PRINCIPAL FINANCIAL GROUP INC
Form 10-Q
May 06, 2009
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

---

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

For the quarterly period ended March 31, 2009

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 x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

Large Accelerated Filer x	Accelerated Filer o
Non-accelerated Filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The total number of shares of the registrant s Common Stock, $0.01 par value, outstanding as of April 29, 2009, was 259,993,890.

Table of Contents

PRINCIPAL FINANCIAL GROUP, INC.

TABLE OF CONTENTS

		Page
Part I - FINANCIAL INFORMATION		
Item 1.	Financial Statements	3
	Consolidated Statements of Financial Position at March 31, 2009 (Unaudited) and December 31, 2008	3
	Unaudited Consolidated Statements of Operations for the three months ended March 31, 2009 and 2008	4
	Unaudited Consolidated Statements of Stockholders Equity for the three months ended March 31, 2009 and 2008	5
	Unaudited Consolidated Statements of Cash Flows for the three months ended March 31, 2009 and 2008	6
	Notes to Unaudited Consolidated Financial Statements March 31, 2009	8
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	55
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	92
Item 4.	Controls and Procedures	97
Part II OTHER INFORMATION		
Item 1.	Legal Proceedings	98
Item 1A.	Risk Factors	98
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	98
Item 6.	Exhibits	99
Signature		100

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.
Consolidated Statements of Financial Position

	March 31, 2009 (Unaudited)	December 31, 2008
	(in millions)	
Assets		
Fixed maturities, available-for-sale	**$ 39,997.9**	$ 40,117.2
Fixed maturities, trading	**821.4**	843.4
Equity securities, available-for-sale	**192.8**	242.7
Equity securities, trading	**126.2**	158.0
Mortgage loans	**12,927.6**	13,113.6
Real estate	**930.0**	919.4
Policy loans	**894.8**	896.4
Other investments	**2,582.7**	2,816.6
Total investments	**58,473.4**	59,107.3
Cash and cash equivalents	**2,699.6**	2,608.0
Accrued investment income	**784.6**	750.7
Premiums due and other receivables	**1,183.0**	988.1
Deferred policy acquisition costs	**4,374.7**	4,153.0
Property and equipment	**517.2**	518.2
Goodwill	**379.9**	375.5
Other intangibles	**880.4**	925.3
Separate account assets	**50,534.2**	55,142.6
Other assets	**3,407.8**	3,613.7
Total assets	**$ 123,234.8**	$ 128,182.4
Liabilities		
Contractholder funds	**$ 42,568.3**	$ 43,086.6
Future policy benefits and claims	**18,636.6**	18,494.2
Other policyholder funds	**557.6**	536.2
Short-term debt	**530.8**	500.9
Long-term debt	**1,292.7**	1,290.5
Income taxes currently payable	**1.2**	1.9
Deferred income taxes	**107.4**	102.8
Separate account liabilities	**50,534.2**	55,142.6
Other liabilities	**6,297.1**	6,457.4
Total liabilities	**120,525.9**	125,613.1
Stockholders equity		
Series A preferred stock, par value $.01 per share with liquidation preference of $100 per share - 3.0 million shares authorized, issued and outstanding in 2009 and 2008		
Series B preferred stock, par value $.01 per share with liquidation preference of $25 per share - 10.0 million shares authorized, issued and outstanding in 2009 and 2008	**0.1**	0.1
Common stock, par value $.01 per share - 2,500.0 million shares authorized, 387.9 million and 387.0 million shares issued, and 260.0 million and 259.3 million shares outstanding in 2009 and 2008, respectively	**3.9**	3.9
Additional paid-in capital	**8,342.1**	8,376.5
Retained earnings	**3,845.2**	3,722.5
Accumulated other comprehensive loss	**(4,841.1)**	(4,911.6)
Treasury stock, at cost (127.9 million and 127.7 million shares in 2009 and 2008, respectively)	**(4,721.6)**	(4,718.6)
Total stockholders equity attributable to Principal Financial Group, Inc.	**2,628.6**	2,472.8
Noncontrolling interest	**80.3**	96.5
Total stockholders equity	**2,708.9**	2,569.3
Total liabilities and stockholders equity	**$ 123,234.8**	$ 128,182.4

See accompanying notes.

3

Table of Contents

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

	For the three months ended March 31, 2009	2008
	(in millions, except per share data)	
Revenues		
Premiums and other considerations	**$ 949.9**	$ 1,053.0
Fees and other revenues	**473.5**	613.4
Net investment income	**828.5**	960.3
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	**32.7**	(58.5)
Total other-than-temporary impairment losses on available-for-sale securities	**(146.6)**	(67.5)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income	**50.6**	
Net impairment losses on available-for-sale securities	**(96.0)**	(67.5)
Net realized capital losses	**(63.3)**	(126.0)
Total revenues	**2,188.6**	2,500.7
Expenses		
Benefits, claims and settlement expenses	**1,306.6**	1,472.0
Dividends to policyholders	**63.5**	70.8
Operating expenses	**688.4**	750.7
Total expenses	**2,058.5**	2,293.5
Income before income taxes	**130.1**	207.2
Income taxes	**7.5**	29.6
Net income	**122.6**	177.6
Net income (loss) attributable to noncontrolling interest	**1.6**	(4.8)
Net income attributable to Principal Financial Group, Inc.	**121.0**	182.4
Preferred stock dividends	**8.2**	8.2
Net income available to common stockholders	**$ 112.8**	$ 174.2
Earnings per common share		
Basic earnings per common share	**$ 0.43**	$ 0.67
Diluted earnings per common share	**$ 0.43**	$ 0.67

See accompanying notes.

4

Table of Contents

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

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Noncontrolling interest	Total stockholders equity
					(in millions)				
Balances at January 1, 2008	$	$ 0.1	$ 3.9	$ 8,295.4	$ 3,414.3	$ 420.2	$ (4,712.2)	$ 97.6	$ 7,519.3
Common stock issued				9.3					9.3
Capital transactions of equity method investee, net of related income taxes				0.1					0.1
Stock-based compensation and additional related tax benefits				21.3					21.3
Treasury stock acquired, common							(6.1)		(6.1)
Dividends to preferred stockholders					(8.2)				(8.2)
Dividends to noncontrolling interest								(5.0)	(5.0)
Capital received from noncontrolling interest								9.0	9.0
Effects of changing post-retirement benefit plan measurement date, net of related income taxes					0.9	(2.0)			(1.1)
Comprehensive loss:									
Net income					182.4			(4.8)	177.6
Net unrealized losses, net						(838.1)			(838.1)
Foreign currency translation adjustment, net of related income taxes						62.8		(0.1)	62.7
Unrecognized post-retirement benefit obligation, net of related income taxes						(2.0)			(2.0)
Comprehensive loss									(599.8)
Balances at March 31, 2008	$	$ 0.1	$ 3.9	$ 8,326.1	$ 3,589.4	$ (359.1)	$ (4,718.3)	$ 96.7	$ 6,938.8
Balances at January 1, 2009	**$**	**$ 0.1**	**$ 3.9**	**$ 8,376.5**	**$ 3,722.5**	**$ (4,911.6)**	**$ (4,718.6)**	**$ 96.5**	**$ 2,569.3**
Common stock issued				**4.0**					**4.0**
Stock-based compensation and additional related tax benefits				**7.0**					**7.0**
Treasury stock acquired, common							**(3.0)**		**(3.0)**
Dividends to preferred stockholders					**(8.2)**				**(8.2)**
Dividends to noncontrolling interest								**(2.3)**	**(2.3)**
Purchase of subsidiary shares from noncontrolling interest				**(45.4)**				**(0.2)**	**(45.6)**
Capital paid to noncontrolling interest								**(15.1)**	**(15.1)**
Effects of reclassifying noncredit component of previously recognized impairment losses on fixed maturities, available-for-sale, net					**9.9**	**(9.9)**			
Comprehensive income:									
Net income					**121.0**			**1.6**	**122.6**
Net unrealized gains, net						**79.9**			**79.9**
Noncredit component of impairment losses on fixed maturities, available-for-sale, net						**(32.6)**			**(32.6)**
Foreign currency translation adjustment, net of related						**18.1**		**(0.2)**	**17.9**

income taxes									
Unrecognized post-retirement benefit obligation, net of related income taxes						**15.0**			**15.0**
Comprehensive income									**202.8**
Balances at March 31, 2009	**$**	**$ 0.1**	**$ 3.9**	**$ 8,342.1**	**$ 3,845.2**	**$ (4,841.1)**	**$ (4,721.6)**	**$ 80.3**	**$ 2,708.9**

See accompanying notes.

5

Table of Contents

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

	For the three months ended March 31, 2009	2008
	(in millions)	
Operating activities		
Net income	**$ 122.6**	$ 177.6
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred policy acquisition costs	**85.1**	69.3
Additions to deferred policy acquisition costs	**(143.8)**	(168.7)
Accrued investment income	**(33.9)**	(22.7)
Net cash flows from trading securities	**74.6**	25.9
Premiums due and other receivables	**(42.9)**	23.9
Contractholder and policyholder liabilities and dividends	**281.9**	507.3
Current and deferred income taxes	**8.2**	34.5
Net realized capital losses	**63.3**	126.0
Depreciation and amortization expense	**33.3**	33.8
Mortgage loans held for sale, acquired or originated	**(10.3)**	(14.0)
Mortgage loans held for sale, sold or repaid, net of gain	**12.2**	15.3
Real estate acquired through operating activities	**(16.3)**	(10.2)
Real estate sold through operating activities		7.2
Stock-based compensation	**5.3**	17.2
Other	**510.6**	175.4
Net adjustments	**827.3**	820.2
Net cash provided by operating activities	**949.9**	997.8
Investing activities		
Available-for-sale securities:		
Purchases	**(1,771.9)**	(1,905.8)
Sales	**765.8**	120.8
Maturities	**892.7**	1,044.0
Mortgage loans acquired or originated	**(92.9)**	(431.9)
Mortgage loans sold or repaid	**283.5**	286.6
Real estate acquired	**(3.7)**	(6.2)
Real estate sold	**0.4**	17.2
Net purchases of property and equipment	**(13.2)**	(26.1)
Purchases of interest in subsidiaries, net of cash acquired	**(34.2)**	(2.3)
Net change in other investments	**(13.1)**	(65.1)
Net cash provided by (used in) investing activities	**$ 13.4**	$ (968.8)

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

	For the three months ended, March 31, 2009	2008
	(in millions)	
Financing activities		
Issuance of common stock	**$ 4.0**	$ 9.3
Acquisition of treasury stock	**(3.0)**	(6.1)
Proceeds from financing element derivatives	**36.8**	43.0
Payments for financing element derivatives	**(25.0)**	(37.5)
Excess tax benefits from share-based payment arrangements	**0.1**	2.5
Dividends to preferred stockholders	**(8.2)**	(8.2)
Issuance of long-term debt		1.0
Principal repayments of long-term debt	**(4.9)**	(4.9)
Net proceeds (repayments) of short-term borrowings	**27.7**	(121.5)
Investment contract deposits	**1,886.2**	2,283.5
Investment contract withdrawals	**(2,819.4)**	(2,599.1)
Net increase in banking operation deposits	**35.5**	186.9
Other	**(1.5)**	(1.6)
Net cash used in financing activities	**(871.7)**	(252.7)
Net increase (decrease) in cash and cash equivalents	**91.6**	(223.7)
Cash and cash equivalents at beginning of period	**2,608.0**	1,344.4
Cash and cash equivalents at end of period	**$ 2,699.6**	$ 1,120.7

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
March 31, 2009
(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (PFG), its majority-owned subsidiaries and its consolidated variable interest entities (VIEs), have been prepared in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2009, are not necessarily indicative of the results that may be expected for the year ended December 31, 2009. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2008, included in our Form 10-K for the year ended December 31, 2008, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2008, 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 prior period financial statements to conform to the March 31, 2009, presentation. See Recent Accounting Pronouncements for impact of new accounting guidance on prior period financial statements.

Recent Accounting Pronouncements

On April 9, 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments* (FSP FAS 115-2). FSP FAS 115-2 provides new guidance on the recognition and presentation of an other-than-temporary impairment (OTTI) and requires additional disclosures. The recognition provisions within FSP FAS 115-2 apply only to debt securities classified as available-for-sale and held-to-maturity, while the presentation and disclosure requirements of FSP FAS 115-2 apply to both debt and equity securities. An impaired debt security will be considered other-than-temporarily impaired if a holder has the intent to sell, or it more likely than not will be required to sell prior to recovery of the amortized cost. If a holder of a debt security does not expect recovery of the entire cost basis, even if there is no intention to sell the security, it will be considered an OTTI as well. FSP FAS 115-2 also changes how an entity recognizes an OTTI for a debt security by separating the loss between the amount representing the credit loss and the amount relating to other factors, if a holder does not have the intent to sell or it more likely than not will not be required to sell prior to recovery of the amortized cost less any current period credit loss. Credit losses will be recognized in net income and losses relating to other factors will be recognized in other comprehensive income (OCI). If the holder has the intent to sell or it more likely than not will be required to sell before its recovery of amortized cost less any current period credit loss, the entire OTTI will continue to be recognized in net income. FSP FAS 115-2 is effective for interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. FSP FAS 115-2 requires a cumulative effect adjustment to the opening balance of retained earnings in the period of adoption with a corresponding adjustment to accumulated OCI. We adopted FSP FAS 115-2 effective January 1, 2009. The cumulative change in accounting principle from adopting this guidance resulted in a net $9.9 million increase to retained earnings and a corresponding decrease to accumulated OCI. The required disclosures have been included in our consolidated financial statements.

On April 9, 2009, the FASB issued FSP FAS 157-4, *Determining Fair Value When Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP FAS 157-4). FSP FAS 157-4 amends Statement of Financial Accounting Standards (SFAS) No. 157, *Fair Value Measurements* (SFAS 157), to provide additional guidance on estimating fair value when the volume and level of activity for an asset or liability have significantly decreased in relation to normal market activity for the asset or liability and clarifies that the use of multiple valuation techniques may be appropriate. FSP FAS 157-4 also provides additional guidance on circumstances that may indicate a transaction is not orderly. Further, this FSP requires additional disclosures about fair value measurements in annual and interim reporting periods and supersedes FSP FAS 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active*. FSP FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We adopted FSP FAS 157-4 effective January 1, 2009, and this guidance did not have a material impact on our consolidated financial statements. See Note 8, Fair Value of Financial Instruments, for further details.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

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

Also on April 9, 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures About Fair Value of Financial Instruments* (FSP FAS 107-1). FSP FAS 107-1 extends the annual disclosure requirements of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to interim financial statements of public companies. FSP FAS 107-1 is effective for interim reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. We will adopt FSP FAS 107-1 for the quarter ended June 30, 2009, which is not expected to have a material impact on our consolidated financial statements.

On March 19, 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). This statement requires (1) qualitative disclosures about objectives and strategies for using derivatives, (2) quantitative disclosures about fair value amounts of gains and losses on derivative instruments and related hedged items and (3) disclosures about credit-risk-related contingent features in derivative instruments. The disclosures are intended to provide users of financial statements with an enhanced understanding of how and why derivative instruments are used, how they are accounted for and the financial statement impacts. We adopted SFAS 161 on January 1, 2009. See Note 3, Derivative Financial Instruments, for further details.

On December 4, 2007, the FASB issued SFAS No. 141(R), *Business Combinations* (SFAS 141(R)). Among the changes, the standard requires that the acquiring entity in a business combination establish the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed, including any noncontrolling interests, and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. In addition, SFAS 141(R) requires direct acquisition costs to be expensed. We adopted SFAS 141(R) on January 1, 2009. All requirements of SFAS 141(R) are applied prospectively.

Also on December 4, 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements an Amendment of Accounting Research Bulletin No. 51* (SFAS 160). Under this statement, noncontrolling interests are to be treated as a separate component of equity, rather than as a liability or other item outside of equity. In addition, SFAS 160 changes the way the consolidated income statement is presented. Under this statement, net income includes the total income of all consolidated subsidiaries, with separate disclosures on the face of the income statement of the income attributable to controlling and noncontrolling interests. Previously, net income attributable to the noncontrolling interest was reported as an operating expense in arriving at consolidated net income. Finally, SFAS 160 revises the accounting requirements for changes in a parent s ownership interest while the parent retains control and for changes in a parent s ownership interest that results in deconsolidation. We adopted SFAS 160 on January 1, 2009. Presentation and disclosure requirements have been applied retrospectively for all periods presented. All other requirements of SFAS 160 should be applied prospectively. Certain separate account arrangements involve ownership of mutual funds to support the investment objective of the separate account. It is possible that, through a separate account arrangement, greater than 50% of the mutual fund shares could be owned. The accounting guidance for this circumstance is not well defined, but we, like many other insurers, do not consolidate the mutual fund as we believe the arrangement qualifies for the exemption afforded investment companies. In January 2009, the FASB asked the Emerging Issues Task Force (EITF) to consider a topic entitled Consideration of an Insurer s Accounting for Majority Owned Investments When the Ownership is through a Separate Account. It is anticipated that the EITF will consider the issue in 2009. It is not possible to predict the outcome of the deliberations with any certainty; however, one outcome could be the recognition of the portion of the mutual fund not held via the separate account arrangement as a noncontrolling interest in equity.

Separate Accounts

As of March 31, 2009, and December 31, 2008, the separate accounts include a separate account valued at $73.2 million and $207.4 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. The separate account shares are recorded at fair value and are reported as separate account assets and separate account liabilities in the consolidated statements of financial position. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

2. Investments

Fixed Maturities and Equity Securities

Fixed maturity securities include bonds, mortgage-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock and nonredeemable preferred stock. We classify fixed maturity securities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 8, Fair Value of Financial Instruments, for policies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders equity, net of adjustments related to deferred policy acquisition costs (DPAC), sales inducements, unearned revenue reserves, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to trading securities and available-for-sale securities in fair value hedging relationships are reflected in net income as net realized capital gains (losses).

The cost of fixed maturity securities is adjusted for amortization of premiums and accrual of discounts, both computed using the interest method. The cost of fixed maturity securities and equity securities is adjusted for other-than temporary impairments recognized in net income. For loan-backed and structured securities, we recognize income using a constant effective yield based on currently anticipated prepayments using a tool that models the prepayment behavior of the underlying collateral based on the current interest rate environment.

The amortized cost, gross unrealized gains and losses, other-than-temporary impairments in OCI and fair value of fixed maturities and equity securities available-for-sale as of March 31, 2009, are summarized as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Other-than-temporary impairments in OCI	Fair value
			(in millions)		
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 582.9	$ 10.4	$ 0.4	$	$ 592.9
Non-U.S. governments	731.8	74.9	13.8		792.9
States and political subdivisions	2,018.9	35.8	67.8		1,986.9
Corporate	33,803.5	354.0	5,208.4	14.2	28,934.9
Residential mortgage-backed securities	2,001.2	70.7	1.0		2,070.9
Commercial mortgage-backed securities	5,583.6	6.6	2,050.6	25.0	3,514.6
Collateralized debt obligations	662.7		397.9	10.8	254.0
Other debt obligations	2,378.8	16.6	526.5	18.1	1,850.8

Total fixed maturities, available-for-sale	$	**47,763.4**	$	**569.0**	$	**8,266.4**	$	**68.1**	$	**39,997.9**
Total equity securities, available-for-sale	$	**310.3**	$	**15.4**	$	**132.9**	$		$	**192.8**

The amortized cost and fair value of fixed maturities available-for-sale at March 31, 2009, by contractual maturity, were as follows:

		Amortized cost		Fair value
		(in millions)		
Due in one year or less	$	**1,581.8**	$	**1,556.8**
Due after one year through five years		**13,402.4**		**12,527.0**
Due after five years through ten years		**10,142.2**		**8,689.3**
Due after ten years		**12,010.7**		**9,534.5**
		37,137.1		**32,307.6**
Mortgage-backed and other asset-backed securities		**10,626.3**		**7,690.3**
Total	$	**47,763.4**	$	**39,997.9**

Actual maturities may differ because issuers may have the right to call or prepay obligations.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

2. Investments (continued)

Our portfolio is diversified by industry, issuer and asset class. Credit concentrations are managed to established limits.

Net Realized Capital Gains and Losses

The major components of net realized capital gains (losses) on investments are summarized as follows:

		For the three months ended March 31, 2009 (in millions)
Fixed maturities, available-for-sale:		
Gross gains	$	49.4
Gross losses		(156.8)
Portion of impairment losses recognized in other comprehensive income		50.6
Hedging (net)		(53.4)
Fixed maturities, trading		23.6
Equity securities, available-for-sale:		
Gross gains		6.8
Gross losses		(0.6)
Equity securities, trading		(9.6)
Mortgage loans		(35.5)
Derivatives		68.2
Other		(6.0)
Net realized capital losses	$	(63.3)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were $0.9 billion for the three months ended March 31, 2009.

Other-Than-Temporary Impairments

We have a process in place to identify fixed maturity and equity 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 review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events and (4) for fixed maturity securities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized.

During first quarter 2009 we adopted FSP FAS 115-2, which changes the recognition and presentation of other-than-temporary impairments. See further discussion of the adoption in Note 1, Nature of Operations and Significant Accounting Policies. The recognition provisions within FSP FAS 115-2 apply only to debt securities classified as available-for-sale and held-to-maturity, while the presentation and disclosure requirements of FSP FAS 115-2 apply to both debt and equity securities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

2. Investments (continued)

Impairment losses on equity securities are recognized in net income. The way in which impairment losses on debt securities are recognized in the financial statements is dependent on the facts and circumstances related to the specific security. If we intend to sell a security or it is more likely than not that we would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, we recognize an other-than-temporary impairment in net income for the difference between amortized cost and fair value. If we do not expect to recover the amortized cost basis, we do not plan to sell the security and if it is not more likely than not that we would be required to sell a security before the recovery of its amortized cost, less any current period credit loss, the recognition of the other-than-temporary impairment is bifurcated. We recognize the credit loss portion in net income and the noncredit loss portion in OCI.

We estimate the amount of the credit loss component of a debt security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The asset-backed securities cash flow estimates are based on bond specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate bond cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or the disposition of assets using bond specific facts and circumstances including timing, security interests and loss severity.

Total other-than-temporary impairment losses on fixed maturity securities were $152.7 million for the three months ended March 31, 2009. The net recoveries from the sale of previously impaired equity securities were $6.1 million for the three months ended March 31, 2009.

The other-than-temporary impairments on fixed maturity securities for which an amount related to credit losses was recognized in net realized capital gains (losses) and an amount related to noncredit losses was recognized in OCI is summarized as follows:

	For the three months ended March 31, 2009 (in millions)	
Total other-than-temporary impairments on fixed maturity securities for which an amount related to noncredit losses was recognized in OCI (1)	**$**	**(99.2)**
Noncredit loss recognized in OCI		**50.6**
Credit loss impairment recognized in net income	**$**	**(48.6)**

(1) Total other-than-temporary impairment losses on available-for-sale securities reported in the consolidated statements of operations also include $53.5 million of impairment losses on fixed maturities for which total impairment losses are recognized in net income and $6.1 million of net recoveries from the sale of previously impaired equity securities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

2. Investments (continued)

The other-than-temporary impairments of fixed maturity securities for which only the amount related to credit losses was recognized in net realized capital gains (losses) on the consolidated statements of operations is summarized as follows:

	For the three months ended March 31, 2009 (in millions)	
Beginning balance	$	**(18.5)**
Credit losses for which an other-than-temporary impairment was not previously recognized		**(48.0)**
Credit losses for which an other-than-temporary impairment was previously recognized		**(0.6)**
Ending balance	$	**(67.1)**

Gross Unrealized Losses for Fixed Maturities and Equity Securities

For fixed maturities and equity securities available-for-sale with unrealized losses, including other-than-temporary impairment losses reported in OCI, as of March 31, 2009, the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as follows:

	Less than twelve months		Greater than or equal to twelve months		Total	
	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses
			(in millions)			
Fixed maturities, available-for-sale:						
U.S. government and agencies	$ **28.4**	$ **0.4**	$	$	$ **28.4**	$ **0.4**
Non-U.S. governments	**46.8**	**6.7**	**69.8**	**7.1**	**116.6**	**13.8**
States and political subdivisions	**552.0**	**20.8**	**479.7**	**47.0**	**1,031.7**	**67.8**
Corporate	**9,860.1**	**1,315.0**	**10,999.8**	**3,907.6**	**20,859.9**	**5,222.6**
Residential mortgage-backed securities	**162.5**	**0.8**	**4.6**	**0.2**	**167.1**	**1.0**
Commercial mortgage-backed securities	**1,620.8**	**543.3**	**1,580.6**	**1,532.3**	**3,201.4**	**2,075.6**
Collateralized debt obligations	**30.9**	**12.0**	**221.6**	**396.7**	**252.5**	**408.7**
Other debt obligations	**303.9**	**60.3**	**1,100.3**	**484.3**	**1,404.2**	**544.6**

Total fixed maturities, available-for-sale	**$**	**12,605.4**	**$**	**1,959.3**	**$**	**14,456.4**	**$**	**6,375.2**	**$**	**27,061.8**	**$**	**8,334.5**
Total equity securities, available-for-sale	**$**	**76.4**	**$**	**65.0**	**$**	**61.0**	**$**	**67.9**	**$**	**137.4**	**$**	**132.9**

As of March 31, 2009, we held $27,061.8 million in available-for-sale fixed maturity securities with unrealized losses of $8,334.5 million. Of these amounts, Principal Life s consolidated portfolio represented $26,293.2 million in available-for-sale fixed maturity securities with unrealized losses of $8,247.3 million. Principal Life s consolidated portfolio consists of fixed maturity securities where 91% are investment grade (rated AAA through BBB-) with an average price of 76 (carrying value/amortized cost) at March 31, 2009. Due to the credit disruption that began in the last half of 2007 and continued into 2009, which reduced liquidity and led to wider credit spreads, we saw an increase in unrealized losses in our securities portfolio. The unrealized losses were more pronounced in the Corporate sector and in structured products, such as commercial mortgage-backed securities, collateralized debt obligations and asset-backed securities.

For those securities that have been in a loss position for less than twelve months, Principal Life s consolidated portfolio holds 1,265 securities with a carrying value of $12,019.1 million and unrealized losses of $1,911.6 million reflecting an average price of 86 at March 31, 2009. Of this portfolio, 92% was investment grade (rated AAA through BBB-) at March 31, 2009, with associated unrealized losses of $1,642.9 million. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

2. Investments (continued)

For those securities that have been in a continuous loss position greater than or equal to twelve months, Principal Life s consolidated portfolio holds 2,067 securities with a carrying value of $14,274.1 million and unrealized losses of $6,335.7 million. The average rating of this portfolio is A- with an average price of 69 at March 31, 2009. Of the $6,335.7 million in unrealized losses, the Corporate sector accounts for $3,868.3 million in unrealized losses with an average price of 74 and an average credit rating of BBB+. The remaining unrealized losses consist primarily of $1,532.3 million in unrealized losses within the commercial mortgage-backed securities sector at March 31, 2009. The average price of the commercial mortgage-backed securities sector is 51 and the average credit rating is AA-. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because it is not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it is not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we do not consider these investments to be other-than-temporarily impaired at March 31, 2009.

Net Unrealized Gains and Losses on Available-for-Sale Securities and Derivative Instruments

The net unrealized gains and losses on investments in fixed maturities available-for-sale, equity securities available-for-sale and derivative instruments are reported as a separate component of stockholders equity. The cumulative amount of net unrealized gains and losses on available-for-sale securities and derivative instruments net of adjustments related to DPAC, sales inducements, unearned revenue reserves, changes in policyholder benefits and claims and applicable income taxes was as follows:

		March 31, 2009 (in millions)
Net unrealized losses on fixed maturities, available-for-sale (1)	$	**(7,697.4)**
Noncredit component of impairment losses on fixed maturities, available-for-sale		**(50.6)**
Net unrealized losses on equity securities, available-for-sale		**(117.5)**
Adjustments for assumed changes in amortization patterns		**1,347.0**
Adjustments for assumed changes in liability for policyholder benefits and claims		**(36.0)**
Net unrealized gains on derivative instruments		**24.4**
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments		**167.3**
Provision for deferred income taxes		**2,239.3**
Effect of reclassifying noncredit component of previously recognized impairment losses on fixed maturities, available-for-sale, net		**(9.9)**
Net unrealized losses on available-for-sale securities and derivative instruments	$	**(4,133.4)**

(1) Excludes net unrealized gains (losses) on fixed maturities, available-for-sale included in fair value hedging relationships.

Securities Posted as Collateral

We posted $767.7 million in fixed maturities, available-for-sale securities at March 31, 2009, to satisfy collateral requirements primarily associated with our derivative credit support annex (collateral) agreements and a reinsurance arrangement. In addition, we posted $1,458.7 million in commercial and residential mortgage-backed securities and commercial mortgage loans as of March 31, 2009, to satisfy collateral requirements associated with our obligation under funding agreements with the Federal Home Loan Bank of Des Moines.

3. Derivative Financial Instruments

Derivatives are generally used to hedge or reduce exposure to market risks associated with assets held or expected to be purchased or sold and liabilities incurred or expected to be incurred. Derivatives are used to change the characteristics of our asset/liability mix consistent with our risk management activities. Derivatives are also used in asset replication strategies. We do not buy, sell or hold these investments for trading purposes.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Types of Derivative Instruments

Interest Rate Contracts

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Sources of interest rate risk include the difference between the maturity and interest rate changes of assets with the liabilities they support, timing differences between the pricing of liabilities and the purchase or procurement of assets and changing cash flow profiles from original projections due to prepayment options embedded within asset and liability contracts. We use various derivatives to manage our exposure to fluctuations in interest rates.

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. Cash is paid or received based on the terms of the swap. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities arising from timing mismatches between assets and liabilities (including duration mismatches). We also use interest rate swaps to hedge against changes in the value of assets we anticipate acquiring and other anticipated transactions and commitments. Interest rate swaps are used to hedge against changes in the value of the guaranteed minimum withdrawal benefit (GMWB) liability. The GMWB rider on our variable annuity products provides for guaranteed minimum withdrawal benefits regardless of the actual performance of various equity and/or fixed income funds available with the product.

A swaption is an option to enter into an interest rate swap at a future date. We write these options and receive a premium in order to transform our callable liabilities into fixed term liabilities. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

In exchange-traded futures transactions, we agree to purchase or sell a specified number of contracts, the values of which are determined by the values of designated classes of securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. We enter into exchange-traded futures with regulated futures commissions merchants who are members of a trading exchange. We have used exchange-traded futures to reduce market risks from changes in interest rates and to alter mismatches between the assets in a portfolio and the liabilities supported by those assets.

A treasury lock is an agreement that allows the holder to lock in an interest rate. If the interest rate increases, the holder is entitled to receive a payment from the counterparty to the agreement equal to the present value of the difference in the current interest rate and the locked-in interest rate. If the interest rate decreases, the holder must pay the counterparty to the agreement an amount equal to the present value of the difference in the current interest rate and the locked-in interest rate. We have used treasury lock agreements to hedge against changes in the value of anticipated transactions and commitments.

Foreign Exchange Contracts

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 we issue, foreign currency-denominated fixed maturity securities we invest in and our investment in and net income of our international operations. We may use currency swaps and currency forwards to hedge foreign currency risk.

Currency swaps are contracts in which we agree with other parties to exchange, at specified intervals, a series of principal and interest payments in one currency for that of another currency. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. The interest payments are primarily fixed-to-fixed rate; however, may also be fixed-to-floating rate or floating-to-fixed rate. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date. We use currency swaps to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Currency forwards are contracts in which we agree with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell. We have also used currency forwards to hedge the currency risk associated with net investments in foreign operations.

Equity Contracts

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in common stock. We use various derivatives to manage our exposure to equity risk, which arises from products in which the interest we credit is tied to an external equity index as well as products subject to minimum contractual guarantees.

We may sell an investment-type insurance contract with attributes tied to market indices (an embedded derivative as noted below), in which case we write an equity call option to convert the overall contract into a fixed-rate liability, essentially eliminating the equity component altogether. We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity products that credit interest based on changes in an external equity index. We use exchange-traded futures and equity put options to hedge against changes in the value of the GMWB liability related to the GMWB rider on our variable annuity product, as previously explained.

Credit Contracts

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also occasionally used to hedge credit exposures in our investment portfolio. Credit derivatives are used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name s credit spread at the time the agreement is executed. In cases where we sell protection, at the same time we enter into these synthetic transactions, we buy a quality cash bond to match against the credit default swap. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Other Contracts

Commodity swaps are used to sell or buy protection on commodity prices in return for receiving or paying a quarterly premium. We purchased AAA rated secured limited recourse notes from VIEs that are consolidated in our financial results. These VIEs use a commodity swap to enhance the return on an investment portfolio by selling protection on a static portfolio of commodity trigger swaps, each referencing a base or precious metal. The portfolio of commodity trigger swaps is a portfolio of deep out-of-the-money European puts on various base or precious metals. The VIEs provide mezzanine protection that the average spot rate will not fall below a certain trigger price on each commodity trigger swap in the portfolio and receive guaranteed quarterly premiums in return until maturity. At the same time the VIEs enter into this synthetic transaction, they buy a quality cash bond to match against the commodity swaps.

We purchase or issue certain financial instruments or products that contain a derivative instrument that is embedded in the financial instrument or product. When it is determined that the embedded derivative possesses economic characteristics that are not clearly or closely related to the economic characteristics of the host contract and a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is bifurcated from the host for measurement purposes. The embedded derivative, which is reported with the host instrument in the consolidated statements of financial position, is carried at fair value.

Embedded Derivatives. We sell investment-type insurance contracts in which the return is tied to an external equity index, a leveraged inflation index or leveraged reference swap. We economically hedge the risk associated with these investment-type insurance contracts.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

We offer group benefit plan contracts that have guaranteed separate accounts as an investment option. We also offer a guaranteed fund as an investment option in our defined contribution plans in Hong Kong.

We have structured investment relationships with trusts we have determined to be VIEs, which are consolidated in our financial statements. The notes issued by these trusts include obligations to deliver an underlying security to residual interest holders and the obligations contain an embedded derivative of the forecasted transaction to deliver the underlying security.

We offer a fixed deferred annuity product that credits interest based on changes in an external equity index. We also offer certain variable annuity products with a GMWB rider, which 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. Declines in the equity market may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these annuity contracts.

Exposure

Our risk of loss is typically limited to the fair value of our derivative instruments and not to the notional or contractual amounts of these derivatives. Risk arises from changes in the fair value of the underlying instruments. We are also exposed to credit losses in the event of nonperformance of the counterparties. Our current credit exposure is limited to the value of derivatives that have become favorable to us. This credit risk is minimized by purchasing such agreements from financial institutions with high credit ratings and by establishing and monitoring exposure limits. We also utilize various credit enhancements, including collateral and credit triggers to reduce the credit exposure to our derivative instruments.

Our derivative transactions are generally documented under International Swaps and Derivatives Association, Inc. Master Agreements. Management believes that such agreements provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, we are permitted to set off our receivable from a counterparty against our payables to the same counterparty arising out of all included transactions. For reporting purposes, we do not offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements.

We posted $290.7 million and $372.8 million in cash and securities under collateral arrangements as of March 31, 2009, and December 31, 2008, respectively, to satisfy collateral requirements associated with our derivative credit support agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value of all derivative instruments with credit-risk-related contingent features that were in a liability position as of March 31, 2009, and December 31, 2008, was $1,828.3 million and $2,100.0 million, respectively, for which we posted collateral of $290.7 million and $372.8 million, respectively, in the normal course of business. If the credit-risk-related contingent features underlying these agreements were triggered on March 31, 2009, we would be required to post an additional $154.9 million of collateral to our counterparties.

As of March 31, 2009, and December 31, 2008, we had received $209.7 million and $262.9 million, respectively, of cash collateral associated with our derivative credit support annex agreements. The cash collateral is included in other assets on the consolidated statements of financial position, with a corresponding liability reflecting our obligation to return the collateral recorded in other liabilities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

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 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. Credit exposure represents the gross amount owed to us under derivative contracts as of the valuation date. The notional amounts and credit exposure of our derivative financial instruments by type were as follows:

	March 31, 2009	December 31, 2008
	(in millions)	
Notional amounts of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 24,799.7**	$ 24,148.6
Swaptions	**20.2**	94.8
Futures	**5.2**	97.3
Foreign exchange contracts:		
Foreign currency swaps	**5,931.3**	6,298.7
Currency forwards	**51.9**	52.1
Equity contracts:		
Options	**810.4**	797.5
Futures	**76.9**	63.6
Credit contracts:		
Credit default swaps	**1,930.7**	1,948.9
Other contracts:		
Embedded derivative financial instruments	**3,014.7**	2,938.6
Commodity swaps	**40.0**	40.0
Total notional amounts at end of period	**$ 36,681.0**	$ 36,480.1
Credit exposure of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 1,044.6**	$ 1,105.1
Foreign exchange contracts:		
Foreign currency swaps	**440.8**	562.5
Currency forwards	**2.2**	0.2
Equity contracts:		
Options	**230.0**	222.1
Credit contracts:		
Credit default swaps	**62.2**	70.7
Total gross credit exposure	**1,779.8**	1,960.6
Less: collateral received	**250.1**	284.2
Net credit exposure	**$ 1,529.7**	$ 1,676.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

The fair value of our derivative instruments classified as assets and liabilities were as follows:

	Derivative assets (1)		Derivative liabilities (2)	
	March 31, 2009	December 31, 2008	March 31, 2009	December 31, 2008
	(in millions)			
Derivatives designated as hedging instruments				
Interest rate contracts	**$ 210.1**	$ 250.8	**$ 708.0**	$ 819.2
Foreign exchange contracts	**345.8**	410.8	**258.0**	300.4
Total derivatives designated as hedging instruments	**$ 555.9**	$ 661.6	**$ 966.0**	$ 1,119.6
Derivatives not designated as hedging instruments				
Interest rate contracts	**$ 731.4**	$ 802.1	**$ 525.3**	$ 621.5
Foreign exchange contracts	**80.9**	121.3	**142.5**	155.1
Equity contracts	**230.0**	222.1		
Credit contracts	**62.2**	70.7	**243.2**	227.2
Other contracts			**110.2**	185.2
Total derivatives not designated as hedging instruments	**$ 1,104.5**	$ 1,216.2	**$ 1,021.2**	$ 1,189.0
Total derivative instruments	**$ 1,660.4**	$ 1,877.8	**$ 1,987.2**	$ 2,308.6

(1) The fair value of derivative assets is reported with other investments on the consolidated statements of financial position.

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of $50.7 million and $60.2 million as of March 31, 2009, and December 31, 2008, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

When we sell credit protection, we are exposed to the underlying credit risk similar to purchasing a fixed maturity security instrument. The majority of our credit derivative contracts sold reference a single name or reference security (referred to as single name credit default swaps).

The remainder of our credit derivatives reference either a basket or index of securities. These instruments are either referenced in an over-the-counter credit derivative transaction, or embedded within an investment structure that has been fully consolidated into our financial statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by $60.8 million for both March 31, 2009, and December 31, 2008. These credit derivative transactions have a net fair value of $21.8 million and $21.2 million at March 31, 2009, and December 31, 2008, respectively. Our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

We purchased certain investment structures with embedded credit features that are fully consolidated into our financial statements. This consolidation results in recognition of the underlying credit derivatives and collateral within the structure, typically high quality fixed maturity securities that are owned by a special purpose vehicle. These credit derivatives reference a single name or several names in a basket structure. In the event of default, the collateral within the structure would typically be liquidated to pay the claims of the credit derivative counterparty.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

The following tables show our credit default swap protection sold by types of contract, types of referenced/underlying asset class and external agency rating for the underlying reference security as of March 31, 2009, and December 31, 2008. The maximum future payments are undiscounted and have not been reduced by the effect of any offsetting transactions, collateral or recourse features described above.

	March 31, 2009			
	Notional amount	Fair value (in millions)	Maximum future payments	Weighted average expected life (in years)
Single name credit default swaps				
Corporate debt				
AA	$ 140.0	$ (10.4)	$ 140.0	5.0
A	539.0	(18.4)	539.0	4.6
BBB	315.0	(26.8)	315.0	2.6
BB	43.0	(0.7)	43.0	0.3
Structured finance				
BBB	16.0	(15.4)	16.0	22.2
BB	22.0	(19.9)	22.0	6.8
B	9.9	(8.9)	9.9	3.3
Total single name credit default swaps	1,084.9	(100.5)	1,084.9	3.6
Basket and index credit default swaps				
Corporate debt				
AAA	35.0	(1.6)	35.0	0.7
A	20.0	(0.9)	20.0	1.3
BBB	20.0	(1.5)	20.0	1.2
BB	15.0	(14.6)	15.0	3.8
B	130.0	(61.9)	130.0	1.2
Near default	20.0	(20.0)	20.0	2.8
Government/municipalities				
AA	50.0	(17.9)	50.0	6.0
Structured finance				
AA	20.0	(15.2)	20.0	6.2
BBB	5.0	(3.9)	5.0	16.9
Total basket and index credit default swaps	315.0	(137.5)	315.0	2.7
Total credit default swap protection sold	$ 1,399.9	$ (238.0)	$ 1,399.9	3.4

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

	December 31, 2008			
	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
		(in millions)		
Single name credit default swaps				
Corporate debt				
AAA	$ 10.0	$ (1.0)	$ 10.0	4.5
AA	135.0	(4.6)	135.0	5.4
A	554.0	(25.8)	554.0	4.8
BBB	305.0	(24.4)	305.0	2.7
BB	33.0	(1.4)	33.0	0.5
Structured finance				
A	9.9	(7.9)	9.9	3.5
BBB	16.0	(15.0)	16.0	22.5
BB	22.0	(18.1)	22.0	7.1
Total single name credit default swaps	1,084.9	(98.2)	1,084.9	4.4
Basket and index credit default swaps				
Corporate debt				
AAA	35.0	(0.2)	35.0	1.0
A	20.0	(1.4)	20.0	1.6
BBB	35.0	(16.3)	35.0	2.6
BB	130.0	(53.3)	130.0	1.5
CCC	20.0	(20.0)	20.0	3.0
Government/municipalities				
AA	50.0	(19.3)	50.0	6.2
Structured finance				
AA	25.0	(15.4)	25.0	8.6
Total basket and index credit default swaps	315.0	(125.9)	315.0	3.0
Total credit default swap protection sold	$ 1,399.9	$ (224.1)	$ 1,399.9	4.1

We also have invested in available-for-sale fixed maturity securities that contain credit default swaps that do not require bifurcation. These securities are subject to the credit risk of the issuer, normally a special purpose vehicle, which consists of the underlying credit default swaps and high quality fixed maturity securities that serve as collateral. A default event occurs if the cumulative losses exceed a specified attachment point, which is typically not the first loss of the portfolio. If a default event occurs that exceeds the specified attachment point, our investment may not be fully returned. We would have no future potential payments under these investments. The following tables show by the types of referenced/underlying asset class and external rating of the available-for-sale fixed maturity security our fixed maturity securities with nonbifurcatable embedded credit derivatives as of March 31, 2009, and December 31, 2008.

21

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

	March 31, 2009		
	Amortized cost	Carrying value	Weighted average expected life (in years)
	(in millions)		
Corporate debt			
AAA	**$ 40.0**	**$ 19.5**	**5.4**
A	**15.0**	**11.6**	**1.1**
BBB	**5.0**	**3.7**	**1.1**
BB	**10.0**	**6.9**	**1.1**
B	**26.5**	**10.1**	**6.5**
CCC	**53.7**	**17.3**	**6.1**
Total corporate debt	**150.2**	**69.1**	**5.2**
Structured finance			
AAA	**9.5**	**1.7**	**3.8**
AA	**54.9**	**13.4**	**5.7**
A	**59.0**	**21.1**	**5.3**
BBB	**23.4**	**7.3**	**5.4**
BB	**35.8**	**16.8**	**7.8**
B	**2.1**	**0.2**	**7.8**
Total structured finance	**184.7**	**60.5**	**6.1**
Total fixed maturity securities with credit derivatives	**$ 334.9**	**$ 129.6**	**5.9**

	December 31, 2008		
	Amortized cost	Carrying value	Weighted average expected life (in years)
	(in millions)		
Corporate debt			
AAA	$ 55.0	$ 25.9	4.5
AA	5.0	4.0	1.3
A	35.0	19.0	3.1
BB	44.9	16.5	5.9
B	1.4	1.4	8.7
C	8.8	5.7	8.0
Total corporate debt	150.1	72.5	5.4
Structured finance			
AAA	32.0	17.1	5.5
AA	47.4	18.4	5.6
A	66.0	15.1	5.5
BBB	34.4	14.4	6.5
BB	54.8	7.0	8.2
CCC	0.4	0.4	3.0
Total structured finance	235.0	72.4	6.1

Total fixed maturity securities with credit derivatives	$	385.1	$	144.9	5.8

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Fair Value Hedges

We use fixed-to-floating rate interest rate swaps to more closely align the interest rate characteristics of certain assets and liabilities. In general, these swaps are used in asset and liability management to modify duration, which is a measure of sensitivity to interest rate changes.

We enter into currency exchange swap agreements to convert certain foreign denominated assets and liabilities into U.S. dollar floating-rate denominated instruments to eliminate the exposure to future currency volatility on those items.

We also sell callable investment-type insurance contracts and use cancellable interest rate swaps and written interest rate swaptions to hedge the changes in fair value of the callable feature.

The net interest effect of interest rate swap and currency swap transactions for derivatives in fair value hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

Hedge effectiveness testing for fair value relationships is performed utilizing a regression analysis approach for both prospective and retrospective evaluations. This regression analysis will consider multiple data points for the assessment that the hedge continues to be highly effective in achieving offsetting changes in fair value. In certain periods, the comparison of the change in value of the derivative and the change in the value of the hedged item may not be offsetting at a specific period in time due to small movements in value. However, any amounts recorded as fair value hedges have shown to be highly effective in achieving offsetting changes in fair value both for present and future periods.

The following table shows the effect of derivatives in fair value hedging relationships and the related hedged items on the consolidated statements of operations for the three months ended March 31, 2009 and 2008. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in fair value	**Amount of gain (loss) recognized in net income on derivative for the three months ended March 31, (1)**	**Hedged items in fair value**	**Amount of gain (loss) recognized in net income on related hedged item for the three months ended March 31, (1)**

hedging relationships	2009	2008	hedging relationships	2009	2008
	(in millions)			(in millions)	
Interest rate contracts	**$ 64.4**	$ (182.6)	Fixed maturities securities, available-for-sale	**$ (62.9)**	$ 170.8
Interest rate contracts	**6.1**	8.2	Investment-type insurance contracts	**(3.0)**	(12.0)
Foreign exchange contracts	**2.1**	(12.7)	Fixed maturities securities, available-for-sale	**2.7**	13.1
Foreign exchange contracts	**12.4**	1.5	Investment-type insurance contracts	**(3.0)**	1.0
Total	**$ 85.0**	$ (185.6)	Total	**$ (66.2)**	$ 172.9

(1) The gain (loss) on both derivatives and hedged items in fair value relationships is reported in net realized capital gains (losses) on the consolidated statements of operations. The net amount represents the ineffective portion of our fair value hedges.

Periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships of fixed maturities securities, available-for-sale of $27.5 million and $4.5 million in losses were reported in net investment income on the consolidated statements of operations for the three months ended March 31, 2009 and 2008, respectively. Periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships of investment-type insurance contracts of $25.8 million and $8.0 million in gains were reported in benefits, claims and settlement expenses on the consolidated statements of operations for the three months ended March 31, 2009 and 2008, respectively.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

Cash Flow Hedges

We utilize floating-to-fixed rate interest rate swaps to eliminate the variability in cash flows of recognized financial assets and liabilities and forecasted transactions. We have also utilized treasury lock agreements to eliminate the variability in cash flows of forecasted transactions.

We enter into currency exchange swap agreements to convert both principal and interest payments of certain foreign denominated assets and liabilities into U.S. dollar denominated fixed-rate instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in cash flow hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

The maximum length of time that we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 11.2 years. At March 31, 2009, we had $136.3 million of gross unrealized gains and $134.1 million of gross unrealized losses reported in accumulated OCI on the consolidated statements of financial position related to hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from OCI into net income. During the three months ended March 31, 2009 and 2008, no amounts were reclassified from OCI into net income as a result of the determination that the hedged cash flows were probable of not occurring.

The following table shows the effect of derivatives in cash flow hedging relationships on the consolidated statements of operations and consolidated statements of financial position for the three months ended March 31, 2009 and 2008. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in accumulated OCI on derivative (effective portion) for the three months ended March 31, 2009	2008	Location of gain (loss) reclassified from accumulated OCI into net income (effective portion)	Amount of gain (loss) reclassified from accumulated OCI on derivative (effective portion) for the three months ended March 31, (1) 2009	2008

		(in millions)			**(in millions)**	
Interest rate contracts	Fixed maturity securities, available-for-sale	**$ 38.7**	$ 53.4	Net investment income	**$ (1.1)**	$ 0.8
Interest rate contracts	Investment-type insurance contracts	**7.2**	(18.3)	Benefits, claims and settlement expenses	**(0.3)**	
Interest rate contracts	Debt	**13.1**	(20.0)	Operating expense	**0.1**	0.1
Foreign exchange contracts	Fixed maturity securities, available-for-sale	**5.9**	(87.8)	Net investment income		
Foreign exchange contracts	Investment-type insurance contracts	**(91.1)**	146.6	Benefits, claims and settlement expenses	**(0.7)**	
				Net realized capital gains (losses)	**26.7**	(2.9)
Total		**$ (26.2)**	$ 73.9	Total	**$ 26.9**	$ (2.0)

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

3. Derivative Financial Instruments (continued)

---

(1) Does not include derivative periodic settlements. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of fixed maturity securities, available-for-sale of $3.8 million and $2.4 million in gains were reported in net investment income on the consolidated statements of operations for the three months ended March 31, 2009 and 2008, respectively. Periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships of investment-type insurance contracts of $3.6 million and $1.6 million in losses were reported in benefits, claims and settlement expenses on the consolidated statements of operations for the three months ended March 31, 2009 and 2008, respectively. We did not have any periodic settlements on interest rate contracts in cash flow hedging relationships of debt for the three months ended March 31, 2009 and 2008.

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net loss resulting from the ineffective portion of interest rate contracts in cash flow hedging relationships was zero and $0.6 million for the three months ended March 31, 2009 and 2008, respectively. The net loss resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was $0.7 million and $0.9 million for the three months ended March 31, 2009 and 2008, respectively.

We expect to reclassify net losses of $6.2 million from accumulated OCI into net income in the next 12 months, which includes both net deferred losses on discontinued hedges and periodic settlements of active hedges.

Net Investment in Foreign Operations Hedges

From time to time, we take measures to hedge our net investments in our foreign subsidiaries from currency risks. We did not use any currency forwards during 2009 or 2008 to hedge our net investment in foreign operations.

Derivatives Not Designated as Hedging Instruments

Our use of futures, certain swaptions and swaps, options and currency forwards are effective from an economic standpoint, but they have not been designated as hedges for financial reporting purposes. As such, periodic changes in the market value of these instruments, which includes unrealized gains and losses as well as periodic and final settlements, flow directly into net realized capital gains (losses).

The following table shows the effect of derivatives not designated as hedging instruments, including market value changes of embedded derivatives that have been bifurcated from the host contract, on the consolidated statements of operations for the three months ended March 31, 2009 and 2008. Gains (losses) are primarily reported in net realized capital gains (losses) on the consolidated statements of operations.

Derivatives not designated as hedging instruments	Amount of gain (loss) recognized in net income on derivative for the three months ended March 31, 2009	2008
	(in millions)	
Interest rate contracts	**$ (23.4)**	$ 14.5
Foreign exchange contracts	**(7.9)**	32.1
Equity contracts	**3.0**	6.5
Credit contracts	**(24.6)**	(59.4)
Other contracts (1)	**9.1**	11.5
Total	**$ (43.8)**	$ 5.2

(1) The gain for other contracts primarily includes the change in fair value of embedded derivatives.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

4. Federal Income Taxes

The effective income tax rate for the three months ended March 31, 2009, was lower than the U.S. corporate income tax rate of 35% (U.S. statutory rate) primarily due to income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income. Taxes on our share of earnings generated from equity method investments reflected in net investment income also contributed to a lower than U.S. statutory rate.

The effective income tax rate for the three months ended March 31, 2008, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the release of state deferred income tax liabilities associated with a reorganization of certain subsidiaries and the interest exclusion from taxable income.

The Internal Revenue Service is currently auditing our federal income tax returns for the years 2004 through 2007. We do not expect the results of these audits or developments in other tax areas to significantly increase or decrease the total amount of unrecognized tax benefits in the next twelve months, but the outcome of tax reviews is uncertain and unforeseen results can occur.

5. Employee and Agent Benefits

Components of net periodic benefit cost (income):

	Pension benefits		Other postretirement benefits	
	For the three months ended March 31,		For the three months ended March 31,	
	2009	**2008**	**2009**	**2008**
	(in millions)			
Service cost	**$ 12.8**	$ 12.4	**$ 2.8**	$ 2.1
Interest cost	**25.2**	24.9	**4.9**	4.2
Expected return on plan assets	**(19.9)**	(32.6)	**(6.5)**	(9.4)
Amortization of prior service benefit	**(1.9)**	(1.9)	**(0.5)**	(0.6)
Recognized net actuarial loss (gain)	**23.2**	0.3	**2.4**	(0.8)
Net periodic benefit cost (income)	**$ 39.4**	$ 3.1	**$ 3.1**	$ (4.5)

In 2008, our return on plans asset was lower than expected, which resulted in an actuarial loss and lower plan assets at December 31, 2008. The 2008 lower than expected return caused the expected return on plan assets in 2009 to be lower and the recognition of the actuarial loss to increase as the loss is amortized.

Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act (ERISA) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2009 will be zero so we will not be required to fund our qualified pension plan during 2009. However, it is possible that we may fund the qualified and nonqualified pension plans in 2009 for a combined total of between $20.0 million to $100.0 million. During the three months ended March 31, 2009, no contributions were made to these plans.

6. Contingencies, Guarantees and Indemnifications

Litigation and Regulatory Contingencies

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

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

6. Contingencies, Guarantees and Indemnifications (continued)

On November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life. Principal Life s Motion to Transfer Venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleged, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleged that these acts constitute prohibited transactions under ERISA. Plaintiff sought to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. On August 27, 2008, the Plaintiff s Motion for Class Certification was denied. The Plaintiff filed a petition seeking permission to appeal that ruling. The petition was denied on October 28, 2008. Principal Life is aggressively defending the lawsuit.

On August 28, 2007, two plaintiffs, Walsh and Young, filed a putative class action lawsuit in the United States District Court for the Southern District of Iowa against Principal Life and Princor Financial Services Corporation (the Principal Defendants). The lawsuit alleges that the Principal Defendants breached alleged fiduciary duties to participants in employer-sponsored 401(k) plans who were retiring or leaving their respective plans, including providing misleading information and failing to act solely in the interests of the participants, resulting in alleged violations of ERISA. The Principal Defendants are aggressively defending the lawsuit.

On February 28, 2007, Luz Zapien (*Zapien*) filed a securities class action against Washington Mutual, Inc. (WaMu), us and certain mutual fund-related entities. The Complaint alleged that WaMu had inadequately disclosed an alleged shelf-space arrangement that misled fund investors during the putative class period. We were named in the Complaint based on our December 2006 purchase of the distributor, investment advisor and assets of the relevant WaMu mutual funds (the acquired business). This action was dismissed with prejudice on June 17, 2008. Plaintiff appealed the dismissal to Ninth Circuit Court of Appeals. On March 26, 2009, the Ninth Circuit Court of Appeals granted the parties stipulation to dismiss the appeal against the Principal defendants. On August 20, 2008, counsel for the Plaintiffs filed a new class action, *Robinson v. WM Trust I, et al.*, in the United States District Court for the Western District of Washington, making the same allegations that were contained in *Zapien*. On September 26, 2008, the Robinson Plaintiffs filed a First Amended Complaint which dropped the WaMu defendants, added four directors of the Principal Mutual Funds entity in their individual capacity, and amended the putative class to include all persons or entities that purchased or otherwise acquired shares, units or like interests in any of the WM Funds (including through the reinvestment of Fund dividends) between March 1, 2002, and December 31, 2006, inclusive . A new lead plaintiff, Dumdie , was substituted for Robinson. On April 17, 2009, the court approved the parties stipulated dismissal, ending the case.

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

Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary, joint ventures and industrial revenue bonds. These agreements generally expire through 2019. The maximum exposure under these agreements as of March 31, 2009, was approximately $214.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. It is possible that performance under these guarantees could materially affect net income in a particular quarter or annual period.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

6. Contingencies, Guarantees and Indemnifications (continued)

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

7. Stockholders Equity

Reconciliation of Outstanding Shares

	Series A preferred stock	Series B preferred stock	Common stock
		(in millions)	
Outstanding shares at January 1, 2008	3.0	10.0	259.1
Shares issued			0.5
Treasury stock acquired			(1.0)
Outstanding shares at March 31, 2008	3.0	10.0	258.6
Outstanding shares at January 1, 2009	**3.0**	**10.0**	**259.3**
Shares issued			**0.9**
Treasury stock acquired			**(0.2)**
Outstanding shares at March 31, 2009	**3.0**	**10.0**	**260.0**

Comprehensive income (loss) is as follows:

For the three months ended March 31,

	2009	2008
	(in millions)	
Net income	**$ 122.6**	$ 177.6
Net change in unrealized gains (losses) on fixed maturities, available-for-sale	**10.8**	(1,455.2)
Net change in noncredit component of impairment losses on fixed maturities, available-for-sale	**(50.6)**	
Net change in unrealized losses on equity securities, available-for-sale	**(52.3)**	(8.9)
Net change in unrealized gains on equity method subsidiaries and noncontrolling interest adjustments	**64.9**	0.6
Adjustments for assumed changes in amortization patterns	**171.8**	171.0
Adjustment for assumed changes in liability for policyholder benefits and claims	**(39.3)**	(7.7)
Net change in unrealized losses on derivative instruments	**(25.6)**	(36.7)
Change in net foreign currency translation adjustment	**24.1**	70.3
Change in unrecognized post-retirement benefit obligation	**23.1**	(3.1)
Provision for deferred income tax benefits (taxes)	**(46.7)**	492.3
Comprehensive income (loss)	**$ 202.8**	$ (599.8)

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments

Valuation hierarchy

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

- **Level 1** Fair values are based on unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities primarily include exchange traded equity securities, mutual funds and U.S. Treasury bonds.

- **Level 2** Fair values are based on inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. Our Level 2 assets and liabilities primarily include fixed maturity securities (including public and private bonds), equity securities, over-the-counter derivatives and other investments for which public quotations are not available but that are priced by third-party pricing services or internal models using substantially all observable inputs.

- **Level 3** Fair values are based on significant unobservable inputs for the asset or liability. Our Level 3 assets and liabilities include certain fixed maturity securities, private equity securities, complex derivatives and embedded derivatives that must be priced using broker quotes or other valuation methods that utilize at least one significant unobservable input.

Determination of fair value

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

Fair value estimates are made at a specific point in time, based on available market information and judgments about the financial instrument. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during the first quarter of 2009.

Fixed Maturities and Equity Securities

In determining fair value for fixed maturities, our first priority is to obtain prices from third party pricing vendors. We have regular interaction with these vendors to ensure we understand their pricing methodologies and to confirm that they are utilizing observable market information. Their methodologies vary by asset class and include inputs such as estimated cash flows, benchmark yields, reported trades, broker quotes, credit quality, industry events and economic events. If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to corporate bonds, as described below, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available. As of March 31, 2009, less than 2% of our fixed maturity securities, which were classified as Level 3 assets, were valued using internal pricing models.

For corporate bonds where quoted market prices are not available, a matrix pricing valuation approach is used. In this approach, securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data 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.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments (continued)

Fair values of equity securities are determined using public quotations, when available. When public quotations are not available, we may utilize internal valuation methodologies appropriate for the specific asset. Fair values might also be determined using broker quotes or through the use of internal models or analysis.

Derivatives

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

Other Investments

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

Cash and Cash Equivalents

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

Separate Account Assets

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

Investment-Type Insurance Contracts

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

Other Liabilities

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities utilizing the yield, credit quality and average maturity of each security.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments (continued)

Assets and liabilities measured at fair value on a recurring basis

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

	As of March 31, 2009			
	Assets / (liabilities) measured at fair value	Fair value hierarchy level Level 1	Level 2	Level 3
	(in millions)			
Assets				
Fixed maturities, available-for-sale:				
U.S. government and agencies	$ 592.9	$ 19.9	$ 573.0	$
Non-U.S. governments	792.9		744.6	48.3
States and political subdivisions	1,986.9		1,986.9	
Corporate	28,934.9	75.3	28,120.4	739.2
Residential mortgage-backed securities	2,070.9		2,070.9	
Commercial mortgage-backed securities	3,514.6		3,466.9	47.7
Collateralized debt obligations	254.0		49.3	204.7
Other debt obligations	1,850.8		1,784.7	66.1
Total fixed maturities, available-for-sale	39,997.9	95.2	38,796.7	1,106.0
Fixed maturities, trading	821.4		763.1	58.3
Equity securities, available-for-sale	192.8	158.3	2.1	32.4
Equity securities, trading	126.2	64.9	61.3	
Derivative assets (1)	1,660.4		1,570.3	90.1
Other investments (2)	62.4	12.5	49.9	
Cash equivalents (3)	1,707.8	775.2	932.6	
Sub-total excluding separate account assets	44,568.9	1,106.1	42,176.0	1,286.8
Separate account assets	50,534.2	27,653.2	17,472.1	5,408.9
Total assets	$ 95,103.1	$ 28,759.3	$ 59,648.1	$ 6,695.7
Liabilities				
Investment-type insurance contracts (4)	$ (50.7)	$	$	$ (50.7)
Derivative liabilities (1)	(1,887.7)		(1,616.0)	(271.7)
Other liabilities (4)	(48.8)		(3.8)	(45.0)
Total liabilities	$ (1,987.2)	$	$ (1,619.8)	$ (367.4)
Net assets (liabilities)	$ 93,115.9	$ 28,759.3	$ 58,028.3	$ 6,328.3

31

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments (continued)

	As of December 31, 2008			
	Assets / (liabilities) measured at fair value	Fair value hierarchy level		
		Level 1	Level 2	Level 3
		(in millions)		
Assets				
Fixed maturities, available-for-sale	$ 40,117.2	$ 126.7	$ 38,817.5	$ 1,173.0
Fixed maturities, trading	843.4		782.7	60.7
Equity securities, available-for-sale	242.7	176.4	10.1	56.2
Equity securities, trading	158.0	61.3	96.7	
Derivative assets (1)	1,877.8		1,777.1	100.7
Other investments (2)	75.9	13.2	62.7	
Cash equivalents (3)	1,807.9	656.3	1,151.6	
Sub-total excluding separate account assets	45,122.9	1,033.9	42,698.4	1,390.6
Separate account assets	55,142.6	30,693.4	18,406.9	6,042.3
Total assets	$ 100,265.5	$ 31,727.3	$ 61,105.3	$ 7,432.9
Liabilities				
Investment-type insurance contracts (4)	$ (60.2)	$	$	$ (60.2)
Derivative liabilities (1)	(2,139.1)		(1,872.2)	(266.9)
Other liabilities (4)	(109.3)		(5.5)	(103.8)
Total liabilities	$ (2,308.6)	$	$ (1,877.7)	$ (430.9)
Net assets (liabilities)	$ 97,956.9	$ 31,727.3	$ 59,227.6	$ 7,002.0

(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities.

(2) Primarily includes seed money investments reported at fair value.

(3) Includes short-term investments with a maturity date of three months or less when purchased.

(4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments (continued)

Changes in Level 3 fair value measurements

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the three months ended March 31, 2009 and 2008, is as follows:

	For the three months ended March 31, 2009						Changes in
	Beginning asset / (liability) balance as of December 31, 2008	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements	Transfers in (out) of Level 3	Ending asset / (liability) balance as of March 31, 2009	unrealized gains (losses) included in net income relating to positions still held (1)
		Included in net income (1)	Included in other comprehensive income				
	(in millions)						
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	$ 45.3	$ 0.3	$ (1.2)	$ 3.9	$	$ 48.3	$ 0.3
Corporate	750.9	(22.6)	(17.1)	(25.7)	53.7	739.2	(21.2)
Commercial mortgage-backed securities	58.0		(4.3)	(2.9)	(3.1)	47.7	
Collateralized debt obligations	236.8	(27.7)	5.6	(2.1)	(7.9)	204.7	(27.5)
Other debt obligations	82.0		0.6	8.1	(24.6)	66.1	
Total fixed maturities, available-for-sale	1,173.0	(50.0)	(16.4)	(18.7)	18.1	1,106.0	(48.4)
Fixed maturities, trading	60.7	(1.4)			(1.0)	58.3	(1.4)
Equity securities, available-for-sale	56.2	6.2	(22.2)	(7.8)		32.4	
Derivative assets	100.7	(10.8)	(0.1)	0.3		90.1	(9.2)
Separate account assets	6,042.3	(575.6)		(55.0)	(2.8)	5,408.9	(574.7)
Liabilities							
Investment-type insurance contracts	(60.2)	3.9		5.6		(50.7)	4.0
Derivative liabilities	(266.9)	(8.2)	3.4			(271.7)	(8.2)
Other liabilities (2)	(103.8)		63.4	(4.6)		(45.0)	

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2009
(Unaudited)

8. Fair Value of Financial Instruments (continued)

	For the three months ended March 31, 2008						
	Beginning asset / (liability) balance as of January 1, 2008	Total realized/unrealized gains (losses) Included in net income (1)	Total realized/unrealized gains (losses) Included in other comprehensive income	Purchases, sales, issuances and settlements	Transfers in (out) of Level 3	Ending asset / (liability) balance as of March 31, 2008	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	(in millions)						
Assets							
Fixed maturities, available-for-sale	$ 2,201.3	$ (41.8)	$ (349.0)	$ (78.7)	$ 79.0	$ 1,810.8	$ (39.6)
Fixed maturities, trading	92.3	(0.6)					