PRINCIPAL FINANCIAL GROUP INC
Form 10-Q
November 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2008

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 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 October 29, 2008, was 259,339,895.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.
Consolidated Statements of Financial Position

	September 30, 2008 (Unaudited)	December 31, 2007
	(in millions)	
Assets		
Fixed maturities, available-for-sale	**$ 44,622.1**	$ 46,738.9
Fixed maturities, trading	**982.2**	529.3
Equity securities, available-for-sale	**246.2**	316.4
Equity securities, trading	**204.8**	269.8
Mortgage loans	**13,268.8**	12,659.6
Real estate	**891.5**	862.5
Policy loans	**883.7**	869.9
Other investments	**1,981.4**	2,118.6
Total investments	**63,080.7**	64,365.0
Cash and cash equivalents	**2,269.0**	1,344.4
Accrued investment income	**806.9**	774.1
Premiums due and other receivables	**1,598.4**	951.2
Deferred policy acquisition costs	**3,727.1**	2,810.1
Property and equipment	**510.8**	469.0
Goodwill	**382.3**	374.7
Other intangibles	**976.1**	1,006.9
Separate account assets	**67,087.6**	80,486.8
Other assets	**2,970.8**	1,938.0
Total assets	**$ 143,409.7**	$ 154,520.2
Liabilities		
Contractholder funds	**$ 44,238.4**	$ 40,288.9
Future policy benefits and claims	**18,770.0**	18,454.7
Other policyholder funds	**559.2**	540.5
Short-term debt	**350.1**	290.8
Long-term debt	**1,378.6**	1,398.8
Income taxes currently payable	**43.6**	41.6
Deferred income taxes	**148.5**	576.3
Separate account liabilities	**67,087.6**	80,486.8
Other liabilities	**5,221.1**	5,020.1
Total liabilities	**137,797.1**	147,098.5
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 2008 and 2007		
Series B preferred stock, par value $.01 per share with liquidation preference of $25 per share - 10.0 million shares authorized, issued and outstanding in 2008 and 2007	**0.1**	0.1
Common stock, par value $.01 per share - 2,500.0 million shares authorized, 386.9 million and 385.8 million shares issued, and 259.2 million and 259.1 million shares outstanding in 2008 and 2007, respectively	**3.9**	3.9

Additional paid-in capital		**8,366.7**		8,295.4
Retained earnings		**3,847.8**		3,414.3
Accumulated other comprehensive income (loss)		**(1,887.3)**		420.2
Treasury stock, at cost (127.7 million and 126.7 million shares in 2008 and 2007, respectively)		**(4,718.6)**		(4,712.2)
Total stockholders equity		**5,612.6**		7,421.7
Total liabilities and stockholders equity	**$**	**143,409.7**	$	154,520.2

See accompanying notes.

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Principal Financial Group, Inc.
Consolidated Statements of Operations

(Unaudited)

	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
	(in millions, except per share data)			
Revenues				
Premiums and other considerations	**$ 1,049.7**	$ 1,171.4	**$ 3,258.9**	$ 3,456.0
Fees and other revenues	**599.0**	738.5	**1,834.9**	1,953.9
Net investment income	**1,079.7**	1,029.0	**3,031.0**	2,928.8
Net realized/unrealized capital gains (losses)	**(230.6)**	(89.3)	**(468.1)**	3.7
Total revenues	**2,497.8**	2,849.6	**7,656.7**	8,342.4
Expenses				
Benefits, claims and settlement expenses	**1,597.2**	1,643.2	**4,703.2**	4,725.9
Dividends to policyholders	**70.4**	73.9	**210.2**	221.9
Operating expenses	**734.1**	800.9	**2,229.2**	2,316.0
Total expenses	**2,401.7**	2,518.0	**7,142.6**	7,263.8
Income from continuing operations before income taxes	**96.1**	331.6	**514.1**	1,078.6
Income taxes (benefits)	**(2.2)**	90.9	**56.8**	260.3
Income from continuing operations, net of related income taxes	**98.3**	240.7	**457.3**	818.3
Loss from discontinued operations, net of related income taxes		(0.2)		(0.4)
Net income	**98.3**	240.5	**457.3**	817.9
Preferred stock dividends	**8.2**	8.2	**24.7**	24.7
Net income available to common stockholders	**$ 90.1**	$ 232.3	**$ 432.6**	$ 793.2
Earnings per common share				
Basic earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.35**	$ 0.88	**$ 1.67**	$ 2.97
Loss from discontinued operations, net of related income taxes			**—**	—
Net income	**$ 0.35**	$ 0.88	**$ 1.67**	$ 2.97
Diluted earnings per common share:				
Income from continuing operations, net of related income taxes	**$ 0.35**	$ 0.87	**$ 1.66**	$ 2.94
Loss from discontinued operations, net of related income taxes			**—**	—
Net income	**$ 0.35**	$ 0.87	**$ 1.66**	$ 2.94

See accompanying notes.

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Principal Financial Group, Inc.
Consolidated Statements of Stockholders Equity

(Unaudited)

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Total stockholders equity
					(in millions)			
Balances at January 1, 2007	$	$ 0.1	$ 3.8	$ 8,141.8	$ 2,824.1	$ 846.9	$ (3,955.9)	$ 7,860.8
Common stock issued				49.5				49.5
Capital transactions of equity method investee, net of related income taxes				0.8				0.8
Stock-based compensation and additional related tax benefits				58.7				58.7
Treasury stock acquired, common							(436.2)	(436.2)
Dividends to preferred stockholders					(24.7)			(24.7)
Comprehensive income:								
Net income					817.9			817.9
Net unrealized losses, net						(492.3)		(492.3)
Foreign currency translation adjustment, net of related income taxes						35.2		35.2
Unrecognized post-retirement benefit obligation, net of related income taxes						(1.4)		(1.4)
Comprehensive income								359.4
Balances at September 30, 2007	$	$ 0.1	$ 3.8	$ 8,250.8	$ 3,617.3	$ 388.4	$ (4,392.1)	$ 7,868.3
Balances at January 1, 2008	**$**	**$ 0.1**	**$ 3.9**	**$ 8,295.4**	**$ 3,414.3**	**$ 420.2**	**$ (4,712.2)**	**$ 7,421.7**
Common stock issued				**31.5**				**31.5**
Capital transactions of equity method				**0.3**				**0.3**

investee, net of related income taxes								
Stock-based compensation and additional related tax benefits				**39.5**				**39.5**
Treasury stock acquired, common							**(6.4)**	**(6.4)**
Dividends to preferred stockholders					**(24.7)**			**(24.7)**
Effects of changing post-retirement benefit plan measurement date, net of related income taxes					**0.9**	**(2.0)**		**(1.1)**
Comprehensive loss:								
Net income					**457.3**			**457.3**
Net unrealized losses, net						**(2,282.8)**		**(2,282.8)**
Foreign currency translation adjustment, net of related income taxes						**(16.7)**		**(16.7)**
Unrecognized post-retirement benefit obligation, net of related income taxes						**(6.0)**		**(6.0)**
Comprehensive loss								**(1,848.2)**
Balances at September 30, 2008	**$**	**$ 0.1**	**$ 3.9**	**$ 8,366.7**	**$ 3,847.8**	**$ (1,887.3)**	**$ (4,718.6)**	**$ 5,612.6**

See accompanying notes.

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Principal Financial Group, Inc.
Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended September 30, 2008	2007
	(in millions)	
Operating activities		
Net income	**$ 457.3**	$ 817.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss from discontinued operations, net of related income taxes		0.4
Amortization of deferred policy acquisition costs	**212.6**	292.2
Additions to deferred policy acquisition costs	**(540.1)**	(416.6)
Accrued investment income	**(32.8)**	(38.1)
Net cash flows from trading securities	**(451.9)**	(196.6)
Premiums due and other receivables	**10.0**	234.4
Contractholder and policyholder liabilities and dividends	**1,747.0**	1,593.4
Current and deferred income taxes (benefits)	**(93.5)**	96.0
Net realized/unrealized capital (gains) losses	**468.1**	(3.7)
Depreciation and amortization expense	**105.4**	86.2
Mortgage loans held for sale, acquired or originated	**(56.4)**	(67.6)
Mortgage loans held for sale, sold or repaid, net of gain	**52.1**	142.7
Real estate acquired through operating activities	**(50.7)**	(36.7)
Real estate sold through operating activities	**14.6**	49.6
Stock-based compensation	**32.8**	52.5
Other	**(7.3)**	437.1
Net adjustments	**1,409.9**	2,225.2
Net cash provided by operating activities	**1,867.2**	3,043.1
Investing activities		
Available-for-sale securities:		
Purchases	**(6,205.6)**	(8,024.7)
Sales	**524.5**	2,727.2
Maturities	**2,483.7**	3,430.1
Mortgage loans acquired or originated	**(1,682.3)**	(2,119.3)
Mortgage loans sold or repaid	**1,041.8**	1,476.3
Real estate acquired	**(20.6)**	(87.8)
Real estate sold	**68.7**	6.2
Net purchases of property and equipment	**(83.3)**	(64.2)
Purchases of interest in subsidiaries, net of cash acquired	**(20.3)**	(69.1)
Net change in other investments	**(124.9)**	(106.6)
Net cash used in investing activities	**$ (4,018.3)**	$ (2,831.9)

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

	For the nine months ended, September 30, 2008	2007
	(in millions)	
Financing activities		
Issuance of common stock	**$ 31.5**	$ 49.5
Acquisition of treasury stock	**(6.4)**	(436.2)
Proceeds from financing element derivatives	**130.6**	122.7
Payments for financing element derivatives	**(91.3)**	(107.0)
Excess tax benefits from share-based payment arrangements	**2.8**	6.6
Dividends to preferred stockholders	**(24.7)**	(24.7)
Issuance of long-term debt	**6.4**	8.5
Principal repayments of long-term debt	**(17.3)**	(42.3)
Net proceeds (repayments) of short-term borrowings	**63.9**	(29.4)
Investment contract deposits	**9,852.4**	6,824.8
Investment contract withdrawals	**(7,160.6)**	(6,427.5)
Net increase in banking operation deposits	**293.0**	811.2
Other	**(4.6)**	
Net cash provided by financing activities	**3,075.7**	756.2
Discontinued operations		
Net cash provided by operating activities		2.2
Net cash used in investing activities		(1.3)
Net cash used in financing activities		(0.4)
Net cash provided by discontinued operations		0.5
Net increase in cash and cash equivalents	**924.6**	967.9
Cash and cash equivalents at beginning of period	**1,344.4**	1,590.8
Cash and cash equivalents at end of period	**$ 2,269.0**	$ 2,558.7
Cash and cash equivalents of discontinued operations included above		
At beginning of period	**$**	$ (0.7)
At end of period	**$**	$ (0.2)

See accompanying notes.

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2008

(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

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

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

Recent Accounting Pronouncements

On September 12, 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) No. FAS 133-1 and FASB Interpretation 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161* (FSP FAS 133-1 and FIN 45-4). FSP FAS 133-1 and FIN 45-4 (1) amends Statement of Financial Accounting Standards (SFAS) No. 133, *Accounting for Derivative Instruments and Hedging Activities*, to require disclosures by sellers of credit derivatives, including credit derivatives embedded in a hybrid instrument;(2) amends FASB Interpretation No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, to require an additional disclosure about the current status of the payment/performance risk of a guarantee and (3) clarifies the FASB s intent about the effective date of SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities an amendment of FASB Statement No. 133* (SFAS 161). FSP FAS 133-1 and FIN 45-4 is effective for reporting periods ending after November 15, 2008. We are currently evaluating the impact this guidance will have on our disclosures.

On March 19, 2008, the FASB issued SFAS 161. This Statement requires (1) qualitative disclosures about objectives and strategies for using derivatives, (2) quantitative disclosures about fair value amounts of gains and losses on derivative instruments and related hedged items and

(3) disclosures about credit-risk-related contingent features in derivative instruments. The disclosures are intended to provide users of financial statements with an enhanced understanding of how and why derivative instruments are used, how they are accounted for and the financial statement impacts. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact this guidance will have on our disclosures.

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)
September 30, 2008
(Unaudited)

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

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

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

On September 15, 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). This standard, which provides guidance for using fair value to measure assets and liabilities, applies whenever other standards require or permit assets or liabilities to be measured at fair value, but does not expand the use of fair value in any new circumstances. SFAS 157 establishes a fair value hierarchy that gives the highest priority to quoted prices in active markets and the lowest priority to unobservable data, and requires fair value measurements to be separately disclosed by level within the hierarchy. On February 12, 2008, the FASB issued FSP FAS 157-2, *Effective Date of Statement No. 157* (FSP FAS 157-2), to defer the effective date of the standard for one year for nonfinancial assets and nonfinancial liabilities that are recognized or disclosed at fair value on a nonrecurring basis. On February 14, 2008, the FASB issued FSP FAS 157-1, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement Under Statement 13*, which amends SFAS 157 to exclude instruments covered by SFAS No. 13, *Accounting for Leases*, and its related interpretive guidance from the scope of SFAS 157. On October 10, 2008, the FASB issued FSP FAS 157-3, *Determining the Fair Value of a Financial Asset in a Market That Is Not Active* (FSP FAS 157-3), which clarifies the application of SFAS 157 in an inactive market and provides an illustrative example to demonstrate how the fair value of a financial asset is determined when the market for that financial asset is inactive. Our adoption of SFAS 157 on January 1, 2008, for assets and liabilities measured at fair value on a recurring basis and financial assets and liabilities measured at fair value on a nonrecurring basis did not have a material impact on our consolidated financial statements. We are deferring the adoption of SFAS 157 for nonfinancial assets and liabilities measured at fair value on a nonrecurring basis until January 1, 2009, in accordance with FSP FAS 157-2. FSP FAS 157-3 is effective upon issuance and is not expected to have a material impact on our consolidated financial statements. See Note 7, Fair Value Measurement, for further details.

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

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

Separate Accounts

As of September 30, 2008, and December 31, 2007, the separate accounts include a separate account valued at $408.0 million and $748.5 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. The separate account shares are recorded at fair value and are reported as separate account assets and separate account liabilities in the consolidated statements of financial position. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

2. Variable Interest Entities

On June 21, 2006, and June 14, 2007, we invested $285.0 million and $100.0 million, respectively, in secured limited recourse notes issued by private investment vehicles. The notes represented Class B notes. Class A notes were senior and Class C notes and below were subordinated to Class B notes. The entities entered into credit default swaps with a third party providing credit protection in exchange for a fee. Defaults in the underlying reference portfolios would only affect the notes if cumulative losses of the synthetic reference portfolios exceeded the loss attachment points on the portfolios. We determined we were not the primary beneficiary of these entities, as we did not hold the majority of the risk of losses. As of September 19, 2008, these fixed maturity securities were unwound due to the default of the credit default swap counterparty. As of September 30, 2008, the invested amounts of $285.0 million and $100.0 million, respectively, were reflected as a receivable on the statement of financial position. Subsequent to period end, our invested amounts have been returned in cash.

3. Federal Income Taxes

The effective income tax rate for the three months ended September 30, 2008, was lower than the U.S. corporate income tax rate of 35% (U.S. statutory rate   ) primarily due to a current quarter adjustment needed to reflect a decrease in the annual estimated effective income tax rate. The change resulted from an increase in our annual estimate of net realized capital losses from the second quarter estimate. Income tax deductions allowed for corporate dividends received and taxes on our share of earnings generated from equity method investments being reflected in net investment income also contributed to a lower than U.S. statutory rate. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and additional U.S. foreign tax credits resulting from the enactment of legislation to increase the Brazilian tax rate in the second quarter of 2008. As we apply the equity method of accounting to our Brazilian operations, the net increase in deferred tax liabilities associated with the newly enacted rate is reflected in net investment income, but the benefit from additional U.S. foreign tax credits is reflected in income tax expense. The effective income tax rates for the three and nine months ended September 30, 2007, were lower than the U.S.

statutory rate primarily due to income tax deductions allowed for corporate dividends received.

We believe it is reasonably possible that the amount of our unrecognized tax benefits could decrease by $0.0 million to $45.0 million within the next twelve months due to the potential resolution of an uncertain tax position related to the disposition of foreign subsidiaries in a prior year. Any foreign taxes paid upon resolution of this uncertain tax position should result in offsetting credits against U.S. income tax. Therefore, the outcome of this uncertain tax position will not result in a material change to our consolidated financial statements.

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

4. Employee and Agent Benefits

Components of net periodic benefit cost (income):

	Pension benefits For the three months ended September 30, 2008		Other postretirement benefits For the three months ended September 30, 2008	2007
		2007		
	(in millions)			
Service cost	$ **12.4**	$ 11.8	$ **2.1**	$ 2.0
Interest cost	**24.9**	22.4	**4.2**	3.9
Expected return on plan assets	**(32.6)**	(28.6)	**(9.4)**	(8.4)
Amortization of prior service benefit	**(1.9)**	(2.1)	**(0.6)**	(0.7)
Recognized net actuarial loss (gain)	**0.3**	2.5	**(0.8)**	(0.5)
Net periodic benefit cost (income)	$ **3.1**	$ 6.0	$ **(4.5)**	$ (3.7)

	Pension benefits For the nine months ended September 30, 2008	2007	Other postretirement benefits For the nine months ended September 30, 2008	2007
	(in millions)			
Service cost	$ **37.2**	$ 35.3	$ **6.3**	$ 6.0
Interest cost	**74.6**	67.1	**12.6**	11.6
Expected return on plan assets	**(97.7)**	(85.6)	**(28.2)**	(25.2)
Amortization of prior service benefit	**(5.8)**	(6.3)	**(1.9)**	(2.0)
Recognized net actuarial loss (gain)	**0.9**	7.5	**(2.4)**	(1.4)
Net periodic benefit cost (income)	$ **9.2**	$ 18.0	$ **(13.6)**	$ (11.0)

Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act (ERISA) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2008 will be zero so we will not be required to fund our qualified pension plan during 2008. However, it is possible that we may fund the qualified and nonqualified pension plans in 2008 in the range of $37.0 million to $50.0 million. During both the three and nine months ended September 30, 2008, we contributed $37.0 million to these plans.

5. 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.

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

5. 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 Insurance Company (Principal Life). Principal Life s Motion to Transfer Venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleges, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleges that these acts constitute prohibited transactions under ERISA. Plaintiff seeks to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. Plaintiff seeks declaratory, injunctive and monetary relief. 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.

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

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. The Plaintiffs filed an appeal to the Ninth Circuit Court of Appeals on September 11, 2008. In addition, on August 20, 2008, counsel for the Plaintiffs filed a new class action, *Robinson v. WM Trust I, et al.*, (Robinson Plaintiffs), 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 . The Purchase Agreement of the acquired business contained an indemnification provision from WaMu that we believed would have significantly limited our exposure in these lawsuits. The bankruptcy filing by WaMu raises concerns as to the availability of any indemnification protection for us. We are aggressively defending both lawsuits.

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.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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5. Contingencies, Guarantees and Indemnifications (continued)

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 September 30, 2008, was approximately $198.0 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.

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

Securities Posted as Collateral

We posted $683.8 million in fixed maturities, available-for-sale securities at September 30, 2008, to satisfy collateral requirements primarily associated with our derivative credit support annex (collateral) agreements and a reinsurance arrangement. In addition, we posted $1,376.2 million in commercial and residential mortgage-backed securities and commercial mortgage loans as of September 30, 2008, to satisfy collateral requirements associated with our obligation under funding agreements with the Federal Home Loan Bank of Des Moines (FHLB of Des Moines).

Cash Posted as Collateral

As of September 30, 2008, we had received $273.8 million of cash collateral associated with our derivative credit support annex (collateral) agreements. The cash collateral is included in other assets with a corresponding liability reflecting our obligation to return the collateral recorded in other liabilities. We did not post any cash collateral associated with these agreements. 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.

As of September 30, 2008, we had also received $398.8 million of cash collateral on securities lending. The cash collateral is included in other assets with a corresponding liability reflecting our obligation to return the collateral recorded in other liabilities.

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Principal Financial Group, Inc.
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6. Stockholders Equity

Reconciliation of Outstanding Shares

	Series A preferred stock	Series B preferred stock (in millions)	Common stock
Outstanding shares at January 1, 2007	3.0	10.0	268.4
Shares issued			1.6
Treasury stock acquired			(7.5)
Outstanding shares at September 30, 2007	3.0	10.0	262.5
Outstanding shares at January 1, 2008	**3.0**	**10.0**	**259.1**
Shares issued			**1.1**
Treasury stock acquired			**(1.0)**
Outstanding shares at September 30, 2008	**3.0**	**10.0**	**259.2**

Comprehensive income (loss) is as follows:

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in millions)			
Net income	**$ 98.3**	$ 240.5	**$ 457.3**	$ 817.9
Net change in unrealized losses on fixed maturities, available-for-sale	**(2,001.6)**	(209.8)	**(4,173.6)**	(923.4)
Net change in unrealized losses on equity securities, available-for-sale	**(31.3)**	(2.8)	**(33.6)**	(8.2)
Net change in unrealized gains (losses) on equity method subsidiaries and minority interest adjustments	**39.2**	(43.4)	**45.3**	53.2
Adjustments for assumed changes in amortization patterns	**338.8**	11.3	**632.5**	129.8
Adjustment for assumed changes in liability for policyholder benefits and claims	**0.4**		**(11.0)**	
Net change in unrealized gains (losses) on derivative instruments	**16.1**	(20.2)	**28.0**	8.6
Change in net foreign currency translation adjustment	**(59.9)**	(2.2)	**(18.8)**	36.1
Change in unrecognized post-retirement benefit obligation	**(3.1)**	(0.8)	**(9.2)**	(2.2)
Provision for deferred income tax benefits	**588.0**	102.3	**1,234.9**	247.6
Comprehensive income (loss)	**$ (1,015.1)**	$ 74.9	**$ (1,848.2)**	$ 359.4

7. Fair Value Measurement

Valuation hierarchy

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

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Principal Financial Group, Inc.
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7. Fair Value Measurement (continued)

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

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

- **Level 3** 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 significant unobservable inputs.

Determination of fair value

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

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

Fixed Maturities and Equity Securities

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

Derivatives

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

Other Investments

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

Cash Equivalents

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

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

7. Fair Value Measurement (continued)

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.

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 September 30, 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	$ **44,622.1**	$ **132.1**	$ **43,043.2**	$ **1,446.8**
Fixed maturities, trading	**982.2**		**911.0**	**71.2**
Equity securities, available-for-sale	**246.2**	**197.4**	**2.0**	**46.8**
Equity securities, trading	**204.8**	**77.4**	**127.4**	

Net derivative assets and liabilities (1)		**208.9**				**284.8**		**(75.9)**
Other investments (2)		**103.5**		**15.7**		**87.8**		
Cash equivalents (3)		**1,818.8**		**231.7**		**1,587.1**		
Sub-total excluding separate account assets		**48,186.5**		**654.3**		**46,043.3**		**1,488.9**
Separate account assets		**67,087.6**		**38,610.0**		**21,666.4**		**6,811.2**
Total assets	**$**	**115,274.1**	**$**	**39,264.3**	**$**	**67,709.7**	**$**	**8,300.1**
Liabilities								
Investment-type insurance contracts (4)	**$**	**7.0**	**$**		**$**		**$**	**7.0**
Total liabilities	**$**	**7.0**	**$**		**$**		**$**	**7.0**

(1) The fair value of our derivative instruments classified as assets and liabilities at September 30, 2008, was $895.0 million and $686.1 million, respectively. Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities.

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

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

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

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Principal Financial Group, Inc.
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7. Fair Value Measurement (continued)

Changes in Level 3 fair value measurements

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

	For the three months ended September 30, 2008						Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses)					
	Beginning balance as of June 30, 2008	Included in net income (1)	Included in other comprehensive income	Purchases, sales, issuances and settlements (in millions)	Transfers in (out) of Level 3	Ending balance as of September 30, 2008	
Assets							
Fixed maturities, available-for-sale	$ 1,851.5	$ (37.0)	$ 40.7	$ (487.4)	$ 79.0	$ 1,446.8	$ (37.3)
Fixed maturities, trading	65.4	(7.0)		3.7	9.1	71.2	(7.0)
Equity securities, available-for-sale	53.2	(10.1)	(23.3)	27.0		46.8	(10.1)
Net derivative assets and liabilities	(35.8)	(29.7)	(10.4)			(75.9)	(44.7)
Separate account assets	7,097.1	(84.7)		(199.4)	(1.8)	6,811.2	(101.2)
Liabilities							
Investment-type insurance contracts	(2.4)	6.0		3.4		7.0	6.1

	For the nine months ended September 30, 2008						Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses)					
	Beginning balance as of January 1, 2008	Included in net income (1)	Included in other comprehensive income	Purchases, sales, issuances and settlements (in millions)	Transfers in (out) of Level 3	Ending balance as of September 30, 2008	

Assets							
Fixed maturities, available-for-sale	$ **2,201.3**	$ **(87.4)**	$ **(321.6)**	$ **(562.1)**	$ **216.6**	$ **1,446.8**	$ **(53.5)**
Fixed maturities, trading	**92.3**	**(8.6)**		**(11.4)**	**(1.1)**	**71.2**	**(8.6)**
Equity securities, available-for-sale	**51.1**	**(44.4)**	**(23.1)**	**25.3**	**37.9**	**46.8**	**(44.9)**
Net derivative assets and liabilities	**(8.0)**	**(65.6)**	**(3.3)**	**1.0**		**(75.9)**	**(67.2)**
Separate account assets	**7,313.2**	**(368.5)**		**(59.3)**	**(74.2)**	**6,811.2**	**(371.9)**
Liabilities							
Investment-type insurance contracts	**(49.3)**	**13.3**		**43.0**		**7.0**	**13.5**

(1) Both realized and unrealized gains and losses for the three and nine months ended September 30, 2008, are generally reported in net realized/unrealized capital gains (losses) within the consolidated statements of operations. Gains and losses for separate account assets are not reflected in the consolidated statements of operations.

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Principal Financial Group, Inc.
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7. Fair Value Measurement (continued)

Assets and liabilities measured at fair value on a nonrecurring basis

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

Transition

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

8. Segment Information

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

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

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

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

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

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

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

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)
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8. Segment Information (continued)

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

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

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

	September 30, 2008	December 31, 2007
	(in millions)	
Assets:		
U.S. Asset Accumulation	**$ 114,790.5**	$ 126,131.1
Global Asset Management	**1,276.6**	1,438.9
International Asset Management and Accumulation	**9,365.6**	9,350.5
Life and Health Insurance	**14,664.5**	14,816.6
Corporate and Other	**3,312.5**	2,783.1
Total consolidated assets	**$ 143,409.7**	$ 154,520.2

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Principal Financial Group, Inc.
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8. Segment Information (continued)

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in millions)			
Operating revenues by segment:				
U.S. Asset Accumulation	**$ 1,237.5**	$ 1,404.9	**$ 3,697.9**	$ 3,849.9
Global Asset Management	**141.7**	138.9	**425.0**	401.5
International Asset Management and Accumulation	**265.5**	224.6	**700.4**	540.9
Life and Health Insurance	**1,158.9**	1,211.6	**3,527.1**	3,635.5
Corporate and Other	**(52.4)**	(41.9)	**(152.2)**	(107.2)
Total segment operating revenues	**2,751.2**	2,938.1	**8,198.2**	8,320.6
Add:				
Net realized/unrealized capital losses (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**(248.3)**	(89.3)	**(517.5)**	(6.0)
Terminated commercial mortgage securities issuance operation	**(5.1)**	0.7	**(24.0)**	27.4
Subtract:				
Operating revenues from a discontinued real estate investment		(0.1)		(0.4)
Total revenues per consolidated statements of operations	**$ 2,497.8**	$ 2,849.6	**$ 7,656.7**	$ 8,342.4
Operating earnings (losses) by segment, net of related income taxes:				
U.S. Asset Accumulation	**$ 136.5**	$ 186.7	**$ 428.5**	$ 505.9
Global Asset Management	**23.5**	28.3	**67.4**	73.0
International Asset Management and Accumulation	**44.4**	39.3	**107.9**	85.3
Life and Health Insurance	**73.9**	73.4	**219.8**	179.0
Corporate and Other	**(27.1)**	(11.7)	**(59.9)**	(18.7)
Total segment operating earnings, net of related income taxes	**251.2**	316.0	**763.7**	824.5
Net realized/unrealized capital losses, as adjusted (1)	**(156.3)**	(59.4)	**(316.4)**	(18.2)
Other after-tax adjustments (2)	**(4.8)**	(24.3)	**(14.7)**	(13.1)
Net income available to common stockholders per consolidated statements of operations	**$ 90.1**	$ 232.3	**$ 432.6**	$ 793.2

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Principal Financial Group, Inc.
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8. Segment Information (continued)

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in millions)			
Net realized/unrealized capital gains (losses)	**$ (230.6)**	$ (89.3)	**$ (468.1)**	$ 3.7
Periodic settlements and accruals on non-hedge derivatives	**(17.6)**	(5.4)	**(45.8)**	(14.9)
Certain market value adjustments to fee revenues	**(0.1)**	(2.5)	**(3.6)**	(3.5)
Recognition of front-end fee revenues		7.9		8.7
Net realized/unrealized capital losses, net of related revenue adjustments	**(248.3)**	(89.3)	**(517.5)**	(6.0)
Amortization of deferred policy acquisition and sales inducement costs	**16.2**	(6.0)	**46.1**	(4.9)
Capital (gains) losses distributed	**11.8**	2.9	**14.2**	(7.7)
Certain market value adjustments of embedded derivatives	**(3.3)**		**(6.5)**	
Minority interest capital (gains) losses	**(8.1)**	0.2	**(4.4)**	(6.7)
Income tax effect	**75.4**	32.8	**151.7**	7.1
Net realized/unrealized capital losses, as adjusted	**$ (156.3)**	$ (59.4)	**$ (316.4)**	$ (18.2)

(2) For the three months ended September 30, 2008, other after-tax adjustments of $4.8 million included the negative effect of losses associated with our terminated commercial mortgage securities issuance operation that will be exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended September 30, 2007, other after-tax adjustments of $24.3 million included the negative effect of (1) tax refinements related to prior years ($21.2 million) and (2) losses associated with our terminated commercial mortgage securities issuance operation that will be exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP ($3.1 million).

For the nine months ended September 30, 2008, other after-tax adjustments of $14.7 million included (1) the negative effect of losses associated with our terminated commercial mortgage securities issuance operation that will be exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP ($22.3 million) and (2) the positive effect of a change in estimated loss related to a prior year legal contingency ($7.6 million).

For the nine months ended September 30, 2007, other after-tax adjustments of $13.1 million included (1) the negative effect of tax refinements related to prior years ($21.2 million) and (2) the positive effect of earnings associated with our terminated commercial mortgage securities issuance operation that will be exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP ($8.1 million).

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Principal Financial Group, Inc.
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8. Segment Information (continued)

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

	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
	(in millions)			
U.S. Asset Accumulation:				
Full service accumulation	**$ 360.7**	$ 478.5	**$ 1,091.5**	$ 1,215.4
Principal Funds	**159.3**	171.9	**501.4**	508.3
Individual annuities	**278.1**	232.6	**769.9**	567.3
Bank and trust services	**18.9**	18.1	**55.6**	47.7
Eliminations	**(44.2)**	(44.2)	**(138.4)**	(116.4)
Total Accumulation	**772.8**	856.9	**2,280.0**	2,222.3
Investment only	**283.0**	298.7	**845.1**	876.6
Full service payout	**181.7**	249.3	**572.8**	751.0
Total Guaranteed	**464.7**	548.0	**1,417.9**	1,627.6
Total U.S. Asset Accumulation	**1,237.5**	1,404.9	**3,697.9**	3,849.9
Global Asset Management (1)	**141.7**	138.9	**425.0**	401.5
International Asset Management and Accumulation	**265.5**	224.6	**700.4**	540.9
Life and Health Insurance:				
Individual life insurance	**346.1**	341.1	**1,045.8**	1,016.3
Health insurance	**438.6**	497.5	**1,356.0**	1,527.5
Specialty benefits insurance	**374.8**	373.7	**1,127.0**	1,093.7
Eliminations	**(0.6)**	(0.7)	**(1.7)**	(2.0)
Total Life and Health Insurance	**1,158.9**	1,211.6	**3,527.1**	3,635.5
Corporate and Other	**(52.4)**	(41.9)	**(152.2)**	(107.2)
Total operating revenues	**$ 2,751.2**	$ 2,938.1	**$ 8,198.2**	$ 8,320.6
Total operating revenues	**$ 2,751.2**	$ 2,938.1	**$ 8,198.2**	$ 8,320.6
Add:				
Net realized/unrealized capital losses (except periodic settlements and accruals on non-hedge derivatives), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**(248.3)**	(89.3)	**(517.5)**	(6.0)
Terminated commercial mortgage securities issuance operation	**(5.1)**	0.7	**(24.0)**	27.4
Subtract:				
Operating revenues from a discontinued real estate investment		(0.1)		(0.4)
Total revenues per consolidated statements of operations	**$ 2,497.8**	$ 2,849.6	**$ 7,656.7**	$ 8,342.4

(1) Reflects inter-segment revenues of $57.1 million and $57.5 million and $175.0 million and $169.4 million for the three and nine months ended September 30, 2008 and 2007, respectively. These revenues are eliminated within the Corporate and Other segment.

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Principal Financial Group, Inc.
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9. Stock-Based Compensation Plans

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

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

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

	For the nine months ended September 30,	
	2008	**2007**
	(in millions)	
Compensation cost	**$ 33.0**	$ 48.2
Related income tax benefit	**10.6**	15.7
Capitalized as part of an asset	**3.7**	2.8

Nonqualified Stock Options

Nonqualified stock options were granted to certain employees under the 2005 Stock Incentive Plan. Total options granted were 1.6 million for the nine months ended September 30, 2008. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 1.5 percent, a weighted-average expected volatility of 25.4 percent, a weighted-average risk-free interest rate of 3.1 percent and a weighted-average expected term of 6 years. The weighted-average estimated fair value of stock options granted during the nine months ended September 30, 2008, was $15.41 per share.

As of September 30, 2008, there were $16.7 million of total unrecognized compensation costs related to nonvested stock options. The costs are expected to be recognized over a weighted-average service period of approximately 1.8 years.

Performance Share Awards

Performance share awards were granted to certain employees under the 2005 Stock Incentive Plan. Total performance share awards granted were 0.3 million for the nine months ended September 30, 2008. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance objectives to be determined at the end of the respective performance period. The actual number of shares to be awarded at the end of each performance period will range between 0% and 200% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was $59.90 per common share.

As of September 30, 2008, there were $1.7 million of total unrecognized compensation costs related to nonvested performance share awards granted. The costs are expected to be recognized over a weighted-average service period of approximately 0.3 years.

Restricted Stock Units

Restricted stock units were issued to certain employees and agents pursuant to the 2005 Stock Incentive Plan. Total restricted stock units granted were 0.8 million for the nine months ended September 30, 2008. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was $59.52 per common share.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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9. Stock-Based Compensation Plans (continued)

As of September 30, 2008, there were $36.4 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted. The costs are expected to be recognized over a weighted-average period of approximately 2.2 years.

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan, employees purchased 0.6 million shares for the nine months ended September 30, 2008. The weighted-average fair value of the discount on the stock purchased was $7.73 per share.

The maximum number of shares of common stock that we may issue under the Employee Stock Purchase Plan is 2% of the number of shares outstanding immediately following the completion of the Initial Public Offering. As of September 30, 2008, a total of 2.1 million of new shares are available to be made issuable by us for this plan.

10. Earnings Per Common Share

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in millions, except per share data)			
Income from continuing operations, net of related income taxes	**$ 98.3**	$ 240.7	**$ 457.3**	$ 818.3
Subtract:				
Preferred stock dividends	**8.2**	8.2	**24.7**	24.7
Income from continuing operations available to common stockholders, net of related income taxes	**$ 90.1**	$ 232.5	**$ 432.6**	$ 793.6
Weighted-average shares outstanding				
Basic	**259.5**	264.7	**259.2**	266.8
Dilutive effects:				
Stock options	**1.1**	2.1	**1.6**	2.2
Restricted stock units	**0.3**	0.5	**0.4**	0.5
Performance share awards	**0.1**		**0.1**	
Diluted	**261.0**	267.3	**261.3**	269.5
Income from continuing operations per common share:				
Basic	**$ 0.35**	$ 0.88	**$ 1.67**	$ 2.97
Diluted	**$ 0.35**	$ 0.87	**$ 1.66**	$ 2.94

The calculation of diluted earnings per share for the three and nine months ended September 30, 2008 and 2007, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

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Principal Financial Group, Inc.
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(Unaudited)

11. Condensed Consolidating Financial Information

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

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

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Assets					
Fixed maturities, available-for-sale	$	$ 40,035.1	$ 5,168.9	$ (581.9)	$ 44,622.1
Fixed maturities, trading		851.6	130.6	—	982.2
Equity securities, available-for-sale		234.2	12.0	—	246.2
Equity securities, trading		0.4	204.4	—	204.8
Mortgage loans		10,889.7	2,718.1	(339.0)	13,268.8
Real estate		19.9	871.6		891.5
Policy loans		867.2	16.5		883.7
Investment in unconsolidated entities	6,245.3	2,978.3	2,034.0	(10,728.4)	529.2
Other investments		1,175.4	544.6	(267.8)	1,452.2
Cash and cash equivalents	(21.0)	1,531.7	872.5	(114.2)	2,269.0
Accrued investment income		753.0	60.5	(6.6)	806.9
Premiums due and other receivables	—	1,441.1	161.7	(4.4)	1,598.4
Deferred policy acquisition costs		3,513.4	213.7		3,727.1
Property and equipment		435.1	75.7		510.8
Goodwill		96.7	285.6		382.3
Other intangibles		36.1	940.0		976.1
Separate account assets		62,266.3	4,821.3		67,087.6
Other assets	7.1	1,515.4	389.7	1,058.6	2,970.8
Total assets	$ 6,231.4	$ 128,640.6	$ 19,521.4	$ (10,983.7)	$ 143,409.7
Liabilities					
Contractholder funds	$	$ 44,450.4	$ 27.6	$ (239.6)	$ 44,238.4
Future policy benefits and claims		15,889.2	2,889.4	(8.6)	18,770.0
Other policyholder funds		539.4	19.8		559.2
Short-term debt			350.1		350.1
Long-term debt	601.8	99.5	1,290.4	(613.1)	1,378.6
Income taxes currently payable (receivable)	(13.3)	(358.4)	43.0	372.3	43.6

Deferred income taxes	(9.0)	(885.0)	265.1	777.4	148.5
Separate account liabilities		62,266.3	4,821.3	—	67,087.6
Other liabilities	39.3	1,937.3	3,569.4	(324.9)	5,221.1
Total liabilities	618.8	123,938.7	13,276.1	(36.5)	137,797.1
Stockholders equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	3.9	2.5		(2.5)	3.9
Additional paid-in capital	8,366.7	5,622.8	7,793.2	(13,416.0)	8,366.7
Retained earnings	3,847.8	1,151.5	323.2	(1,474.7)	3,847.8
Accumulated other comprehensive loss	(1,887.3)	(2,074.9)	(1,871.1)	3,946.0	(1,887.3)
Treasury stock, at cost	(4,718.6)				(4,718.6)
Total stockholders equity	5,612.6	4,701.9	6,245.3	(10,947.2)	5,612.6
Total liabilities and stockholders equity	$ 6,231.4	$ 128,640.6	$ 19,521.4	$ (10,983.7)	$ 143,409.7

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2008
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11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2007

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Assets					
Fixed maturities, available-for-sale	$	$ 42,178.6	$ 5,288.6	$ (728.3)	$ 46,738.9
Fixed maturities, trading		267.4	261.9		529.3
Equity securities, available-for-sale		305.0	11.4		316.4
Equity securities, trading			269.8		269.8
Mortgage loans		10,284.2	2,693.1	(317.7)	12,659.6
Real estate		10.9	851.6		862.5
Policy loans		853.7	16.2		869.9
Investment in unconsolidated entities	8,031.2	703.1	3,861.1	(12,104.7)	490.7
Other investments		3,559.5	464.7	(2,396.3)	1,627.9
Cash and cash equivalents	(3.2)	927.8	536.4	(116.6)	1,344.4
Accrued investment income		722.9	59.2	(8.0)	774.1
Premiums due and other receivables	0.9	696.8	267.2	(13.7)	951.2
Deferred policy acquisition costs		2,626.7	183.4		2,810.1
Property and equipment		421.6	47.4		469.0
Goodwill		94.6	280.1		374.7
Other intangibles		38.3	968.6		1,006.9
Separate account assets		75,743.3	4,743.5		80,486.8
Other assets	6.3	1,371.2	395.3	165.2	1,938.0
Total assets	$ 8,035.2	$ 140,805.6	$ 21,199.5	$ (15,520.1)	$ 154,520.2
Liabilities					
Contractholder funds	$	$ 40,511.7	$ 21.4	$ (244.2)	$ 40,288.9
Future policy benefits and claims		15,626.4	2,834.2	(5.9)	18,454.7
Other policyholder funds		526.0	14.5		540.5
Short-term debt			371.9	(81.1)	290.8
Long-term debt	601.8	99.5	1,320.8	(623.3)	1,398.8
Income taxes currently payable (receivable)	(7.0)	(255.0)	38.9	264.7	41.6
Deferred income taxes	(6.2)	253.1	340.3	(10.9)	576.3
Separate account liabilities		75,743.3	4,743.5		80,486.8

Other liabilities		24.9		1,823.9		3,482.8		(311.5)		5,020.1
Total liabilities		613.5		134,328.9		13,168.3		(1,012.2)		147,098.5
Stockholders equity										
Series A preferred stock										
Series B preferred stock		0.1								0.1
Common stock		3.9		2.5				(2.5)		3.9
Additional paid-in capital		8,295.4		5,595.9		7,760.7		(13,356.6)		8,295.4
Retained earnings (deficit)		3,414.3		760.8		(156.7)		(604.1)		3,414.3
Accumulated other comprehensive income		420.2		117.5		427.2		(544.7)		420.2
Treasury stock, at cost		(4,712.2)								(4,712.2)
Total stockholders equity		7,421.7		6,476.7		8,031.2		(14,507.9)		7,421.7
Total liabilities and stockholders equity	$	8,035.2	$	140,805.6	$	21,199.5	$	(15,520.1)	$	154,520.2

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Revenues					
Premiums and other considerations	$	$ 3,050.9	$ 208.0	$	$ 3,258.9
Fees and other revenues		1,109.8	1,059.0	(333.9)	1,834.9
Net investment income (loss)	(0.2)	2,447.8	566.6	16.8	3,031.0
Net realized/unrealized capital losses	(1.2)	(467.7)	(63.0)	63.8	(468.1)
Total revenues	(1.4)	6,140.8	1,770.6	(253.3)	7,656.7
Expenses					
Benefits, claims and settlement expenses		4,216.2	499.0	(12.0)	4,703.2
Dividends to policyholders		210.2			210.2
Operating expenses	35.8	1,491.4	992.1	(290.1)	2,229.2
Total expenses	35.8	5,917.8	1,491.1	(302.1)	7,142.6
Income (loss) from continuing operations before income taxes	(37.2)	223.0	279.5	48.8	514.1
Income taxes (benefits)	(15.5)	25.7	49.2	(2.6)	56.8
Equity in the net income of subsidiaries	479.0	192.5	248.7	(920.2)	
Net income	457.3	389.8	479.0	(868.8)	457.3
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	$ 432.6	$ 389.8	$ 479.0	$ (868.8)	$ 432.6

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2008
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11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2007

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Revenues					
Premiums and other considerations	$	$ 3,275.5	$ 180.5	$	$ 3,456.0
Fees and other revenues		1,212.7	1,043.8	(302.6)	1,953.9
Net investment income	6.2	2,447.6	476.9	(1.9)	2,928.8
Net realized/unrealized capital gains (losses)		(59.6)	56.3	7.0	3.7
Total revenues	6.2	6,876.2	1,757.5	(297.5)	8,342.4
Expenses					
Benefits, claims and settlement expenses		4,379.2	358.3	(11.6)	4,725.9
Dividends to policyholders		221.9			221.9
Operating expenses	36.2	1,596.3	952.7	(269.2)	2,316.0
Total expenses	36.2	6,197.4	1,311.0	(280.8)	7,263.8
Income (loss) from continuing operations before income taxes	(30.0)	678.8	446.5	(16.7)	1,078.6
Income taxes (benefits)	(12.4)	170.6	101.7	0.4	260.3
Equity in the net income of subsidiaries, excluding discontinued operations	835.9	212.7	490.9	(1,539.5)	
Income from continuing operations, net of related income taxes	818.3	720.9	835.7	(1,556.6)	818.3
Loss from discontinued operations, net of related income taxes	(0.4)		(0.2)	0.2	(0.4)
Net income	817.9	720.9	835.5	(1,556.4)	817.9
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	$ 793.2	$ 720.9	$ 835.5	$ (1,556.4)	$ 793.2

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	$ (24.3)	$ 1,450.3	$ 399.1	$ 42.1	$ 1,867.2
Investing activities					
Available-for-sale securities:					
Purchases		(5,519.2)	(635.7)	(50.7)	(6,205.6)
Sales		356.3	168.2		524.5
Maturities		2,307.5	176.2		2,483.7
Mortgage loans acquired or originated		(1,563.6)	(206.2)	87.5	(1,682.3)
Mortgage loans sold or repaid		941.6	166.4	(66.2)	1,041.8
Real estate acquired		(0.3)	(20.3)		(20.6)
Real estate sold			68.7		68.7
Net purchases of property and equipment		(53.7)	(29.6)		(83.3)
Purchases of interests in subsidiaries, net of cash acquired			(20.3)		(20.3)
Dividends received from unconsolidated entities	6.1	104.3	7.5	(117.9)	
Net change in other investments	—	(139.0)	35.9	(21.8)	(124.9)
Net cash provided by (used in) investing activities	6.1	(3,566.1)	(289.2)	(169.1)	(4,018.3)
Financing activities					
Issuance of common stock	31.5				31.5
Acquisition of treasury stock	(6.4)				(6.4)
Proceeds from financing element derivatives		130.6			130.6
Payments for financing element derivatives		(91.3)			(91.3)
Excess tax benefits from share-based payment arrangements		0.7	2.1		2.8
Dividends to preferred stockholders	(24.7)				(24.7)

Issuance of long-term debt						23.4		(17.0)		6.4
Principal repayments of long-term debt						(44.4)		27.1		(17.3)
Net proceeds of short-term borrowings						62.5		1.4		63.9
Dividends paid to parent				(7.5)		(110.4)		117.9		
Investment contract deposits				9,852.4						9,852.4
Investment contract withdrawals				(7,160.6)						(7,160.6)
Net increase in banking operation deposits						293.0				293.0
Other				(4.6)						(4.6)
Net cash provided by financing activities		0.4		2,719.7		226.2		129.4		3,075.7
Net increase (decrease) in cash and cash equivalents		(17.8)		603.9		336.1		2.4		924.6
Cash and cash equivalents at beginning of period		(3.2)		927.8		536.4		(116.6)		1,344.4
Cash and cash equivalents at end of period	$	(21.0)	$	1,531.7	$	872.5	$	(114.2)	$	2,269.0

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2007

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	$ (14.5)	$ 2,417.9	$ 1,135.3	$ (495.6)	$ 3,043.1
Investing activities					
Available-for-sale securities:					
Purchases		(7,448.6)	(590.1)	14.0	(8,024.7)
Sales		2,499.9	227.3		2,727.2
Maturities		3,204.8	225.3		3,430.1
Mortgage loans acquired or originated		(1,636.7)	(567.3)	84.7	(2,119.3)
Mortgage loans sold or repaid		1,317.3	182.0	(23.0)	1,476.3
Real estate acquired		(70.8)	(17.0)		(87.8)
Real estate sold		4.6	1.6		6.2
Net purchases of property and equipment		(36.5)	(27.7)		(64.2)
Purchases of interests in subsidiaries, net of cash acquired			(69.1)		(69.1)
Dividends received from (contributions to) unconsolidated entities	506.3	(86.0)	456.3	(876.6)	
Net change in other investments	—	(159.7)	(128.4)	181.5	(106.6)
Net cash provided by (used in) investing activities	506.3	(2,411.7)	(307.1)	(619.4)	(2,831.9)
Financing activities					
Issuance of common stock	49.5				49.5
Acquisition of treasury stock	(436.2)				(436.2)
Proceeds from financing element derivatives		122.7			122.7
Payments for financing element derivatives		(107.0)			(107.0)
Excess tax benefits from share-based payment arrangements		4.5	2.1		6.6
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt		10.4	95.3	(97.2)	8.5

Principal repayments of long-term debt			(42.3)		(42.3)
Net repayments of short-term borrowings			(62.3)	32.9	(29.4)
Dividends paid to parent		(456.3)	(420.3)	876.6	
Investment contract deposits		6,824.8			6,824.8
Investment contract withdrawals		(6,427.5)			(6,427.5)
Net increase in banking operation deposits			811.2		811.2
Net cash provided by (used in) financing activities	(411.4)	(28.4)	383.7	812.3	756.2
Discontinued operations					
Net cash provided by operating activities			2.2		2.2
Net cash used in investing activities			(1.3)		(1.3)
Net cash used in financing activities	—	—	(0.4)		(0.4)
Net cash provided by discontinued operations			0.5		0.5
Net increase (decrease) in cash and cash equivalents	80.4	(22.2)	1,212.4	(302.7)	967.9
Cash and cash equivalents at beginning of period	30.9	1,399.8	261.1	(101.0)	1,590.8
Cash and cash equivalents at end of period	$ 111.3	$ 1,377.6	$ 1,473.5	$ (403.7)	$ 2,558.7
Cash and cash equivalents of discontinued operations included above					
At beginning of period	$	$	$ (0.7)	$	$ (0.7)
At end of period	$	$	$ (0.2)	$	$ (0.2)

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

11. Condensed Consolidating Financial Information (continued)

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

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

Condensed Consolidating Statements of Financial Position
September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Assets					
Fixed maturities, available-for-sale	$	$	$ 44,622.1	$	$ 44,622.1
Fixed maturities, trading			982.2		982.2
Equity securities, available-for-sale			246.2		246.2
Equity securities, trading			204.8		204.8
Mortgage loans			13,268.8		13,268.8
Real estate			891.5		891.5
Policy loans			883.7		883.7
Investment in unconsolidated entities	6,245.3	6,832.5	529.0	(13,077.6)	529.2
Other investments		53.1	1,420.4	(21.3)	1,452.2
Cash and cash equivalents	(21.0)	536.1	2,414.9	(661.0)	2,269.0
Accrued investment income			806.9		806.9
Premiums due and other receivables	—	2.6	1,608.2	(12.4)	1,598.4
Deferred policy acquisition costs			3,727.1		3,727.1
Property and equipment			510.8		510.8
Goodwill			382.3		382.3

Other intangibles						976.1				976.1
Separate account assets						67,087.6				67,087.6
Other assets		7.1		9.4		2,924.5		29.8		2,970.8
Total assets	$	6,231.4	$	7,433.7	$	143,487.1	$	(13,742.5)	$	143,409.7

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)
September 30, 2008
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

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

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Liabilities					
Contractholder funds	$	$	$ 44,238.4	$	$ 44,238.4
Future policy benefits and claims			18,770.0		18,770.0
Other policyholder funds			559.2		559.2
Short-term debt		304.2	337.4	(291.5)	350.1
Long-term debt	601.8	454.8	322.0		1,378.6
Income taxes currently payable (receivable)	(13.3)	(4.7)	15.7	45.9	43.6
Deferred income taxes	(9.0)	1.6	169.8	(13.9)	148.5
Separate account liabilities			67,087.6		67,087.6
Other liabilities	39.3	432.5	5,154.5	(405.2)	5,221.1
Total liabilities	618.8	1,188.4	136,654.6	(664.7)	137,797.1
Stockholders equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	3.9		17.8	(17.8)	3.9
Additional paid-in capital	8,366.7	7,793.2	7,140.8	(14,934.0)	8,366.7
Retained earnings	3,847.8	323.2	1,530.5	(1,853.7)	3,847.8
Accumulated other comprehensive loss	(1,887.3)	(1,871.1)	(1,854.6)	3,725.7	(1,887.3)
Treasury stock, at cost	(4,718.6)		(2.0)	2.0	(4,718.6)
Total stockholders equity	5,612.6	6,245.3	6,832.5	(13,077.8)	5,612.6
Total liabilities and stockholders equity	$ 6,231.4	$ 7,433.7	$ 143,487.1	$ (13,742.5)	$ 143,409.7

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)
September 30, 2008
(Unaudited)

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Financial Position
December 31, 2007

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Assets					
Fixed maturities, available-for-sale	$	$	$ 46,738.9	$	$ 46,738.9
Fixed maturities, trading			529.3		529.3
Equity securities, available-for-sale			316.4		316.4
Equity securities, trading			269.8		269.8
Mortgage loans			12,659.6		12,659.6
Real estate			862.5		862.5
Policy loans			869.9		869.9
Investment in unconsolidated entities	8,031.2	8,713.7	490.7	(16,744.9)	490.7
Other investments		41.9	1,595.1	(9.1)	1,627.9
Cash and cash equivalents	(3.2)	349.1	1,665.1	(666.6)	1,344.4
Accrued investment income			774.1		774.1
Premiums due and other receivables	0.9	7.7	951.8	(9.2)	951.2
Deferred policy acquisition costs			2,810.1		2,810.1
Property and equipment			469.0		469.0
Goodwill			374.7		374.7
Other intangibles			1,006.9		1,006.9
Separate account assets			80,486.8		80,486.8
Other assets	6.3	9.0	1,897.5	25.2	1,938.0
Total assets	$ 8,035.2	$ 9,121.4	$ 154,768.2	$ (17,404.6)	$ 154,520.2
Liabilities					
Contractholder funds	$	$	$ 40,288.9	$	$ 40,288.9
Future policy benefits and claims			18,454.7		18,454.7
Other policyholder funds			540.5		540.5
Short-term debt		233.2	402.1	(344.5)	290.8
Long-term debt	601.8	454.7	342.3		1,398.8
Income taxes currently payable (receivable)	(7.0)	(2.4)	12.2	38.8	41.6
Deferred income taxes	(6.2)	17.0	576.3	(10.8)	576.3
Separate account liabilities			80,486.8		80,486.8
Other liabilities	24.9	387.7	4,950.7	(343.2)	5,020.1
Total liabilities	613.5	1,090.2	146,054.5	(659.7)	147,098.5

Stockholders equity					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	3.9		17.8	(17.8)	3.9
Additional paid-in capital	8,295.4	7,760.7	7,125.6	(14,886.3)	8,295.4
Retained earnings (deficit)	3,414.3	(156.7)	1,135.0	(978.3)	3,414.3
Accumulated other comprehensive income	420.2	427.2	437.3	(864.5)	420.2
Treasury stock, at cost	(4,712.2)		(2.0)	2.0	(4,712.2)
Total stockholders equity	7,421.7	8,031.2	8,713.7	(16,744.9)	7,421.7
Total liabilities and stockholders equity	$ 8,035.2	$ 9,121.4	$ 154,768.2	$ (17,404.6)	$ 154,520.2

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Revenues					
Premiums and other considerations	$	$	$ 3,258.9	$	$ 3,258.9
Fees and other revenues		0.1	1,846.0	(11.2)	1,834.9
Net investment income (loss)	(0.2)	(2.2)	3,033.4		3,031.0
Net realized/unrealized capital losses	(1.2)	(0.4)	(466.4)	(0.1)	(468.1)
Total revenues	(1.4)	(2.5)	7,671.9	(11.3)	7,656.7
Expenses					
Benefits, claims and settlement expenses			4,703.2		4,703.2
Dividends to policyholders			210.2		210.2
Operating expenses	35.8	32.6	2,172.1	(11.3)	2,229.2
Total expenses	35.8	32.6	7,085.5	(11.3)	7,142.6
Income (loss) from continuing operations before income taxes	(37.2)	(35.1)	586.4		514.1
Income taxes (benefits)	(15.5)	(29.7)	102.0		56.8
Equity in the net income of subsidiaries	479.0	484.4		(963.4)	
Net income	457.3	479.0	484.4	(963.4)	457.3
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	$ 432.6	$ 479.0	$ 484.4	$ (963.4)	$ 432.6

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Operations
For the nine months ended September 30, 2007

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Revenues					
Premiums and other considerations	$	$	$ 3,456.0	$	$ 3,456.0
Fees and other revenues			1,962.8	(8.9)	1,953.9
Net investment income	6.2	2.1	2,920.2	0.3	2,928.8
Net realized/unrealized capital gains		2.5	1.2		3.7
Total revenues	6.2	4.6	8,340.2	(8.6)	8,342.4
Expenses					
Benefits, claims and settlement expenses			4,725.9		4,725.9
Dividends to policyholders			221.9		221.9
Operating expenses	36.2	30.3	2,258.1	(8.6)	2,316.0
Total expenses	36.2	30.3	7,205.9	(8.6)	7,263.8
Income (loss) from continuing operations before income taxes	(30.0)	(25.7)	1,134.3		1,078.6
Income taxes (benefits)	(12.4)	(8.5)	281.2		260.3
Equity in the net income of subsidiaries, excluding discontinued operations	835.9	853.1		(1,689.0)	
Income from continuing operations, net of related income taxes	818.3	835.9	853.1	(1,689.0)	818.3
Loss from discontinued operations, net of related income taxes	(0.4)	(0.4)	(0.4)	0.8	(0.4)
Net income	817.9	835.5	852.7	(1,688.2)	817.9
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	$ 793.2	$ 835.5	$ 852.7	$ (1,688.2)	$ 793.2

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2008

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	$ (24.3)	$ 10.1	$ 1,889.9	$ (8.5)	$ 1,867.2
Investing activities					
Available-for-sale securities:					
Purchases			(6,205.6)		(6,205.6)
Sales			524.5		524.5
Maturities			2,483.7		2,483.7
Mortgage loans acquired or originated			(1,682.3)		(1,682.3)
Mortgage loans sold or repaid			1,041.8		1,041.8
Real estate acquired			(20.6)		(20.6)
Real estate sold			68.7		68.7
Net purchases of property and equipment			(83.3)		(83.3)
Purchases of interests in subsidiaries, net of cash acquired		(2.3)	(18.0)		(20.3)
Dividends received from unconsolidated entities	6.1	75.1		(81.2)	
Net change in other investments	—	39.4	(125.4)	(38.9)	(124.9)
Net cash provided by (used in) investing activities	6.1	112.2	(4,016.5)	(120.1)	(4,018.3)
Financing activities					
Issuance of common stock	31.5				31.5
Acquisition of treasury stock	(6.4)				(6.4)
Proceeds from financing element derivatives			130.6		130.6
Payments for financing element derivatives			(91.3)		(91.3)
Excess tax benefits from share-based payment arrangements			2.8		2.8
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt			6.4		6.4
			(17.3)		(17.3)

Principal repayments of long-term debt					
Net proceeds (repayments) of short-term borrowings		**70.8**	**(59.9)**	**53.0**	**63.9**
Dividends paid to parent		**(6.1)**	**(75.1)**	**81.2**	
Investment contract deposits			**9,852.4**		**9,852.4**
Investment contract withdrawals			**(7,160.6)**		**(7,160.6)**
Net increase in banking operation deposits			**293.0**		**293.0**
Other			**(4.6)**		**(4.6)**
Net cash provided by financing activities	**0.4**	**64.7**	**2,876.4**	**134.2**	**3,075.7**
Net increase (decrease) in cash and cash equivalents	**(17.8)**	**187.0**	**749.8**	**5.6**	**924.6**
Cash and cash equivalents at beginning of period	**(3.2)**	**349.1**	**1,665.1**	**(666.6)**	**1,344.4**
Cash and cash equivalents at end of period	**$ (21.0)**	**$ 536.1**	**$ 2,414.9**	**$ (661.0)**	**$ 2,269.0**

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

11. Condensed Consolidating Financial Information (continued)

Condensed Consolidating Statements of Cash Flows
For the nine months ended September 30, 2007

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations and Other	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	$ (14.5)	$ 740.9	$ 2,703.0	$ (386.3)	$ 3,043.1
Investing activities					
Available-for-sale securities:					
Purchases		49.6	(8,074.3)		(8,024.7)
Sales		13.4	2,713.8		2,727.2
Maturities			3,430.1		3,430.1
Mortgage loans acquired or originated			(2,119.3)		(2,119.3)
Mortgage loans sold or repaid			1,476.3		1,476.3
Real estate acquired			(87.8)		(87.8)
Real estate sold			6.2		6.2
Net purchases of property and equipment			(64.2)		(64.2)
Purchases of interests in subsidiaries, net of cash acquired		(75.0)	5.9		(69.1)
Dividends received from unconsolidated entities	506.3	403.3		(909.6)	
Net change in other investments	—	4.3	(89.3)	(21.6)	(106.6)
Net cash provided by (used in) investing activities	506.3	395.6	(2,802.6)	(931.2)	(2,831.9)
Financing activities					
Issuance of common stock	49.5				49.5
Acquisition of treasury stock	(436.2)				(436.2)
Proceeds from financing element derivatives			122.7		122.7
Payments for financing element derivatives			(107.0)		(107.0)
Excess tax benefits from share-based payment arrangements			6.6		6.6
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt			8.5		8.5
Principal repayments of long-term debt		(10.5)	(31.8)		(42.3)
Net repayments of short-term borrowings			(14.3)	(15.1)	(29.4)
Dividends paid to parent		(506.3)	(403.3)	909.6	
Investment contract deposits			6,824.8		6,824.8
Investment contract withdrawals			(6,427.5)		(6,427.5)
Net increase in banking operation deposits			811.2		811.2
Net cash provided by (used in) financing activities	(411.4)	(516.8)	789.9	894.5	756.2
Discontinued operations					
Net cash provided by operating activities			2.2		2.2
Net cash used in investing activities			(1.3)		(1.3)
Net cash used in financing activities			(0.4)		(0.4)
Net cash provided by discontinued operations			0.5		0.5
Net increase in cash and cash equivalents	80.4	619.7	690.8	(423.0)	967.9

Cash and cash equivalents at beginning of period		30.9		129.2		2,031.3		(600.6)		1,590.8
Cash and cash equivalents at end of period	$	111.3	$	748.9	$	2,722.1	$	(1,023.6)	$	2,558.7
Cash and cash equivalents of discontinued operations included above										
At beginning of period	$		$		$	(0.7)	$		$	(0.7)
At end of period	$		$		$	(0.2)	$		$	(0.2)

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

12. Subsequent Event

On October 11, 2008, our Board of Directors declared an annual common stock dividend of approximately $116.7 million, equal to $0.45 per share, payable on December 5, 2008, to common stockholders of record as of November 14, 2008.

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

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

Forward-Looking Information

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

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties. Those risks and uncertainties include, but are not limited to the risk factors listed in Part II, Item 1A. Risk Factors.

Overview

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

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

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

- International Asset Management and Accumulation, which consists of Principal International, offers retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products through operations in Brazil, Chile, China, Hong Kong, India, Malaysia and Mexico.

- Life and Health Insurance, which provides individual life insurance, group health insurance as well as specialty benefits in the U.S. Our individual life insurance products include universal and variable universal life insurance and traditional life insurance. Our health insurance products include group medical insurance and fee-for-service claims administration and wellness services. Our specialty benefits products include group dental and vision insurance, individual and group disability insurance and group life insurance.

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

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Recent Events

Common Stockholder Dividend

On October 11, 2008, our Board of Directors declared an annual common stock dividend of approximately $116.7 million, equal to $0.45 per share, payable on December 5, 2008, to common stockholders of record as of November 14, 2008.

Government Programs

In response to the financial crisis affecting the financial markets, on October 3, 2008, President Bush signed the Emergency Economic Stabilization Act of 2008 (the EESA) into law. Pursuant to the EESA, the U.S. Treasury has the authority to, among other things, make equity investments in certain financial institutions and purchase mortgage-backed and other securities from financial institutions for an aggregate total amount of up to $700.0 billion. On October 14, 2008, the U.S. Treasury announced that the U.S. government would acquire up to a total of $250.0 billion of equity stakes in financial institutions throughout the U.S., including preferred shares of nine of the largest financial institutions in the U.S.

In addition, on October 7, 2008, the Federal Reserve announced that it would buy U.S. commercial paper through a special funding facility designed to provide liquidity to short-term-funding markets and backstop U.S. issuers of commercial paper. The facility will buy unsecured and asset-backed three-month commercial paper directly from eligible issuers and the U.S. Federal Reserve will lend funds to the funding vehicle at the target federal funds rate. The Federal Reserve began purchasing U.S. commercial paper under this program on October 27, 2008. PFS has been granted approval to participate in the commercial paper program.

The federal government, Federal Reserve and other governmental and regulatory bodies have taken or are considering taking other actions to address the financial crisis, including future investments in other financial institutions. There can be no assurance as to what impact such actions will have on the financial markets, including the extreme levels of volatility currently being experienced. Such continued volatility could materially and adversely affect our business, financial condition and results of operations, or the trading price of our common stock. As details emerge, we are evaluating our options and considering a strategy to utilize these additional sources of liquidity and capital flexibility.

Transactions Affecting Comparability of Results of Operations

Acquisitions

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

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

Dispositions

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

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

The property had revenues of $(0.1) million and $(0.4) million for the three and nine months ended September, 30, 2007, respectively. The property had after-tax net losses of $0.2 million and $0.4 million for the three and nine months ended September 30, 2007, respectively.

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Other

Commercial Mortgage Securities Issuance Operation. During the third quarter of 2008, we made a decision to terminate our commercial mortgage securities issuance operation. This termination does not qualify for discontinued operations treatment under U.S. GAAP. Therefore, the results of the terminated commercial mortgage securities issuance operation are still included in our consolidated income from continuing operations.

As a result of our decision to terminate our commercial mortgage securities issuance operation, amounts previously included in our Global Asset Management segment operating earnings related to our commercial mortgage securities issuance operation have been removed from operating earnings for all periods presented and are reported as other after-tax adjustments. Our commercial mortgage securities issuance operation had operating revenues of $(5.1) million and $0.7 million for the three months ended September 30, 2008 and 2007, respectively, and $(24.0) million and $27.4 million for the nine months ended September 30, 2008 and 2007, respectively. Our commercial mortgage securities issuance operation had after-tax operating earnings (losses) of $(4.8) million and $(3.1) million for the three months ended September 30, 2008 and 2007, respectively, and $(22.3) million and $8.1 million for the nine months ended September 30, 2008 and 2007, respectively.

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

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

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

Foreign currency exchange rate fluctuations create variances in our financial statement line items but have not had a material impact on our consolidated net income. Our consolidated net income was positively impacted by $5.2 million and $2.0 million for the three months ended September 30, 2008 and 2007, respectively, and positively impacted $11.4 million and $3.4 million for the nine months ended September 30, 2008 and 2007, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Stock-Based Compensation Plans

For information related to our Stock-Based Compensation Plans, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Stock-Based Compensation Plans.

Defined Benefit Pension Expense

The 2008 annual pension benefit expense for substantially all of our employees and certain agents is expected to be $12.3 million pre-tax, which is an $11.7 million decrease from the 2007 pre-tax pension expense of $24.0 million. This decrease is primarily due to the increase in discount rate and greater than estimated returns on plan assets. The expected long-term return on plan assets assumption remained at 8.25%. Approximately $3.1 million and $9.2 million of pre-tax pension expense were reflected in the determination of net income for the three and nine months ended September 30, 2008, respectively. In addition, approximately $3.1 million of pre-tax pension expense will be reflected in the last quarter for 2008. The discount rate used to develop the 2008 expense was raised to 6.3%, up from the 6.15% discount rate used to develop the 2007 expense.

Recent Accounting Pronouncements

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

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Results of Operations

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

	For the three months ended September 30,			For the nine months ended September 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Revenues:						
Premiums and other considerations	**$ 1,049.7**	$ 1,171.4	$ (121.7)	**$ 3,258.9**	$ 3,456.0	$ (197.1)
Fees and other revenues	**599.0**	738.5	(139.5)	**1,834.9**	1,953.9	(119.0)
Net investment income	**1,079.7**	1,029.0	50.7	**3,031.0**	2,928.8	102.2
Net realized/unrealized capital gains (losses)	**(230.6)**	(89.3)	(141.3)	**(468.1)**	3.7	(471.8)
Total revenues	**2,497.8**	2,849.6	(351.8)	**7,656.7**	8,342.4	(685.7)
Expenses:						
Benefits, claims and settlement expenses	**1,597.2**	1,643.2	(46.0)	**4,703.2**	4,725.9	(22.7)
Dividends to policyholders	**70.4**	73.9	(3.5)	**210.2**	221.9	(11.7)
Operating expenses	**734.1**	800.9	(66.8)	**2,229.2**	2,316.0	(86.8)
Total expenses	**2,401.7**	2,518.0	(116.3)	**7,142.6**	7,263.8	(121.2)
Income from continuing operations before income taxes	**96.1**	331.6	(235.5)	**514.1**	1,078.6	(564.5)
Income taxes (benefits)	**(2.2)**	90.9	(93.1)	**56.8**	260.3	(203.5)
Income from continuing operations, net of related income taxes	**98.3**	240.7	(142.4)	**457.3**	818.3	(361.0)
Loss from discontinued operations, net of related income taxes		(0.2)	0.2		(0.4)	0.4
Net income	**98.3**	240.5	(142.2)	**457.3**	817.9	(360.6)
Preferred stock dividends	**8.2**	8.2		**24.7**	24.7	
Net income available to common stockholders	**$ 90.1**	$ 232.3	$ (142.2)	**$ 432.6**	$ 793.2	$ (360.6)

Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Net Income Available to Common Stockholders

Net income available to common stockholders decreased primarily due to a $98.1 million after-tax change in net realized/unrealized capital losses. The change in net realized/unrealized capital losses was primarily driven by higher other than temporary impairments of fixed maturity and equity securities partially offset by gains versus losses for derivatives not in a hedge accounting relationship. In addition, net income available to common stockholders for the U.S. Asset Accumulation segment included a $30.1 million after-tax benefit in 2007 for our full service accumulation business associated with the unlocking of our unearned revenue and DPAC assumptions following a comprehensive assumption study that was completed in the third quarter of 2007.

Total Revenues

Premiums decreased $57.4 million for the U.S. Asset Accumulation segment, primarily resulting from a decrease in sales of full service payout annuities with life contingencies. In addition, premiums and other considerations decreased $55.3 million for the Life and Health Insurance segment primarily due to a reduction in average covered medical members in our health insurance business.

Fees for the U.S. Asset Accumulation segment decreased $139.3 million, primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred revenue.

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Net investment income increased primarily due to a $1,876.6 million increase in average invested assets and cash and a slight increase in the average annualized yield on invested assets and cash. The average annualized yield on invested assets and cash was 6.5% for the three months ended September 30, 2008, compared to 6.4% for the three months ended September 30, 2007.

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

Total Expenses

Benefits, claims and settlement expenses decreased $40.8 million in our U.S. Asset Accumulation segment primarily due to a decrease in the change in reserves in our full service payout business resulting from lower sales of full service payout annuities with life contingencies. In addition, benefits, claims and settlement expenses decreased $36.3 million for the Life and Health Insurance segment, as a decrease in average covered medical members was partially offset by higher medical claim costs per member in our health insurance business and due to growth in our individual life insurance business. Partially offsetting these decreases was a $31.2 million increase for the International Asset Management and Accumulation segment, primarily due to higher interest crediting rates to customers and the strengthening of the Chilean peso against the U.S. dollar, which were partially offset by a lower change in reserves associated with decreased sales of single premium annuities with life contingencies in Chile.

Operating expenses decreased $70.6 million for the U.S. Asset Accumulation segment primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred expenses.

Income Taxes

The effective income tax rates were (2)% and 27% for the three months ended September 30, 2008 and 2007, respectively. The effective income tax rate for the three months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to a current quarter adjustment needed to reflect a decrease in the annual estimated effective income tax rate resulting from an increase in our annual estimate of net realized capital losses from the second quarter estimate. Income tax deductions allowed for corporate dividends received and taxes on our share of earnings generated from equity method investments being 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 September 30, 2007, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received. The effective income tax rate decreased to (2)% from 27% for the three months ended September 30, 2008 and 2007, respectively, primarily due to a current quarter adjustment needed to reflect a decrease in the annual estimated effective income tax rate and due to tax refinements made in 2007 related to prior years.

Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Net Income Available to Common Stockholders

Net income available to common stockholders decreased primarily due to a $317.1 million after-tax change in net realized/unrealized capital gains (losses). The change in net realized/unrealized capital gains (losses) was primarily driven by higher other than temporary impairments of fixed maturity and equity securities and net losses versus net gains on trading fixed maturity and equity securities.

Total Revenues

Premiums and other considerations decreased $137.7 million for the Life and Health Insurance segment primarily due to a reduction in average covered medical members in our health insurance business. In addition, premiums decreased $87.1 million for the U.S. Asset Accumulation segment primarily due to a decrease in sales of full service payout annuities with life contingencies, which was partially offset by an increase in sales of individual payout annuities with life contingencies from certain distribution channels.

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Fees for the U.S. Asset Accumulation segment decreased $155.0 million primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred revenue. Partially offsetting this decrease was a $28.0 million increase for the Life and Health Insurance segment primarily due to growth in the individual universal life and variable universal life insurance lines of business, which was partially offset by a change in classification in 2008 of the reimbursement of certain pass-through expenses, removing them from both fee revenues and operating expenses for our health insurance business.

Net investment income increased primarily due to a $1,873.4 million increase in average invested assets and cash and a slight increase in the average annualized yield on invested assets and cash. The average annualized yield on invested assets and cash was 6.2% for the nine months ended September 30, 2008, compared to 6.1% for the nine months ended September 30, 2007.

Net realized/unrealized capital gains (losses) can be volatile due to other than temporary impairments of invested assets, mark to market adjustments of certain invested assets and our decision to sell appreciated invested assets. Net realized/unrealized capital losses increased primarily due to higher other than temporary impairments, net of recoveries from sales, on fixed maturity and equity securities and net losses versus net gains on trading fixed maturity and equity securities. For additional information, see Investments Investment Results.

Total Expenses

Benefits, claims and settlement expenses decreased $148.2 million for the Life and Health Insurance segment primarily due to a decrease in average covered medical members and favorable prior period claim development relative to the same period a year ago in our health insurance business. In addition, benefit expense for the U.S. Asset Accumulation segment decreased $13.7 million, primarily due to a decrease in the change in reserves resulting from lower sales of full service payout annuities with life contingencies. Partially offsetting this decrease was an increase in our individual annuities business due to an increase in cost of interest credited resulting from a growing block of fixed deferred annuities and an increase in the change in reserves resulting from higher sales of our payout annuities with life contingencies. Partially offsetting the overall decrease in benefit expense was a $139.7 million increase for the International Asset Management and Accumulation segment, primarily as a result of higher interest crediting rates to customers in Chile, a higher change in reserves due to increased sales of single premium annuities with life contingencies in Chile and the strengthening of the Chilean peso against the U.S. dollar.

Operating expenses decreased $80.5 million for the U.S. Asset Accumulation segment primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred expenses.

Income Taxes

The effective income tax rates were 11% and 24% for the nine months ended September 30, 2008 and 2007, respectively. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate. The effective income tax rate for the nine months ended September 30, 2007, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received. The effective income tax rate decreased to 11% from 24% for the nine months ended September 30, 2008 and 2007, respectively, primarily due to a decrease in the 2008 estimated annual effective income tax rate resulting from an increase in our annual estimate of net realized capital losses, tax refinements made in 2007 related to prior years, and additional U.S. foreign tax credits resulting from the aforementioned Brazilian tax rate increase. The net increase in deferred tax liabilities associated with the newly enacted Brazilian income tax rate is reflected in net investment income because the equity method of accounting is applied to our Brazilian operations; however, the benefit from additional U.S. foreign tax credits is reflected in income tax expense.

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Results of Operations by Segment

For results of operations by segment see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Segment Information.

U.S. Asset Accumulation Segment

U.S. Asset Accumulation Segment Summary Financial Data

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

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

	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
	(in billions)			
Account values, beginning of period	**$ 177.2**	$ 174.4	**$ 180.8**	$ 163.3
Net cash flow	**0.8**	3.2	**6.9**	5.2
Credited investment performance	**(11.1)**	3.4	**(19.4)**	12.6
Other	**(0.5)**	0.8	**(1.9)**	0.7
Account values, end of period	**$ 166.4**	$ 181.8	**$ 166.4**	$ 181.8

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

	For the three months ended September 30, 2008	2007	Increase (decrease)	For the nine months ended September 30, 2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	**$ 146.2**	$ 203.6	$ (57.4)	**$ 447.8**	$ 534.9	$ (87.1)
Fees and other revenues	**366.6**	500.5	(133.9)	**1,134.1**	1,280.4	(146.3)
Net investment income	**724.7**	700.8	23.9	**2,116.0**	2,034.6	81.4
Total operating revenues	**1,237.5**	1,404.9	(167.4)	**3,697.9**	3,849.9	(152.0)

Expenses:						
Benefits, claims and settlement expenses, including dividends to policyholders	**702.8**	745.3	(42.5)	**2,062.9**	2,079.8	(16.9)
Operating expenses	**361.9**	415.3	(53.4)	**1,086.7**	1,130.3	(43.6)
Total expenses	**1,064.7**	1,160.6	(95.9)	**3,149.6**	3,210.1	(60.5)
Operating earnings before income taxes	**172.8**	244.3	(71.5)	**548.3**	639.8	(91.5)
Income taxes	**36.3**	57.6	(21.3)	**119.8**	133.9	(14.1)
Operating earnings	**$ 136.5**	$ 186.7	$ (50.2)	**$ 428.5**	$ 505.9	$ (77.4)

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Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Operating Earnings

Operating earnings decreased $46.5 million in our full service accumulation business primarily due to a $30.1 million benefit in 2007 associated with the unlocking of our unearned revenue and DPAC assumptions following a comprehensive assumption study that was completed in the third quarter of 2007. Reduced fees resulting from the declining equity markets, a change in the mix of investments and products and a decrease in market value adjustments on customer withdrawals stemming from a declining interest rate environment also contributed to the decrease in full service accumulation earnings. In addition, operating earnings growth for this business was also reduced by a decline in the tax benefits associated with the dividends received deduction stemming from a declining equity environment. Furthermore, operating earnings decreased $4.5 million in our Principal Funds business primarily due to a decline in fee income stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Operating Revenues

Premiums decreased $62.3 million in our full service payout business primarily due to a decrease in sales of annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period.

Fees from our full service accumulation business decreased $115.9 million primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred revenue. Reduced fees resulting from the declining equity market, a change in the mix of investments and products and a decrease in market value adjustments on customer withdrawals stemming from a declining interest rate environment also contributed to the decrease in full service accumulation fee revenue. Fees in our Principal Funds business decreased $12.2 million primarily due to a decline in distribution income and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Net investment income increased primarily due to a $2,756.7 million increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 5.7% for the three months ended September 30, 2008, and 5.9% for the three months ended September 30, 2007.

Total Expenses

Benefits, claims and settlement expenses, including dividends to policyholders, decreased $64.7 million in our full service payout business primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies. In addition, our investment only business benefits, claims and settlement expenses decreased $14.8 million primarily due to a decline in variable crediting rates. Partially offsetting the overall decrease was a $36.3 million increase in our individual annuities business due to an increase in cost of interest credited and higher benefit payments resulting from a growing block of fixed annuities.

Operating expenses in our full service accumulation business decreased $54.0 million primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred expenses. In addition, operating expenses in Principal Funds decreased $4.8 million primarily due to lower fees paid to advisors resulting from a decrease in average account values.

Income Taxes

The effective income tax rates for this segment were 21% and 24% for the three months ended September 30, 2008 and 2007, respectively. The effective income tax rates for the three months ended September 30, 2008 and 2007, were lower than the U.S. statutory rate primarily as a result of income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

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Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Operating Earnings

Operating earnings decreased $67.3 million in our in full service accumulation business primarily due to a $30.1 million benefit in 2007 associated with the unlocking of our unearned revenue and DPAC assumptions following a comprehensive assumption study that was completed in the third quarter of 2007, reduced fees resulting from the declining equity market, a change in the mix of investments and products and a decrease in market value adjustments on customer withdrawals stemming from a declining interest rate environment. In addition, operating earnings growth for this business was also reduced by a decline in the tax benefits associated with the dividends received deduction stemming from a declining equity environment. Furthermore, operating earnings decreased $9.4 million in Principal Funds primarily due to a decline in fee income stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Operating Revenues

Premiums decreased $168.7 million in our full service payout business primarily due to a decrease in sales of annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. Partially offsetting this decrease was an $81.6 million increase in our individual payout annuity business primarily due to increased sales of annuities with life contingencies from certain distribution channels.

Fees from our full service accumulation business decreased $121.4 million primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred revenue. Reduced fees resulting from the declining equity market, a change in the mix of investments and products and a decrease in market value adjustments on customer withdrawals stemming from a declining interest rate environment also contributed to the decrease in full service accumulation fee revenue. In addition, fees in our Principal Funds business decreased $27.7 million primarily due to a decline in distribution and management fees stemming from a decrease in average account values, which resulted from a decline in the equity markets in 2008.

Net investment income increased primarily due to a $2,305.5 million increase in average invested assets and cash for the segment. The increase was partially offset by a decrease in the average annualized yield on invested assets and cash, which was 5.6% for the nine months ended September 30, 2008, and 5.7% for the nine months ended September 30, 2007.

Total Expenses

Benefits, claims and settlement expenses, including dividends to policyholders, decreased $165.6 million in our full service payout business primarily due to a decrease in the change in reserves resulting from lower sales of annuities with life contingencies. In addition, our investment only business benefits, claims and settlement expenses decreased $32.5 million primarily due to a decline in variable crediting rates. Partially offsetting the overall decrease was a $173.8 million increase in our individual annuities business due to an increase in cost of interest credited resulting from a growing block of fixed deferred annuities and an increase in the change in reserves resulting from higher sales of our payout annuities with life contingencies.

Operating expenses decreased $56.2 million in our full service accumulation business primarily due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the third quarter 2007 recognition of previously deferred expenses. In addition, operating expenses decreased $12.5 million in our Principal Funds business primarily due to lower fees paid to advisors stemming from a decrease in average account values.

Income Taxes

The effective income tax rates for this segment were 22% and 21% for the nine months ended September 30, 2008 and 2007, respectively. The effective income tax rates for the nine months ended September 30, 2008 and 2007, were lower than the U.S. statutory rate as a result of income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

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Global Asset Management Segment

Global Asset Management Segment Summary Financial Data

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

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in billions)			
AUM, beginning of period	**$ 233.0**	$ 210.5	**$ 236.0**	$ 191.4
Net cash flow	**1.9**	4.8	**9.2**	11.3
Investment performance	**(15.2)**	4.3	**(22.9)**	13.2
Operations acquired (1)		13.7		13.7
Other	**(1.6)**	(0.6)	**(4.2)**	3.1
AUM, end of period	**$ 218.1**	$ 232.7	**$ 218.1**	$ 232.7

(1) Includes acquisition of Morley Financial Services in 2007.

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

	For the three months ended September 30, 2008	2007	Increase (decrease)	For the nine months ended September 30, 2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Fees and other revenues	**$ 136.6**	$ 129.9	$ 6.7	**$ 406.4**	$ 373.9	$ 32.5
Net investment income	**5.1**	9.0	(3.9)	**18.6**	27.6	(9.0)
Total operating revenues	**141.7**	138.9	2.8	**425.0**	401.5	23.5
Expenses:						
Total expenses	**106.3**	95.7	10.6	**321.8**	288.8	33.0
Operating earnings before income taxes	**35.4**	43.2	(7.8)	**103.2**	112.7	(9.5)
Income taxes	**11.9**	14.9	(3.0)	**35.8**	39.7	(3.9)
Operating earnings	**$ 23.5**	$ 28.3	$ (4.8)	**$ 67.4**	$ 73.0	$ (5.6)

Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Operating Earnings

Operating earnings in our fee mandate business decreased $2.6 million. While management fee revenue continues to grow, recent market conditions have led to the dampening of revenue growth. Also contributing to the decrease in operating revenues was a decline in borrower fees and transaction fees from our real estate line of business as well as an increase in total expenses due to the continued growth in the business, including the acquisition of Morley Financial Services. Operating earnings in our spread business decreased $2.2 million primarily due to lower earnings as a result of lower investment income and loan volumes in 2008 compared to 2007.

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Operating Revenues

Fees in our fee mandate business increased $8.5 million despite recent market conditions, which have dampened our overall revenue growth. In addition to the acquisition of Morley Financial Services, we continued to see growth in management fees from our fixed income and equity lines of business. However, a decrease in borrower fees and transaction fees was primarily the result of lower real estate activity. Partially offsetting this increase is a decrease in our spread business of $1.8 million due to lower loan origination fees in 2008 compared to 2007.

Net investment income decreased $2.2 million in our fee mandate business as a result of the declining interest rate environment. Net investment income in our spread business decreased $1.7 million due to lower investment income earned on our loan portfolio.

Total Expenses

Total expenses increased $11.2 million in our fee mandate business due to growth in the business, including the acquisition of Morley Financial Services.

Income Taxes

The effective income tax rate for this segment was 34% for both the three months ended September 30, 2008 and 2007. The effective income tax rates for the three months ended September 30, 2008 and 2007, were lower than the U.S. statutory rate as a result of income exclusion from taxable income.

Nine months ended September 30, 2008, Compared to Nine months ended September 30, 2007

Operating Earnings

Operating earnings in our spread business decreased $4.9 million primarily due to lower loan origination volumes and lower investment income earned on our loan portfolio.

Operating Revenues

Fees in our fee mandate business increased $35.3 million due to continued growth in management fees across all lines of business, despite recent market conditions, in addition to the acquisition of Morley Financial Services.

Net investment income decreased $5.6 million in our spread business due to lower investment income earned on our loan portfolio. Net investment income decreased $3.4 million in our fee mandate business as a result of the declining interest rate environment.

Total Expenses

Total expenses increased $33.9 million in our fee mandate business due to growth in the business, including the acquisition of Morley Financial Services.

Income Taxes

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

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International Asset Management and Accumulation Segment

International Asset Management and Accumulation Segment Summary Financial Data

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

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in billions)			
AUM, beginning of period	**$ 30.0**	$ 25.3	**$ 28.7**	$ 19.1
Net cash flow	**(0.5)**	1.5	**0.7**	2.3
Investment performance	**(0.3)**	0.3	**(0.7)**	2.2
Effect of exchange rates	**(0.7)**	(0.1)		1.2
Other (1)	**0.1**	(0.1)	**(0.1)**	2.1
AUM, end of period	**$ 28.6**	$ 26.9	**$ 28.6**	$ 26.9

(1) Other increases to AUM for the nine months ended September 30, 2007, include $2.2 billion related to our SBB acquisition in Malaysia.

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the three months ended September 30, Increase (decrease)	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007	For the nine months ended September 30, Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	**$ 47.0**	$ 56.1	$ (9.1)	**$ 186.8**	$ 159.3	$ 27.5
Fees and other revenues	**31.1**	35.1	(4.0)	**100.0**	97.9	2.1
Net investment income	**187.4**	133.4	54.0	**413.6**	283.7	129.9
Total operating revenues	**265.5**	224.6	40.9	**700.4**	540.9	159.5
Expenses:						
Benefits, claims and settlement expenses	**184.8**	153.5	31.3	**488.7**	348.7	140.0

Operating expenses	**37.2**	25.1	12.1	**112.5**	96.9	15.6
Total expenses	**222.0**	178.6	43.4	**601.2**	445.6	155.6
Operating earnings before income taxes	**43.5**	46.0	(2.5)	**99.2**	95.3	3.9
Income taxes (benefits)	**(0.9)**	6.7	(7.6)	**(8.7)**	10.0	(18.7)
Operating earnings	**$ 44.4**	$ 39.3	$ 5.1	**$ 107.9**	$ 85.3	$ 22.6

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Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Operating Earnings

Operating earnings in our equity method investment in Brazil increased $14.2 million primarily due to pricing changes resulting in positive net unlocking and true-up adjustments that lowered DPAC and present value of future profits (PVFP) amortization and also drove higher fees, coupled with AUM growth and the strengthening of the Brazilian real against the U.S. dollar. Partially offsetting this increase was a decrease in operating earnings for Mexico primarily related to $9.2 million of net unlocking adjustments resulting in lower DPAC and PVFP amortization in 2007 related to enacted legislation.

Operating Revenues

Premiums in Chile decreased $9.2 million primarily due to lower sales of single premium annuities with life contingencies.

Fees and other revenues decreased primarily due to reduced fee charges and lower AUM for our operations in India, partially offset by higher AUM for our operations in Mexico.

Net investment income increased primarily due to a higher annualized yield on average invested assets and cash, excluding our equity method investments, due to higher inflation in Chile. The annualized yield on average invested assets and cash, excluding our equity method investments, was 18.2% for the three months ended September 30, 2008, compared to 14.1% for the three months ended September 30, 2007. To a lesser extent, the increase was due to higher earnings from our equity method investment in Brazil and a $227.5 million increase in average invested assets and cash, excluding our equity method investments.

Total Expenses

Benefits, claims and settlement expenses increased $29.7 million in Chile, primarily due to higher interest crediting rates to customers and the strengthening of the Chilean peso against the U.S. dollar, partially offset by a lower change in reserves associated with decreased sales of single premium annuities with life contingencies.

Operating expenses in Mexico increased primarily due to net unlocking adjustments resulting in lower DPAC and PVFP amortization in 2007 related to enacted legislation.

Income Taxes

The effective income tax rates for this segment were (2)% and 15% for the three months ended September 30, 2008 and 2007, respectively. The effective income tax rate for the three months ended September 30, 2008, was lower than the U.S. statutory rate, primarily as a result of taxes on our share of earnings generated from equity method investments being reflected in net investment income, lower tax rates of foreign jurisdictions and U.S. foreign tax credits that offset a local tax rate that is higher than the U.S. statutory rate for our equity method investment in Brazil. The effective income tax rate for the three months ended September 30, 2007, was lower than the U.S. statutory rate, primarily as a result of taxes on our share of earnings generated from equity method investments that are included in net investment income and due to the lower tax rates of foreign jurisdictions.

Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Operating Earnings

Operating earnings in our equity method investment in Brazil increased $15.8 million primarily due to the strengthening of the Brazilian real against the U.S. dollar, coupled with AUM growth and pricing changes resulting in positive net unlocking and true-up adjustments that lowered DPAC and PVFP amortization and also drove higher fees. Operating earnings in Chile increased $8.1 million primarily due to inflation.

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Operating Revenues

Premiums in Chile increased $29.0 million primarily due to higher sales of single premium annuities with life contingencies and the strengthening of the Chilean peso against the U.S. dollar.

Fees and other revenues in Mexico increased $6.1 million primarily due to growth in AUM and the strengthening of the Mexican peso against the U.S. dollar. Partially offsetting this increase was a $4.1 million decrease in India primarily related to lower AUM and reduced fee charges in 2008.

Net investment income increased primarily due to a higher annualized yield on average invested assets and cash, excluding our equity method investments, due to higher inflation in Chile. The annualized yield on average invested assets and cash, excluding our equity method investments, was 13.4% for the nine months ended September 30, 2008, compared to 9.6% for the nine months ended September 30, 2007. To a lesser extent, the increase was due to a $337.0 million increase in average invested assets and cash, excluding our equity method investments.

Total Expenses

Benefits, claims and settlement expenses increased $134.9 million in Chile, primarily due to higher interest crediting rates to customers, a higher change in reserves due to increased sales of single premium annuities with life contingencies and the strengthening of the Chilean peso against the U.S. dollar.

Operating expenses in Mexico increased primarily due to net unlocking adjustments resulting in lower DPAC and PVFP amortization in 2007 related to enacted legislation.

Income Taxes

The effective income tax rates for this segment were (9)% and 10% for the nine months ended September 30, 2008 and 2007, respectively. The effective income tax rate for the nine months ended September 30, 2008, was lower than the U.S. statutory rate, primarily due to additional U.S. foreign tax credits resulting from the second quarter 2008 enactment of legislation to increase the Brazilian tax rate, taxes on our share of earnings generated from equity method investments being reflected in net investment income and lower tax rates of foreign jurisdictions. The Brazilian tax rate change caused a one-time increase in the net deferred tax liabilities within our equity method investment during the second quarter that was offset by U.S. foreign tax credits, which reduced income tax expenses. There was no total impact to operating earnings. The effective income tax rate for the nine months ended September 30, 2007, was lower than the U.S. statutory rate as a result of taxes on our share of earnings generated from equity method investments being reflected in net investment income and due to the lower tax rates of foreign jurisdictions.

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Life and Health Insurance Segment

Individual Life Insurance Trends

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

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

	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
		(in millions)		
Universal and variable universal life insurance fee revenue	**$ 83.5**	$ 72.9	**$ 247.0**	$ 203.5
Traditional life insurance premiums	**143.6**	148.1	**442.8**	455.5

Health Insurance Trends

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

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

	For the three months ended September 30, 2008	2007	For the nine months ended September 30, 2008	2007
		(in millions)		
Premium and fees:				
Group medical insurance	**$ 395.1**	$ 444.8	**$ 1,223.0**	$ 1,369.5
Fee-for-service	**35.7**	41.7	**108.4**	125.8

Specialty Benefits Insurance Trends

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

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

	For the three months ended September 30, 2008	For the three months ended September 30, 2007	For the nine months ended September 30, 2008	For the nine months ended September 30, 2007
	(in millions)			
Premium and fees:				
Group dental and vision insurance	**$ 140.2**	$ 136.3	**$ 417.7**	$ 403.0
Group life insurance	**87.3**	86.0	**262.2**	255.4
Group disability insurance	**73.7**	79.5	**227.3**	226.5
Individual disability insurance	**43.1**	40.5	**128.5**	118.4

Life and Health Insurance Segment Summary Financial Data

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

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

	For the three months ended September 30,			For the nine months ended September 30,		
	2008	2007	Increase (decrease)	2008	2007	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	**$ 855.0**	$ 910.3	$ (55.3)	**$ 2,620.1**	$ 2,757.8	$ (137.7)
Fees and other revenues	**130.5**	126.3	4.2	**390.7**	362.7	28.0
Net investment income	**173.4**	175.0	(1.6)	**516.3**	515.0	1.3
Total operating revenues	**1,158.9**	1,211.6	(52.7)	**3,527.1**	3,635.5	(108.4)
Expenses:						
Benefits, claims and settlement expenses	**710.7**	748.3	(37.6)	**2,160.5**	2,308.0	(147.5)
Dividends to policyholders	**69.8**	73.3	(3.5)	**208.3**	219.9	(11.6)
Operating expenses	**268.2**	280.4	(12.2)	**830.0**	841.5	(11.5)
Total expenses	**1,048.7**	1,102.0	(53.3)	**3,198.8**	3,369.4	(170.6)
Operating earnings before income taxes	**110.2**	109.6	0.6	**328.3**	266.1	62.2
Income taxes	**36.3**	36.2	0.1	**108.5**	87.1	21.4
Operating earnings	**$ 73.9**	$ 73.4	$ 0.5	**$ 219.8**	$ 179.0	$ 40.8

Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Operating Earnings

Operating earnings in our specialty benefits insurance business increased $3.8 million primarily due to favorable claims experience in our disability and group life insurance businesses. In addition, operating earnings for our health insurance business increased $2.5 million primarily as a result of favorable prior period claim development partially offset by a decline in average covered medical members. At the end of a reporting period we recognize a liability for the estimate of claims incurred but not reported. In subsequent periods, an adjustment of prior period claim development is made to reflect actual or updated estimates of incurred claims. Partially offsetting these increases was a $5.8 million decrease in our individual life insurance business due to an increase in DPAC amortization primarily resulting from lower equity market performance and due to lower prepayment fee income.

Operating Revenues

Premiums decreased $48.9 million in our health insurance business due to a reduction in average covered medical members, as lapses were greater than new sales.

Fees and other revenues increased $11.0 million in our individual life insurance business primarily due to growth in the universal life and variable universal life insurance lines of business. Partially offsetting this increase in fees and other revenues was a decrease of $6.9 million in our health insurance business, largely due to a change in classification in 2008 of the reimbursement of certain pass-through expenses, removing them from both fee revenues and operating expenses.

Total Expenses

Benefits, claims and settlement expenses decreased $47.4 million in our health insurance business due to a decrease in average covered medical members partially offset by higher claim costs per member. Partially offsetting this decrease was a $17.0 million increase in benefits, claims and settlement expenses for our individual life insurance business as a result of growth in the business and worse claims experience.

Operating expenses decreased $15.3 million in our health insurance business primarily due to staff and other reductions associated with the decline in average insured medical and average fee-for-service medical covered members and due to a change in classification in 2008 of the reimbursement of certain pass-through expenses, removing them from both fee revenues and operating expenses. Partially offsetting this decrease was a $2.4 million increase in our specialty benefits insurance business operating expenses due to modest growth in the underlying business.

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Income Taxes

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

Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Operating Earnings

Operating earnings in our health insurance business increased $23.8 million primarily due to favorable prior period claim development relative to the same period a year ago. In addition, operating earnings in our specialty benefits insurance business increased $17.2 million primarily due to favorable claims experience in our disability and group life product lines, as well as modest growth in the business.

Operating Revenues

Premiums decreased $144.8 million in our health insurance business due to a reduction in average covered medical members, as lapses were greater than new sales.

Fees and other revenues increased $46.0 million in our individual life insurance business primarily due to growth in the universal life and variable universal life insurance lines of business. Partially offsetting this increase in fees and other revenues was a decrease of $19.5 million in our health insurance business, largely due to a change in classification in 2008 of the reimbursement of certain pass-through expenses, removing them from both fee revenues and operating expenses and a decrease in average fee-for-service medical members.

Total Expenses

Benefits, claims and settlement expenses decreased $165.8 million in our health insurance business due to a decrease in average covered medical members and favorable prior period claim development relative to the same period a year ago.

Operating expenses decreased $41.6 million in our health insurance business due to staff and other reductions associated with the decline in average insured medical and average fee-for-service medical covered members, a change in classification in 2008 of the reimbursement of certain pass-through expenses, removing them from both fee revenues and operating expenses and lower commission expense resulting from a reduction in premium. Partially offsetting this decrease was a $16.9 million increase in our individual life insurance business primarily related to higher DPAC amortization as expense improvements increased current period margins and as lower current period equity performance reduced future expected margins. Individual life insurance expenses also increased due to sales growth. Additionally, operating expenses increased $12.9 million in our specialty benefits insurance business due to moderate growth in the business.

Income Taxes

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

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Corporate and Other Segment

Corporate and Other Segment Summary Financial Data

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

	For the three months ended September 30,			For the nine months ended September 30,		
	2008	**2007**	**Increase (decrease)**	**2008**	**2007**	**Increase (decrease)**
			(in millions)			
Operating revenues:						
Total operating revenues	**$ (52.4)**	$ (41.9)	$ (10.5)	**$ (152.2)**	$ (107.2)	$ (45.0)
Expenses:						
Total expenses	**(25.7)**	(28.8)	3.1	**(78.0)**	(86.1)	8.1
Operating losses before income taxes and preferred stock dividends	**(26.7)**	(13.1)	(13.6)	**(74.2)**	(21.1)	(53.1)
Income tax benefits	**(7.8)**	(9.6)	1.8	**(39.0)**	(27.1)	(11.9)
Preferred stock dividends	**8.2**	8.2		**24.7**	24.7	
Operating losses	**$ (27.1)**	$ (11.7)	$ (15.4)	**$ (59.9)**	$ (18.7)	$ (41.2)

Three Months Ended September 30, 2008, Compared to Three Months Ended September 30, 2007

Operating Losses

Operating losses increased due to a decline in average annualized investment yields and a decrease in average invested assets for the segment. Also contributing to the increase in operating losses was the increase in state deferred income tax liabilities associated with the intended change in filing status of a subsidiary in 2008.

Operating Revenues

Operating revenues decreased due to a decline in investment yields, which included lower earnings on certain equity method partnership interests where the underlying assets are marked to market and a decline in joint venture real estate operating performance. In addition, operating revenues decreased due to lower average invested assets for the segment.

Total Expenses

Total expenses increased due to higher interest expense related to federal income tax activities.

Income Taxes

Income tax benefits decreased due to the establishment of state deferred income tax liabilities associated with the intended change in filing status of a subsidiary in 2008, as well as the reduction of synthetic fuel tax credits expiring as of December 31, 2007. The decreased tax benefits were offset in large part by an increase in income tax benefits due to an increase in operating losses before income taxes.

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Nine Months Ended September 30, 2008, Compared to Nine Months Ended September 30, 2007

Operating Losses

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

Operating Revenues

Operating revenues decreased due to a decline in average annualized investment yields, resulting from above average gains on equity real estate sales activity in the prior year, as well as lower earnings on certain equity method partnership interests where the underlying assets are marked to market. In addition, operating revenues decreased due to lower average invested assets for the segment. Further contributing to the decline in operating revenues was an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses. These decreases were partially offset by lower investment expenses due to the unwinding of our variable interest in a synthetic fuel production facility in 2008.

Total Expenses

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

Income Taxes

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

Liquidity and Capital Resources

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

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Liquidity and Capital

Our liquidity requirements have been and will continue to be met by funds from consolidated operations as well as the issuance of commercial paper, common stock, debt or other capital securities and borrowings from credit facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of our operations, including reasonably foreseeable contingencies. However, there can be no assurance that future experience regarding benefits and surrenders will be similar to historic experience since benefits and surrender levels are influenced by such factors as the interest rate environment, our claims paying ability and our financial strength ratings. For factors that could affect our expectations for liquidity, see Item 3. Quantitative and Qualitative Disclosures About Market Risk.

Given market conditions, we have built additional liquidity by increasing cash and cash equivalent holdings to $2.3 billion as of September 30, 2008. Actions to increase liquidity and manage capital include: (i) becoming a member of the FHLB of Des Moines in second quarter 2008 enabling us to access a new source of liquidity to meet business unit and corporate borrowing needs, (ii) investing new cash flows into more liquid securities, (iii) reducing our common stock dividend from prior year levels to $0.45 per share and (iv) suspending purchases of our common stock under the existing share repurchase authorization, effective October 13, 2008. While the underlying performance of our commercial mortgage-backed securities (CMBS) holdings remains strong, we completed our planned investment in CMBS for the year in July 2008. Currently, new cash inflows are primarily being invested in cash, short-term government-backed securities and other liquid investments. As a Savings and Loan holding company, we are eligible to participate in certain recently announced government programs. As details emerge, we are evaluating our options and considering a strategy to utilize these additional sources of liquidity and capital flexibility.

Approximately $20.6 billion, or 96%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity.

The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc. The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and raise capital to meet operating and growth needs. Dividends from Principal Life, our primary subsidiary, are limited by Iowa law. Under Iowa laws, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa (the Commissioner) to pay a stockholder dividend if such a stockholder dividend would exceed certain statutory limitations. The current statutory limitation is the greater of (i) 10% of Principal Life s statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year.

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

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

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

	For the nine months ended September 30, 2008