005, our investments in Canada totaled $1,388.7 million.

The following tables present the amortized cost of our top ten exposures including approved counterparty exposure limits as of June 30, 2005, and December 31, 2004.

	June 30, 2005 Amortized Cost (in millions)
Bank of America Corp.(3)	**$ 402.2**
MBIA Inc.(2)	**380.3**
HSBC Holdings PLC(1)	**365.5**
American International Group Inc.(3)	**351.0**
JP Morgan Chase & Co.(3)	**330.5**
General Electric Co	**320.7**
Goldman Sachs Group Inc.(3)	**294.6**
Royal Bank of Scotland Group PLC(3)	**294.0**
Verizon Communications	**260.1**
Citigroup Inc.(3)	**258.6**
Total Top Ten Exposures	**$ 3,257.5**

(1) Includes a $238.3 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 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, 2004
	Amortized Cost
	(in millions)
HSBC Holdings PLC(1)	$ 446.2
Bank of America Corp.(3)	419.6
MBIA Inc.(2)	411.7
American International Group Inc.(3)	394.8
JP Morgan Chase & Co.(3)	321.2
General Electric Co	313.4
Royal Bank of Scotland Group PLC(3)	296.6
Goldman Sachs Group Inc.(3)	285.5
Citigroup Inc.(3)	280.9
Verizon Communications Inc.	261.5
Total Top Ten Exposures	$ 3,431.4

(1) Includes a $238.3 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 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 June 30, 2005 and December 31, 2004. As of June 30, 2005 and December 31, 2004, 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 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 June 30, 2005, 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 94%.

We also monitor the credit drift of our corporate fixed maturity securities portfolio. Credit drift is defined as the ratio of the percentage of rating downgrades, including defaults, divided by the percentage of rating upgrades. We measure credit drift once each fiscal year, assessing the changes in our internally developed credit ratings that have occurred during the year. Standard & Poor’s annual credit ratings drift ratio measures the credit rating change, within a specific year, of companies that have been assigned ratings by Standard & Poor’s. The annual internal credit drift ratio on corporate fixed maturity securities we held in our general account was 0.53 times compared to the Standard & Poor’s drift ratio of 0.90 times, as of December 31, 2004.

The following table presents our total fixed maturity securities by NAIC designation and the equivalent ratings of the nationally recognized securities rating organizations as of June 30, 2005, and December 31, 2004, 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)

NAIC Rating	Rating Agency Equivalent	June 30, 2005 Amortized Cost	June 30, 2005 Carrying Amount	June 30, 2005 % of Total Carrying Amount	December 31, 2004 Amortized Cost	December 31, 2004 Carrying Amount	December 31, 2004 % of Total Carrying Amount
			($ in millions)				
1	Aaa/Aa/A	$ **21,205.2**	$ **22,515.3**	**56%**	$ 19,807.0	$ 20,979.9	54%
2	Baa	**14,369.9**	**15,393.1**	**38**	14,939.9	16,012.2	41
3	Ba	**1,801.8**	**1,925.6**	**5**	1,555.9	1,698.7	4
4	B	**309.3**	**320.4**	**1**	323.4	332.3	1
5	Caa and lower	**12.9**	**13.2**	**—**	42.2	44.2	—
6	In or near default	**138.2**	**148.0**	**—**	160.2	159.4	—
	Total fixed maturities	$ **37,837.3**	$ **40,315.6**	**100%**	$ 36,828.6	$ 39,226.7	100%

(1) Includes 101 securities with an amortized cost of $866.3 million, gross gains of $64.8 million, gross losses of $5.1 million and a carrying amount of $926.0 million as of June 30, 2005, 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 June 30, 2005, we had invested 2.6% of new cash flow for the year in below investment grade assets. While the general account investment returns have improved due to the below investment grade asset class, we manage its growth strategically by limiting it to 10% of the total fixed maturity securities portfolios.

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

The following table shows the carrying amount of our corporate fixed maturity securities by Salomon industry category, as well as the percentage of the total corporate portfolio that each Salomon industry category comprises as of June 30, 2005, and December 31, 2004.

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

	June 30, 2005 Carrying Amount	June 30, 2005 % of Total	December 31, 2004 Carrying Amount	December 31, 2004 % of Total
		($ in millions)		
Industry Class				
Finance — Bank	$ **3,612.8**	**12%**	$ 3,644.0	12%
Finance — Insurance	**2,860.4**	**10**	2,604.0	9
Finance — Other	**3,962.2**	**13**	3,838.0	13
Industrial — Consumer	**1,051.0**	**4**	975.0	3
Industrial — Energy	**3,037.7**	**10**	2,755.8	9
Industrial — Manufacturing	**5,484.8**	**18**	5,594.0	19
Industrial — Other	**115.6**	**—**	135.1	1
Industrial — Service	**4,541.0**	**15**	4,623.2	15
Industrial — Transport	**876.0**	**3**	934.0	3
Utility — Electric	**2,860.7**	**9**	3,052.4	10
Utility — Other	**58.4**	**—**	56.3	—
Utility — Telecom	**1,879.4**	**6**	1,910.0	6
Total	$ **30,340.0**	**100%**	$ 30,121.8	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 where market value is less than seventy-five percent of amortized cost to determine 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 gain relating to other than temporary credit impairments of fixed maturity securities was $52.3 million for the six months ended June 30, 2005. $52.0 million of the $59.7 million of realized gains is due to a recovery related to previously impaired securities received as the result of a litigation settlement with the balance coming as recoveries on the sales of previously impaired securities. Offsetting this realized gain was $7.4 million of other than temporary credit impaired write-downs.

For the six months ended June 30, 2005, we realized $22.6 million of gross losses upon disposal of bonds excluding hedging adjustments. Included in this $22.6 million is $16.3 million related to sales of sixteen credit impaired 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. Sales generate both gains and losses.

The following tables present our fixed maturity securities available-for-sale by industry category and the associated gross unrealized gains and losses as of June 30, 2005, and December 31, 2004.

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

	June 30, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Finance — Bank	$ **3,428.6**	$ **190.0**	$ **5.8**	$ **3,612.8**
Finance — Insurance	**2,709.4**	**156.5**	**5.5**	**2,860.4**
Finance — Other	**3,737.6**	**232.3**	**7.7**	**3,962.2**
Industrial — Consumer	**991.6**	**60.8**	**1.4**	**1,051.0**
Industrial — Energy	**2,742.3**	**304.2**	**8.8**	**3,037.7**
Industrial — Manufacturing	**5,187.2**	**315.2**	**17.6**	**5,484.8**
Industrial — Other	**108.3**	**7.3**	**—**	**115.6**
Industrial — Service	**4,236.7**	**312.6**	**8.3**	**4,541.0**
Industrial — Transport	**804.0**	**78.9**	**6.9**	**876.0**
Utility — Electric	**2,674.2**	**190.9**	**4.4**	**2,860.7**
Utility — Other	**48.9**	**9.5**	**—**	**58.4**
Utility — Telecom	**1,700.0**	**182.5**	**3.1**	**1,879.4**
Total corporate securities	**28,368.8**	**2,040.7**	**69.5**	**30,340.0**
U.S. Government and agencies	**255.5**	**5.1**	**0.2**	**260.4**
States and political subdivisions	**1,075.1**	**63.6**	**0.8**	**1,137.9**
Non-U.S. governments	**422.9**	**60.2**	**0.1**	**483.0**
Mortgage-backed and other asset-backed securities	**7,631.4**	**390.1**	**18.5**	**8,003.0**
Total fixed maturity securities, available-for-sale	$ **37,753.7**	$ **2,559.7**	$ **89.1**	$ **40,224.3**

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

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Finance — Bank	$ 3,467.0	$ 183.6	$ 6.6	$ 3,644.0

Finance — Insurance	2,497.1	115.6	8.7	2,604.0
Finance — Other	3,648.0	199.2	9.2	3,838.0
Industrial — Consumer	916.1	60.7	1.8	975.0
Industrial — Energy	2,504.9	259.4	8.5	2,755.8
Industrial — Manufacturing	5,233.4	367.1	6.5	5,594.0
Industrial — Other	127.4	7.9	0.2	135.1
Industrial — Service	4,289.9	339.0	5.7	4,623.2
Industrial — Transport	871.2	73.3	10.5	934.0
Utility — Electric	2,852.6	203.0	3.2	3,052.4
Utility — Other	48.9	7.4	—	56.3
Utility — Telecom	1,742.5	170.3	2.8	1,910.0
Total corporate securities	28,199.0	1,986.5	63.7	30,121.8
U.S. Government and agencies	268.6	6.3	0.7	274.2
States and political subdivisions	894.1	53.6	0.7	947.0
Non-U.S. governments	428.4	61.9	—	490.3
Mortgage-backed and other asset-backed securities	6,952.6	371.3	23.5	7,300.4
Total fixed maturity securities, available-for-sale	$ 36,742.7	$ 2,479.6	$ 88.6	$ 39,133.7

The total unrealized losses on our fixed maturity securities available-for-sale were $89.1 million and $88.6 million as of June 30, 2005 and December 31, 2004, respectively. Of the $89.1 million in gross unrealized losses as of June 30, 2005, there were $1.7 million in losses attributed to securities scheduled to mature in one year or less, $30.6 million is attributed to securities scheduled to mature between one to five years, $24.6 million is attributed to securities scheduled to mature between five to ten years, $13.7 million is attributed to securities scheduled to mature after ten years, and $18.5 million is related to mortgage-backed and other asset-backed securities. The gross unrealized losses as of June 30, 2005 were concentrated primarily in the Industrial — Manufacturing sectors and Mortgage-backed and other asset-backed securities. The gross unrealized losses as of December 31, 2004 were concentrated primarily in the Mortgage-backed and other asset-backed securities and Industrial — Transportation 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 June 30, 2005, and December 31, 2004.

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

	June 30, 2005			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Investment Grade:				
Public	**$ 24,512.2**	**$ 1,559.2**	**$ 46.4**	**$ 26,025.0**
Private	**10,979.3**	**838.8**	**26.0**	**11,792.1**
Below Investment Grade:				
Public	**1,389.6**	**75.5**	**7.3**	**1,457.8**
Private	**872.6**	**86.2**	**9.4**	**949.4**
Total fixed maturity securities, available-for-sale	**$ 37,753.7**	**$ 2,559.7**	**$ 89.1**	**$ 40,224.3**

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

	December 31, 2004			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Carrying Amount
	(in millions)			
Investment Grade:				
Public	$ 23,634.9	$ 1,553.5	$ 36.8	$ 25,151.6
Private	11,026.1	753.2	31.8	11,747.5
Below Investment Grade:				
Public	1,239.2	93.1	6.7	1,325.6
Private	842.5	79.8	13.3	909.0
Total fixed maturity securities, available-for-sale	$ 36,742.7	$ 2,479.6	$ 88.6	$ 39,133.7

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

	June 30, 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	**$ 829.1**	**$ 6.3**	**$ 175.0**	**$ 3.4**	**$ 1,004.1**	**$ 9.7**
Greater than three to six months	**1,299.3**	**9.6**	**248.9**	**2.1**	**1,548.2**	**11.7**
Greater than six to nine months	**828.7**	**11.6**	**645.2**	**9.4**	**1,473.9**	**21.0**
Greater than nine to twelve onths	**190.7**	**3.1**	**79.0**	**1.5**	**269.7**	**4.6**
Greater than twelve to twenty-four months	**738.5**	**14.1**	**455.2**	**7.8**	**1,193.7**	**21.9**

Greater than twenty-four to thirty-six months	**59.7**	**1.6**	**77.0**	**1.8**	**136.7**	**3.4**
Greater than thirty-six months	**2.1**	**0.1**	**—**	**—**	**2.1**	**0.1**
Total fixed maturities, available-for-sale	**$ 3,948.1**	**$ 46.4**	**$ 1,680.3**	**$ 26.0**	**$ 5,628.4**	**$ 72.4**

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

	December 31, 2004					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 1,608.3	$ 9.4	$ 620.5	$ 4.7	$ 2,228.8	$ 14.1
Greater than three to six months	298.1	3.6	630.2	8.2	928.3	11.8
Greater than six to nine months	869.6	13.1	421.6	6.1	1,291.2	19.2
Greater than nine to twelve months	225.1	3.8	107.1	2.7	332.2	6.5
Greater than twelve to twenty-four months	232.0	6.3	282.8	10.1	514.8	16.4
Greater than twenty-four to thirty-six months	—	—	—	—	—	—
Greater than thirty-six months	5.3	0.6	—	—	5.3	0.6
Total fixed maturities, available-for-sale	$ 3,238.4	$ 36.8	$ 2,062.2	$ 31.8	$ 5,300.6	$ 68.6

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

	June 30, 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	**$ 105.6**	**$ 0.5**	**$ 48.9**	**$ 1.6**	**$ 154.5**	**$ 2.1**
Greater than three to six months	**101.7**	**2.9**	**30.8**	**0.6**	**132.5**	**3.5**
Greater than six to nine months	**—**	**—**	**30.2**	**0.7**	**30.2**	**0.7**
Greater than nine to twelve months	**—**	**—**	**0.9**	**0.1**	**0.9**	**0.1**
Greater than twelve to twenty-four months	**27.4**	**1.6**	**0.6**	**0.1**	**28.0**	**1.7**
Greater than twenty-four to thirty-six months	**—**	**—**	**2.0**	**1.0**	**2.0**	**1.0**
Greater than thirty-six months	**45.2**	**2.3**	**66.9**	**5.3**	**112.1**	**7.6**
Total fixed maturities, available-for-sale	**$ 279.9**	**$ 7.3**	**$ 180.3**	**$ 9.4**	**$ 460.2**	**$ 16.7**

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

	December 31, 2004					
	Public		Private		Total	
	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses	Carrying Amount	Gross Unrealized Losses
	(in millions)					
Three months or less	$ 3.4	$ 1.5	$ 50.4	$ 2.8	$ 53.8	$ 4.3
Greater than three to six months	—	—	0.9	0.1	0.9	0.1
Greater than six to nine months	16.6	0.3	—	—	16.6	0.3
Greater than nine to twelve months	39.4	0.6	—	—	39.4	0.6
Greater than twelve to twenty-four months	—	—	6.2	1.0	6.2	1.0
Greater than twenty-four to thirty-six months	2.4	0.1	34.7	2.8	37.1	2.9
Greater than thirty-six months	44.4	4.2	55.9	6.6	100.3	10.8
Total fixed maturities, available-for-sale	$ 106.2	$ 6.7	$ 148.1	$ 13.3	$ 254.3	$ 20.0

Of total gross unrealized losses as of June 30, 2005 and December 31, 2004, $72.4 million and $68.6 million were related to investment grade securities, respectively. Gross unrealized losses related to below investment grade securities were $16.7 million and $20.0 million as of June 30, 2005 and December 31, 2004, respectively.

The following tables present the carrying amount and gross unrealized losses on fixed maturity securities available-for-sale, where the estimated fair value has declined and remained below amortized cost by 20% or more as of June 30, 2005, and December 31, 2004.

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

	June 30, 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	$ —	$ —	$ —	$ —	$ —	$ —
Greater than three to six months	—	—	—	—	—	—
Greater than six to nine months	—	—	—	—	—	—
Greater than nine to twelve months	—	—	—	—	—	—
Greater than twelve months	**2.0**	**1.0**	—	—	**2.0**	**1.0**
Total fixed maturity securities, available-for-sale	**$ 2.0**	**$ 1.0**	$ —	$ —	**$ 2.0**	**$ 1.0**

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

	December 31, 2004					
	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	$ 3.5	$ 2.7	$ 6.1	$ 1.5	$ 9.6	$ 4.2
Greater than three to six months	—	—	—	—	—	—
Greater than six to nine months	—	—	—	—	—	—
Greater than nine to twelve months	—	—	—	—	—	—
Greater than twelve months	2.0	0.9	—	—	2.0	0.9
Total fixed maturity securities, available-for-sale	$ 5.5	$ 3.6	$ 6.1	$ 1.5	$ 11.6	$ 5.1

Gross unrealized losses on fixed maturity securities where the estimated fair value has been 20% or more below amortized cost were $1.0 million as of June 30, 2005 and $5.1 million as of December 31, 2004. The gross unrealized losses attributed to those securities considered to be “problem”, “potential problem” or “restructured” were $1.0 million and $3.6 million as of June 30, 2005, and December 31, 2004, respectively.

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

	June 30, 2005	December 31, 2004
	($ in millions)	
Total fixed maturity securities (public and private)	**$ 40,315.6**	$ 39,226.7
Problem fixed maturity securities	**$ 55.3**	$ 68.5
Potential problem fixed maturity securities	**116.6**	119.6
Restructured fixed maturity securities	—	10.4
Total problem, potential problem and restructured fixed maturity securities	**$ 171.9**	$ 198.5
Total problem, potential problem and restructured fixed maturity securities as a percent of total fixed maturity securities	**1%**	1%

Mortgage Loans

Mortgage loans consist primarily of commercial mortgage loans on real estate. At June 30, 2005, commercial mortgage loans aggregated to $10,127.5 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 June 30, 2005. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building's design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses by building and geographic fault lines the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

Our commercial loan portfolio is highly diversified by borrower. As of June 30, 2005, 36% 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 June 30, 2005 and December 31, 2004 was 1,315 and 1,318, respectively. The average loan size of our commercial mortgage portfolio was $7.7 million as of June 30, 2005.

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 are subjective. Our periodic evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. The current portfolio statistics and past loss experience produced a provision for the Principal Life general account totaling $33.4 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 $2.3 million for the six months ended June 30, 2005, and $7.2 million for the year ended December 31, 2004.

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

U.S. Invested Assets
Commercial Mortgage Valuation Allowance

	For the six months ended June 30, 2005	**For the year ended December 31, 2004**
	($ in millions)	
Beginning balance	**$ 42.4**	$ 49.6
Provision	**4.7**	14.4
Release	**(7.0)**	(21.6)
Ending balance	**$ 40.1**	$ 42.4
Valuation allowance as % of carrying value before reserves	**1%**	1%

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

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

	June 30, 2005	December 31, 2004
	($ in millions)	
Total commercial mortgages	**$ 10,127.5**	$ 10,224.7
Problem commercial mortgages(1)	**$ 37.9**	$ 38.2
Potential problem commercial mortgages	**17.4**	51.2
Restructured commercial mortgages	**66.1**	59.3
Total problem, potential problem and restructured commercial mortgages	**$ 121.4**	$ 148.7
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	**1%**	2%

(1) Problem commercial mortgages include mortgage loans in foreclosure of $10.3 million as of June 30, 2005. There were no mortgage loans in foreclosure as of December 31, 2004.

Equity Real Estate

We hold commercial equity real estate as part of our investment portfolio. As of June 30, 2005, and December 31, 2004, the carrying amount of equity real estate investment was $1,013.3 million and $972.1 million, or 2% 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 $852.0 million as of June 30, 2005, and $836.0 million as of December 31, 2004. 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 June 30, 2005 and December 31, 2004, there were no such impairment adjustments.

The carrying amount of real estate held for sale as of June 30, 2005, and December 31, 2004, was $161.3 million and $136.1 million, net of valuation allowances of $4.3 million and $5.8 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 June 30, 2005. By property type, there is a concentration in office buildings that represented approximately 40% of the equity real estate portfolio as of June 30, 2005.

Other Investments

Our other investments totaled $907.6 million as of June 30, 2005, compared to $1,339.7 million as of December 31, 2004. Derivatives accounted for $535.0 million in other investments as of June 30, 2005. The remaining invested assets include minority interests in unconsolidated entities and properties owned jointly with venture partners and operated by the partners.

International Investment Operations

As of June 30, 2005, our international investment operations consist of the investments of Principal International comprised of $2.6 billion in invested assets. Principal Global Investors works with each Principal International affiliate to develop 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, which are approved by Principal Global Investors. Each international affiliate is required to submit a compliance report relative to its strategy to Principal Global Investors. Principal

Global Investors employees and international affiliate company credit analysts jointly review each corporate credit annually.

Overall Composition of International Invested Assets

As shown in the following table, the major categories of international invested assets as of June 30, 2005, and December 31, 2004, were fixed maturity securities and residential mortgage loans:

International Invested Assets

	June 30, 2005		December 31, 2004	
	Carrying Amount	% of Total	Carrying Amount	% of Total
	($ in millions)			
Fixed maturity securities				
Public	**$ 1,890.5**	**72%**	$ 1,782.6	72%
Private	**0.6**	**—**	—	—
Equity securities	**31.7**	**1**	36.7	2

Mortgage loans				
Residential	**415.4**	**16**	385.8	16
Real estate held for investment	**10.0**	**—**	10.8	—
Other investments	**299.4**	**11**	246.0	10
Total invested assets	**2,647.6**	**100%**	2,461.9	100%
Cash and cash equivalents	**23.9**		83.0	
Total invested assets and cash	**$ 2,671.5**		$ 2,544.9	

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. 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 manage the interest rate risk inherent in our assets relative to the interest rate risk inherent in our liabilities. One of the measures we use to quantify this exposure is duration. To calculate duration, we project asset and liability cashflows. These cashflows 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.

As of June 30, 2005, the difference between the asset and liability durations on our primary duration managed portfolio was -.06. 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 $31,344.6 million as of June 30, 2005.

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 single premium deferred annuities, we manage interest rate risk based on a modeling process that considers the target average life, maturities, crediting rates and assumptions of policyholder behavior. As of June 30, 2005, the weighted-average difference between the asset and liability durations on these portfolios was +.71. 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 $15,549.4 million as of June 30, 2005.

We also have a block of participating general account pension business that passes 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 $1,782.1 million as of June 30, 2005.

Using the assumptions and data in effect as of June 30, 2005, we estimate that a 100 basis point immediate, parallel increase in interest rates decreases the net fair value of our portfolio by approximately $91.6 million. The following table details the estimated changes by risk management strategy. The table also gives the weighted-average duration of the asset portfolio for each category, and the net duration gap (i.e. the weighted-average difference between the asset and liability durations).

Risk Management Strategy	June 30, 2005 Value of Total Assets (in millions)	Duration of Assets	Net Duration Gap	Net Fair Value Change (in millions)
Primary duration-managed	**$ 31,344.6**	**3.97**	**(.06)**	**$ 18.8**
Duration-monitored	**15,549.4**	**5.29**	**.71**	**(110.4)**
Non duration-managed	**1,782.1**	**6.12**	**N/A**	**N/A**
Total	**$ 48,676.1**			**$ (91.6)**

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.

Cash Flow Volatility

Cash flow volatility arises as a result of several factors. One is the inherent difficulty in perfectly matching the cash flows of new asset purchases with that of new liabilities. Another factor is the inherent cash flow volatility of some classes of assets and liabilities. In order to minimize cash flow volatility, we manage differences between expected asset and liability cash flows within pre-established guidelines.

We also seek to minimize cash flow volatility by restricting the portion of securities with redemption features held in our invested asset portfolio. These asset securities include redeemable corporate securities, mortgage-backed securities or other assets with options that, if exercised, could alter the expected future cash inflows. In addition, we limit sales of liabilities with features such as puts or other options that may change the cash flow profile of the liability portfolio.

Derivatives

We use various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, swaptions, futures, Treasury rate guarantees, interest rate lock commitments and mortgage-backed forwards and options. We use interest rate 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 liability or a liability with attributes similar to a call option. In these cases, we will use interest rate swaptions or similar products to hedge the risk of early liability payment thereby transforming the callable liability into a fixed term liability.

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. An example of an investment we limit because of the option risk is residential mortgage-backed securities. We assess option risk in all investments we make and, when we assume such risk, we seek to price for it accordingly to achieve an appropriate return on our investments.

We use commercial mortgage-backed security total return swaps to minimize exposure to commercial mortgage-backed security spread movement in our securitization operations.

We have increased our credit exposure through credit default swaps by investing in $42.5 million of subordinated tranches of a synthetic collateralized debt obligation. The outstanding notional amount as of June 30, 2005 was $500.0 million and the fair value was $8.8 million which was reflected as an other invested asset on the consolidated statements of financial position. We also invested in credit default swaps creating replicated assets with a notional amount of $656.3 million and a fair value of $2.8 million which was reflected as an other invested asset on the consolidated statements of financial position as of June 30, 2005.

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.

We have determined that this grantor trust is a variable interest entity and that we are the primary beneficiary of the trust due to our sole interest in the variable interest entity and management of the synthetic reference portfolios. Upon consolidation of the trust, as of June 30, 2005, our consolidated statements of financial position include $130.0 million of available-for-sale fixed maturity securities, which represented the collateral held by the trust. As of June 30, 2005, the credit default swap entered into by the trust has an outstanding notional amount of $130.0 million and a change in fair value of a $2.2 million pre-tax loss that is recorded in earnings and is reflected on the consolidated statements of financial position as an other liability. The creditors of the grantor trusts have no recourse to the assets of our company.

We also offer a guaranteed fund as an investment option in our defined contribution plans in Hong Kong. This fund contains an embedded option that has been bifurcated and accounted for separately in realized gains (losses). There was no pre-tax gain or loss recognized for the six months ended June 30, 2005.

The obligation to deliver the underlying securities of certain consolidated grantor trusts to various unrelated trust certificate holders contains an embedded derivative of the forecasted transaction to deliver the underlying securities.

We offer an equity indexed annuity product that contains an embedded derivative that has been bifurcated and accounted for separately in realized gains (losses). We economically hedge the equity indexed annuity product by purchasing options that match the product’s profile. For the six months ended June 30, 2005, we recognized a $0.3 million pre-tax loss on the call spread options purchased and a $0.7 million pre-tax loss on the change in fair value of the embedded derivatives.

We offer certain variable annuity products with a guaranteed minimum withdrawal benefit (“GMWB”) rider. The GMWB provides that the contractholder will receive at least their principal deposit back through withdrawals of up to a specified annual amount, even if the account value is reduced to zero. The GMWB represents an embedded derivative in the variable annuity contract that is required to be reported separately from the host variable annuity contract. Declines in the equity market may increase our exposure to benefits under contracts with the GMWB. We economically hedge the GMWB exposure using futures, options and interest rate swaps. For the six months ended June 30, 2005, we recognized a $0.1 million pre-tax loss on the hedging instruments and a $0.6 million pre-tax loss on the change in fair value of the embedded derivatives.

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.

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 June 30, 2005, and December 31, 2004.

Derivative Financial Instruments — Notional Amounts

	June 30, 2005		December 31, 2004	
	Notional Amount	% of Total	Notional Amount	% of Total
	($ in millions)			
Interest rate swaps	**$ 7,977.6**	**47%**	$ 7,481.9	49%
Foreign currency swaps	**3,461.9**	**20**	3,037.5	20
Credit default swaps	**1,286.3**	**8**	988.3	7
Embedded derivative financial instruments	**935.0**	**6**	894.4	6
Interest rate lock commitments	**766.6**	**5**	634.3	4
Swaptions	**547.2**	**3**	429.0	3
Bond forwards	**491.5**	**3**	508.0	3
Mortgage-backed forwards and options	**424.0**	**2**	586.8	4
Total return swaps	**400.0**	**2**	—	—
Currency forwards	**375.8**	**2**	441.7	3
Futures	**131.3**	**1**	11.8	—
Call options	**131.2**	**1**	73.0	1
Bond options	**38.5**	**—**	38.5	—
Total	**$ 16,966.9**	**100%**	$ 15,125.2	100%

Derivative Financial Instruments — Credit Exposures

	June 30, 2005		December 31, 2004	
	Credit Exposure	% of Total	Credit Exposure	% of Total
	($ in millions)			
Foreign currency swaps	**$ 464.4**	**77%**	$ 805.2	85%
Bond forwards	**65.7**	**11**	66.8	7
Interest rate swaps	**38.0**	**6**	41.5	4
Credit default swaps	**15.3**	**3**	19.3	2
Call options	**13.1**	**2**	10.5	1
Currency forwards	**5.0**	**1**	7.1	1
Bond options	**0.6**	**—**	0.7	—
Total credit exposure	**602.1**	**100%**	951.1	100%
Less: Collateral received	**(126.0)**		(396.5)	
Total	**$ 476.1**		$ 554.6	

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.

	June 30, 2005				
			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	**$ 7,977.6**	**6.08(1)**	**$ (418.1)**	**$ (151.0)**	**$ 88.5**
Mortgage-backed forwards and options	**424.0**	**.05(4)**	**(1.4)**	**(0.3)**	**1.7**
Bond forwards	**491.5**	**2.20(4)**	**92.7**	**65.4**	**39.4**

Swaptions	547.2	8.55(3)	(16.6)	(31.1)	(56.0)
Futures	131.0	.21(2)	(6.7)	—	6.8
Total return swaps	400.0	.47(1)	—	—	—
Bond options	38.5	2.63(4)	(3.2)	(1.2)	0.7
Total	$ 10,009.8		$ (353.3)	$ (118.2)	$ 81.1

(1) Based on maturity date of swap.
(2) Based on maturity date.
(3) Based on option date of swaption.
(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.

Debt Issued and Outstanding

As of June 30, 2005, the aggregate fair value of long-term debt was $1,070.1 million. A 100 basis point, immediate, parallel decrease in interest rates would increase the fair value of debt by approximately $34.7 million.

	June 30, 2005 Fair Value (no accrued interest)		
	-100 Basis Point Change	No Change	+100 Basis Point Change
		(in millions)	
8.2% notes payable, due 2009	$ 546.5	$ 527.3	$ 509.1
8% surplus notes payable, due 2044	127.1	117.6	107.8
Non-recourse mortgages and notes payable	352.0	346.7	343.4
Other mortgages and notes payable	79.2	78.5	77.8
Total long-term debt	$ 1,104.8	$ 1,070.1	$ 1,038.1

Equity Risk

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in a particular common stock. As of June 30, 2005, the fair value of our equity securities was $767.3 million. A 10% decline in the value of the equity securities would result in an unrealized loss of $76.7 million. As of June 30, 2005, a 10% immediate and sustained decline in the equity markets would result in a decrease of asset-based fee revenues of $31.9 million over the next six months. 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.

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 purchased, and our international operations. The foreign currency risk on funding agreements and fixed maturity securities is eliminated by using currency

swaps that swap the foreign currency interest and principal payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities as of June 30, 2005, was $2,888.5 million. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturity securities as of June 30, 2005, was $549.3 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.

Additionally, we may take measures to hedge our net equity investments in our foreign subsidiaries from currency risks. As of June 15, 2005, we settled currency forwards used to hedge a portion of our net equity investment in our Mexican operations from currency fluctuations. We recognized a $2.7 million dollar pre-tax loss on these contracts which is included in accumulated other comprehensive income. Currently, there are no other outstanding net equity investment hedges.

We estimate that as of June 30, 2005, 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. 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.

Effects of Inflation

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

Item 4. Controls and Procedures

Changes in Internal Control Over Financial Reporting

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

Disclosure Controls and Procedures

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

Our Chief Executive Officer, J. Barry Griswell, and our Chief Financial Officer, Michael H. Gersie, have reviewed and evaluated our disclosure controls and procedures as of June 30, 2005, 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, and 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 others 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. We received a subpoena on March 3, 2005, from the Office of the Attorney General of the State of New York seeking information on compensation agreements associated with the sale of retirement products. We are cooperating fully with the inquiry. We have received requests from regulators and other governmental authorities relating to industry issues and may

receive such requests 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 new 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.

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, financial position or net income. 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, 2005 – January 31, 2005	950,449(3)	$ 40.24	935,000	$ 37.4(1)
February 1, 2005 – February 28, 2005	945,964(3)	$ 39.88	937,165	$ —(1)
March 1, 2005 – March 31, 2005	2,292,194(3)	$ 38.66	2,290,542	$ 161.4(2)
April 1, 2005 – April 30, 2005	3,578,538(3)	$ 38.07	3,578,500	$ 25.2(2)
May 1, 2005 – May 31, 2005	660,398	$ 38.17	660,398	$ —(2)
June 1, 2005 – June 30, 2005	13,740,653(3)	$ 39.47	13,740,000	$ 52.8(4)
Total	22,168,196		22,141,605	

(1) In May 2004, our Board of Directors authorized a repurchase program of up to $700.0 million of our outstanding common stock. Our first purchase on this program was on May 28, 2004, which was after the completion of the May 2003 repurchase program, which authorized the repurchase of up to $300.0 million of our outstanding common stock. On February 22, 2005, the program that was announced in May 2004 was completed.

(2) In March 2005, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. Our first purchase on this program was on March 8, 2005, which was after the completion of the May 2004 repurchase program, which authorized the repurchase of up to

$700.0 million of our outstanding common stock. On May 3, 2005, the program that was announced in March 2005 was completed.

(3) The number of shares include shares of common stock utilized to execute certain stock incentive awards in 2005: 15,449 shares in January, 8,799 shares in February, 1,652 shares in March, 38 shares in April, and 653 shares in June.

(4) In June 2005, following our Board of Directors' authorization of the repurchase of up to 15.0 million shares of our outstanding common stock, we entered into an accelerated stock repurchase agreement with a third party investment banker for approximately 13.7 million shares of our common stock with an initial payment of $542.3 million. This transaction is subject to a market pricing adjustment provision based on the volume weighted average market price over the execution period, which can be settled in shares or cash.

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

At the Company's annual meeting of stockholders on May 17, 2005, the stockholders elected four Class I directors each for a term expiring at the Company's 2008 annual meeting. The voting results are as follows:

	VOTES FOR	VOTES WITHHELD
Betsy J. Bernard	169,886,448	4,381,060
Jocelyn Carter-Miller	169,845,539	4,421,969
Gary E. Costley	169,712,168	4,555,340
William T. Kerr	168,154,708	6,112,800

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

CLASS II DIRECTORS – TERM EXPIRES IN 2006

J. Barry Griswell
Charles S. Johnson
Richard L. Keyser
Arjun K. Mathrani
Elizabeth E. Tallett

CLASS III DIRECTORS – TERM EXPIRES IN 2007

David J. Drury
C. Daniel Gelatt
Sandra L. Helton
Federico F. Pena

In addition, the stockholders ratified the appointment of Ernst & Young LLP as the Company's independent auditors for 2005. The voting results are as follows:

FOR	AGAINST	ABSTAIN
169,513,185	2,482,272	2,272,051

Further, the stockholders voted to approve the Principal Financial Group, Inc. Directors Stock Plan pursuant to the following vote:

FOR	AGAINST	ABSTAIN
137,182,068	19,365,639	3,384,860

Finally, the stockholders also voted to approve the Principal Financial Group, Inc. Stock Incentive Plan pursuant to the following vote:

FOR	AGAINST	ABSTAIN
135,276,714	21,451,825	3,204,028

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits

Exhibit Number	Description
10.1.1	Principal Financial Group, Inc. 2005 Stock Incentive Plan
10.7.1	Principal Financial Group, Inc. 2005 Directors Stock Plan
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: August 3, 2005

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	Page
10.1.1	Principal Financial Group, Inc. 2005 Stock Incentive Plan	87
10.7.1	Principal Financial Group, Inc. 2005 Directors Stock Plan	103
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges	109
31.1	Certification of J. Barry Griswell	110
31.2	Certification of Michael H. Gersie	111
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code – J. Barry Griswell	112
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code – Michael H. Gersie	113

Exhibit 10.1.1

PRINCIPAL FINANCIAL GROUP, INC.
2005 STOCK INCENTIVE PLAN

SECTION 1.
PURPOSE

The purpose of the "PRINCIPAL FINANCIAL GROUP, INC. 2005 STOCK INCENTIVE PLAN" (the "Plan") is to foster and promote the long-term financial success of the Company and its subsidiaries and materially increase shareholder value by (a) motivating superior performance by means of performance-related incentives, (b) encouraging and providing for the acquisition of an ownership interest in the Company by the Company's and its Subsidiaries' employees and agents, and (c) enabling the Company to attract and retain the services of outstanding employees upon whose judgment, interest, and special effort the successful conduct of its operations is largely dependent.

SECTION 2.
DEFINITIONS

(a) *Definitions.* Whenever used herein, the following terms shall have the respective meanings set forth below:

(1) "Agent" means each insurance agent (whether or not a statutory employee) and each other individual providing personal service to the Company or any Subsidiary who, in either case, is not an Employee.

(2) "Approved Retirement" means termination of a Participant's employment or service *(i)* on or after the normal retirement date or any early retirement date established under any defined benefit pension plan maintained by the Company or a Subsidiary and in which the Participant participates or *(ii)* with the approval of the Committee (which may be given at or after grant), on or after attaining age 50 and completing such period of service as the Committee shall determine from time to time.

(3) "Award" means an Option, SAR, award of Restricted Stock or Performance Shares, an award of Restricted Stock Units or Performance Units or an Other Stock-Based Award.

(4) "Beneficial Owner" means such term as defined in Rule 13d-3 under the Exchange Act.

(5) "Board" means the Board of Directors of the Company.

(6) "Cause" means *(i)* dishonesty, fraud or misrepresentation, *(ii)* the Participant's engaging in conduct that is injurious to the Company or any Subsidiary in any way, including, but not limited to, by way of damage to its reputation or standing in the industry, *(iii)* the Participant's having been convicted of, or entered a plea of *nolo contendere* to, a crime that constitutes a felony; *(iv)* the breach by the Participant of any written covenant or agreement with the Company or any Subsidiary not to disclose or misuse any information pertaining to, or misuse any property of, the Company or any Subsidiary or not to compete or interfere with the Company or any Subsidiary or *(v)* a violation by the Participant of any policy of the Company or any Subsidiary.

(7) "Change of Control" means the occurrence of any one or more of the following:

(i) any SEC Person becomes the Beneficial Owner of 25% or more of the Common Stock or of Voting Securities representing 25% or more of the combined voting power of all Voting Securities of the Company (such an SEC Person, a "25% Owner"); or

(ii) the Incumbent Directors cease for any reason to constitute at least a majority of the Board (other than in connection with a Merger of Equals); or

(iii) consummation of a merger, reorganization, consolidation, or similar transaction (any of the foregoing, a "Reorganization Transaction") other than a Reorganization Transaction *(x)* following which the Continuity of Ownership is more than 60% or *(y)* which is (and continues to qualify as) a Merger of Equals; or

(iv) consummation of a plan or agreement that has been approved by the shareholders of the Company for the sale or other disposition of all or substantially all of the consolidated assets of the Company or a plan of liquidation of the Company; or

(v) any other event or circumstance (or services of events or circumstances) that the Board shall determine to constitute a Change of Control.

(8) "Change of Control Price" means the highest price per share of Common Stock offered in conjunction with any transaction resulting in a Change of Control (as determined in good faith by the Committee if any part of the offered price is payable other than in cash) or, in the case of a Change of Control occurring solely by reason of a change in the composition of the Board, the highest Fair Market Value of the Common Stock on any of the 30 trading days immediately preceding the date on which a Change of Control occurs.

(9) "Code" means the Internal Revenue Code of 1986, as amended.

(10) "Committee" means the Human Resources Committee of the Board or such other committee of the Board as the Board shall designate from time to time.

(11) "Common Stock" means the common stock of the Company, par value $0.01 per share.

(12) "Company" means Principal Financial Group, Inc., a Delaware corporation, and any successor thereto.

(13) "Continuity of Ownership" of a stated percentage means that the SEC Persons who were the direct or indirect owners of the outstanding Common Stock and Voting Securities of the Company immediately before such Reorganization Transaction became, immediately after the consummation of such Reorganization Transaction, the direct or indirect owners of both the stated percentage of the then-outstanding common stock of the Surviving Corporation and Voting Securities representing the stated percentage of the combined voting power of the then-outstanding Voting Securities of the Surviving Corporation, in substantially the same respective proportions as such Persons' ownership of the Common Stock and Voting Securities of the Company immediately before such Reorganization Transaction.

(14) "Disability" means, with respect to any Participant, long-term disability as defined under any long-term disability plan maintained by the Company or a Subsidiary in which the Participant participates. In the event of any question as to whether a Participant has a Disability, the plan administrator of the relevant long-term disability plan shall determine whether a disability exists, in accordance with such plan.

(15) "Domestic Partner" means any person qualifying to be treated as a domestic partner of a Participant under the applicable policies, if any, of the Company or Subsidiary which employs the Participant.

(16) "Employee" means any employee (including each officer) of the Company or any Subsidiary.

(17) "Exchange Act" means the Securities Exchange Act of 1934, as amended.

(18) "Executive Officer" means any officer of the Company or any Subsidiary who is subject to the reporting requirements under Section 16(b) of the Exchange Act.

(19) "Fair Market Value" means, on any date, the price of the last trade, regular way, in the Common Stock on such date on the New York Stock Exchange or, if at the relevant time, the Common Stock is not listed to trade on the New York Stock Exchange, on such other recognized quotation system on which the trading prices of the Common Stock are then quoted (the "applicable exchange"). In the event that *(i)* there are no Common Stock transactions on the applicable exchange on any relevant date, Fair Market Value for such date shall mean the closing price on the immediately preceding date on which Common Stock transactions were so reported and *(ii)* the applicable exchange adopts a trading policy permitting trades after 5 P.M. Eastern Standard Time ("EST"), Fair Market Value shall mean the last trade, regular way, reported on or before 5 P.M. EST (or such earlier or later time as the Committee may establish from time to time).

(20) "Family Member" means, as to a Participant, any *(i)* child, stepchild, grandchild, parent, stepparent, grandparent, spouse, mother-in-law, father-in-law, son-in-law or daughter-in-law (including adoptive relationships), or Domestic Partner of such Participant, *(ii)* trusts for the exclusive benefit of one or more such persons and/or the Participant and *(iii)* other entity owned solely by one or more such persons and/or the Participant.

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(21) "Imminent Control Change Period" means the period commencing on the date any one or more of the following events occurs (or the first of such events in a series of such events) and ending on the date on which a Change of Control or a Merger of Equals occurs:

(i) The Company enters into an agreement the consummation of which would constitute a Change of Control;

(ii) Any SEC Person attempts to become a 25% Owner, as evidenced by filing or other certification of notice of such intent with any state's governmental agency established to regulate the insurance industry, which, if consummated, would constitute a Change of Control;

(iii) Any SEC Person commences a "tender offer" (as such term is used in Section 14(d) of the Exchange Act) or exchange offer, which, if consummated, would result in a Change of Control; or

(iv) Any SEC Person files with the SEC a preliminary or definitive proxy solicitation or election contest to elect or remove one or more members of the Board, which, if consummated or effected, would result in a Change of Control;

provided, however, that an Imminent Control Change Period will lapse upon the occurrence of any of the following:

(A) With respect to an event described in clause (i) of this definition, the date such agreement is terminated, cancelled or expires without a Change of Control or Merger of Equals occurring;

(B) With respect to an event described in clause (ii) of this definition, the date such filing or other certification is withdrawn, expires or is denied or otherwise rejected by the relevant state regulators without a Change of Control or Merger of Equals occurring;

(C) With respect to an event described in clause (iii) of this definition, the date such tender offer or exchange offer is withdrawn or terminates without a Change of Control or Merger of Equals occurring;

(D) With respect to an event described in clause (iv) of this definition, *(1)* the date the validity of such proxy solicitation or election contest expires under relevant state corporate law, or *(2)* the date such proxy solicitation or election contest culminates in a stockholder vote, in either case without a Change of Control or Merger of Equals occurring; or

(E) The date a majority of the Incumbent Directors makes a good faith determination that any event or condition described in clause (i), (ii), (iii) or (iv) of this definition is no longer likely to result in a Change of Control, *provided that* such determination may not be made prior to the six (6) month anniversary of the occurrence of such event.

(22) "Incentive Stock Option" (ISO) means an option within the meaning of Section 422 of the Code.

(23) “Incumbent Directors” means, as of any date, the individuals then serving as members of the Board who were also members of the Board as of the date two years prior to the date of determination; *provided that* any member appointed or elected as a member of the Board after such prior date, but whose election, or nomination for election, was approved by a vote or written consent of at least a majority of the directors then comprising the Incumbent Directors shall also be considered an Incumbent Director unless such person’s election, or nominated for election, to the Board was as a result of, or in connection with, a proxy contest or a Reorganization Transaction.

(24) “Merger of Equals” means the occurrence of a Reorganization Transaction that satisfies all of the following:

(i) the consummation of such Reorganization Transaction results in Continuity of Ownership of at least 40%, but not more than 60%; and

(ii) an SEC Person does not become a 25% Owner as a result of such Reorganization Transaction; and

(iii) throughout the period beginning on the effective date of the event and ending on the second anniversary of such effective date, the Incumbent Directors continue to constitute not less than

(A) a majority of the Board, if subclause (i) of this definition is satisfied because the Reorganization Transaction resulted in Continuity of Ownership of at least 50%, but not more than 60%; or

(B) one (1) member less than a majority of the Board, if subclause (i) of this definition is satisfied because the Reorganization Transaction resulted in Continuity of Ownership of at least 40%, but less than 50%; and

(iv) the person who was the Chief Executive Officer of the Company immediately prior to the first to occur of (x) the day prior to the beginning of the Imminent Control Change Period or (y) the day prior to the effective date of the Reorganization Transaction shall serve as the Chief Executive Officer of the Surviving Corporation at all times during the period commencing on the effective date of the Reorganization Transaction and ending on the first anniversary thereof, provided that this condition shall not fail to be satisfied due to the death or Disability of the Chief Executive Officer;

provided, however, that a Reorganization Transaction shall cease to be considered a Merger of Equals (and shall instead be treated as a Change of Control) from and after the first date:

(A) during the two year period following the date as of which such Reorganization Transaction occurs that any of the conditions of any of clause (ii), (iii) or (iv) of this definition shall not be satisfied; or

(B) prior to the first anniversary of the effective date of the Reorganization Transaction, the Company shall make a filing with the Securities and Exchange Commission, issue a press release, or make a public announcement to the effect that the Surviving Corporation is seeking or intends to seek a replacement for its Chief Executive Officer (other than due to the death or Disability of such person), whether such replacement is to become effective before or after such first anniversary.

(25) “Net Exercised” shall mean the exercise of an Option or any portion thereof by the delivery of the greatest number of whole shares of Common Stock having a Fair Market Value on the date of exercise not in excess of the difference between the aggregate Fair Market Value of the shares of Common Stock subject to the Option (or the portion of such Option then being exercised) and the aggregate exercise price for all such shares of Common Stock under the Option (or the portion thereof then being exercised), with any fractional share that would result from such equation to be payable in cash.

(26) “Nonstatutory Stock Option” (NSO) means an option which is not an Incentive Stock Option within the meaning of Section 422 of the Code.

(27) “Option” means the right to purchase Common Stock at a stated price for a specified period of time. For purposes of the Plan, an Option may be either *(i)* an “Incentive Stock Option” (ISO) within the meaning of Section 422 of the Code or *(ii)* an option which is not an Incentive Stock Option (a “Nonstatutory Stock Option” (NSO)).

(28) “Other Stock-Based Award” means an award of, or related to, shares of Common Stock other than an Award of Options, SAR, Restricted Stock, Performance Shares, Restricted Stock Units or Performance Units, as granted by the Committee in accordance with the provisions of Section 9 hereof.

(29) “Participant” means any Employee or Agent designated by the affirmative action of the Committee (or its delegate) to participate in the Plan.

(30) “Performance Criteria” means the objectives established by the Committee for a Performance Period pursuant to Section 7(c) for the purpose of determining the extent to which an award of Performance Shares or Performance Units has been earned.

(31) “Performance Period” means the period selected by the Committee during which performance is measured for the purpose of determining the extent to which an award of Performance Shares or Performance Units has been earned.

(32) “Performance Share” means an award granted pursuant to Section 7 of the Plan of a contractual right to receive one share of Common Stock (or the Fair Market Value thereof in cash or any combination of

cash and Common Stock, as determined by the Committee), or a fraction or multiple thereof, upon the achievement, in whole or in part, of the applicable Performance Criteria.

(33) "Performance Unit" means an award granted pursuant to Section 7 of the Plan of a contractual right to receive a fixed or variable dollar denominated unit (or a unit denominated in the Participant's local currency), or a fraction or multiple thereof, upon the achievement, in whole or in part, of the applicable Performance Criteria. The Committee shall determine whether the earned portion of any such Performance Units shall be payable in cash, Common Stock or any combination thereof.

(34) "Period of Restriction" means the period specified by the Committee or established pursuant to the Plan during which a Restricted Stock or Restricted Stock Unit award is subject to forfeiture.

(35) "Prior Plan" means the Principal Financial Group Inc. Stock Incentive Plan.

(36) "Reorganization Transaction" shall have the meaning ascribed thereto in the definition of Change of Control.

(37) "Restricted Stock" means an award of Stock made pursuant to Section 6 that is forfeitable by the Participant until the completion of a specified period of future service, the achievement of pre-established performance objectives or until otherwise determined by the Committee or in accordance with the terms of the Plan.

(38) "Restricted Stock Unit" means a contractual right awarded pursuant to Section 6 that entitles the holder to receive shares of Common Stock (or the value thereof in cash) upon the completion of a specified period of future service or the achievement of pre-established performance objectives or at such other time or times determined by the Committee or in accordance with the terms of the Plan.

(39) "SAR" means a stock appreciation right granted under Section 8 of the Plan in respect of one or more shares of Common Stock that entitles the holder thereof to receive, in Common Stock (unless otherwise determined by the Committee at the time of grant), an amount per share of Common Stock equal to the excess, if any, of the Fair Market Value on the date the SAR is exercised over the Fair Market Value on the date the SAR is granted.

(40) "SEC Person" means any person (as such term is defined in Section 3(a)(9) of the Exchange Act) or group (as such term is used in Rule 13d-5 under the Exchange Act), other than an affiliate or any employee benefit plan (or any related trust) of the Company or any of its affiliates.

(41) "Subsidiary" means *(i)* any corporation in which the Company owns, directly or indirectly, at least 50% of the total combined voting power of all classes of stock of such corporation, *(ii)* any partnership or limited liability company in which the Company owns, directly or indirectly, at least 50% of the capital interests or profits interest of such partnership or limited liability company and *(iii)* any other business entity in which the Company owns at least 50% of the equity interests thereof, *provided that*, in any such case, the Company is in effective control of such corporation, partnership, limited liability company or other entity.

(42) "Surviving Corporation" means the corporation resulting from a Reorganization Transaction or, if securities representing at least 50% of the aggregate voting power of such resulting corporation are directly or indirectly owned by another corporation, such other corporation.

(43) "25% Owner" shall have the meaning ascribed thereto in the definition of Change of Control.

(44) "Voting Securities" means, with respect to any corporation, securities of such corporation that are entitled to vote generally in the election of directors of such corporation.

SECTION 3.
POWERS OF THE COMMITTEE; GENERAL TERMS OF AWARDS

(a) *Power to Grant.* The Committee shall determine those Employees and/or Agents to whom an Award shall be granted and the terms and conditions of any and all such Awards. The Committee may establish different terms and conditions for different Awards and different Participants and for the same Participant for each Award such Participant may receive, whether or not granted at different times.

(b) *Rules, Interpretations and Determinations.* The Plan shall be administered by the Committee. The Committee shall have full authority to interpret and administer the Plan, to establish, amend, and rescind rules and regulations relating to the Plan, to provide for conditions deemed necessary or advisable to protect the interests of

the Company, to construe the terms of any Award or any document evidencing the grant of such Award and to make all other determinations necessary or advisable for the administration and interpretation of the Plan in order to carry out its provisions and purposes. Unless otherwise expressly provided hereunder, any power, discretion or authority conveyed to or reserved to the Committee may be exercised by it in its sole and absolute discretion. Determinations, interpretations, or other actions made or taken by the Committee shall be final, binding, and conclusive for all purposes and upon all persons.

(c) *Delegation of Authority.* The Committee may delegate to the Company's Chief Executive Officer and/or to such other officer(s) of the Company the power and authority to make and/or administer Awards under the Plan with respect to individuals who are below the position of Senior Vice President (or any analogous title), pursuant to such conditions and limitations as the Committee may establish; *provided* that only the Committee or the Board may select, and grant Awards to, Executive Officers or exercise any other discretionary authority under the Plan in respect of Awards granted to such Executive Officers. Unless the Committee shall otherwise specify, any delegate shall have the authority and right to exercise (within the scope of such person's delegated authority) all of the same powers and discretion that would otherwise be available to the Committee pursuant to the terms hereof. The Committee may also appoint agents (who may be officers or employees of the Company) to assist in the administration of the Plan and may grant authority to such persons to execute agreements or other documents on its behalf. All expenses incurred in the administration of the Plan, including, without limitation, for the engagement of any counsel, consultant or agent, shall be paid by the Company.

(d) *Restrictive Covenants and Other Conditions.* Without limiting the generality of the foregoing, the Committee may condition the grant of any Award under the Plan upon the Participant to whom such Award would be granted agreeing in writing to certain conditions (such as restrictions on the ability to transfer the underlying shares of Common Stock) or covenants in favor of the Company and/or one or more Subsidiaries (including, without limitation, covenants not to compete, not to solicit employees and customers and not to disclose confidential information, that may have effect following the termination of the Participant's employment or service with the Company and its Subsidiaries and after the Common Stock subject to the Award has been transferred to the Participant), including, without limitation, the requirement that the Participant disgorge any profit, gain or other benefit received in respect of the Award prior to any breach of any such covenant.

(e) *Participants Based Outside the United States.* To conform with the provisions of local laws and regulations, or with local compensation practices and policies, in foreign countries in which the Company or any of its Subsidiaries operate, but subject to the limitations set forth herein regarding the maximum number of shares issuable hereunder and the maximum award to any single Participant, the Committee may *(i)* modify the terms and conditions of Awards granted to Participants employed outside the United States ("*Non-US Awards*"), *(ii)* establish subplans with modified exercise procedures and such other modifications as may be necessary or advisable under the circumstances ("*Subplans*"), and *(iii)* take any action which it deems advisable to obtain, comply with or otherwise reflect any necessary governmental regulatory procedures, exemptions or approvals with respect to the Plan. The Committee's decision to grant Non-US Awards or to establish Subplans is entirely voluntary, and at the complete discretion of the Committee. The Committee may amend, modify or terminate any Subplans at any time, and such amendment, modification or termination may be made without prior notice to the Participants. The Company, Subsidiaries, and members of the Committee shall not incur any liability of any kind to any Participant as a result of any change, amendment or termination of any Subplan at any time. The benefits and rights provided under any Subplan or by any Non-US Award *(i)* are wholly discretionary and, although provided by either the Company or a Subsidiary, do not constitute regular or periodic payments and *(ii)* are not to be considered part of the Participant's salary or compensation under the Participant's employment with the Participant's local employer for purposes of calculating any severance, resignation, redundancy or other end of service payments, vacation, bonuses, long-term service awards, indemnification, pension or retirement benefits, or any other payments, benefits or rights of any kind. If a Subplan is terminated, the Committee may direct the payment of Non-US Awards (or direct the deferral of payments whose amount shall be determined) prior to the dates on which payments would otherwise have been made, and, in the Committee's discretion, such payments may be made in a lump sum or in installments.

(f) *Maximum Individual Grants.* Subject to adjustment as provided in Section 4(d), no Participant shall be granted *(i)* Options or SARs (with tandem Options and SARs being counted only once with respect to this limit) during any 36-month period with respect to more than 3,000,000 shares of Common Stock or *(ii)* Restricted Stock, Restricted Stock Units, Performance Shares and/or Other Stock-Based Awards during any 12-month period that are denominated in shares of Common Stock with respect to more than 250,000 shares of Common Stock. In addition to the foregoing, the maximum dollar value payable to any participant in any 12-month period with respect

to Performance Units and/or Other Stock-Based Awards that are valued with reference to cash or property other than shares of Common Stock is $10,000,000.

(g) *Dividends and Dividends Equivalents.* Unless otherwise determined by the Committee at the time of grant, to the extent that shares of Common Stock are issued at the time of grant of any Award under the Plan, the Participant shall be entitled to receive all dividends and other distributions paid with respect to those shares, provided that if any such dividends or distributions are paid in shares of Common Stock, such shares shall be subject to the same forfeiture restrictions and restrictions on transferability as apply to the shares subject to such Award on which such dividends or distributions were paid. To the extent that shares of Common Stock are not issued at the time of the grant of any Award, the Committee shall determine whether, and to what extent, the Participant shall be entitled to receive the payment of dividend equivalents in respect of that number of outstanding shares of Common Stock corresponding to the shares subject to such Award. Unless otherwise determined by the Committee at or after grant, any additional shares credited in respect of any dividends or dividend equivalents payable in respect of any shares of Common Stock subject to any Award shall become vested and nonforfeitable upon the same terms and conditions as are applicable to the shares underlying the Award in respect of which they are payable (including, with respect to any Award that will become earned and vested upon the attainment of Performance Criteria, the achievement of such Performance Criteria).

SECTION 4.
COMMON STOCK SUBJECT TO PLAN

(a) *Number.* Subject to Section 4(d) below, unless the shareholders of the Company approve an increase in such number by a shareholder vote, the maximum number of shares of Common Stock that may be made issuable or distributable under the Plan is 24,000,000. The number of shares of Common Stock subject to an Option or SAR shall be counted against such limit as one share for each share issued or issuable, provided that when a SAR is granted in tandem with an Option, so that only one may be exercised with the other terminating upon such exercise, the number of shares of Common Stock subject to the tandem Option and SAR award shall only be taken into account once (and not as to both awards) for purposes of this limit (and for purposes of the provisions of Section 4(b) below). Without limiting the generality of the foregoing, the maximum number of shares as to which Incentive Stock Options may be granted shall not exceed 10 million shares. The shares to be delivered under the Plan may consist, in whole or in part, of treasury Common Stock or authorized but unissued Common Stock, not reserved for any other purpose.

(b) *Canceled or Terminated Awards.* Any shares of Common Stock subject to an Award (as determined under Section 4(a)) or any award made or granted under the Prior Plan which for any reason expires without having been exercised, is canceled or terminated or otherwise is settled without the issuance of any Common Stock shall again be available for grant under the Plan. In applying the immediately preceding sentence, if *(i)* shares otherwise issuable or issued in respect of, or as part of, any Award that are withheld to cover taxes shall not be treated as having been issued under the Plan and *(ii)* any SARs are settled in shares of Common Stock or any Options are Net Exercised, only the net number of shares of Common Stock issued in respect of such SARs or Options shall be deemed issued under the Plan. In addition, shares of Common Stock tendered to exercise outstanding Options or other Awards or to cover taxes shall also be available for issuance under the Plan (and shall be counted as one share for purposes of Section 4(a)), except and unless such shares are tendered more than ten years after the effective date of the Plan.

(c) *Repurchased Shares.* In addition to the shares otherwise authorized for issuance hereunder, any shares of Common Stock that are acquired by the Company through the application of the cash proceeds received in connection with the exercise of Options shall also be available for issuance under the Plan in the same manner as though such shares had been tendered to exercise the corresponding Options.

(d) *Adjustment Due to Change in Capitalization.* In the event of any Common Stock dividend or Common Stock split, recapitalization (including, but not limited to, the payment of an extraordinary dividend to the shareholders of the Company), merger, consolidation, combination, spin-off, distribution of assets to shareholders (other than ordinary cash dividends), exchange of shares, or other similar corporate change, the aggregate number of

shares of Common Stock available for grant under Section 4(a) or subject to outstanding Awards and the respective exercise prices or base prices, if any, applicable to outstanding Awards may be appropriately adjusted by the Committee, in its discretion, and the Committee's determination shall be conclusive.

(e) *Assumption of Options and Other Equity-Based Awards.* In the event that there is a merger, stock purchase or other transaction whereby the Company or any of its Subsidiaries acquires another business or any portion thereof, and that pursuant to the arrangements governing such acquisition, the Company agrees to provided options and/or other awards in respect of the Common Stock upon the assumption or in substitution of existing equity-based awards for other securities held by employees and other service providers of the acquired business, the shares of Common Stock subject to such assumed or substituted awards shall not be counted against the limits set forth under Section 4(a) (and no shares related to any such assumed or substituted awards shall be added to the number of awards issuable under this Plan pursuant to Section 4(b)), and none of the provisions of the Plan that would otherwise limit or constrain the ability of the Company to make such assumption or substitution (such as the provisions hereof that require the issuance of Options with an exercise price at least equal to the Fair Market Value on the date of grant) shall apply to the awards issued in substitution of the awards granted in respect of the employees and service providers of such acquired business.

SECTION 5.
STOCK OPTIONS

(a) *Grant of Options.* Subject to the provisions of Section 3(f) and Section 4 above, Options may be granted to Participants at such time or times as shall be determined by the Committee. Options granted under the Plan may be of two types: *(i)* Incentive Stock Options and *(ii)* Nonstatutory Stock Options. Except as otherwise provided herein, the Committee shall have complete discretion in determining the number of Options, if any, to be granted to a Participant, except that Incentive Stock Options may only be granted to Employees. The terms and conditions of each Option grant, including, but not limited to, the type of Option granted, the exercise price, the duration of the Option, the number of shares of Common Stock to which the Option pertains, shall be evidenced in writing. Each such Option grant may also contain such other terms and conditions not inconsistent with the provisions of the Plan as the Committee shall determine.

(b) *Exercise Price.* Nonstatutory Stock Options and Incentive Stock Options granted pursuant to the Plan shall have an exercise price no less than the Fair Market Value of a share of Common Stock on the date on which the Option is granted. No Option granted hereunder may have its exercise price reduced (other than pursuant to the provisions of Section 4(d)) unless such action is expressly authorized by shareholder action in accordance with Section 11.

(c) *Exercise of Options.* The Committee shall determine the exercise schedule applicable with respect to any Option granted hereunder. Such schedule may require a minimum period of service that must be completed before all or a portion of such Option shall be exercisable, and may establish performance-based conditions to the exercise of such Option which are in addition to, in lieu of, or as an alternative to any service requirement. Except as otherwise expressly provided in the Plan *(i)* upon a termination of employment due to death, Disability or Approved Retirement or *(ii)* in connection with a Change of Control, and unless the Committee shall determine that special circumstances (including, but not limited to, the achievement of performance objectives) justify an exception, the minimum period of service required to exercise an Option, in whole or in part, shall be one year. Subject to the provisions of this Section 5, once any portion of any Option has become exercisable it shall remain exercisable for its full term. The Committee shall determine the term of each Nonstatutory Stock Option or Incentive Stock Option granted hereunder, but, except as expressly provided below, in no event shall any such Option be exercisable for more than ten (10) years after the date on which it is granted.

(d) *Payment.* The Committee shall establish procedures governing the exercise of Options. No shares shall be delivered pursuant to any exercise of an Option unless arrangements satisfactory to the Committee have been made to assure full payment of the exercise price therefor. Without limiting the generality of the foregoing, payment of the exercise price may be made *(i)* in cash or its equivalent; *(ii)* by exchanging shares of Common Stock (which are not the subject of any pledge or other security interest) which have been owned by the person exercising the Option for at least six (6) months at the time of exercise; *(iii)* by any combination of the foregoing; *provided* that the combined value of all cash and cash equivalents paid and the Fair Market Value of any such Common Stock tendered to the Company, valued as of the date of such tender, is at least equal to such exercise price; or *(iv)* in accordance with any other procedure or arrangement approved by the Committee. Additionally, to the extent authorized by the Committee (whether at or after grant), Options may be Net Exercised subject to such terms and conditions as the Committee may from time to time impose.

(e) *Incentive Stock Options.* Notwithstanding anything in the Plan to the contrary, no Option that is intended to be an Incentive Stock Option may be granted after the tenth (10th) anniversary of the effective date of

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the Plan and no term of this Plan relating to Incentive Stock Options shall be interpreted, amended or altered, nor shall any discretion or authority granted under the Plan be so exercised, so as to disqualify the Plan under Section 422 of the Code, or, without the consent of any Participant affected thereby, to disqualify any Incentive Stock Option under such Section 422.

(f) *Termination of Employment or Service.*

(i) *Due to Death.* In the event a Participant's employment or service terminates by reason of death, any Options granted to such Participant shall become immediately exercisable in full and may be exercised by the Participant's designated beneficiary or, if none is named, by the person determined in accordance with Section 12(b) below, at any time prior to the earlier to occur of (i) the expiration of the term of the Options or (ii) the third (3rd) anniversary (or such earlier date as the Committee shall determine at the time of grant) of the Participant's death.

(ii) *Due to Disability.* In the event a Participant's employment or service is terminated by reason of Disability, any Options granted to such Participant shall become immediately exercisable in full and may be exercised by the Participant (or, in the event of the Participant's death after termination of employment or service when the Option is exercisable pursuant to its terms, by the Participant's designated beneficiary or, if none is named, by the person determined in accordance with Section 12(b) below), at any time prior to the earlier to occur of *(i)* the expiration of the term of the Options or *(ii)* the third (3rd) anniversary (or such earlier date as the Committee shall determine at the time of grant) of the Participant's termination of employment or service.

(iii) *Approved Retirement.* In the event a Participant's employment or service terminates by reason of Approved Retirement, any Options granted to such Participant shall become immediately exercisable in full and may be exercised by the Participant (or, in the event of the Participant's death after termination of employment or service when the Option is exercisable pursuant to its terms, by the Participant's designated beneficiary or, if none is named, by the person determined in accordance with Section 12(b) below), at any time prior to the expiration date of the term of the Options (or such shorter period following the Participant's Approved Retirement as the Committee shall determine at the time of grant).

(iv) *Termination of Employment For Cause or Resignation.* In the event a Participant's employment or service is terminated by the Company or any Subsidiary for Cause or by the Participant other than due to the Participant's death, Disability or Approved Retirement, any Options granted to such Participant that have not yet been exercised shall expire at the time of such termination and shall not be exercisable thereafter.

(v) *Termination of Employment for Any Other Reason.* Unless otherwise determined by the Committee at or following the time of grant, in the event the employment or service of the Participant shall terminate for any reason other than one described in Section 5(f)(i), (ii), (iii), or (iv) above, any Options granted to such Participant which are exercisable at the date of the Participant's termination of employment or service may be exercised by the Participant (or, in the event of the Participant's death after termination of employment or service when the Option is exercisable pursuant to its terms, by the Participant's designated beneficiary, or, if none is named, by the person determined in accordance with Section 12(b)), at any time prior to the expiration of the term of the Options or the ninetieth (90th) day following the Participant's termination of employment or service, whichever period is shorter, and any Options that are not exercisable at the time of termination of employment or service shall expire at the time of such termination and shall not be exercisable thereafter.

SECTION 6.
RESTRICTED STOCK AND RESTRICTED STOCK UNITS

(a) *Grant of Restricted Stock.* The Committee may grant Restricted Stock or Restricted Stock Units to Participants at such times and in such amounts, and subject to such other terms and conditions not inconsistent with the Plan as it shall determine. If Restricted Stock is evidenced by the issuance of stock certificates, the Committee shall require that such stock certificates be held in the custody of the Secretary of the Company until the Period of Restriction lapses, and that, as a condition of such Restricted Stock award, the Participant shall have delivered a stock power, endorsed in blank, relating to the Common Stock covered by such award. The terms and conditions of each grant of Restricted Stock or Restricted Stock Units shall be evidenced in writing.

(b) *Restrictions on Transferability.* Except as provided in Section 12(a), no Restricted Stock may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the lapse of the Period of Restriction. The Committee shall determine the Period of Restriction applicable with respect to any award of Restricted Stock;

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provided, however, that, except as otherwise expressly provided in the Plan the Period of Restriction with respect to any such Award shall not be less than three years but may lapse ratably over such three year Period of Restriction. Notwithstanding the foregoing, such minimum three-year Period of Restriction shall not be applicable with respect to any grant made to a newly-hired employee made to compensate for equity-based or other forms of compensation forfeited from a prior employer or grants made in satisfaction of incentive or other compensation payable to the Participant in respect of service to the Company or any of its Subsidiaries. The Committee may provide that the Period of Restriction on Restricted Stock shall lapse, in whole or in part, upon the achievement of performance criteria (and without regard to the minimum service requirement), which criteria shall be selected from those available to the Committee under Section 7(c), *provided, however, that* any Award of Restricted Stock made to any Executive Officer that is intended to qualify as other performance based compensation under Section 162(m) of the Code shall be subject to the same restrictions and limitations applicable to Performance Share Awards under Section 7(d) and subject to the certification required under Section 7(e).

(c) *Rights as a Shareholder.* Unless otherwise determined by the Committee at the time of grant and subject to Section 3(g), Participants holding shares of Restricted Stock may exercise full voting rights and other rights as a shareholder with respect to those shares during the Period of Restriction.

(d) *Termination of Employment Due to Approved Retirement, Disability or Death.* Unless otherwise determined by the Committee at the time of grant, in the event a Participant's employment or service terminates by reason of Approved Retirement, any shares related to Restricted Stock held by such Participant shall become non-forfeitable at the time the restrictions would have lapsed had the Participant continued in employment; *provided, however, that* the Committee may waive any forfeiture and transfer restrictions with respect to up to the portion of the Award as is necessary for the Participant to satisfy any applicable tax withholding obligations in connection with such Award arising at the time of such termination of employment. Unless otherwise determined by the Committee at the time of grant, in the event a Participant's employment or service terminates by reason of Disability or death, any shares related to Restricted Stock held by such Participant shall become non-forfeitable on the date of termination.

(e) *Termination of Employment for Any Other Reason.* Unless otherwise determined by the Committee at or after the time of grant, in the event the employment or service of the Participant shall terminate for any reason other than one described in Section 6(d), any Restricted Stock awarded to such Participant as to which the Period of Restriction has not lapsed shall be forfeited.

(f) *Restricted Stock Units.* The Committee may elect to grant any Participant Restricted Stock Units, which are intended to be the economic equivalent of an award of Restricted Stock. Any such Restricted Stock Units Award shall be made on substantially the same terms as apply to an Award of Restricted Stock under this Section 6, except that a Participant receiving such Award shall not have any rights as a shareholder prior to the actual issuance of such Common Stock (although, pursuant to Section 3(g), the Committee may authorize the payment of dividend equivalents on such rights equal to the dividends that would have been payable had the corresponding equity rights been outstanding shares of Common Stock).

SECTION 7
PERFORMANCE SHARES AND PERFORMANCE UNITS

(a) *Generally.* The Committee shall have the authority to determine the Participants who shall receive Performance Shares and Performance Units, the number of Performance Shares and the number and value of Performance Units each Participant receives for each or any Performance Period, and the Performance Criteria applicable in respect of such Performance Shares and Performance Units for each Performance Period. The Committee shall determine the duration of each Performance Period (the duration of Performance Periods may differ from each other), and there may be more than one

Performance Period in existence at any one time as to any Participant or all or any class of Participants. Performance Periods may be no shorter than twelve months. Each grant of Performance Shares and Performance Units shall be evidenced in writing and shall specify the number of Performance Shares and the number and value of Performance Units awarded to the Participant, the Performance Criteria applicable thereto, and such other terms and conditions not inconsistent with the Plan as the Committee shall determine. No shares of Common Stock will be issued at the time an Award of Performance Shares is made, and the Company shall not be required to set aside a fund for the payment of Performance Shares or Performance Units.

(b) *Earned Performance Shares and Performance Units.* Performance Shares and Performance Units shall become earned, in whole or in part, based upon the attainment of specified Performance Criteria or the occurrence

of any event or events, including a Change of Control, as the Committee shall determine, either at or after the time of grant. In addition to the achievement of the specified Performance Criteria, the Committee may, at the grant date, condition payment of Performance Shares and Performance Units on the Participant completing a minimum period of service following the date of grant or on such other conditions as the Committee shall specify.

(c) *Performance Criteria.* At the discretion of the Committee, Performance Criteria may be based on the total return to the Company's shareholders, inclusive of dividends paid, during the applicable Performance Period (determined either in absolute terms or relative to the performance of one or more similarly situated companies or a published index covering the performance of a number of companies), or upon the attainment of one or more of the following criteria, whether in absolute terms or relative to the performance of one or more similarly situated companies or a published index covering the performance of a number of companies: stock price, operating earnings, net earnings, return on equity, income, market share, combined ratio, level of expenses, growth in revenue, earnings before interest, taxes, depreciation and amortization, cash flow, earnings per share, return on invested capital, return on assets, economic value added, improvements in or attainment of working capital levels, and, in the case of persons who are not Executive Officers, such other criteria as may be determined by the Committee. Performance Criteria may be established on a Company-wide basis or with respect to one or more business units or divisions or Subsidiaries. When establishing Performance Criteria for a Performance Period, the Committee may exclude any or all "extraordinary items" as determined under U.S. generally accepted accounting principles including, without limitation, the charges or costs associated with restructurings of the Company or any Subsidiary, discontinued operations, other unusual or non-recurring items, and the cumulative effects of accounting changes. Except to the extent that the exercise of (or the ability to exercise) such discretion in the case of Awards to Executive Officers intended to be other performance-based compensation under Section 162(m)(4) of the Code would cause them to fail to satisfy that requirement, the Committee may also adjust the Performance Criteria for any Performance Period as it deems equitable in recognition of unusual or non-recurring events affecting the Company, changes in applicable tax laws or accounting principles, or such other factors as the Committee may determine.

(d) *Special Rule for Performance Criteria.* If, at the time of grant, the Committee intends a Performance Share Award or Performance Unit to qualify as other performance based compensation within the meaning of Section 162(m)(4) of the Code, the Committee must establish Performance Criteria for the applicable Performance Period no later than the 90th day after the Performance Period begins (or by such other date as may be required under Section 162(m) of the Code), and the Committee shall not have the authority in respect of such Awards to exercise any discretion applicable to a grant of Performance Shares or Performance Units otherwise conveyed by this Section 7, if the ability to exercise such discretion would cause such Award not to qualify as other performance based compensation.

(e) *Certification of Attainment of Performance Criteria.* As soon as practicable after the end of a Performance Period and prior to any payment in respect of such Performance Period, the Committee shall certify in writing the number of Performance Shares and the number and value of Performance Units which have been earned on the basis of performance in relation to the established Performance Criteria.

(f) *Payment of Awards.* Earned Performance Shares and the value of earned Performance Units shall be distributed to the Participant or, if the Participant has died, to the Participant's beneficiary, as soon as practicable after the expiration of the Performance Period and the Committee's certification under paragraph 7(e) above, provided that *(i)* earned Performance Shares and the value of earned Performance Units shall not be distributed to a Participant until any other conditions on payment of such Awards established by the Committee have been satisfied, and *(ii)* any amounts payable in respect of Performance Shares or Performance Units pursuant to Section 10 shall be distributed in accordance with Section 10. The Committee shall determine whether Performance Shares and the value of earned Performance Units are to be distributed in the form of cash, shares of Common Stock or in a combination thereof, with the value or number of shares payable to be determined based on the Fair Market Value of Common Stock on the date of the Committee's certification under paragraph 7(e) above.

(g) *Newly Eligible Participants.* Notwithstanding anything in this Section 7 to the contrary, the Committee shall be entitled to make such rules, determinations and adjustments as it deems appropriate with respect to any Participant who becomes eligible to receive Performance Shares or Performance Units after the commencement of a Performance Period.

(h) *Termination of Employment.*

(i) *Termination of Employment due to Approved Retirement, Disability or Death.* Unless otherwise determined by the Committee at or after the time of grant, a Participant whose employment or service terminates by reason of Approved Retirement, Disability or death shall be entitled to receive the same payment or distribution in respect of Performance Shares and Performance Units (without pro-ration) that would have been payable for the Performance Period had his or her employment continued until the end of the applicable Performance Period. Any Performance Shares or value of Performance Units becoming payable in accordance with the preceding sentence shall be paid at the same time as Performance Shares and the value of Performance Units are paid to other Participants (or at such earlier time as the Committee may permit). Any rights that a Participant or beneficiary may have in respect of any Performance Shares or Performance Units outstanding at the date of such termination of employment that may not be earned (or that are eligible to be earned, but are not earned) in accordance with this section 7(h)(i) shall be forfeited and canceled, effective as of the date of the Participant's termination of employment or service (or, if eligible to be earned, but are not earned, the date of the Committee's certification pursuant to Section 7(e)).

(ii) *Termination for any Other Reason.* Unless otherwise determined by the Committee at or after the time of grant, in the event the employment or service of the Participant shall terminate during a Performance Period for any reason other than the one described in Section 7(h)(i),

all of the Participant's rights to Performance Shares and Performance Units related to such Performance Period shall be immediately forfeited and canceled as of the date of such termination of employment.

(iii) *Cause.* Notwithstanding anything in this Section 7 to the contrary, a Participant's rights in respect of unearned Performance Shares and Performance Units shall in all events be immediately forfeited and canceled as of the date of the Participant's termination of employment for Cause.

SECTION 8
STOCK APPRECIATION RIGHTS

(a) *Grant of SARs.* SARs may be granted to any Participants, all Participants, any class of Participants at such time or times as shall be determined by the Committee. SARs may be granted in tandem with an Option, or may be granted on a freestanding basis, not related to any Option. The term and conditions of any SAR grant shall be evidenced in writing, and shall include such provisions not inconsistent with the Plan as the Committee shall determine.

(b) *Terms and Conditions of SARs.* Unless the Committee shall otherwise determine, the terms and conditions (including, without limitation, the exercise period of the SAR, the vesting schedule applicable thereto and the impact of any termination of service on the Participant's rights with respect to the SAR) applicable with respect to *(i)* SARs granted in tandem with an Option shall be substantially identical (to the extent possible taking into account the differences related to the character of the SAR) to the terms and conditions applicable to the tandem Options and *(ii)* freestanding SARs shall be substantially identical (to the extent possible taking into account the differences related to the character of the SAR) to the terms and conditions that would have been applicable under Section 5 above were the grant of the SARs a grant of an Option.

(c) *Exercise of Tandem SARs.* SARs which are granted in tandem with an Option may only be exercised upon the surrender of the right to exercise such Option for an equivalent number of shares and may be exercised only with respect to the shares of Common Stock for which the related Option is then exercisable.

(d) *Payment of SAR Amount.* Upon exercise of a SAR, the holder shall be entitled to receive payment, in cash, in shares of Common Stock or in a combination thereof, as determined by the Committee, of an amount determined by multiplying:

(i) the excess, if any, of the Fair Market Value of a share of Common Stock at the date of exercise over the Fair Market Value of a share of Common Stock on the date of grant, by

(ii) the number of shares of Common Stock with respect to which the SARs are then being exercised.

SECTION 9.
OTHER STOCK-BASED AWARDS

(a) *Other Stock-Based Awards.* The Committee may grant other types of equity-based and equity-related awards in addition to Options, SARs, Restricted Stock, Performance Shares, Restricted Stock Units and

Performance Units, including, but not limited to, the outright grant of Common Stock in satisfaction of obligations of the Company or any Subsidiary under another compensatory plan, program or arrangement, modified awards intended to comply with or structured in accordance with the provisions of applicable non-U.S. law or practice, or the sale of Common Stock, in such amounts and subject to such terms and conditions as the Committee shall determine, including, but not limited to, the satisfaction of Performance Criteria. Notwithstanding the immediately preceding sentence, except in the case of Other Stock-Based Awards issued in satisfaction of an obligation of the Company or any Subsidiary to make a payment in cash in respect of a Participant (including, but not limited to, when an annual or long-term incentive compensation award is satisfied with the issuance of shares of Common Stock instead of cash or in respect of a Participant's accrued benefit under a deferred compensation plan), except as provided under Section 10, no Participant shall be entitled to vest in any such Other Stock-Based Award on a schedule which is more favorable to the Participant than ratably over a period of three years from the date of grant. Each such Other Stock-Based Award shall be evidenced in writing and specify the terms and conditions applicable thereto. Any such Other Stock-Based Award may entail the transfer of actual shares of Common Stock or the payment of the value of such Award in cash based upon the value of a specified number of shares of Common Stock, or any combination of the foregoing, as determined by the Committee. The terms of any Other Stock-Based Award need not be uniform in application to all (or any class of) Participants, and each Other Stock-Based Award granted to any Participant (whether or not at the same time) may have different terms.

(b) *Termination of Employment or Service.* In addition to any other terms and conditions that may be specified by the Committee but subject to the limitations set forth in Section 9(a), each Other Stock Based Award shall specify the impact of termination of employment upon the rights of a Participant in respect of such Award. At the discretion of the Committee, such conditions may be the same as apply with respect to Restricted Stock or Restricted Stock Units, or may be contain terms that are more or less favorable to the Participant.

SECTION 10.
CHANGE OF CONTROL

(a) *Accelerated Vesting and Payment.* Subject to the provisions of Section 10(b) below, in the event of a Change of Control *(i)* each Option and SAR then outstanding shall be fully exercisable regardless of the exercise schedule otherwise applicable to such Option and/or SAR, *(ii)* the Period of Restriction shall lapse as to each share of Restricted Stock then outstanding, *(iii)* each outstanding Restricted Stock Unit shall become fully vested and payable, *(iv)* each outstanding Performance Share Award and Performance Unit Award shall be deemed earned at the target level of performance for such Award, and *(v)* each outstanding Other Stock-Based Award shall become fully vested and payable. In addition, in connection with such a Change of Control, the Committee may, in its discretion, provide that each Option and/or SAR shall, upon the occurrence of such Change of Control, be canceled in exchange for a payment per share in cash (the "Settlement Payment") in an amount equal to the excess, if any, of the Change of Control Price over the exercise price for such Option or the base price of such SAR. Should the Committee authorize any Settlement Payments in respect of Options, the Committee may determine that any Options which have an exercise price per share below the Change of Control Price shall be deemed cancelled and satisfied in full for a deemed

Settlement Payment of zero. The Committee may also direct that each Restricted Stock Unit, Other Stock-Based Award, Performance Share and/or Performance Unit shall be settled in cash with its value determined based on the Change of Control Price.

(b) *Alternative Awards.* Notwithstanding Section 10(a), no cancellation, acceleration of exercisability, vesting, cash settlement or other payment shall occur with respect to any Award if the Committee reasonably determines in good faith, prior to the occurrence of a Change of Control, that such Award shall be honored or assumed, or new rights substituted therefor (such honored, assumed or substituted award hereinafter called an "Alternative Award"), by a Participant's employer (or the parent or an affiliate of such employer) immediately following the Change of Control; *provided* that any such Alternative Award must:

(i) be based on stock which is traded on an established U.S. securities market;

(ii) provide such Participant with rights and entitlements substantially equivalent to or better than the rights, terms and conditions applicable under such Award, including, but not limited to, an identical or better exercise or vesting schedule and identical or better timing and methods of payment;

(iii) have substantially equivalent economic value to such Award (determined at the time of the Change of Control); and

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(iv) have terms and conditions which provide that in the event that, during the 24-month period following the Change of Control, the Participant's employment or service is involuntarily terminated for any reason (including, but not limited to a termination due to death, Disability or without Cause) or Constructively Terminated (as defined below), all of such Participant's Options and/or SARs shall be deemed immediately and fully exercisable, the Period of Restriction shall lapse as to each of the Participant's outstanding Restricted Stock awards, each of the Participant's outstanding Restricted Stock Unit awards and other Stock-Based Awards shall be payable in full and each such Alternative Award shall be settled for a payment per each share of stock subject to the Alternative Award in cash, in immediately transferable, publicly traded securities or in a combination thereof, in an amount equal to, in the case of an Option or SAR, the excess of the Fair Market Value of such stock on the date of the Participant's termination over the corresponding exercise or base price per share and, in the case of any Restricted Stock, Restricted Stock Unit, or Other Stock-Based Award, the Fair Market Value of the number of shares of Common Stock subject or related thereto.

For this purpose, a Participant's employment or service shall be deemed to have been Constructively Terminated if, without the Participant's written consent, the Participant terminates employment or service within 120 days following either (x) a material reduction in the Participant's base salary or a Participant's incentive compensation opportunity, or (y) the relocation of the Participant's principal place of employment or service to a location more than 35 miles away from the Participant's prior principal place of employment or service.

(c) *Section 409A.* Should any event constitute a Change of Control for purposes of the Plan, but not constitute a change of control within the meaning of Section 409A of the Code, if necessary to avoid the imposition of an additional tax on the recipient, no payment or distribution shall be made to any affected Participant by reason of such Change of Control (although any other modification or enhancement to the Award, such as accelerated vesting, shall still apply) and the value of such Award as determined by the Committee prior to such Change of Control shall be paid to the affected Participant on the earlier to occur of *(i)* the day after the six month anniversary of such Participant's termination of employment and *(ii)* whichever of the following is applicable to such Award *(A)* with respect to any unvested Award that would have become vested solely upon the passage of time and the continued performance of service, the date the Award would have otherwise become vested without regard to the Change of Control, *(B)* with respect to any unvested Award that would have become vested upon the achievement of specified Performance Criteria, on the last day of the applicable Performance Period or *(C)* if the Award was already vested at the time the Change of Control occurs, on the date on which the Award would have expired in accordance with its terms.

SECTION 11
AMENDMENT, MODIFICATION, AND TERMINATION OF PLAN

The Board may, at any time and from time to time amend, modify, suspend, or terminate this Plan, in whole or in part, without notice to or the consent of any Participant, Employee or Agent; *provided*, *however*, *that* any amendment which would *(i)* increase the number of shares available for issuance under the Plan, *(ii)* lower the minimum exercise price at which an Option (or the base price at which a SAR) may be granted or otherwise permit the repricing of any outstanding Options or SARs (other than in the context of a transaction referenced in Section 4(d)), *(iii)* extend the maximum term for Options or SARs granted hereunder or *(iv)* otherwise amend the Plan in a material fashion that would require the approval of shareholders under the applicable rules and regulations of any exchange or automated quotation system on which the Common Stock is listed to trade shall be subject to the approval of the Company's shareholders. No amendment, modification, or termination of the Plan shall in any manner adversely affect any Award theretofore granted under the Plan, without the consent of the Participant.

SECTION 12.
MISCELLANEOUS PROVISIONS

(a) *Transferability.* No Award granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than in accordance with Section 12(b) below, *provided that* the Committee may permit transfers of Awards (other than Incentive Stock Options) to Family Members (including, without limitation, transfers effected by a domestic relations order) subject to such terms and conditions as the Committee shall determine.

(b) *Beneficiary Designation.* Each Participant under the Plan may from time to time name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid or

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by whom any right under the Plan is to be exercised in case of the Participant's death; *provided that*, if the Participant shall not have designated any beneficiary under this Plan, the Participant's beneficiary shall be deemed to be the person designated by the Participant under the group life insurance plan of the Company or a Subsidiary in which such Participant participates (unless such designated beneficiary is not a Family Member). Each designation made

hereunder will revoke all prior designations by the same Participant with respect to all Awards previously granted (including, solely for purposes of this Plan, any deemed designation), shall be in a form prescribed by the Committee, and will be effective only when received by the Committee in writing during the Participant's lifetime. In the absence of any such effective designation (including a deemed designation), benefits remaining unpaid at the Participant's death shall be paid to or exercised by the Participant's surviving spouse, if any, or otherwise to or by the Participant's estate. Except as otherwise expressly provided herein, nothing in this Plan is intended or may be construed to give any person other than Participants any rights or remedies under this Plan.

(c) *Deferral of Payment.* At the time any Award is granted (or such earlier time as the Committee may require), the Committee may permit a Participant to elect, upon such terms and conditions as the Committee may establish, to defer receipt of shares of Common Stock that would otherwise be issued in connection with an Award.

(d) *No Guarantee of Employment or Participation.* The existence of this Plan, as in effect at any time or from time to time, or any grant of Award under the Plan shall not interfere with or limit in any way the rights of the Company or any Subsidiary to terminate any Participant's employment or other service provider relationship at any time, nor confer upon any Participant any rights to continue in the employ or service of the Company or any Subsidiary or any other affiliate of the Company. Except to the extent expressly selected by the Committee to be a Participant, no person (whether or not an Employee, an Agent or a Participant) shall at anytime have a right to be selected for participation in the Plan or, having been selected as a Participant, to receive any additional awards hereunder, despite having previously participated in an incentive or bonus plan of the Company or an affiliate. The existence of the Plan shall not be deemed to constitute a contract of employment between the Company or any affiliate and any Employee, Agent or Participant, nor shall it constitute a right to remain in the employ or service of the Company or any affiliate. Except as may be provided in a separate written agreement, employment with or service for the Company or any affiliate is at-will and either party may terminate the participant's employment or other service provider relationship at any time, for any reason, with or without cause or notice.

(e) *Tax Withholding.* The Company or an affiliate shall have the right to deduct from all payments or distributions hereunder any federal, state, foreign or local taxes or other obligations required by law to be withheld with respect thereto. The Company may defer issuance of Common Stock in respect of any Award until such requirements are satisfied. The Committee may, in its discretion, permit a Participant to elect, subject to such conditions as the Committee shall impose, (i) to have shares of Common Stock otherwise to be issued under the Plan withheld by the Company or (ii) to deliver to the Company previously acquired shares of Common Stock, in either case for the greatest number of whole shares having a Fair Market Value on the date immediately preceding the date on which the applicable tax liability is determined not in excess of the minimum amount required to satisfy the statutory withholding tax obligations with respect to any Award.

(f) *No Limitation on Compensation; Scope of Liabilities.* Nothing in the Plan shall be construed to limit the right of the Company to establish other plans if and to the extent permitted by applicable law. The liability of the Company or any affiliate under this Plan is limited to the obligations expressly set forth in the Plan, and no term or provision of this Plan may be construed to impose any further or additional duties, obligations, or costs on the Company or any affiliate thereof or the Committee not expressly set forth in the Plan.

(g) *Requirements of Law.* The granting of Awards and the issuance of shares of Common Stock shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.

(h) *Term of Plan.* The Plan shall be effective upon the date, if any, on which it is approved by the Company's shareholders. The Plan shall continue in effect, unless sooner terminated pursuant to Section 11 above, until the tenth anniversary of the date of such shareholder approval.

(i) *Governing Law.* The Plan, and all Awards granted hereunder (and the terms and conditions of any document evidencing any such grant), shall be construed in accordance with and governed by the laws of the State of Delaware, without regard to principles of conflict of laws.

(j) *No Impact On Benefits.* Except as may otherwise be specifically stated under any employee benefit plan, policy or program, Awards shall not be treated as compensation for purposes of calculating an Employee's or Agent's right or benefits under any such plan, policy or program.

(k) *No Constraint on Corporate Action.* Except as provided in Section 11 above, nothing contained in this Plan shall be construed to prevent the Company, or any affiliate, from taking any corporate action (including, but not limited to, the Company's right or power to make adjustments, reclassifications, reorganizations or changes of its capital or business structure, or to merge or consolidate, or dissolve, liquidate, sell, or transfer all or any part of its business or assets) which is deemed by it to be appropriate, or in its best interest, whether or not such action would have an adverse effect on this Plan, or any awards made under this Plan. No director, beneficiary, or other person shall have any claim against the Company, or any of its affiliates, as a result of any such action.

(l) *Indemnification.* Each member of the Board and each member of the Committee shall be indemnified and held harmless by the Company and each Employer against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such member of the Board or Committee in connection with or resulting from any claim, action, suit, or proceeding to which such member may be made a party or in which such member may be involved by reason of any action taken or failure to act under the Plan (in the absence of bad faith) and against and from any and all amounts paid by such member in settlement thereof, with the Company's approval, or paid by such member in satisfaction of any judgment in any such action, suit, or proceeding against such member, *provided that* such member shall give the Company an opportunity, at its own expense, to handle and defend the same before such member undertakes to handle and defend it individually. The foregoing right of indemnification shall not be exclusive and shall be independent of any other rights of indemnification to which any such person may be entitled under the Company's Certificate of Incorporation or By-Laws, by contract, as a matter of law, or otherwise.

(m) *Rights as a Stockholder.* A Participant shall have no rights as a stockholder with respect to any shares of Common Stock covered by any Award until the Participant shall have become the holder of record of such shares.

(n) *Captions.* The headings and captions appearing herein are inserted only as a matter of convenience. They do not define, limit, construe, or describe the scope or intent of the provisions of the Plan.

PRINCIPAL FINANCIAL GROUP, INC.
2005 DIRECTORS STOCK PLAN

ARTICLE I.
PURPOSE

The purposes of the "PRINCIPAL FINANCIAL GROUP, INC. 2005 DIRECTORS STOCK PLAN" (the "Plan") are to enable the Company to attract, retain and motivate the best qualified non-employee directors and to enhance a long-term aligning of interests between the non-employee directors and shareholders of the Company by granting equity-based awards as provided herein.

ARTICLE II.
DEFINITIONS

2.1 *Definitions.* Whenever used herein, the following terms shall have the respective meanings set forth below:

1) "Award" means an Option, an award of Restricted Stock, an award of Restricted Stock Units, or an Other Stock-Based Award.

2) "Board" means the Board of Directors of the Company.

3) "Code" means the Internal Revenue Code of 1986, as amended.

4) "Common Stock" means the common stock of the Company, par value $0.01 per share.

5) "Committee" means the Nominating and Governance Committee of the Board or such other committee of the Board as the Board shall designate from time to time.

6) "Company" means Principal Financial Group, Inc., a Delaware corporation, and any successor thereto.

7) "Domestic Partner" means any person qualifying to be treated as a domestic partner of a Participant under the applicable policies, if any, of the Company.

8) "Fair Market Value" means, on any date, the price of the last trade, regular way, in the Common Stock on such date on the New York Stock Exchange or, if at the relevant time, the Common Stock is not listed to trade on the New York Stock Exchange, on such other recognized quotation system on which the trading prices of the Common Stock are then quoted (the "applicable exchange"). In the event that *(i)* there are no Common Stock transactions on the applicable exchange on any relevant date, Fair Market Value for such date shall mean the closing price on the immediately preceding date on which Common Stock transactions were so reported and *(ii)* the applicable exchange adopts a trading policy permitting trades after 5 P.M. Eastern Standard Time ("EST"), Fair Market Value shall mean the last trade, regular way, reported on or before 5 P.M. EST (or such earlier or later time as the Committee may establish from time to time).

9) "Family Member" means, as to a Participant, any *(i)* child, stepchild, grandchild, parent, stepparent, grandparent, spouse, mother-in-law, father-in-law, son-in-law or daughter-in-law (including adoptive relationships), or Domestic Partner of such Participant, *(ii)* trusts for the exclusive benefit of one or more such persons and/or the Participant and *(iii)* other entity owned solely by one or more such persons and/or the Participant.

10) "Net Exercised" shall mean the exercise of an Option or any portion thereof by the delivery of the greatest number of whole shares of Common Stock having a Fair Market Value on the date of exercise not in excess of the difference between the aggregate Fair Market Value of the shares of Common Stock subject to the Option (or the portion of such Option then being exercised) and the aggregate exercise price for all such shares of Common Stock under the Option (or the portion thereof then being exercised), with any fractional share that would result from such equation to be payable in cash.

11) "Option" means the right to purchase one share of Common Stock at a stated purchase price on the terms specified in Article V of the Plan. The Options are nonstatutory stock options not intended to qualify under Section 422 of the Code.

12) "Other Stock-Based Award" means an award of, or related to, shares of Common Stock other than an Award of Options, Restricted Stock or Restricted Stock Units, as granted by the Committee in accordance with the provisions of Article VII hereof.

13) "Participant" means a member of the Board who is not an officer or employee of the Company or any entity controlling, controlled by, or under common control with the Company, and is not the beneficial owner of a controlling interest in the voting stock of the Company or of any entity that holds a controlling interest in the Company's voting stock.

14) "Period of Restriction" means the period specified by the Committee or established pursuant to the Plan during which a Restricted Stock or Restricted Stock Unit award is subject to forfeiture.

15) "Plan" means the Principal Financial Group, Inc. 2005 Directors Stock Plan, as set forth herein and as amended from time to time.

16) "Prior Plan" means the Principal Financial Group Inc. Directors Stock Plan.

17) "Restricted Stock" means an award of Common Stock made pursuant to Article VI that is forfeitable by the Participant until the completion of a specified period of future service as a member of the Board or until otherwise determined by the Committee or in accordance with the terms of the Plan.

18) "Restricted Stock Unit" means a contractual right awarded pursuant to Article VI that entitles the holder to receive shares of Common Stock (or the value thereof in cash) upon the completion of a specified period of future service as a member of the Board or at such other time or times determined by the Committee or in accordance with the terms of the Plan.

ARTICLE III.
ADMINISTRATION

3.1 *Rules, Interpretation and Determinations.* The Plan shall be administered by the Committee. The Committee shall have full authority to interpret and administer the Plan, to establish, amend and rescind rules for carrying out the Plan, to construe the respective option agreements and to make all other determinations and to take all other actions that it deems necessary or advisable for administering the Plan; *provided that,* no Committee member may participate in any decision with respect to such member's benefits or entitlements under the Plan, unless such decision applies generally to all non-employee directors. Each determination, interpretation or other action made or taken by the Committee shall be final and binding for all purposes and upon all persons.

3.2 *Agents and Expenses.* The Committee may appoint agents (who may be officers or employees of the Company) to assist in the administration of the Plan and may grant authority to such persons to execute agreements or other documents on its behalf. The Committee may employ such legal counsel, consultants and agents as it may deem desirable for the administration of the Plan and may rely upon any opinion received from any such counsel or consultant and any computation received from any such consultant or agent. All expenses incurred in the administration of the Plan, including, without limitation, for the engagement of any counsel, consultant or agent, shall be paid by the Company.

ARTICLE IV.
SHARES ISSUABLE

4.1 *Number of Shares.* Subject to Section 4.3 below, unless the shareholders of the Company approve an increase in such number by a shareholder vote, the maximum number of shares of Common Stock that may be made issuable or distributable under the Plan is 500,000. Shares of Common Stock to be issued under the Plan may consist, in whole or in part, of treasury shares or authorized but unissued shares not reserved for any other purpose.

4.2 *Canceled, Terminated, or Forfeited Awards.* Any shares of Common Stock subject to an Award (as determined under Section 4.1) or any award made or granted under the Prior Plan which for any reason expires without having been exercised, is canceled or terminated or otherwise is settled without the issuance of any Common Stock shall again be available for grant under the Plan. In applying the immediately preceding sentence, if *(i)* shares otherwise issuable or issued in respect of, or as part of, any Award that are withheld to cover taxes shall

not be treated as having been issued under the Plan and *(ii)* any Options are Net Exercised, only the net number of shares of Common Stock issued in respect of such Options shall be deemed issued under the Plan. In addition, shares of Common Stock tendered to exercise outstanding Options or other Awards or to cover taxes shall also be available for issuance under the Plan (and shall be counted as one share for purposes of Section 4.1), except and unless such shares are tendered more than ten years after the effective date of the Plan.

4.3 *Adjustment Due to Change in Capitalization.* In the event of any Common Stock dividend or split, recapitalization (including, but not limited, to the payment of an extraordinary dividend to the shareholders of the Company), merger, consolidation, combination, spin-off, distribution of assets to shareholders (other than ordinary cash dividends), exchange of shares, or other similar corporate change, the aggregate number of shares of Common Stock available for grant under Section 4.1 or subject to outstanding Awards and the respective exercise prices, if any, applicable to outstanding Awards may be appropriately adjusted by the Committee, in its discretion, and the Committee's determination shall be conclusive.

ARTICLE V.
AWARDS AND TERMS OF OPTIONS

5.1 *Grants of Options.* The Committee shall have the power to grant to any Participant or all Participants Options to purchase such number of shares of Common Stock, and on such terms and conditions, as it shall determine. The Committee may adopt different terms and conditions of each Option, whether granted to different Participants or the same Participant, and whether or not granted at the same time.

5.2 *Exercise Price.* The exercise price for any share of Common Stock subject to an Option shall be not less than the Fair Market Value on the date such Option is granted. No Option granted hereunder may have its exercise price reduced (other than pursuant to the provisions of Section 4.3) unless such action is expressly authorized by shareholder action in accordance with Article VIII.

5.3 *Period of Exercisability.* The Committee shall determine the date or dates at which Options become exercisable. Each Option shall, if not previously exercised in accordance with the terms of the Plan, in all events expire on the tenth (10th) anniversary of the date of the grant thereof. If a Participant shall cease to provide services to the Company, such Participant or, in the case of death, the Participant's estate or beneficiary, may exercise any Option exercisable by the Participant at the date his or her service terminated until the earlier of (A) five (5) years from the date the Participant ceased to provide services to the Company and (B) the tenth (10th) anniversary of the date the Option was granted.

5.5 *Procedure for Exercise.* The Committee shall establish procedures governing the exercise of Options. No shares shall be delivered pursuant to any exercise of any Options unless arrangements satisfactory to the Committee have been made to assure full payment of the exercise price therefor. Without limiting the generality of the foregoing, payment of the exercise price may be made *(i)* in cash or its equivalent; *(ii)* by exchanging shares of Common Stock (which are not the subject of any pledge or other security interest), subject to such terms and conditions as the Committee shall establish; *(iii)* by any combination of the foregoing; *provided* that the combined value of all cash and cash equivalents paid and the Fair Market Value of any such Common Stock tendered to the Company, valued as of the date of such tender, is at least equal to such exercise price; or *(iv)* in accordance with any other procedure or arrangement approved by the Committee, except that, in no event shall the Company loan a Participant funds or otherwise extend credit to a Participant to facilitate such Participant's exercise of any of his or her Options. Additionally, to the extent authorized by the Committee (whether at or after grant), Options may be Net Exercised subject to such terms and conditions as the Committee may from time to time impose.

ARTICLE VI.
RESTRICTED STOCK

6.1 *Standard Grants of Restricted Stock Units.* Unless otherwise determined by the Committee, on the date of each annual meeting of shareholders occurring during the term of the Plan (including, without limitation, the meeting occurring in 2005), each director in office immediately following such shareholders' meeting shall be granted the greatest whole number of Restricted Stock Units having a value (based on the 20-day average of the Fair Market Value preceding such date) not in excess of $75,000 (or such greater or lesser amount as the Committee shall determine from time to time). If a person becomes a member of the Board after the effective date of the Plan other than on the date of an annual meeting of shareholders, on or after the date of such Participant's election to the Board, such Participant shall be granted a number of Restricted Stock Units as determined by the Committee in its sole discretion.

6.2 *Discretionary Grants of Restricted Stock or Restricted Stock Units.* Without limiting the generality of Section 6.1, the Committee may also grant Restricted Stock or Restricted Stock Units to any Participant or all Participants at such times, with respect to such number of shares of Common Stock and on such terms and conditions (including, in the case of any grant made in exchange for foregoing the receipt of fees otherwise payable in cash, a discount in the value of the Common Stock subject to the award to reflect the applicable restrictions on the Award) not inconsistent with the Plan as the Committee shall determine.

6.3 *Agreements; Restrictions on Certificates.* The terms and conditions of each grant of Restricted Stock or Restricted Stock Units shall be evidenced in writing. If Restricted Stock is evidenced by the issuance of stock certificates, the Committee shall require that such stock certificates be held in the custody of the Secretary of the Company until the Period of Restriction lapses, and that, as a condition of such Restricted Stock award, the Participant shall have delivered a stock power, endorsed in blank, relating to the Common Stock covered by such Award.

6.4 *Restrictions on Transferability.* Except as provided in Section 9.2, no shares of Restricted Stock or Restricted Stock Units may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated until the lapse of the Period of Restriction. The Committee shall establish the Period of Restriction and the date or dates at which such Period of Restriction shall lapse, in whole or in part, with respect to any award made pursuant to Section 6.2. Unless otherwise determined by the Committee at the time of grant, the Period of Restriction with respect to any award of Restricted Stock Units granted under Section 6.1 shall lapse on the scheduled date of the first annual meeting of shareholders scheduled to occur after the date such Restricted Stock Units are granted. Notwithstanding the foregoing, unless otherwise determined by the Committee, the Period of Restriction applicable to any Restricted Stock or Restricted Stock Units shall not lapse, in whole or in part, at any time after the Participant has ceased to provide services to the Company.

6.5 *Distributions in Respect of Restricted Stock Units.* Unless the Committee shall otherwise determine at or prior to the time of grant, any Restricted Stock Units awarded under Section 6.1 shall not be distributed to a Participant (regardless of when such Restricted Stock Units become vested and nonforfeitable) until after the date the Participant's services as member of the Board terminate. At the time the Committee makes any grant of Restricted Stock Units pursuant to Section 6.2, the Committee shall specify when such Restricted Stock Units shall be distributed.

6.6 *Rights as a Shareholder.* Unless otherwise determined by the Committee at the time of grant and subject to Section 6.7, Participants holding shares of Restricted Stock may exercise full voting rights and other rights as a shareholder with respect to those shares during the Period of Restriction. A Participant receiving Restricted Stock Units shall not have any rights as a shareholder prior to the actual issuance of Common Stock in respect thereof in accordance with Section 6.5, except that the Participant shall be entitled to payment of dividend equivalents on such rights equal to the dividends that would have been payable (or accumulated, pursuant to Section 6.6) had the corresponding equity rights been actual shares of Restricted Stock.

6.7 *Dividends and Dividends Equivalents.* Unless otherwise determined by the Committee at the time of grant, *(i)* any cash dividends paid on shares of Restricted Stock will not be paid currently, but rather will be credited to an account established for the Participant and invested in additional shares of Common Stock based on the Fair Market Value on the distribution date for such dividends, *(ii)* any distributions paid on Restricted Stock in property other than Common Stock shall be converted into cash, which will be treated in the same manner as any cash dividends, *(iii)* any dividends or distributions paid on Restricted Stock in shares of Common Stock will be held for the benefit of the Participant and *(iv)* any additional shares credited to or held for a Participant pursuant to this Section 6.7 in respect of any such dividends or distributions on Restricted Stock shall become vested and nonforfeitable upon the same terms and conditions as are applicable to the shares underlying the Award in respect of which they were paid. With respect to any grant of Restricted Stock Units, there will be credited to an account established for the Participant dividend equivalents in respect of the dividends and distributions paid on that number of outstanding shares of Common Stock corresponding to the shares subject to such Award and such account will be administered in substantially the same manner as the account established for a Participant hereunder in respect of dividends and distributions paid on Restricted Stock (including, without limitation, the condition pertaining to vesting and forfeiture).

6.8 *Termination of Service.* Unless otherwise determined by the Committee at or after the time of grant, in the event the service of the Participant as member of the Board shall terminate for any reason, any Restricted Stock or Restricted Stock Units awarded to such Participant as to which the Period of Restriction has not lapsed shall be forfeited.

ARTICLE VII
OTHER STOCK-BASED AWARDS

7.1 *Other Stock Based Awards.* The Committee may make Other Stock-Based Awards, including, but not limited to, the outright grant of Common Stock in satisfaction of obligations of the Company under another compensatory plan, program or arrangement, modified awards intended to comply with or structured in accordance with the provisions of applicable non-U.S. law or practice, or the sale of Common Stock, in such amounts and subject to such terms and conditions as the Committee shall determine. Each such Other Stock-Based Award shall be evidenced in writing and specify the terms and conditions applicable thereto. Any such Other Stock-Based Award may entail the transfer of actual shares of Common Stock or the payment of the value of such Award in cash based upon the value of a specified number of shares of Common Stock, or any combination of the foregoing, as determined by the Committee. The terms of any Other Stock-Based Award need not be uniform in application to all (or any class of) Participants, and each Other Stock-Based Award granted to any Participant (whether or not at the same time) may have different terms.

7.2 *Termination of Employment or Service.* In addition to any other terms and conditions that may be specified by the Committee, each Other Stock-Based Award shall specify the impact of termination of services as a member of the Board upon the rights of a Participant in respect of such Award.

ARTICLE VIII
TERMINATION, MODIFICATION AND AMENDMENT

The Board may, at any time and from time to time amend, modify, suspend, or terminate this Plan, in whole or in part, without notice to or the consent of any Participant; *provided, however, that* any amendment which would *(i)* increase the number of shares available for issuance under the Plan, *(ii)* lower the minimum exercise price at which an Option may be granted or otherwise permit the repricing of any outstanding Options (other than in the context of a transaction referenced in Section 4.3), *(iii)* extend the maximum term for Options granted hereunder or *(iv)* otherwise amend the Plan in a material fashion that would require the approval of shareholders under the applicable rules and regulations of any exchange or automated quotation system on which the Common Stock is listed to trade shall be subject to the approval of the Company's shareholders. No amendment, modification, or termination of the Plan shall in any manner adversely affect any Award theretofore granted under the Plan, without the consent of the Participant.

ARTICLE IX
GENERAL PROVISIONS

9.1 *No Right to Remain as a Director.* The Plan shall not impose any obligations on the Company to retain any Participant as a Director nor shall it impose any obligation on the part of any Participant to remain in service to the Company.

9.2 *Transferability.* No Awards granted under the Plan may be sold, transferred, pledged, assigned, or otherwise alienated or hypothecated, other than in accordance with Section 9.3 below, by will or by the laws of descent and distribution; provided that the Committee may, in the appropriate award agreement or otherwise, permit transfers of Awards to Family Members (including, without limitation, transfers effected by a domestic relations order) subject to such terms and conditions as the Committee shall determine.

9.3 *Beneficiary Designation.* Each Participant under the Plan may from time to time name any beneficiary or beneficiaries (who may be named contingently or successively) to whom any benefit under the Plan is to be paid or by whom any right under the Plan is to be exercised in case of the Participant's death. Each designation will revoke all prior designations by the same Participant with respect to all Awards previously granted, shall be in a form prescribed by the Committee, and will be effective only when received by the Committee in writing during the Participant's lifetime. In the absence of any such effective designation, benefits remaining unpaid at the Participant's death shall be paid to or exercised by the Participant's surviving spouse, if any, or otherwise to or by the Participant's estate. Except as otherwise expressly provided herein, nothing in this Plan is intended or may be construed to give any person other than Participants any rights or remedies under this Plan.

9.4 *Rights as a Stockholder.* No Participant nor any beneficiary thereof shall have any rights as a stockholder with respect to any shares of Common Stock covered by any Award until such person shall have become the holder of record of such shares.

9.5 *Requirements of Law.* The granting of Awards and the issuance of shares of Common Stock shall be subject to all applicable laws, rules, and regulations, and to such approvals by any governmental agencies or national securities exchanges as may be required.

9.6 *Term of Plan.* The Plan shall be effective upon the date, if any, on which it is approved by the Company's shareholders. The Plan shall continue in effect, unless sooner terminated pursuant to Article VIII above, until the tenth anniversary of the date of such shareholder approval.

9.7 *Governing Law.* The Plan, and all agreements hereunder, shall be construed in accordance with and governed by the laws of the State of Delaware, without regard to principles of conflict of laws.

9.8 *No Constraint on Corporate Action.* Except as provided in Article VIII above, nothing contained in this Plan shall be construed to prevent the Company, or any affiliate, from taking any corporate action (including, but not limited to, the Company's right or power to make adjustments, reclassifications, reorganizations or changes of its capital or business structure, or to merge or consolidate, or dissolve, liquidate, sell, or transfer all or any part of its business or assets) which is deemed by it to be appropriate, or in its best interest, whether or not such action would have an adverse effect on this Plan, or any awards made under this Plan. No director, beneficiary, or other person shall have any claim against the Company, or any of its affiliates, as a result of any such action.

9.9 *Indemnification.* Each member of the Board and the Committee shall be indemnified and held harmless by the Company (or, if applicable, any affiliate of the Company) against and from any loss, cost, liability, or expense that may be imposed upon or reasonably incurred by such member of the Board or the Committee in connection with or resulting from any claim, action, suit, or proceeding to which such member may be made a party or in which such member may be involved by reason of any action taken or failure to act under the Plan (in the absence of bad faith) and against and from any and all amounts paid by such member in settlement thereof, with the Company's (or, if appropriate, an affiliate's) approval, or paid by such member in satisfaction of any judgment in any such action, suit, or proceeding against such member, provided that such member shall give the Company (or, if applicable, an affiliate) an opportunity, at its own expense, to handle and defend the same before such member undertakes to handle and defend it individually. The foregoing right of indemnification shall not be exclusive and shall be independent of any other rights of indemnification to which any such person may be entitled under the Company's Certificate of Incorporation or By-Laws, by contract, as a matter of law, or otherwise.

9.10 *Deferral of Payment*. At the time any Award is granted (or such earlier time as the Committee may require), the Committee may permit a Participant to elect, upon such terms and conditions as the Committee may establish, to defer receipt of shares of Common Stock that would otherwise be issued in connection with an Award.

9.11 *Headings and Captions.* The headings and captions herein are provided for reference and convenience only, shall not be considered part of the Plan, and shall not be employed in the construction of the Plan.

Principal Financial Group, Inc.

Computation of Earnings to Fixed Charges Ratio

	For the six months ended June 30,		For the year ended December 31,				
	2005	**2004**	**2004**	**2003**	**2002**	**2001**	**2000**
	($ in millions)						
1. Income from continuing operations before income taxes	**$ 563.0**	$ 370.0	$ 879.3	$ 822.2	$ 371.5	$ 249.9	$ 751.1
2. Interest expense	**34.3**	60.1	96.9	120.3	108.9	94.8	116.8
3. Interest factor of rental expense	**2.3**	2.3	4.6	4.8	8.0	9.4	15.1
4. Undistributed income from equity investees	**(15.6)**	(4.5)	(19.4)	(18.3)	4.3	(17.4)	(27.1)
5. Earnings before interest credited on investment products	**584.0**	427.9	961.4	929.0	492.7	336.7	855.9
6. Interest credited on investment products.	**409.1**	365.6	763.7	735.7	743.4	773.1	723.5
7. Earnings	**$ 993.1**	$ 793.5	$ 1,725.1	$ 1,664.7	$ 1,236.1	$ 1,109.8	$ 1,579.4
8. Interest expense	**$ 34.3**	$ 60.1	$ 96.9	$ 120.3	$ 108.9	$ 94.8	$ 116.8
9. Interest factor of rental expense	**2.3**	2.3	4.6	4.8	8.0	9.4	15.1
10. Preferred stock dividend requirements of majority-owned subsidiaries (non-intercompany)	**—**	—	—	1.2	0.4	—	—
11. Fixed charges before interest credited on investment products	**36.6**	62.4	101.5	126.3	117.3	104.2	131.9
12. Interest credited on investment products.	**409.1**	365.6	763.7	735.7	743.4	773.1	723.5
13. Fixed charges	**$ 445.7**	$ 428.0	$ 865.2	$ 862.0	$ 860.7	$ 877.3	$ 855.4
14. Ratio of earnings to fixed charges before interest credited on investment products (Line item 5/Line item 11)	**16.0**	6.9	9.5	7.4	4.2	3.2	6.5
15. Ratio of earnings to fixed charges (Line item 7/Line item 13)	**2.2**	1.9	2.0	1.9	1.4	1.3	1.8

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: August 3, 2005

/s/ J. Barry Griswell
J. Barry Griswell
Chairman, President 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: August 3, 2005

/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 June 30, 2005 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10-Q for the quarter ended June 30, 2005 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, President and Chief Executive Officer
Date: August 3, 2005

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 June 30, 2005 fully complies with the requirements of Section 13(a) of the Securities Exchange Act of 1934 and (ii) the information contained in the Form 10-Q for the quarter ended June 30, 2005 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: August 3, 2005