PRINCIPAL FINANCIAL GROUP INC
Form 10-Q
November 03, 2010
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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, 2010

OR

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

1-16725

(Commission file number)

PRINCIPAL FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**42-1520346**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

711 High Street, Des Moines, Iowa 50392

(Address of principal executive offices)

(515) 247-5111

(Registrant s telephone number, including area code)

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

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

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

Large accelerated filer 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 27, 2010, was 320,353,148.

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.

Consolidated Statements of Financial Position

	September 30, 2010 (Unaudited)	December 31, 2009
	(in millions)	
Assets		
Fixed maturities, available-for-sale (2010 includes $251.4 million related to consolidated variable interest entities)	**$ 49,310.5**	$ 46,220.6
Fixed maturities, trading (2010 includes $162.2 million related to consolidated variable interest entities)	**1,500.0**	1,032.4
Equity securities, available-for-sale	**173.8**	214.0
Equity securities, trading (2010 includes $69.3 million related to consolidated variable interest entities)	**215.2**	221.5
Mortgage loans	**11,095.8**	11,845.6
Real estate	**1,086.9**	1,034.6
Policy loans	**903.8**	902.5
Other investments (2010 includes $129.2 million related to consolidated variable interest entities of which $129.1 million are measured at fair value under the fair value option)	**3,008.6**	2,465.3
Total investments	**67,294.6**	63,936.5
Cash and cash equivalents (2010 includes $150.0 million related to consolidated variable interest entities)	**2,268.8**	2,240.4
Accrued investment income	**710.3**	691.9
Premiums due and other receivables	**1,294.7**	1,065.4
Deferred policy acquisition costs	**3,240.1**	3,681.4
Property and equipment	**461.1**	489.3
Goodwill	**343.8**	386.4
Other intangibles	**842.1**	851.7
Separate account assets	**65,659.4**	62,738.5
Other assets	**1,341.7**	1,677.9
Total assets	**$ 143,456.6**	$ 137,759.4
Liabilities		
Contractholder funds	**$ 38,549.5**	$ 39,801.9
Future policy benefits and claims	**19,753.5**	19,248.3
Other policyholder funds	**583.3**	559.2
Short-term debt	**132.1**	101.6
Long-term debt	**1,582.1**	1,584.6
Income taxes currently payable	**3.7**	2.8
Deferred income taxes	**558.6**	120.2
Separate account liabilities	**65,659.4**	62,738.5
Other liabilities (2010 includes $467.7 million related to consolidated variable interest entities of which $111.4 million are measured at fair value under the fair value option)	**6,600.1**	5,585.9
Total liabilities	**133,422.3**	129,743.0

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 2010 and 2009				
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 2010 and 2009		**0.1**		0.1
Common stock, par value $.01 per share - 2,500.0 million shares authorized, 448.4 million and 447.0 million shares issued, and 320.3 million and 319.0 million shares outstanding in 2010 and 2009		**4.5**		4.5
Additional paid-in capital		**9,547.5**		9,492.9
Retained earnings		**4,591.6**		4,160.7
Accumulated other comprehensive income (loss)		**476.8**		(1,042.0)
Treasury stock, at cost (128.1 million and 128.0 million shares in 2010 and 2009, respectively)		**(4,725.0)**		(4,722.7)
Total stockholders equity attributable to Principal Financial Group, Inc.		**9,895.5**		7,893.5
Noncontrolling interest		**138.8**		122.9
Total stockholders equity		**10,034.3**		8,016.4
Total liabilities and stockholders equity	**$**	**143,456.6**	$	137,759.4

See accompanying notes.

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Principal Financial Group, Inc.

Consolidated Statements of Operations

(Unaudited)

	For the three months ended September 30, 2010	For the three months ended September 30, 2009	For the nine months ended September 30, 2010	For the nine months ended September 30, 2009
	(in millions, except per share data)			
Revenues				
Premiums and other considerations	**$ 865.4**	$ 932.9	**$ 2,612.5**	$ 2,820.5
Fees and other revenues	**563.5**	550.7	**1,685.9**	1,539.4
Net investment income	**880.3**	853.3	**2,620.3**	2,541.9
Net realized capital gains, excluding impairment losses on available-for-sale securities	**28.9**	50.6	**50.7**	62.5
Total other-than-temporary impairment losses on available-for-sale securities	**(55.9)**	(162.5)	**(247.6)**	(510.0)
Portion of impairment losses on fixed maturities, available-for-sale recognized in other comprehensive income	**6.3**	45.3	**64.3**	162.4
Net impairment losses on available-for-sale securities	**(49.6)**	(117.2)	**(183.3)**	(347.6)
Net realized capital losses	**(20.7)**	(66.6)	**(132.6)**	(285.1)
Total revenues	**2,288.5**	2,270.3	**6,786.1**	6,616.7
Expenses				
Benefits, claims and settlement expenses	**1,320.3**	1,317.1	**3,932.6**	3,958.0
Dividends to policyholders	**53.2**	61.9	**164.7**	188.3
Operating expenses	**751.5**	643.0	**2,111.2**	1,894.1
Total expenses	**2,125.0**	2,022.0	**6,208.5**	6,040.4
Income before income taxes	**163.5**	248.3	**577.6**	576.3
Income taxes	**12.2**	44.1	**78.5**	85.5
Net income	**151.3**	204.2	**499.1**	490.8
Net income attributable to noncontrolling interest	**0.9**	11.3	**7.4**	18.3
Net income attributable to Principal Financial Group, Inc.	**150.4**	192.9	**491.7**	472.5
Preferred stock dividends	**8.2**	8.2	**24.7**	24.7
Net income available to common stockholders	**$ 142.2**	$ 184.7	**$ 467.0**	$ 447.8
Earnings per common share				
Basic earnings per common share	**$ 0.44**	$ 0.58	**$ 1.46**	$ 1.54
Diluted earnings per common share	**$ 0.44**	$ 0.57	**$ 1.45**	$ 1.54

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	Noncontrolling interest	Total stockholders equity
					(in millions)				
Balances at January 1, 2009	$	$ 0.1	$ 3.9	$ 8,376.5	$ 3,722.5	$ (4,911.6)	$ (4,718.6)	$ 96.5	$ 2,569.3
Common stock issued			0.6	1,122.4					1,123.0
Stock-based compensation and additional related tax benefits				27.7					27.7
Treasury stock acquired, common							(4.1)		(4.1)
Dividends to preferred stockholders					(24.7)				(24.7)
Distributions to noncontrolling interest								(17.1)	(17.1)
Purchase of subsidiary shares from noncontrolling interest				(45.9)				0.2	(45.7)
Effects of reclassifying noncredit component of previously recognized impairment losses on fixed maturities, available-for-sale, net					9.9	(9.9)			
Comprehensive income:									
Net income					472.5			18.3	490.8
Net unrealized gains, net						3,426.2			3,426.2
Noncredit component of impairment losses on fixed maturities, available-for-sale, net						(99.0)			(99.0)
Foreign currency translation adjustment, net of related income taxes						115.3		0.1	115.4
Unrecognized postretirement benefit obligation, net of related income taxes						44.9			44.9
Comprehensive income									3,978.3
Balances at September 30, 2009	$	$ 0.1	$ 4.5	$ 9,480.7	$ 4,180.2	$ (1,434.1)	$ (4,722.7)	$ 98.0	$ 7,606.7
Balances at January 1, 2010	**$**	**$ 0.1**	**$ 4.5**	**$ 9,492.9**	**$ 4,160.7**	**$ (1,042.0)**	**$ (4,722.7)**	**$ 122.9**	**$ 8,016.4**
Common stock issued				**20.0**					**20.0**
Stock-based compensation and additional related tax benefits				**34.6**					**34.6**

Treasury stock acquired, common							(2.3)		(2.3)
Dividends to preferred stockholders					(24.7)				(24.7)
Distributions to noncontrolling interest								(5.6)	(5.6)
Contributions from noncontrolling interest								14.0	14.0
Effects of implementation of accounting change related to variable interest entities, net					(10.7)	10.7			
Effects of electing fair value option for fixed maturities upon implementation of accounting change related to embedded credit derivatives, net					(25.4)	25.4			
Comprehensive income:									
Net income					491.7			7.4	499.1
Net unrealized gains, net						1,339.0			1,339.0
Noncredit component of impairment losses on fixed maturities, available-for-sale, net						(37.3)			(37.3)
Foreign currency translation adjustment, net of related income taxes						9.1		0.1	9.2
Unrecognized postretirement benefit obligation, net of related income taxes						171.9			171.9
Comprehensive income									1,981.9
Balances at September 30, 2010	**$**	**$ 0.1**	**$ 4.5**	**$ 9,547.5**	**$ 4,591.6**	**$ 476.8**	**$ (4,725.0)**	**$ 138.8**	**$ 10,034.3**

See accompanying notes.

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Principal Financial Group, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the nine months ended September 30,	
	2010	2009
	(in millions)	
Operating activities		
Net income	$ 499.1	$ 490.8
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred policy acquisition costs	211.6	70.4
Additions to deferred policy acquisition costs	(367.5)	(361.0)
Accrued investment income	(18.4)	8.0
Net cash flows for trading securities	(56.7)	(101.0)
Premiums due and other receivables	(30.8)	(106.1)
Contractholder and policyholder liabilities and dividends	1,004.6	1,189.6
Current and deferred income taxes	22.1	128.0
Net realized capital losses	132.6	285.1
Depreciation and amortization expense	131.2	104.4
Mortgage loans held for sale, acquired or originated	(42.4)	(41.7)
Mortgage loans held for sale, sold or repaid, net of gain	42.8	49.4
Real estate acquired through operating activities		(25.1)
Real estate sold through operating activities	33.9	3.2
Stock-based compensation	34.1	26.9
Other	333.3	73.5
Net adjustments	1,430.4	1,303.6
Net cash provided by operating activities	1,929.5	1,794.4
Investing activities		
Available-for-sale securities:		
Purchases	(5,226.5)	(6,600.7)
Sales	1,374.1	3,770.5
Maturities	3,608.4	3,146.0
Mortgage loans acquired or originated	(662.4)	(271.8)
Mortgage loans sold or repaid	1,238.7	1,247.2
Real estate acquired	(23.8)	(50.2)
Real estate sold		22.1
Net purchases of property and equipment	(11.4)	(20.6)
Purchases of interest in subsidiaries, net of cash acquired		(45.7)
Net change in other investments	8.8	(40.6)
Net cash provided by investing activities	$ 305.9	$ 1,156.2

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Principal Financial Group, Inc.

Consolidated Statements of Cash Flows (continued)

(Unaudited)

	For the nine months ended September 30,	
	2010	2009
	(in millions)	
Financing activities		
Issuance of common stock	**$ 20.0**	$ 1,123.0
Acquisition of treasury stock	**(2.3)**	(4.1)
Proceeds from financing element derivatives	**78.6**	121.3
Payments for financing element derivatives	**(36.2)**	(57.7)
Excess tax benefits from share-based payment arrangements	**0.8**	0.2
Dividends to preferred stockholders	**(24.7)**	(24.7)
Issuance of long-term debt	**1.7**	745.1
Principal repayments of long-term debt	**(8.9)**	(465.9)
Net proceeds from (repayments of) short-term borrowings	**27.1**	(397.4)
Investment contract deposits	**3,015.7**	3,438.2
Investment contract withdrawals	**(5,311.6)**	(6,871.1)
Net increase in banking operation deposits	**36.0**	80.2
Other	**(3.2)**	(4.5)
Net cash used in financing activities	**(2,207.0)**	(2,317.4)
Net increase in cash and cash equivalents	**28.4**	633.2
Cash and cash equivalents at beginning of period	**2,240.4**	2,608.0
Cash and cash equivalents at end of period	**$ 2,268.8**	$ 3,241.2

See accompanying notes.

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2010

(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, 2010, are not necessarily indicative of the results that may be expected for the year ended December 31, 2010. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2009, included in our Form 10-K for the year ended December 31, 2009, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2009, 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.

Recent Accounting Pronouncements

In October 2010, the Financial Accounting Standards Board (FASB) issued authoritative guidance that modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the successful acquisition of new or renewal insurance contracts. Capitalized costs should include incremental direct costs of contract acquisition, as well as certain costs related directly to acquisition activities such as underwriting, policy issuance and processing, medical and inspection, and sales force contract selling. This guidance will be effective for us on January 1, 2012, with retrospective application permitted but not required. We are currently evaluating the impact this guidance will have on our consolidated financial statements.

In July 2010, the FASB issued authoritative guidance that requires new and expanded disclosures related to the credit quality of financing receivables and the allowance for credit losses. Reporting entities are required to provide qualitative and quantitative disclosures on the allowance for credit losses, credit quality, impaired loans, modifications and nonaccrual and past due financing receivables. The disclosures are required to be presented on a disaggregated basis by portfolio segment and class of financing receivable. Disclosures required by the guidance that relate to the end of a reporting period will be effective for us in our December 31, 2010, consolidated financial statements. Disclosures required by the guidance that relate to an activity that occurs during a reporting period will be effective for us on January 1, 2011. We do not anticipate this guidance will have a material impact on our consolidated financial statements.

In April 2010, the FASB issued authoritative guidance addressing how investments held through the separate accounts of an insurance entity affect the entity s consolidation analysis. This guidance clarifies that an insurance entity should not consider any separate account interests held for the benefit of policyholders in an investment to be the insurer s interests and should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation. This guidance will be effective for us on January 1, 2011, and will not have a material impact on our consolidated financial statements.

In March 2010, the FASB issued authoritative guidance that amends and clarifies the guidance on evaluation of credit derivatives embedded in beneficial interests in securitized financial assets, including asset-backed securities, credit-linked notes, collateralized loan obligations and collateralized debt obligations (CDOs). This guidance eliminates the scope exception for bifurcation of embedded credit derivatives in interests in securitized financial assets, unless they are created solely by subordination of one financial instrument to another. We adopted this guidance effective July 1, 2010, and elected the fair value option for our fixed maturities within the scope of this guidance, effectively reclassifying them from available-for-sale to trading. The cumulative change in accounting principle related to unrealized losses on these fixed maturities resulted in a net $25.4 million decrease to retained earnings, with a corresponding increase to accumulated other comprehensive income.

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)

September 30, 2010

(Unaudited)

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

In January 2010, the FASB issued authoritative guidance that requires new disclosures related to fair value measurements and clarifies existing disclosure requirements about the level of disaggregation, inputs and valuation techniques. Specifically, reporting entities now must disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In addition, in the reconciliation for Level 3 fair value measurements, a reporting entity should present separately information about purchases, sales, issuances and settlements. The guidance clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities for disclosure of fair value measurement, considering the level of disaggregated information required by other applicable U.S. GAAP guidance and should also provide disclosures about the valuation techniques and inputs used to measure fair value for each class of assets and liabilities. This guidance was effective for us on January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair value measurements, which will be effective for us on January 1, 2011. This guidance will not have a material impact on our consolidated financial statements.

In June 2009, the FASB issued authoritative guidance to improve the relevance, representational faithfulness and comparability of the information that a reporting entity provides in its financial reports about a transfer of financial assets; the effects of a transfer on its financial position, financial performance and cash flows; and a transferor s continuing involvement in transferred financial assets. The most significant change is the elimination of the concept of a qualifying special-purpose entity (QSPE). Therefore, former QSPEs, as defined under previous accounting standards, should be evaluated for consolidation by reporting entities on and after the effective date in accordance with the applicable consolidation guidance. This guidance was effective for us on January 1, 2010, and did not have a material impact on our consolidated financial statements.

Also in June 2009, the FASB issued authoritative guidance related to the accounting for VIEs, which amends prior guidance and requires an enterprise to perform an analysis to determine whether the enterprise s variable interest or interests give it a controlling financial interest in a VIE. This analysis identifies the primary beneficiary of a VIE as the enterprise with (1) the power to direct the activities of a VIE that most significantly impact the entity s economic performance and (2) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. In addition, this guidance requires ongoing reassessments of whether an enterprise is the primary beneficiary of a VIE. Furthermore, we are required to enhance disclosures that will provide users of financial statements with more transparent information about an enterprise s involvement in a VIE. The enhanced disclosures are required for any enterprise that holds a variable interest in a VIE. We adopted this guidance prospectively effective January 1, 2010. Due to the implementation of this guidance, certain previously unconsolidated VIEs were consolidated and certain previously consolidated VIEs were deconsolidated. The cumulative change in accounting principle from adopting this guidance resulted in a net $10.7 million decrease to retained earnings and a net $10.7 million increase to accumulated other comprehensive income. In February 2010, the FASB issued an amendment to this guidance. The amendment indefinitely defers the consolidation requirements for reporting enterprises interests in entities that have the characteristics of investment companies and regulated money market funds. This amendment was effective January 1, 2010, and did not have a material impact to our consolidated financial statements. The required disclosures are included in our consolidated financial statements. See Note 3, Variable Interest Entities, for further details.

Separate Accounts

At September 30, 2010 and December 31, 2009, the separate accounts include a separate account valued at $181.5 million and $191.5 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. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. 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.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2010
(Unaudited)

2. Goodwill

The changes in carrying value of goodwill reported in our operating segments for the nine months ended September 30, 2010, were as follows:

	U.S. Asset Accumulation	Global Asset Management	International Asset Management and Accumulation	U.S. Insurance Solutions	Corporate	Consolidated
			(in millions)			
Balances at January 1, 2010	**$ 72.6**	**$ 169.0**	**$ 56.3**	**$ 43.4**	**$ 45.1**	**$ 386.4**
Impairment					**(43.6)**	**(43.6)**
Foreign currency translation			**1.0**			**1.0**
Balances at September 30, 2010	**$ 72.6**	**$ 169.0**	**$ 57.3**	**$ 43.4**	**$ 1.5**	**$ 343.8**

On September 30, 2010, we announced our decision to exit the group medical insurance business. This event constituted a substantive change in circumstances that would more likely than not reduce the fair value of our group medical insurance reporting unit below its carrying amount. Accordingly, we performed an interim goodwill impairment test as of September 30, 2010. As a result of the shortened period of projected cash flows, we determined that the goodwill related to this reporting unit within our Corporate operating segment was impaired and it was written down to a value of zero. We recorded a $43.6 million pre-tax impairment loss as an operating expense in the consolidated statements of operations during both the three and nine months ended September 30, 2010. We had no other significant impairments as of September 30, 2010.

3. Variable Interest Entities

We have relationships with and may have a variable interest in various types of special purpose entities. Following is a discussion of our interest in entities that meet the definition of a VIE. When we are the primary beneficiary we are required to consolidate the entity in our financial statements. On January 1, 2010, we adopted authoritative guidance that changed the method of determining the primary beneficiary of a VIE. Prior to January 1, 2010, the primary beneficiary was the enterprise who absorbed the majority of the entity s expected losses, received a majority of the expected residual returns or both. The new guidance identifies the primary beneficiary of a VIE as the enterprise with (1) the power to direct the activities of a VIE that most significantly impact the entity s economic performance and (2) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. The guidance also requires ongoing assessment of whether we are the primary beneficiary of a VIE. See further discussion of the adoption in Note 1, Nature of Operations and Significant Accounting Policies.

Consolidated Variable Interest Entities

Grantor Trusts

We contributed undated subordinated floating rate notes to three grantor trusts. The trusts separated the cash flows by issuing an interest-only certificate and a residual certificate related to each note contributed. Each interest-only certificate entitles the holder to interest on the stated note for a specified term, while the residual certificate entitles the holder to interest payments subsequent to the term of the interest-only certificate and to all principal payments. We retained the interest-only certificates and the residual certificates were subsequently sold to third parties.

We have determined these grantor trusts are VIEs due to insufficient equity to sustain them. As our interest-only certificates are exposed to the majority of the risk of loss due to interest rate risk, we determined we were the primary beneficiary prior to January 1, 2010. Beginning January 1, 2010, we determined we remain the primary beneficiary as a result of our contribution of securities into the trusts.

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
September 30, 2010
(Unaudited)

3. Variable Interest Entities (continued)

Collateralized Private Investment Vehicles

We invest in synthetic CDOs, collateralized bond obligations, collateralized loan obligations, collateralized commodity obligations and other collateralized structures, which are VIEs due to insufficient equity to sustain the entities (collectively known as collateralized private investment vehicles). The performance of the notes of these structures is primarily linked to a synthetic portfolio by derivatives; each note has a specific loss attachment and detachment point. The notes and related derivatives are collateralized by a pool of permitted investments. The investments are held by a trustee and can only be liquidated to settle obligations of the trusts. These obligations primarily include derivatives, financial guarantees and the notes due at maturity or termination of the trusts.

Prior to January 1, 2010, we determined we were the primary beneficiary of a certain number of these entities due to the nature of our direct investment in the VIEs. As of December 31, 2009, we consolidated five collateralized private investment vehicles with assets of $135.7 million. Upon adoption of the new accounting guidance as of January 1, 2010, we determined we were no longer the primary beneficiary of three of these entities with assets of $65.4 million. For these three entities, we do not control the decisions affecting the economic performance of the entities and we were not involved with the design of the entities. As of September 30, 2010, we continue to hold $55.0 million of investments in these entities classified on the consolidated statements of financial position as fixed maturities, available-for-sale or fixed maturities, trading. We also determined we are the primary beneficiary of two additional collateralized private investment vehicles. For all the collateralized structures consolidated as of September 30, 2010, we are the primary beneficiary because we act as the investment manager of the underlying portfolio and we have an ownership interest.

Commercial Mortgage-Backed Securities

In September 2000, we sold commercial mortgage loans to a real estate mortgage investment conduit trust. The trust issued various commercial mortgage-backed securities (CMBS) certificates using the cash flows of the underlying commercial mortgages it purchased. Prior to January 1, 2010, this entity was scoped out of the consolidation guidance as a QSPE. Based on the new accounting guidance, the previous scope exception for QSPEs no longer exists and this entity is now a VIE due to the entity having insufficient equity to sustain itself. We have determined we are the primary beneficiary as we retained the special servicing role for the assets within the trust as well as the ownership of the bond class which controls the unilateral kick out rights of the special servicer.

Hedge Funds

We are a general partner with an insignificant equity ownership in various hedge funds. These entities are deemed VIEs due to the equity owners not having decision-making ability. Before January 1, 2010, we consolidated these VIEs due to our related parties ownership. Beginning January 1, 2010, we continue to consolidate these entities due to our control through our management relationship, related party ownership and our fee structure in certain of these funds. These entities contain various fixed maturities held as available-for-sale and trading and equity securities held as trading.

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Principal Financial Group, Inc.
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3. Variable Interest Entities (continued)

The carrying amounts of our consolidated VIE assets, which can only be used to settle obligations of consolidated VIEs, and liabilities of consolidated VIEs for which creditors do not have recourse are as follows:

	Grantor trusts	Collateralized private investment vehicles	CMBS (in millions)	Hedge funds (2)	Total
September 30, 2010					
Fixed maturities, available-for-sale	$ 236.7	$ 14.7	$	$	$ 251.4
Fixed maturities, trading		162.2			162.2
Equity securities, trading				69.3	69.3
Other investments			129.1	0.1	129.2
Cash and cash equivalents		55.0		95.0	150.0
Accrued investment income	0.8	0.1	0.8		1.7
Premiums due and other receivables		1.5		28.7	30.2
Total assets	$ 237.5	$ 233.5	$ 129.9	$ 193.1	$ 794.0
Deferred income taxes	$ 2.5	$	$	$ (0.5)	$ 2.0
Other liabilities (1)	143.3	162.3	97.6	64.5	467.7
Total liabilities	$ 145.8	$ 162.3	$ 97.6	$ 64.0	$ 469.7

(1) Grantor trusts contain an embedded derivative of a forecasted transaction to deliver the underlying securities; collateralized private investment vehicles include derivative liabilities, financial guarantees and obligation to redeem notes at maturity or termination of the trust; CMBS includes obligation to the bondholders; and hedge funds include liabilities to securities brokers.

(2) The consolidated statements of financial position included a $127.9 million noncontrolling interest for hedge funds.

We did not provide financial or other support to investees designated as consolidated VIEs during the three or nine months ended September 30, 2010.

Unconsolidated Variable Interest Entities

Invested Securities

We hold a significant variable interest in a number of VIEs where we are not the primary beneficiary. Our investments in securities issued by these VIEs are reported in fixed maturities, available-for-sale and fixed maturities, trading in the consolidated statements of financial position and are described below.

VIEs include CMBS, residential mortgage-backed securities and asset-backed securities. All of these entities were deemed VIEs upon the removal of the QSPE scope exception because the equity within these entities is insufficient to sustain them. We currently are not the primary beneficiary in any of the entities within these categories of investments. This determination was based primarily on the fact we do not own the class of security that controls the unilateral right to replace the special servicer or equivalent function.

As previously discussed, we invest in several types of collateralized private investment vehicles, which are VIEs. These include cash and synthetic structures that we do not manage. We are currently not the primary beneficiary of these collateralized private investment vehicles primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

We have invested in various VIE trusts as a debt holder. All of these entities are classified as VIEs due to insufficient equity to sustain them. Prior to January 1, 2010, we had performed a quantitative analysis and concluded that although we held a significant variable interest in these entities we were not the primary beneficiary due to lack of majority of the risk of loss or because they were scoped out as a QSPE. Beginning January 1, 2010, we concluded we are not the primary beneficiary primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

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Principal Financial Group, Inc.
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3. Variable Interest Entities (continued)

The carrying value and maximum loss exposure for our unconsolidated VIEs are as follows:

	Asset carrying value	Maximum exposure to loss (1)
	(in millions)	
September 30, 2010		
Fixed maturities, available-for-sale:		
Corporate	**$ 439.4**	**$ 367.4**
Residential mortgage-backed securities	**3,003.4**	**2,867.5**
Commercial mortgage-backed securities	**3,814.6**	**4,570.9**
Collateralized debt obligations	**253.3**	**369.4**
Other debt obligations	**3,128.2**	**3,180.4**
Fixed maturities, trading:		
Residential mortgage-backed securities	**206.7**	**206.7**
Commercial mortgage-backed securities	**3.5**	**3.5**
Collateralized debt obligations	**84.5**	**84.5**
Other debt obligations	**120.7**	**120.7**

(1) Our risk of loss is limited to our initial investment measured at amortized cost for fixed maturities, available-for-sale and to fair value for our fixed maturities, trading.

Sponsored Investment Funds

We are the investment manager for certain money market mutual funds that are deemed to be VIEs. We are not the primary beneficiary of these VIEs since our involvement is limited primarily to being a service provider, and our variable interest does not absorb the majority of the variability of the entities net assets. As of September 30, 2010, these VIEs held $1.7 billion in total assets. We chose to contribute $3.2 million to these VIEs during both the three and nine months ended September 30, 2010, for competitive reasons and have no contractual obligation to further contribute to the funds.

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4. Investments

Fixed Maturities and Equity Securities

Fixed maturities include bonds, asset-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock and nonredeemable preferred stock. We classify fixed maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 10, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders equity, net of adjustments related to deferred policy acquisition costs (DPAC), sales inducements, unearned revenue reserves, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). We also have trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. Mark-to-market adjustments related to these trading securities are reflected in net investment income.

The cost of fixed maturities is adjusted for amortization of premiums and accrual of discounts, both computed using the interest method. The cost of fixed maturities and equity securities classified as available-for-sale is adjusted for declines in value that are other than temporary. Impairments in value deemed to be other than temporary are primarily reported in net income as a component of net realized capital gains (losses), with noncredit impairment losses for certain fixed maturities, available-for-sale reported in other comprehensive income (OCI). For loan-backed and structured securities, we recognize income using a constant effective yield based on currently anticipated cash flows.

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

	Amortized cost	Gross unrealized gains	Gross unrealized losses (in millions)	Other-than-temporary impairments in OCI	Fair value
September 30, 2010					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 554.7	$ 26.0	$	$	$ 580.7
Non-U.S. governments	763.7	170.5			934.2
States and political subdivisions	2,315.2	115.9	4.5		2,426.6
Corporate	33,163.9	2,535.9	502.7	27.6	35,169.5
Residential mortgage-backed securities	2,867.5	136.7	0.8		3,003.4
Commercial mortgage-backed securities	4,570.9	117.3	670.2	203.4	3,814.6

Collateralized debt obligations		**369.4**		**0.9**		**86.7**		**30.3**		**253.3**
Other debt obligations		**3,180.4**		**85.1**		**55.9**		**81.4**		**3,128.2**
Total fixed maturities, available-for-sale	**$**	**47,785.7**	**$**	**3,188.3**	**$**	**1,320.8**	**$**	**342.7**	**$**	**49,310.5**
Total equity securities, available-for-sale	**$**	**180.0**	**$**	**8.4**	**$**	**14.6**			**$**	**173.8**
December 31, 2009										
Fixed maturities, available-for-sale:										
U.S. government and agencies	$	550.1	$	9.1	$	0.5	$		$	558.7
Non-U.S. governments		741.5		114.8		1.4				854.9
States and political subdivisions		2,008.7		53.4		13.5				2,048.6
Corporate		32,767.0		1,296.8		1,075.0		58.0		32,930.8
Residential mortgage-backed securities		3,049.5		87.4		3.8				3,133.1
Commercial mortgage-backed securities		4,898.0		20.9		1,211.5		107.7		3,599.7
Collateralized debt obligations		607.5		1.8		200.7		39.0		369.6
Other debt obligations		2,994.1		34.6		229.8		73.7		2,725.2
Total fixed maturities, available-for-sale	$	47,616.4	$	1,618.8	$	2,736.2	$	278.4	$	46,220.6
Total equity securities, available-for-sale	$	231.1	$	17.2	$	34.3			$	214.0

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Principal Financial Group, Inc.
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4. Investments (continued)

The amortized cost and fair value of fixed maturities available-for-sale as of September 30, 2010, by contractual maturity, were as follows:

	Amortized cost	Fair value
	(in millions)	
Due in one year or less	$ 2,436.9	$ 2,490.9
Due after one year through five years	13,442.1	14,145.5
Due after five years through ten years	9,278.6	9,987.3
Due after ten years	11,639.9	12,487.3
Subtotal	36,797.5	39,111.0
Mortgage-backed and other asset-backed securities	10,988.2	10,199.5
Total	$ 47,785.7	$ 49,310.5

Actual maturities may differ because issuers may have the right to call or prepay obligations. Our portfolio is diversified by industry, issuer and asset class. Credit concentrations are managed to established limits.

Net Realized Capital Gains and Losses

Net realized capital gains and losses on sales of investments are determined on the basis of specific identification. In general, in addition to realized capital gains and losses on investment sales and periodic settlements on derivatives not designated as hedges, gains and losses related to other-than-temporary impairments, certain trading securities, certain seed money investments, fair value hedge and cash flow hedge ineffectiveness, mark-to-market adjustments on derivatives not designated as hedges, changes in the mortgage loan valuation allowance and impairments of real estate held for investment are reported as net realized capital gains (losses). Investment gains and losses on sales of certain real estate held for sale, which do not meet the criteria for classification as a discontinued operation, are reported as net investment income and are excluded from net realized capital gains (losses). We also have trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities for which the mark-to-market adjustments are reported as net investment income and are excluded from net realized capital gains (losses). The major components of net realized capital gains (losses) on investments are summarized as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
		(in millions)		
Fixed maturities, available-for-sale:				

Gross gains	**$ 10.5**	$ 43.8	**$ 51.3**	$ 107.4
Gross losses	**(62.3)**	(154.9)	**(285.3)**	(505.3)
Portion of other-than-temporary impairment losses recognized in OCI	**6.3**	45.3	**64.3**	162.4
Hedging, net	**80.8**	68.3	**257.4**	(165.3)
Fixed maturities, trading	**11.8**	15.7	**26.3**	57.5
Equity securities, available-for-sale:				
Gross gains	**0.9**	12.6	**8.7**	25.1
Gross losses	**(0.7)**	(21.7)	**(2.8)**	(35.8)
Equity securities, trading	**(1.7)**	19.2	**6.1**	29.9
Mortgage loans	**(19.7)**	(39.2)	**(128.1)**	(115.8)
Derivatives	**(25.4)**	(64.5)	**(232.3)**	197.6
Other	**(21.2)**	8.8	**101.8**	(42.8)
Net realized capital losses	**$ (20.7)**	$ (66.6)	**$ (132.6)**	$ (285.1)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were $0.2 billion and $2.1 billion for the three months ended September 30, 2010 and 2009, and $1.3 billion and $3.7 billion for the nine months ended September 30, 2010 and 2009, respectively.

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Principal Financial Group, Inc.
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4. Investments (continued)

Other-Than-Temporary Impairments

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

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

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

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

Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities, were as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	**2009**	**2010**	**2009**
	(in millions)			
Fixed maturities, available-for-sale	**$ (56.2)**	$ (153.0)	**$ (251.7)**	$ (498.8)
Equity securities, available-for-sale	**0.3**	(9.5)	**4.1**	(11.2)
Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities	**$ (55.9)**	$ (162.5)	**$ (247.6)**	$ (510.0)

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4. Investments (continued)

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Total other-than-temporary impairments on fixed maturities for which an amount related to noncredit losses was recognized in OCI	**$ 2.1**	$ (113.2)	**$ (156.5)**	$ (312.5)
Noncredit loss recognized in OCI	**6.3**	45.3	**64.3**	162.4
Credit loss impairment recognized in net realized capital losses (1)	**$ 8.4**	$ (67.9)	**$ (92.2)**	$ (150.1)

(1) Includes additions to bifurcated credit losses recognized in net realized capital gains (losses) during the period for fixed maturities for which an other-than-temporary impairment was not previously recognized and additional credit losses for previously recognized other-than-temporary impairments of $36.0 million and $69.2 million for the three months ended September 30, 2010 and 2009, respectively, and $176.3 million and $151.7 million for the nine months ended September 30, 2010 and 2009, respectively. These losses are offset by reductions for previously recognized bifurcated credit losses on fixed maturities now sold or intended to be sold and fixed maturities reclassified from available-for-sale to trading, which did not impact net income for the period, of $44.4 million and $1.3 million for the three months ended September 30, 2010 and 2009, respectively, and $84.1 million and $1.6 million for the nine months ended September 30, 2010 and 2009, respectively. See the credit loss rollforward table below for further details on bifurcated credit losses.

Non-bifurcated other-than-temporary impairment losses, net of recoveries from the sale of previously impaired available-for-sale securities, for fixed maturities recognized in net realized capital gains (losses) during the period were $13.9 million and $38.5 million for the three months ended September 30, 2010 and 2009, respectively, and $11.1 million and $184.7 million for the nine months ended September 30, 2010 and 2009, respectively.

The following table provides a rollforward of accumulated credit losses for fixed maturities with bifurcated credit losses. The purpose of the table is to provide detail of (1) additions to the bifurcated credit loss amounts recognized in net realized capital gains (losses) during the period and (2) decrements for previously recognized bifurcated credit losses where the loss is no longer bifurcated and/or there has been a positive change in expected cash flows or accretion of the bifurcated credit loss amount.

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Beginning balance	**$ (303.0)**	$ (100.6)	**$ (204.7)**	$ (18.5)
Credit losses for which an other-than-temporary impairment was not previously recognized	**(3.7)**	(55.2)	**(97.9)**	(127.5)
Credit losses for which an other-than-temporary impairment was previously recognized	**(32.3)**	(14.0)	**(78.4)**	(24.2)
Reduction for credit losses previously recognized on fixed maturities now sold or intended to be sold		1.3	**39.7**	1.6
Reduction for credit losses previously recognized on fixed maturities reclassified to trading (1)	**44.4**		**44.4**	
Reduction for positive changes in cash flows expected to be collected and amortization (2)	**0.6**	0.7	**2.9**	0.8
Ending balance	**$ (294.0)**	$ (167.8)	**$ (294.0)**	$ (167.8)

(1) Fixed maturities previously classified as available-for-sale have been reclassified to trading as a result of electing the fair value option upon adoption of accounting guidance related to the evaluation of credit derivatives embedded in beneficial interests in securitized financial assets.

(2) Amounts are recognized in net investment income.

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Principal Financial Group, Inc.
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4. Investments (continued)

Gross Unrealized Losses for Fixed Maturities and Equity Securities

For fixed maturities and equity securities available-for-sale with unrealized losses, including other-than-temporary impairment losses reported in OCI, as of September 30, 2010, the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities were in a continuous unrealized loss position are summarized as follows:

	September 30, 2010					
	Less than twelve months		Greater than or equal to twelve months		Total	
	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
Non-U.S. governments	$ 0.8	$	$	$	$ 0.8	$
States and political subdivisions	37.2	1.5	76.3	3.0	113.5	4.5
Corporate	845.4	28.4	4,328.5	501.9	5,173.9	530.3
Residential mortgage-backed securities	107.8	0.8	0.5		108.3	0.8
Commercial mortgage-backed securities	267.5	3.7	1,306.2	869.9	1,573.7	873.6
Collateralized debt obligations	11.6	0.3	224.5	116.7	236.1	117.0
Other debt obligations	225.4	2.5	636.5	134.8	861.9	137.3
Total fixed maturities, available-for-sale	$ 1,495.7	$ 37.2	$ 6,572.5	$ 1,626.3	$ 8,068.2	$ 1,663.5
Total equity securities, available-for-sale	$ 40.7	$ 7.1	$ 82.1	$ 7.5	$ 122.8	$ 14.6

Of the total amounts, Principal Life Insurance Company s (Principal Life) consolidated portfolio represented $7,706.4 million in available-for-sale fixed maturities with gross unrealized losses of $1,615.3 million. Principal Life s consolidated portfolio consists of fixed maturities where 71% were investment grade (rated AAA through BBB-) with an average price of 83 (carrying value/amortized cost) at September 30, 2010. Gross unrealized losses in our fixed maturities portfolio decreased during the nine months ended September 30, 2010, primarily due to a decline in interest rates. The decrease is primarily attributed to the corporate and commercial mortgage-backed securities sectors.

For those securities that had been in a loss position for less than twelve months, Principal Life s consolidated portfolio held 195 securities with a carrying value of $1,370.5 million and unrealized losses of $31.2 million reflecting an average price of 98 at September 30, 2010. Of this portfolio, 85% was investment grade (rated AAA through BBB-) at September 30, 2010, with associated unrealized losses of $20.0 million. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 849 securities with a carrying value of $6,335.9 million and unrealized losses of $1,584.1 million. The average rating of this portfolio was BBB with an average price of 80 at September 30, 2010. Of the $1,584.1 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $869.8 million in unrealized losses with an average price of 60 and an average credit rating of BBB+. The remaining unrealized losses consist primarily of $459.7 million within the corporate sector at September 30, 2010. The average price of the corporate sector was 90 and the average credit rating was BBB. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

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4. Investments (continued)

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

	December 31, 2009					
	Less than twelve months		Greater than or equal to twelve months		Total	
	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses	Carrying value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
U.S. government and agencies	$ 32.7	$ 0.4	$ 1.0	$ 0.1	$ 33.7	$ 0.5
Non-U.S. governments	24.6	0.5	36.6	0.9	61.2	1.4
States and political subdivisions	242.8	1.9	247.9	11.6	490.7	13.5
Corporate	2,595.9	69.2	7,958.2	1,063.8	10,554.1	1,133.0
Residential mortgage-backed securities	491.9	3.7	0.6	0.1	492.5	3.8
Commercial mortgage-backed securities	468.1	16.7	2,217.3	1,302.5	2,685.4	1,319.2
Collateralized debt obligations			366.1	239.7	366.1	239.7
Other debt obligations	335.4	23.4	902.3	280.1	1,237.7	303.5
Total fixed maturities, available-for-sale	$ 4,191.4	$ 115.8	$ 11,730.0	$ 2,898.8	$ 15,921.4	$ 3,014.6
Total equity securities, available-for-sale	$ 4.4	$ 0.1	$ 116.1	$ 34.2	$ 120.5	$ 34.3

Of the total amounts, Principal Life s consolidated portfolio represented $14,979.2 million in available-for-sale fixed maturities with unrealized losses of $2,928.9 million. Principal Life s consolidated portfolio consists of fixed maturities where 83% were investment grade (rated AAA through BBB-) with an average price of 84 (carrying value/amortized cost) at December 31, 2009. Due to the credit disruption that began in the last half of 2007 and continued into first quarter of 2009, which reduced liquidity and led to wider credit spreads, we saw an increase in unrealized losses in our securities portfolio. The unrealized losses were more pronounced in the corporate sector and in structured products, such as commercial mortgage-backed securities, collateralized debt obligations and asset-backed securities (included in other debt obligations). During the second quarter of 2009 and continuing through the end of the year, a narrowing of credit spreads and improvement in liquidity resulted in a decrease in the unrealized losses in our securities portfolio relative to year-end 2008.

For those securities that had been in a loss position for less than twelve months, Principal Life s consolidated portfolio held 406 securities with a carrying value of $3,739.3 million and unrealized losses of $100.5 million reflecting an average price of 97 at December 31, 2009. Of this portfolio, 97% was investment grade (rated AAA through BBB-) at December 31, 2009, with associated unrealized losses of $82.7 million. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 1,481 securities with a carrying value of $11,239.9 million and unrealized losses of $2,828.4 million. The average rating of this portfolio was BBB+ with an average price of 80 at December 31, 2009. Of the $2,828.4 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $1,302.5 million in unrealized losses with an average price of 63 and an average credit rating of AA-. The remaining unrealized losses consist primarily of $993.5 million within the corporate sector at December 31, 2009. The average price of the corporate sector was 88 and the average credit rating was BBB. The losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because it was not our intent to sell the fixed maturities, available-for-sale with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at September 30, 2010 and December 31, 2009.

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4. Investments (continued)

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

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

	September 30, 2010	December 31, 2009
	(in millions)	
Net unrealized gains (losses) on fixed maturities, available-for-sale (1)	**$ 1,794.6**	$ (1,117.4)
Noncredit component of impairment losses on fixed maturities, available-for-sale	**(342.7)**	(260.9)
Net unrealized losses on equity securities, available-for-sale	**(6.2)**	(17.1)
Adjustments for assumed changes in amortization patterns	**(433.9)**	211.9
Adjustments for assumed changes in policyholder liabilities	**(248.5)**	(75.7)
Net unrealized gains on derivative instruments	**94.7**	16.8
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments	**119.3**	214.1
Provision for deferred income tax benefits (taxes)	**(316.1)**	397.7
Effects of implementation of accounting change related to variable interest entities, net	**10.7**	
Effects of electing fair value option for fixed maturities upon implementation of accounting change related to embedded credit derivatives, net	**25.4**	
Effects of reclassifying noncredit component of previously recognized impairment losses on fixed maturities, available-for-sale, net		(9.9)
Net unrealized gains (losses) on available-for-sale securities and derivative instruments	**$ 697.3**	$ (640.5)

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

Securities Posted as Collateral

We posted $1,140.8 million in fixed maturities as of September 30, 2010, to satisfy collateral requirements primarily associated with a reinsurance arrangement and our derivative credit support annex (collateral) agreements. In addition, we posted $1,747.2 million in commercial mortgage loans as of September 30, 2010, to satisfy collateral requirements associated with our obligation under funding agreements with the Federal Home Loan Bank of Des Moines.

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5. Derivative Financial Instruments

Derivatives are generally used to hedge or reduce exposure to market risks associated with assets held or expected to be purchased or sold and liabilities incurred or expected to be incurred. Derivatives are used to change the characteristics of our asset/liability mix consistent with our risk management activities. Derivatives are also used in asset replication strategies.

Types of Derivative Instruments

Interest Rate Contracts

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

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

Interest rate caps and interest rate floors, which can be combined to form interest rate collars, are contracts that entitle the purchaser to pay or receive the amounts, if any, by which a specified market rate exceeds a cap strike interest rate, or falls below a floor strike interest rate, respectively, at specified dates. We have entered into interest rate collars whereby we receive amounts if a specified market rate falls below a floor strike interest rate, and we pay if a specified market rate exceeds a cap strike interest rate. We use interest rate collars to manage interest rate risk related to guaranteed minimum interest rate liabilities in our individual annuities contracts.

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

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

Foreign Exchange Contracts

Foreign currency risk is the risk that we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements we issue, foreign currency-denominated fixed maturities we invest in and our investment in and net income of our international operations. We may use currency swaps and currency forwards to hedge foreign currency risk.

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Principal Financial Group, Inc.
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5. Derivative Financial Instruments (continued)

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

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

Equity Contracts

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

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

Credit Contracts

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in our investment portfolio. Credit derivatives are

used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name s credit spread at the time the agreement is executed. In cases where we sell protection, at the same time we enter into these synthetic transactions, we buy a quality cash bond to match against the credit default swap. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Other Contracts

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

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5. Derivative Financial Instruments (continued)

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

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

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

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

We have fixed deferred annuities that credit interest based on changes in an external equity index. We also have certain variable annuity products with a GMWB rider, which provides that the contractholder will receive at least their principal deposit back through withdrawals of up to a specified annual amount, even if the account value is reduced to zero. Declines in the equity market may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these annuity contracts, as previously explained.

Exposure

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

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

We posted $327.0 million and $273.7 million in cash and securities under collateral arrangements as of September 30, 2010, and December 31, 2009, respectively, to satisfy collateral requirements associated with our derivative credit support agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the rating on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of September 30, 2010, and December 31, 2009, was $1,533.6 million and $1,139.7 million, respectively. With respect to these derivatives, we posted collateral of $327.0 million and $273.7 million as of September 30, 2010 and December 31, 2009, respectively, in the normal course of business, which reflects netting under derivative credit support annex agreements. If the credit-risk-related contingent features underlying these agreements were triggered on September 30, 2010, we would be required to post an additional $35.0 million of collateral to our counterparties.

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Principal Financial Group, Inc.
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5. Derivative Financial Instruments (continued)

As of September 30, 2010, and December 31, 2009, we had received $305.8 million and $353.4 million, respectively, of cash collateral associated with our derivative credit support annex agreements. The cash collateral is included in other assets on the consolidated statements of financial position, with a corresponding liability reflecting our obligation to return the collateral recorded in other liabilities.

Notional amounts are used to express the extent of our involvement in derivative transactions and represent a standard measurement of the volume of our derivative activity. Notional amounts represent those amounts used to calculate contractual flows to be exchanged and are not paid or received, except for contracts such as currency swaps. Credit exposure represents the gross amount owed to us under derivative contracts as of the valuation date. The notional amounts and credit exposure of our derivative financial instruments by type were as follows:

	September 30, 2010	December 31, 2009
	(in millions)	
Notional amounts of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 19,549.1**	$ 19,588.6
Interest rate collars	**500.0**	
Swaptions	**68.5**	
Futures	**0.1**	43.3
Foreign exchange contracts:		
Foreign currency swaps	**4,708.0**	5,284.4
Currency forwards	**79.8**	91.5
Equity contracts:		
Options	**1,039.2**	818.2
Futures	**0.2**	84.6
Credit contracts:		
Credit default swaps	**1,567.4**	1,586.4
Other contracts:		
Embedded derivative financial instruments	**3,837.0**	3,344.5
Commodity swaps		40.0
Total notional amounts at end of period	**$ 31,349.3**	$ 30,881.5
Credit exposure of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 877.0**	$ 579.1
Interest rate collars	**14.1**	
Foreign exchange contracts:		
Foreign currency swaps	**499.1**	594.4
Currency forwards	**4.1**	3.8
Equity contracts:		
Options	**238.5**	149.8
Credit contracts:		

Credit default swaps		**8.4**		15.5
Total gross credit exposure		**1,641.2**		1,342.6
Less: collateral received		**344.7**		395.6
Net credit exposure	**$**	**1,296.5**	$	947.0

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Principal Financial Group, Inc.
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5. Derivative Financial Instruments (continued)

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

	Derivative assets (1)		Derivative liabilities (2)	
	September 30, 2010	December 31, 2009	September 30, 2010	December 31, 2009
	(in millions)			
Derivatives designated as hedging instruments				
Interest rate contracts	**$ 117.4**	$ 81.5	**$ 547.9**	$ 309.1
Foreign exchange contracts	**375.3**	444.4	**131.5**	240.6
Total derivatives designated as hedging instruments	**$ 492.7**	$ 525.9	**$ 679.4**	$ 549.7
Derivatives not designated as hedging instruments				
Interest rate contracts	**$ 691.4**	$ 433.5	**$ 629.8**	$ 336.8
Foreign exchange contracts	**106.3**	107.5	**60.7**	75.0
Equity contracts	**238.5**	149.8		
Credit contracts	**8.4**	15.5	**213.0**	84.0
Other contracts			**200.6**	128.1
Total derivatives not designated as hedging instruments	**$ 1,044.6**	$ 706.3	**$ 1,104.1**	$ 623.9
Total derivative instruments	**$ 1,537.3**	$ 1,232.2	**$ 1,783.5**	$ 1,173.6

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

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of $54.6 million and $23.6 million as of September 30, 2010, and December 31, 2009, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

When we sell credit protection, we are exposed to the underlying credit risk similar to purchasing a fixed maturity security instrument. The majority of our credit derivative contracts sold reference a single name or reference security (referred to as single name credit default swaps). The remainder of our credit derivatives reference either a basket or index of securities. These instruments are either referenced in an over-the-counter credit derivative transaction, or embedded within an investment structure that has been fully consolidated into our financial statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by $10.0 million and $47.0 million as of September 30, 2010, and December 31, 2009, respectively. These credit derivative transactions had a net asset (liability) fair value of $(0.9) million and $2.4 million as of September 30, 2010, and December 31, 2009, respectively. Our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

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

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5. Derivative Financial Instruments (continued)

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

	September 30, 2010			
	Notional amount	Fair value (in millions)	Maximum future payments	Weighted average expected life (in years)
Single name credit default swaps				
Corporate debt				
AA	$ 135.0	$ (0.9)	$ 135.0	4.1
A	579.0	(2.1)	579.0	3.0
BBB	175.0	(0.4)	175.0	1.4
BB	10.0		10.0	
Structured finance				
B	25.9	(21.3)	25.9	6.2
CCC	22.0	(20.9)	22.0	9.6
Total single name credit default swaps	946.9	(45.6)	946.9	3.1
Basket and index credit default swaps				
Corporate debt				
A	6.0	(0.1)	6.0	1.2
CCC (1)	170.0	(147.9)	170.0	6.1
Government/municipalities				
A	40.0	(9.3)	40.0	5.6
Structured finance				
AA	20.0	(2.7)	20.0	4.7
BBB	5.0	(0.5)	5.0	15.2
Total basket and index credit default swaps	241.0	(160.5)	241.0	6.0
Total credit default swap protection sold	$ 1,187.9	$ (206.1)	$ 1,187.9	3.6

(1) The increase from December 31, 2009, resulted from the consolidation of additional collateralized private investment vehicles due to our implementation of new authoritative guidance related to the accounting for VIEs effective January 1, 2010.

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5. Derivative Financial Instruments (continued)

	December 31, 2009			
	Notional amount	Fair value (in millions)	Maximum future payments	Weighted average expected life (in years)
Single name credit default swaps				
Corporate debt				
AA	$ 135.0	$ (0.6)	$ 135.0	4.9
A	609.0	1.2	609.0	3.6
BBB	220.0	0.2	220.0	1.8
BB	10.0		10.0	0.8
Structured finance				
AA	9.9	(6.0)	9.9	2.5
BBB	16.0	(15.2)	16.0	9.6
CCC	22.0	(20.2)	22.0	10.4
Total single name credit default swaps	1,021.9	(40.6)	1,021.9	3.6
Basket and index credit default swaps				
Corporate debt				
A	6.0	(0.1)	6.0	2.0
BBB	20.0		20.0	0.5
CCC	15.0	(11.9)	15.0	3.0
Government/municipalities				
A	50.0	(9.3)	50.0	5.1
Structured finance				
AA	20.0	(5.9)	20.0	5.4
BBB	5.0	(1.2)	5.0	15.9
Total basket and index credit default swaps	116.0	(28.4)	116.0	4.4
Total credit default swap protection sold	$ 1,137.9	$ (69.0)	$ 1,137.9	3.6

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

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5. Derivative Financial Instruments (continued)

	September 30, 2010		
	Amortized cost	Carrying value	Weighted average expected life (in years)
	(in millions)		
Corporate debt			
BB	$ 25.0	$ 17.5	6.2
CCC	50.0	44.5	2.4
CC	12.1	1.2	5.5
Total corporate debt	87.1	63.2	3.9
Structured finance			
AA	9.5	4.8	8.2
BBB	29.5	22.5	5.8
BB	19.1	15.4	5.0
B	16.4	9.7	6.7
CCC	22.5	6.8	6.1
CC	2.8	0.5	8.1
C	11.9	5.6	9.0
Total structured finance	111.7	65.3	6.5
Total fixed maturities with credit derivatives	$ 198.8	$ 128.5	5.3

	December 31, 2009		
	Amortized cost	Carrying value	Weighted average expected life (in years)
	(in millions)		
Corporate debt			
AA	$ 15.0	$ 14.3	0.7
A	15.0	14.6	0.3
BBB	5.0	4.9	0.3
BB	48.9	42.9	3.5
CCC	51.4	43.8	4.5
C	22.7	6.5	6.6
Total corporate debt	158.0	127.0	3.9
Structured finance			
AA	9.5	5.6	9.1
A	7.0	5.0	6.8
BBB	41.1	23.2	6.8
BB	32.6	17.4	7.3
B	7.4	3.1	7.3
CCC	16.1	5.7	19.4
CC	18.0	0.8	7.8

C		10.8		3.3	12.9
Total structured finance		142.5		64.1	11.2
Total fixed maturities with credit derivatives	$	300.5	$	191.1	8.0

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5. Derivative Financial Instruments (continued)

Fair Value Hedges

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

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

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

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

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

The following table shows the effect of derivatives in fair value hedging relationships and the related hedged items on the consolidated statements of operations. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in fair value hedging	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, (1)	Hedged items in fair value	Amount of gain (loss) recognized in net income on related hedged item for the three months ended September 30, (1)

relationships	2010	2009	hedging relationships	2010	2009
	(in millions)			(in millions)	
Interest rate contracts	**$ (76.7)**	$ (61.1)	Fixed maturities, available-for-sale	**$ 76.5**	$ 49.8
Interest rate contracts	**(10.4)**	6.7	Investment-type insurance contracts	**8.9**	(4.1)
Foreign exchange contracts	**(5.7)**	9.3	Fixed maturities, available-for-sale	**5.8**	(10.5)
Foreign exchange contracts	**44.3**	(32.1)	Investment-type insurance contracts	**(46.6)**	8.5
Total	**$ (48.5)**	$ (77.2)	Total	**$ 44.6**	$ 43.7

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, (1) 2010	2009	Hedged items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the nine months ended September 30, (1) 2010	2009
	(in millions)			(in millions)	
Interest rate contracts	**$ (230.0)**	$ 198.0	Fixed maturities, available-for-sale	**$ 226.4**	$ (187.6)
Interest rate contracts	**(8.7)**	(15.0)	Investment-type insurance contracts	**10.5**	27.1
Foreign exchange contracts	**5.2**	2.8	Fixed maturities, available-for-sale	**(3.8)**	(4.1)
Foreign exchange contracts	**0.9**	80.3	Investment-type insurance contracts	**(1.9)**	(89.9)
Total	**$ (232.6)**	$ 266.1	Total	**$ 231.2**	$ (254.5)

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Principal Financial Group, Inc.
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5. Derivative Financial Instruments (continued)

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

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships.

Hedged item	Amount of gain (loss) for the three months ended September 30, 2010	2009	Amount of gain (loss) for the nine months ended September 30, 2010	2009
		(in millions)		
Fixed maturities, available-for-sale (1)	**$ (39.9)**	$ (37.7)	**$ (122.3)**	$ (101.4)
Investment-type insurance contracts (2)	**18.4**	26.2	**61.1**	79.8

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(1) Reported in net investment income on the consolidated statements of operations.

(2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

Cash Flow Hedges

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

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

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

The maximum length of time that we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 9.7 years. At September 30, 2010, we had $114.0 million of gross unrealized gains reported in accumulated other comprehensive income (AOCI) on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from AOCI into net income. No amounts were reclassified from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring during the three and nine months ended September 30, 2010, or the three months ended September 30, 2009. During the nine months ended September 30, 2009, $40.4 million of gross unrealized losses were reclassified from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows of a forecasted liability issuance were probable of not occurring.

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Principal Financial Group, Inc.
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5. Derivative Financial Instruments (continued)

The following table shows the effect of derivatives in cash flow hedging relationships on the consolidated statements of operations and consolidated statements of financial position. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three months ended September 30, 2010	2009	Location of gain (loss) reclassified from AOCI into net income (effective portion)	Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the three months ended September 30, 2010	2009
		(in millions)			(in millions)	
Interest rate contracts	Fixed maturities, available-for-sale	**$ (7.5)**	$ (137.4)	Net investment income	**$ 2.0**	$ 0.9
				Net realized capital gains (losses)		0.6
Interest rate contracts	Investment-type insurance contracts	**18.6**	91.8	Benefits, claims and settlement expenses	**(0.3)**	(0.3)
Interest rate contracts	Debt			Operating expense	**(1.2)**	(1.0)
Foreign exchange contracts	Fixed maturities, available-for-sale	**(130.9)**	(63.4)	Net investment income		
Foreign exchange contracts	Investment-type insurance contracts	**139.7**	99.0	Benefits, claims and settlement expenses	**(1.6)**	(1.5)
				Net realized capital gains (losses)	**(0.1)**	
Total		**$ 19.9**	$ (10.0)	Total	**$ (1.2)**	$ (1.3)

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the nine months ended September 30, 2010	2009	Location of gain (loss) reclassified from AOCI into net income (effective portion)	Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the nine months ended September 30, 2010	2009
		(in millions)			(in millions)	
Interest rate contracts	Fixed maturities, available-for-sale	**$ (34.7)**	$ (137.8)	Net investment income	**$ 5.3**	$ 3.3
Interest rate contracts	Investment-type insurance contracts	**62.1**	143.3	Benefits, claims and settlement expenses	**(0.8)**	(0.8)
Interest rate contracts	Debt		30.6	Operating expense	**(3.5)**	(1.4)
Foreign exchange contracts	Fixed maturities, available-for-sale	**136.9**	(232.9)	Net investment income		
		(103.6)	171.2		**(4.6)**	(4.1)

Foreign exchange contracts	Investment-type insurance contracts					Benefits, claims and settlement expenses				
						Net realized capital gains (losses)		**(0.1)**		22.9
Total		**$**	**60.7**	$	(25.6)	Total	**$**	**(3.7)**	$	19.9

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5. Derivative Financial Instruments (continued)

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships.

Hedged item	Amount of gain (loss) for the three months ended September 30, 2010	Amount of gain (loss) for the three months ended September 30, 2009	Amount of gain (loss) for the nine months ended September 30, 2010	Amount of gain (loss) for the nine months ended September 30, 2009
	(in millions)			
Fixed maturities, available-for-sale (1)	**$ 2.5**	$ 4.7	**$ 8.5**	$ 12.8
Investment-type insurance contracts (2)	**(2.6)**	(5.6)	**(9.9)**	(14.7)

(1) Reported in net investment income on the consolidated statements of operations.

(2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net gain resulting from the ineffective portion of interest rate contracts in cash flow hedging relationships was zero for both the three and nine months ended September 30, 2010 and 2009. The net gain (loss) resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was $(0.7) million and $1.6 million for the three months ended September 30, 2010 and 2009, respectively, and $0.8 million and $2.0 million for the nine months ended September 30, 2010 and 2009, respectively.

We expect to reclassify net gains of $23.3 million from AOCI into net income in the next 12 months, which includes both net deferred gains on discontinued hedges and net deferred losses on periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

Net Investment in Foreign Operations Hedges

From time to time, we take measures to hedge our net investments in our foreign subsidiaries from currency risks. We did not use any currency forwards during 2010 or 2009 to hedge our net investment in foreign operations.

Derivatives Not Designated as Hedging Instruments

Our use of futures, certain swaptions and swaps, collars, options and forwards are effective from an economic standpoint, but they have not been designated as hedges for financial reporting purposes. As such, periodic changes in the market value of these instruments, which includes mark-to-market gains and losses as well as periodic and final settlements, primarily flow directly into net realized capital gains (losses) on the consolidated statements of operations. Gains and losses on certain derivatives used in relation to certain trading portfolios are reported in net investment income on the consolidated statements of operations.

The following tables show the effect of derivatives not designated as hedging instruments, including market value changes of embedded derivatives that have been bifurcated from the host contract, on the consolidated statements of operations.

Derivatives not designated as hedging instruments	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, 2010	2009	Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, 2010	2009
	(in millions)			
Interest rate contracts	**$ (0.5)**	$ 41.0	**$ 17.4**	$ (54.1)
Foreign exchange contracts	**51.4**	(2.1)	**(27.5)**	93.9
Equity contracts	**(23.1)**	(16.1)	**27.8**	(84.6)
Credit contracts	**6.0**	12.6	**(11.2)**	60.9
Other contracts (1)	**18.2**	(8.9)	**(49.5)**	17.0
Total	**$ 52.0**	$ 26.5	**$ (43.0)**	$ 33.1

(1) Primarily includes the change in fair value of embedded derivatives.

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6. Federal Income Taxes

The effective income tax rate for the three months ended September 30, 2010, was lower than the U.S. corporate income tax rate of 35% (U.S. statutory rate) primarily due to income tax deductions allowed for corporate dividends received, a third quarter adjustment to reflect a decrease in our estimated annual effective income tax rate and the interest exclusion from taxable income.

The effective income tax rate for the nine months ended September 30, 2010, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, taxes on our share of earnings generated from equity method investments reflected in net investment income and the interest exclusion from taxable income.

The effective income tax rate for the three and nine months ended September 30, 2009, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, taxes on our share of earnings generated from equity method investments reflected in net investment income and the interest exclusion from taxable income.

We are a U.S. shareholder in various foreign entities classified as controlled foreign corporations (CFCs) for U.S. tax purposes. U.S. shareholders of CFCs are generally required to take into account as gross income in the U.S. certain passive income earned by the CFCs (Subpart F income) even if the income is not currently distributed. A temporary exception (the active financing exception) was applicable for tax years beginning before January 1, 2010, to avoid the current recognition of Subpart F income derived in the active conduct of a banking, financing, insurance or similar business. As of September 30, 2010, the U.S. Congress and the President have yet to enact extenders legislation. Whether or not the active financing exception legislation is enacted during the fourth quarter and effective for 2010, the tax impact of the Subpart F income will be immaterial.

The Internal Revenue Service is currently auditing our federal income tax returns for the years 2004 through 2008. We do not expect the results of these audits or developments in other tax areas to significantly change the possible increase in the amount of unrecognized tax benefits, but the outcome of tax reviews is uncertain and unforeseen results can occur. Consistent with December 31, 2009, we estimate that it is reasonably possible that the amount of our unrecognized tax benefit could increase $0.0 to $11.0 million within the next twelve months.

7. Employee and Agent Benefits

Components of Net Periodic Benefit Cost

	Pension benefits For the three months ended September 30,		Other postretirement benefits For the three months ended September 30,	
	2010	**2009**	**2010**	**2009**
		(in millions)		
Service cost	**$ 11.4**	$ 12.8	**$ 2.8**	$ 2.8
Interest cost	**26.4**	25.2	**5.3**	4.9
Expected return on plan assets	**(24.6)**	(19.9)	**(7.5)**	(6.5)
Amortization of prior service benefit	**(2.5)**	(1.9)	**(0.5)**	(0.5)
Recognized net actuarial loss	**16.9**	23.2	**1.2**	2.4
Net periodic benefit cost	**$ 27.6**	$ 39.4	**$ 1.3**	$ 3.1

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7. Employee and Agent Benefits (continued)

	Pension benefits For the nine months ended September 30,		Other postretirement benefits For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Service cost	**$ 34.2**	$ 38.4	**$ 8.4**	$ 8.4
Interest cost	**79.2**	75.6	**15.9**	14.7
Expected return on plan assets	**(73.8)**	(59.7)	**(22.5)**	(19.5)
Amortization of prior service benefit	**(7.5)**	(5.7)	**(1.5)**	(1.5)
Recognized net actuarial loss	**50.7**	69.6	**3.6**	7.2
Net periodic benefit cost	**$ 82.8**	$ 118.2	**$ 3.9**	$ 9.3

The reduction in net periodic benefit cost for both the three and nine months ended September 30, 2010, compared to September 30, 2009, reflects that in 2009 the return on plan assets was greater than expected, resulting in an actuarial gain and higher than expected plan assets at December 31, 2009. The higher asset value increased the expected return on plan assets in 2010 and the actuarial gain reduced the previous actuarial loss and its amortization in 2010.

Impact of Amendment to Retiree Health Benefits

In September 2010, an amendment to retiree health benefits was announced. This amendment, which will be effective for individuals retiring on or after January 1, 2011, resulted in a plan remeasurement as of September 30, 2010. Under this amendment, the company-paid subsidy for pre-Medicare-eligible coverage will be 40% and the cost of coverage for Medicare-eligible retirees (or their dependents) will no longer be subsidized. Prior to amendment, the subsidy calculation was complex and varied based on age and service with the company at the time of retirement. In addition to the changes for individuals retiring on or after January 1, 2011, the plan was simplified to a single consolidated plan design, the coordination with Medicare was changed for certain post-1984 retirees and the method for determining the premium equivalent rate was changed to be based solely on retiree experience. For the remeasurement of the retiree health benefits as of September 30, 2010, the assumptions used were a 5.40% discount rate to determine the benefit obligation; a 7.25% weighted-average expected long-term return on plan assets used to determine the net periodic benefit cost; and a health care cost initial trend rate of 9.5% pre-Medicare and 9.0% post-Medicare, decreasing to an ultimate rate of 5.0% in the year 2021. The plan amendment resulted in a $153.6 million reduction to the accumulated postretirement benefit obligation as of September 30, 2010. The plan amendment and remeasurement will result in a $14.0 million reduction in the 2010 net periodic postretirement benefit cost, which will be reflected in the fourth quarter.

Impact from Exit of Group Medical Insurance Business

On September 30, 2010, we announced our decision to exit the group medical insurance business and entered into an agreement with United Healthcare Services, Inc. to renew medical insurance coverage for our customers as the business transitions over the next 36 months. Our exit from the group medical insurance business will result in a curtailment associated with the pension and other postretirement benefits of the impacted employees. We anticipate that the curtailment will result in a gain, which will be recognized in our consolidated financial statements as impacted employees are terminated over the next 36 months.

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 2010 will be zero so we will not be required to fund our qualified pension plan during 2010. However, it is possible that we may fund the qualified and nonqualified pension plans in 2010 for a combined total of $40.0 million to $50.0 million. During the three and nine months ended September 30, 2010, we contributed $13.0 million and $33.0 million to these plans, respectively.

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8. 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 unspecified or substantial punitive and treble damages. In addition, regulatory bodies such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor and other regulatory agencies 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 industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life. Principal Life s motion to transfer venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleged, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleged that these acts constitute prohibited transactions under ERISA. Plaintiff sought to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. On August 27, 2008, the plaintiff s motion for class certification was denied. The plaintiff s new motion for class certification, filed May 11, 2009, was stricken by the court on March 31, 2010. Principal Life continues to aggressively defend the lawsuit.

On August 28, 2007, a putative class action lawsuit was filed by Patricia Walsh (and another plaintiff, who subsequently withdrew) in the United States District Court for the Southern District of Iowa against Principal Life and Princor Financial Services Corporation (the Walsh Defendants). The lawsuit alleges that the Walsh 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 plaintiff s motion for class certification was denied on March 24, 2010. On July 7, 2010, the plaintiffs filed a voluntary dismissal with prejudice.

On October 28, 2009, Judith Curran filed a derivative action lawsuit on behalf of the Principal Funds, Inc. and Strategic Asset Management Portfolio in the United States District Court for the Southern District of Iowa against Principal Management Corporation, Principal Global Investors, LLC, and Principal Funds Distributor, Inc. (the Curran Defendants). The lawsuit alleges the Curran Defendants breached their fiduciary duty under Section 36(b) of the Investment Company Act by charging advisory fees and distribution fees that were excessive. The Curran Defendants filed a motion to dismiss the case on January 29, 2010. That motion was granted in part and overruled in part. Principal Global Investors, LLC was dismissed from the suit. The remaining Curran Defendants are aggressively defending the lawsuit.

On December 2, 2009 and December 4, 2009, two plaintiffs, Cruise and Mullaney, each filed putative class action lawsuits in the United States District Court for the Southern District of New York against us, Principal Life, Principal Global Investors, LLC, and Principal Real Estate Investors, LLC (the Cruise/Mullaney Defendants). The lawsuits alleged the Cruise/Mullaney Defendants failed to manage the Principal U.S. Property Separate Account (PUSPSA) in the best interests of investors, improperly imposed a withdrawal freeze on September 26, 2008, and instituted a withdrawal queue to honor withdrawal requests as sufficient liquidity became available. Plaintiffs allege these actions constitute a breach of fiduciary duties under ERISA. Plaintiffs seek to certify a class including all qualified ERISA plans and the participants of those plans that invested in PUSPSA between September 26, 2008, and the present that have suffered losses caused by the queue. The two lawsuits, as well as two subsequently filed complaints asserting similar claims, have been consolidated and are now known as *In re Principal U.S. Property Account Litigation*. On April 22, 2010, an order was entered granting the motion made by the Cruise/Mullaney Defendants for change of venue to the United States District Court for the Southern District of Iowa. The plaintiffs have filed a Consolidated Complaint adding five new plaintiffs. The Cruise/Mullaney Defendants are aggressively defending the lawsuit.

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Principal Financial Group, Inc.
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8. Contingencies, Guarantees and Indemnifications (continued)

On July 1, 2010, Debra and Russell Hurd filed a putative class action lawsuit in the United States District Court for the Southern District of Iowa against us and Principal Life (the Hurd Defendants). The complaint alleges the Hurd Defendants underpay out-of-network health claims by using an allegedly flawed database to calculate usual and customary charges. Plaintiffs are suing on behalf of all participants and/or beneficiaries in group health plans in the United States issued, insured or administered by [us] as to which [we] have administered claims and/or paid or denied benefits for out-of-network benefit claims. The complaint alleges four causes of action, all based on violations of ERISA. The Hurd Defendants are aggressively defending the lawsuit.

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

Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary, joint ventures and industrial revenue bonds. These agreements generally expire through 2019. The maximum exposure under these agreements as of September 30, 2010, was approximately $221.0 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 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.

9. Stockholders Equity

Reconciliation of Outstanding Shares

	Series A preferred stock	Series B preferred stock (in millions)	Common stock
Outstanding shares at January 1, 2009	3.0	10.0	259.3
Shares issued			59.9
Treasury stock acquired			(0.3)
Outstanding shares at September 30, 2009	3.0	10.0	318.9
Outstanding shares at January 1, 2010	**3.0**	**10.0**	**319.0**
Shares issued			**1.4**
Treasury stock acquired			**(0.1)**
Outstanding shares at September 30, 2010	**3.0**	**10.0**	**320.3**

In May 2009 we issued 58.2 million shares of common stock at a price of $19.75 per share. Net proceeds from the issuance were $1,109.1 million. The proceeds from this offering were used for general corporate purposes.

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9. Stockholders Equity (continued)

Comprehensive Income

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Net income	**$ 151.3**	$ 204.2	**$ 499.1**	$ 490.8
Net change in unrealized gains on fixed maturities, available-for-sale	**1,149.7**	3,079.4	**2,912.0**	6,176.4
Net change in noncredit component of impairment losses on fixed maturities, available-for-sale	**(6.3)**	(45.3)	**(64.3)**	(162.4)
Net change in unrealized gains on equity securities, available-for-sale	**17.2**	44.7	**10.9**	28.2
Net change in unrealized gains (losses) on equity method subsidiaries and noncontrolling interest adjustments	**(2.3)**	(39.5)	**(94.8)**	81.9
Adjustments for assumed changes in amortization patterns	**(270.7)**	(581.6)	**(648.1)**	(942.0)
Adjustments for assumed changes in policyholder liabilities	**(38.9)**	(57.6)	**(172.8)**	(97.7)
Net change in unrealized gains (losses) on derivative instruments	**28.8**	18.6	**77.9**	(2.3)
Change in net foreign currency translation adjustment	**75.6**	25.7	**(4.7)**	134.9
Change in unrecognized postretirement benefit obligation	**234.2**	23.1	**264.4**	69.1
Provision for deferred income taxes	**(384.8)**	(859.1)	**(797.7)**	(1,798.6)
Comprehensive income	**$ 953.8**	$ 1,812.6	**$ 1,981.9**	$ 3,978.3

10. Fair Value Measurements

We use fair value measurements to record fair value of certain assets and liabilities and to estimate fair value of financial instruments not recorded at fair value but required to be disclosed at fair value. Certain financial instruments, particularly policyholder liabilities other than investment-type insurance contracts, are excluded from these fair value disclosure requirements.

Fair Value of Financial Instruments

The carrying value and estimated fair value of financial instruments were as follows:

	September 30, 2010		December 31, 2009	
	Carrying amount	Fair value	Carrying amount	Fair value
	(in millions)			
Assets (liabilities)				
Fixed maturities, available-for-sale	**$ 49,310.5**	**$ 49,310.5**	$ 46,220.6	$ 46,220.6
Fixed maturities, trading	**1,500.0**	**1,500.0**	1,032.4	1,032.4
Equity securities, available-for-sale	**173.8**	**173.8**	214.0	214.0
Equity securities, trading	**215.2**	**215.2**	221.5	221.5
Mortgage loans	**11,095.8**	**11,329.3**	11,845.6	11,407.8
Policy loans	**903.8**	**1,050.9**	902.5	1,022.6
Other investments	**304.9**	**304.9**	188.5	188.5
Cash and cash equivalents	**2,268.8**	**2,268.8**	2,240.4	2,240.4
Derivative assets	**1,537.3**	**1,537.3**	1,232.2	1,232.2
Separate account assets	**65,659.4**	**65,659.4**	62,738.5	62,738.5
Cash collateral	**307.9**	**307.9**	386.4	386.4
Investment-type insurance contracts	**(34,101.3)**	**(33,111.4)**	(35,672.8)	(34,181.0)
Short-term debt	**(132.1)**	**(132.1)**	(101.6)	(101.6)
Long-term debt	**(1,582.1)**	**(1,795.0)**	(1,584.6)	(1,608.4)
Separate account liabilities	**(59,316.7)**	**(58,200.6)**	(56,897.4)	(55,867.5)
Derivative liabilities	**(1,585.6)**	**(1,585.6)**	(1,050.8)	(1,050.8)
Bank deposits	**(2,210.9)**	**(2,222.3)**	(2,185.8)	(2,188.5)
Cash collateral payable	**(307.9)**	**(307.9)**	(367.8)	(367.8)
Other liabilities	**(272.8)**	**(272.8)**	(99.2)	(99.2)

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10. Fair Value Measurements (continued)

Valuation Hierarchy

Fair value is defined 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). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels.

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

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

- **Level 3** Fair values are based on significant unobservable inputs for the asset or liability. Our Level 3 assets and liabilities include certain fixed maturities, private equity securities, real estate and commercial mortgage loan investments of our separate accounts, commercial mortgage loan investments and obligations of consolidated VIEs for which the fair value option was elected, complex derivatives and embedded derivatives that must be priced using broker quotes or other valuation methods that utilize at least one significant unobservable input.

Determination of Fair Value

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

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

investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during 2010.

Fixed Maturities

Fixed maturities include bonds, asset-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. When available, the fair value of fixed maturities is based on quoted prices of identical assets in active markets. These are reflected in Level 1 and primarily include U.S. Treasury bonds and actively traded redeemable corporate preferred securities.

When quoted prices are not available, our first priority is to obtain prices from third party pricing vendors. We have regular interaction with these vendors to ensure we understand their pricing methodologies and to confirm they are utilizing observable market information. Their methodologies vary by asset class and include inputs such as estimated cash flows, benchmark yields, reported trades, broker quotes, credit quality, industry events and economic events. Fixed maturities with validated prices from pricing services, which includes the majority of our public fixed maturities in all asset classes, are generally reflected in Level 2. Also included in Level 2 are corporate bonds where quoted market prices are not available, for which a matrix pricing valuation approach is used. In this approach, securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors.

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10. Fair Value Measurements (continued)

If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to the asset class, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available, which are reflected in Level 3 and can include fixed maturities across all asset classes. These models primarily use projected cash flows discounted using a rate derived from market interest rate curves and relevant risk spreads. As of September 30, 2010, less than 1% of our fixed maturities were valued using internal pricing models, which have been classified as Level 3 assets accordingly.

Equity Securities

Equity securities include mutual funds, common stock and nonredeemable preferred stock. Fair values of equity securities are determined using quoted prices in active markets for identical assets when available, which are reflected in Level 1. When quoted prices are not available, we may utilize internal valuation methodologies appropriate for the specific asset that use observable inputs such as underlying share prices, which are reflected in Level 2. Fair values might also be determined using broker quotes or through the use of internal models or analysis that incorporate significant assumptions deemed appropriate given the circumstances and consistent with what other market participants would use when pricing such securities, which are reflected in Level 3.

Mortgage Loans

Mortgage loans are not measured at fair value on a recurring basis. Fair values of commercial and residential mortgage loans are primarily determined by discounting the expected cash flows at current treasury rates plus an applicable risk spread, which reflects credit quality and maturity of the loans. The risk spread is based on market clearing levels for loans with comparable credit quality, maturities and risk. The fair value of mortgage loans may also be based on the fair value of the underlying real estate collateral, which is estimated using appraised values.

Policy Loans

Policy loans are not measured at fair value on a recurring basis. Fair values of policy loans are estimated by discounting expected cash flows using a risk-free rate based on the U.S. Treasury curve.

Derivatives

The fair values of exchange-traded derivatives are determined through quoted market prices, which are reflected in Level 1. Exchange-traded derivatives include interest rate and equity futures that are settled daily such that their fair value is not reflected in the consolidated statements of financial position. The fair values of over-the-counter derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The majority of our over-the-counter derivatives are valued with models that use market observable inputs, which are reflected in Level 2. Significant inputs include contractual terms, interest rates, currency exchange rates, credit spread curves, equity prices, and volatilities. These valuation models consider projected discounted cash flows, relevant swap curves, and appropriate implied volatilities. Certain over-the-counter derivatives utilize unobservable market data, primarily independent broker quotes that are nonbinding quotes based on models that do not reflect the result of market transactions, which are reflected in Level 3.

Our derivative contracts are generally documented under ISDA Master Agreements, which provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Collateral arrangements are bilateral and based on current ratings of each entity. We utilize the LIBOR interest rate curve to value our positions, which includes a credit spread. This credit spread incorporates an appropriate level of nonperformance risk into our valuations given the current ratings of our counterparties, as well as the collateral agreements in place. Counterparty credit risk is routinely monitored to ensure our adjustment for non-performance risk is appropriate.

Interest Rate Contracts. We use discounted cash flow valuation techniques to determine the fair value of interest rate swaps using observable swap curves as the inputs. These are reflected in Level 2. In addition, we have a limited number of complex inflation-linked interest rate swaps and interest rate collars that are valued using broker quotes. These are reflected in Level 3. We use option pricing models to determine the fair value of swaptions using observable swap interest rate curves and observable implied volatilities as inputs. These are reflected in Level 2.

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10. Fair Value Measurements (continued)

Foreign Exchange Contracts. We use discounted cash flow valuation techniques that utilize observable swap curves and exchange rates as the inputs to determine the fair value of foreign currency swaps. These are reflected in Level 2. In addition, we have a limited number of non-standard currency swaps that are valued using broker quotes. These are reflected within Level 3. Currency forwards are valued using observable market inputs, including forward currency exchange rates. These are reflected in Level 2.

Equity Contracts. We use an option pricing model using observable implied volatilities, dividend yields, index prices and swap curves as the inputs to determine the fair value of equity options. These are reflected in Level 2.

Credit Contracts. We use either the ISDA Credit Default Swap Standard discounted cash flow model that utilizes observable default probabilities and recovery rates as inputs or broker prices to determine the fair value of credit default swaps. These are reflected in Level 3.

Other Contracts. We use broker prices to determine the fair value of commodity swaps. These are reflected in Level 3.

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. The net asset value of the fund represents the price at which we feel we would be able to initiate a transaction. Seed money investments in mutual funds for which the net asset value is published are reflected in Level 1. Seed money investments in mutual funds or other investment funds in markets that do not have a published net asset value are reflected in Level 2.

Other investments reported at fair value also include commercial mortgage loans of consolidated VIEs for which the fair value option was elected, which are reflected in Level 3. Fair value of these commercial mortgage loans is computed utilizing a discount rate based on the current market. The market discount rate is then adjusted based on various factors that differentiate it from our pool of loans.

The carrying amounts of other assets classified as other investments in the accompanying consolidated statements of financial position, which are not measured at fair value on a recurring basis, approximate their fair values.

Cash and Cash Equivalents

Certain cash equivalents are reported at fair value on a recurring basis and include money market instruments and other short-term investments with maturities of less than three months. Fair values of these cash equivalents may be determined using public quotations, when available, which are reflected in Level 1. When public quotations are not available, because of the highly liquid nature of these assets, carrying amounts may be used to approximate fair values, which are reflected in Level 2.

The carrying amounts of cash and cash equivalents that are not reported at fair value on a recurring basis approximate their fair value.

Separate Account Assets

Separate account assets include equity securities, debt securities and derivative instruments, for which fair values are determined as previously described, and are reflected in Level 1, Level 2 and Level 3. 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. The market clearing spreads vary based on mortgage type, weighted average life, rating and liquidity. These are reflected in Level 3. 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. The real estate within the separate accounts is reflected in Level 3.

Cash Collateral and Cash Collateral Payable

Cash collateral is not measured at fair value on a recurring basis. The carrying amounts of cash collateral received and posted under derivative credit support annex (collateral) agreements and the carrying amount of the payable associated with our obligation to return the cash collateral received approximate their fair value.

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

Investment-Type Insurance Contracts

Investment-type insurance contracts are not measured at fair value on a recurring basis. The fair values of our reserves and liabilities for investment-type insurance contracts are estimated using discounted cash flow analyses based on current interest rates, including non-performance risk, being offered for similar contracts with maturities consistent with those remaining for the investment-type contracts being valued. Investment-type insurance contracts include insurance, annuity and other policy contracts that do not involve significant mortality or morbidity risk and are only a portion of the policyholder liabilities appearing in the consolidated statements of financial position. Insurance contracts include insurance, annuity and other policy contracts that do involve significant mortality or morbidity risk. The fair values for our insurance contracts, other than investment-type contracts, are not required to be disclosed.

Certain annuity contracts and other investment-type insurance contracts include embedded derivatives that have been bifurcated from the host contract and that are measured at fair value on a recurring basis, which are reflected in Level 3. The key assumptions for calculating the fair value of the embedded derivative liabilities are market assumptions (such as equity market returns, interest rate levels, market volatility and correlations) and policyholder behavior assumptions (such as lapse, mortality, utilization and withdrawal patterns). They are valued using a combination of historical data and actuarial judgment. Stochastic models are used to value the embedded derivatives that incorporate a spread reflecting our own creditworthiness and risk margins.

The assumption for our own non-performance risk for investment-type insurance contracts and any embedded derivatives bifurcated from certain annuity and investment-type insurance contracts is based on the current market credit spreads for debt-like instruments that we have issued and are available in the market.

Short-Term Debt

Short-term debt is not measured at fair value on a recurring basis. The carrying amount of short-term debt approximates its fair value because of the relatively short time between origination of the debt instrument and its maturity.

Long-Term Debt

Long-term debt is not measured at fair value on a recurring basis. Fair values for debt issues are estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements.

Separate Account Liabilities

Separate account liabilities are not measured at fair value on a recurring basis. Fair values of separate account liabilities, excluding insurance-related elements, are estimated based on market assumptions around what a potential acquirer would pay for the associated block of business, including both the separate account assets and liabilities. As the applicable separate account assets are already reflected at fair value, any adjustment to the fair value of the block is an assumed adjustment to the separate account liabilities. To compute fair value, the separate account liabilities are originally set to equal separate account assets because these are pass-through contracts. The separate account liabilities are reduced by the amount of future fees expected to be collected that are intended to offset upfront acquisition costs already incurred that a potential acquirer would not have to pay. The estimated future fees are adjusted by an adverse deviation discount and the amount is then discounted at a risk-free rate as measured by the yield on U.S. Treasury securities at maturities aligned with the estimated timing of fee collection.

Bank Deposits

Bank deposits are not measured at fair value on a recurring basis. The fair value of deposits of our Principal Bank subsidiary with no stated maturity, such as demand deposits, savings, and interest-bearing demand accounts, is equal to the amount payable on demand (i.e., their carrying amounts). The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount is estimated using the rates currently offered for deposits of similar remaining maturities. The fair value estimates do not include the benefit that results from the low-cost funding provided by the deposit liabilities compared to the cost of borrowing funds in the market.

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

Other Liabilities

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities. We have had an embedded derivative in which the fair value of the underlying securities was obtained from a third party pricing vendor and was reflected in Level 2. We also have an embedded derivative in which the fair value of the underlying securities is calculated utilizing the yield, credit quality and average maturity of each security, which is reflected in Level 3.

Additionally, obligations of consolidated VIEs for which the fair value option was elected are included in other liabilities. These obligations are valued either based on prices obtained from third party pricing vendors as utilized and described in our discussion of how fair value is determined for fixed maturities, which are reflected in Level 2, or broker quotes, which are reflected in Level 3.

Other liabilities related to financing obligations are not measured at fair value on a recurring basis. The fair value of these obligations is based on the discounted value of contractual cash flows.

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, 2010			
	Assets / (liabilities) measured at fair value	Fair value hierarchy level		
		Level 1	Level 2	Level 3
	(in millions)			
Assets				
Fixed maturities, available-for-sale				
U.S. government and agencies	$ 580.7	$ 30.3	$ 550.4	$
Non-U.S. governments	934.2		909.3	24.9
States and political subdivisions	2,426.6		2,426.6	

Corporate	35,169.5	98.6	34,432.4	638.5
Residential mortgage-backed securities	3,003.4		3,003.4	
Commercial mortgage-backed securities	3,814.6		3,798.1	16.5
Collateralized debt obligations	253.3		153.8	99.5
Other debt obligations	3,128.2		3,013.8	114.4
Total fixed maturities, available-for-sale	49,310.5	128.9	48,287.8	893.8
Fixed maturities, trading	1,500.0	250.6	953.6	295.8
Equity securities, available-for-sale	173.8	124.3	2.5	47.0
Equity securities, trading	215.2	123.2	92.0	
Derivative assets (1)	1,537.3		1,487.5	49.8
Other investments (2)	207.7	14.3	64.3	129.1
Cash equivalents (3)	1,321.0	207.8	1,113.2	
Sub-total excluding separate account assets	54,265.5	849.1	52,000.9	1,415.5
Separate account assets	65,659.4	47,203.8	14,586.1	3,869.5
Total assets	$ 119,924.9	$ 48,052.9	$ 66,587.0	$ 5,285.0
Liabilities				
Investment-type insurance contracts (4)	$ (54.6)	$	$	$ (54.6)
Derivative liabilities (1)	(1,585.6)		(1,359.0)	(226.6)
Other liabilities (4)	(254.7)		(97.0)	(157.7)
Total liabilities	$ (1,894.9)	$	$ (1,456.0)	$ (438.9)
Net assets	$ 118,030.0	$ 48,052.9	$ 65,131.0	$ 4,846.1

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

	As of December 31, 2009			
	Assets / (liabilities) measured at fair value		Fair value hierarchy level	
		Level 1	Level 2	Level 3
	(in millions)			
Assets				
Fixed maturities, available-for-sale				
U.S. government and agencies	$ 558.7	$ 25.1	$ 533.6	$
Non-U.S. governments	854.9		838.8	16.1
States and political subdivisions	2,048.6		2,037.1	11.5
Corporate	32,930.8	100.8	32,092.7	737.3
Residential mortgage-backed securities	3,133.1		3,133.1	
Commercial mortgage-backed securities	3,599.7		3,565.4	34.3
Collateralized debt obligations	369.6		72.8	296.8
Other debt obligations	2,725.2		2,648.6	76.6
Total fixed maturities, available-for-sale	46,220.6	125.9	44,922.1	1,172.6
Fixed maturities, trading	1,032.4	189.4	779.5	63.5
Equity securities, available-for-sale	214.0	139.9	2.4	71.7
Equity securities, trading	221.5	130.9	90.6	
Derivative assets (1)	1,232.2		1,177.8	54.4
Other investments (2)	74.7	15.7	59.0	
Cash equivalents (3)	1,565.3	815.1	750.2	
Sub-total excluding separate account assets	50,560.7	1,416.9	47,781.6	1,362.2
Separate account assets	62,738.5	40,503.0	18,114.8	4,120.7
Total assets	$ 113,299.2	$ 41,919.9	$ 65,896.4	$ 5,482.9
Liabilities				
Investment-type insurance contracts (4)	$ (23.6)	$	$	$ (23.6)
Derivative liabilities (1)	(1,050.8)		(957.1)	(93.7)
Other liabilities (4)	(99.2)		(10.1)	(89.1)
Total liabilities	$ (1,173.6)	$	$ (967.2)	$ (206.4)
Net assets	$ 112,125.6	$ 41,919.9	$ 64,929.2	$ 5,276.5

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(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities. Refer to Note 5, Derivative Financial Instruments, for further information on fair value by class of derivative instruments. Our derivatives are primarily Level 2, with the exception of some credit default swaps and other swaps that are Level 3.

(2) Primarily includes seed money investments and, beginning in 2010, commercial mortgage loans of consolidated VIEs reported at fair value.

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

(4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported and, beginning in 2010, other liabilities include obligations of consolidated VIEs reported at fair value.

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Principal Financial Group, Inc.
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10. Fair Value Measurements (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) are summarized as follows:

	For the three months ended September 30, 2010						
	Beginning asset / (liability) balance as of June 30, 2010	Total realized/unrealized gains (losses) Included in net income (1)	Total realized/unrealized gains (losses) Included in other comprehensive income	Purchases, sales, issuances and settlements (4)	Transfers in (out) of Level 3	Ending asset / (liability) balance as of September 30, 2010	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
				(in millions)			
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	$ 24.6	$	$ 0.4	$ (0.1)	$	$ 24.9	$
State and political subdivisions	12.4		0.1		(12.5)		
Corporate	628.0	(7.3)	27.1	2.4	(11.7)	638.5	(5.5)
Commercial mortgage-backed securities	27.1	(0.1)		0.2	(10.7)	16.5	(0.1)
Collateralized debt obligations	165.6		10.2	(73.8)	(2.5)	99.5	
Other debt obligations	82.2		1.6	(2.3)	32.9	114.4	
Total fixed maturities, available-for-sale	939.9	(7.4)	39.4	(73.6)	(4.5)	893.8	(5.6)
Fixed maturities, trading	240.6	6.7		48.5		295.8	6.7
Equity securities, available-for-sale	43.8	0.5	3.7	(1.0)		47.0	0.5
Derivative assets	37.4	12.5		(0.1)		49.8	12.5
Other investments	130.4	2.2		(3.5)		129.1	2.2
Separate account assets (2)	3,960.4	138.0	0.5	(224.5)	(4.9)	3,869.5	110.0
Liabilities							
Investment-type insurance contracts	(78.2)	18.7		4.9		(54.6)	20.0
Derivative liabilities	(236.4)	11.7	(1.0)	(0.9)		(226.6)	10.1
Other liabilities (3)	(145.3)	5.2	(12.9)	(4.7)		(157.7)	5.3

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10. Fair Value Measurements (continued)

	For the three months ended September 30, 2009						
	Beginning asset / (liability) balance as of June 30, 2009	Total realized/unrealized gains (losses) Included in net income (1)	Total realized/unrealized gains (losses) Included in other comprehensive income	Purchases, sales, issuances and settlements	Transfers in (out) of Level 3	Ending asset / (liability) balance as of September 30, 2009	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	(in millions)						
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	$ 48.0	$ (10.5)	$ 1.3	$ (25.3)	$	$ 13.5	$
Corporate	796.0	8.9	136.6	(152.8)	(51.2)	737.5	(2.3)
Commercial mortgage-backed securities	34.2		4.4	(2.0)		36.6	
Collateralized debt obligations	248.1	(18.9)	51.9	(3.1)		278.0	(18.8)
Other debt obligations	117.4	(0.7)	5.9	(1.2)	(36.1)	85.3	(0.7)
Total fixed maturities, available-for-sale	1,243.7	(21.2)	200.1	(184.4)	(87.3)	1,150.9	(21.8)
Fixed maturities, trading	68.2	4.2			(9.3)	63.1	4.2
Equity securities, available-for-sale	25.1	1.4	20.8	(21.5)	9.0	34.8	
Derivative assets	67.6	(6.0)	(0.1)	0.9		62.4	(2.3)
Separate account assets (2)	4,886.7	(383.4)		(6.3)	(43.1)	4,453.9	(393.8)
Liabilities							
Investment-type insurance contracts	(31.2)	(9.8)		6.0		(35.0)	(8.1)
Derivative liabilities	(165.5)	37.2	0.6	11.7		(116.0)	35.1
Other liabilities (3)	(32.0)		(60.9)	(4.7)		(97.6)	

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

	For the nine months ended September 30, 2010						
	Beginning asset / (liability) balance as of December 31, 2009	Total realized/unrealized gains (losses)		Purchases, sales, issuances and settlements (4)	Transfers in (out) of Level 3	Ending asset / (liability) balance as of September 30, 2010	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Included in net income (1)	Included in other comprehensive income				
	(in millions)						
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	$ 16.1	$	$ 0.5	$ 8.3	$	$ 24.9	$
State and political subdivisions	11.5		1.0		(12.5)		
Corporate	737.3	10.3	38.3	(139.9)	(7.5)	638.5	2.9
Commercial mortgage-backed securities	34.3	(0.1)	1.0	11.5	(30.2)	16.5	(0.1)
Collateralized debt obligations	296.8	(14.8)	22.3	(116.5)	(88.3)	99.5	(1.8)
Other debt obligations	76.6		4.6	38.1	(4.9)	114.4	
Total fixed maturities, available-for-sale	1,172.6	(4.6)	67.7	(198.5)	(143.4)	893.8	1.0
Fixed maturities, trading	63.5	8.1		224.2		295.8	7.8
Equity securities, available-for-sale	71.7	3.0	(6.7)	(19.5)	(1.5)	47.0	3.1
Derivative assets	54.4	(1.8)		(2.8)		49.8	(0.6)
Other investments		23.1		106.0		129.1	23.1
Separate account assets (2)	4,120.7	196.2	(0.1)	(461.7)	14.4	3,869.5	159.2
Liabilities							
Investment-type insurance contracts	(23.6)	(49.5)		18.5		(54.6)	(49.6)
Derivative liabilities	(93.7)	(9.6)	(3.3)	(120.0)		(226.6)	(12.1)
Other liabilities (3)	(89.1)	16.0	(40.4)	(44.2)		(157.7)	16.0

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10. Fair Value Measurements (continued)

	For the nine months ended September 30, 2009						
	Beginning asset / (liability) balance as of December 31, 2008	Total realized/unrealized gains (losses) Included in net income (1)	Total realized/unrealized gains (losses) Included in other comprehensive income	Purchases, sales, issuances and settlements	Transfers in (out) of Level 3	Ending asset / (liability) balance as of September 30, 2009	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
	(in millions)						
Assets							
Fixed maturities, available-for-sale							
Non-U.S. governments	$ 45.3	$ (10.3)	$ 2.4	$ (23.9)	$	$ 13.5	$
Corporate	750.9	(23.9)	135.1	(287.0)	162.4	737.5	(30.4)
Commercial mortgage-backed securities	58.0	(0.3)	8.7	(10.6)	(19.2)	36.6	
Collateralized debt obligations	236.8	(60.2)	117.6	(8.3)	(7.9)	278.0	(59.8)
Other debt obligations	82.0	(2.1)	20.8	28.8	(44.2)	85.3	(1.6)
Total fixed maturities, available-for-sale	1,173.0	(96.8)	284.6	(301.0)	91.1	1,150.9	(91.8)
Fixed maturities, trading	60.7	12.7			(10.3)	63.1	12.7
Equity securities, available-for-sale	56.2	1.4	23.4	(55.2)	9.0	34.8	
Derivative assets	100.7	(35.6)	(0.2)	(2.5)		62.4	(22.5)
Separate account assets (2)	6,042.3	(1,377.3)		(169.6)	(41.5)	4,453.9	(1,278.2)
Liabilities							
Investment-type insurance contracts	(60.2)	6.3		18.9		(35.0)	6.6
Derivative liabilities	(266.9)	134.8	4.4	11.7		(116.0)	133.1
Other liabilities (3)	(103.8)		20.1	(13.9)		(97.6)	

(1) Both realized gains (losses) and mark-to-market unrealized gains (losses) are generally reported in net realized capital gains (losses) within the consolidated statements of operations. Realized and unrealized gains (losses) on certain fixed maturities, trading and certain derivatives used in relation to certain trading portfolios are reported in net investment income within the consolidated statements of operations.

(2) Gains and losses for separate account assets do not impact net income as the change in value of separate account assets is offset by a change in value of separate account liabilities. Foreign currency translation adjustments related to the International Asset Management and Accumulation segment separate account assets are recorded in accumulated other comprehensive income and are offset by foreign currency translation adjustments of the corresponding separate account liabilities.

(3) Certain embedded derivatives reported in other liabilities are part of a cash flow hedge, with the effective portion of the unrealized gains (losses) recorded in accumulated other comprehensive income.

(4) As a result of our implementation of new authoritative guidance related to the accounting for VIEs effective January 1, 2010, certain previously unconsolidated VIEs were consolidated and certain previously consolidated VIEs were deconsolidated. The fair value of the Level 3 assets and liabilities of the newly consolidated and deconsolidated VIEs is primarily included in fixed maturities, trading; other investments; derivative liabilities and other liabilities. As a result of our implementation of new authoritative guidance related to the accounting for embedded credit derivatives effective July 1, 2010, we elected the fair value option for certain securities previously included in fixed maturities, available-for-sale, effectively reclassifying them to fixed maturities, trading.

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

Transfers

Transfers between fair value hierarchy levels are recognized at the beginning of the reporting period.

Assets transferred into Level 3 during the three months ended September 30, 2010 and 2009, were $56.0 million and $70.6 million, respectively, and during the nine months ended September 30, 2010 and 2009, were $210.5 million and $375.6 million, respectively. The assets transferred into Level 3 primarily include those assets for which we are now unable to obtain pricing from a recognized third party pricing vendor and, to a lesser extent, assets added to our watch list that were previously priced using a matrix pricing valuation approach that may no longer be relevant when applied to asset-specific situations.

Assets transferred out of Level 3 during the three months ended September 30, 2010 and 2009, were $65.4 million and $201.3 million, respectively, and during the nine months ended September 30, 2010 and 2009, were $341.0 million and $327.3 million, respectively. The majority of assets that transferred out of Level 3 include those for which we are now able to obtain pricing from a recognized third party pricing vendor.

Significant transfers into Level 2 during the nine months ended September 30, 2010, primarily included $3,128.3 million of separate account assets that transferred out of Level 1 into Level 2 during the three months ended June 30, 2010. Significant transfers out of Level 2 during the three and nine months ended September 30, 2010, primarily included $3,300.3 million and $6,600.6 million, respectively, of separate account assets that transferred out of Level 2 into Level 1. These transfers related to foreign equity securities that were valued using adjusted prices provided by a third party vendor as of both December 31, 2009 and June 30, 2010, which is reflected in Level 2, and that were valued at the local close price of the exchange where the assets traded as of both March 31, 2010 and September 30, 2010, which is reflected in Level 1. When events materially affecting the value occur between the close of the local exchange and the New York Stock Exchange, we use adjusted prices determined by a third party pricing vendor to update the foreign market closing prices. Other transfers into and out of Level 2 during the three and nine months ended September 30, 2010, primarily include those that transferred out of and into Level 3, respectively.

Significant transfers into Level 1 during the three and nine months ended September 30, 2010, and out of Level 1 during the nine months ended September 30, 2010, included the separate account assets transferred out of and into Level 2, respectively. We did not have any significant transfers out of Level 1 during the three months ended September 30, 2010.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis. During the nine months ended September 30, 2010, certain mortgage loans had been impaired or written down to fair value of $238.3 million. The impairments resulted in a loss of $12.0 million and $66.9 million for the three and nine months ended September 30, 2010, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During the nine months ended September 30, 2010, real estate had been written down to fair value of $1.4 million. This write down resulted in a loss of $0.3 million for the nine months ended September 30, 2010, that was recorded in net realized capital gains (losses). This is a Level 3 fair value measurement, as the fair value of real estate is estimated using appraised values that involve significant unobservable inputs.

During the nine months ended September 30, 2010, mortgage servicing rights had been written down to fair value of $6.0 million, resulting in a charge of $0.3 million and $0.9 million for the three and nine months ended September 30, 2010, respectively, 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.

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Principal Financial Group, Inc.
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10. Fair Value Measurements (continued)

During the nine months ended September 30, 2010, we recorded a goodwill impairment. See Note 2, Goodwill, for further details.

During the nine months ended September 30, 2009, mortgage loans had been written down to fair value of $4.7 million. This write down resulted in a loss of $0.1 million and $7.2 million for the three and nine months ended September 30, 2009, respectively, that was recorded in net realized capital gains (losses). These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During the nine months ended September 30, 2009, real estate had been written down to fair value of $0.9 million. This write down resulted in a loss of $0.4 million and $0.8 million for the three and nine months ended September 30, 2009, respectively, that was recorded in net realized capital gains (losses). This is a Level 3 fair value measurement, as the fair value of the real estate is estimated using appraised values that involve significant unobservable inputs.

Fair Value Option

As a result of our implementation of new authoritative guidance related to the accounting for VIEs effective January 1, 2010, we elected fair value accounting for certain assets and liabilities of newly consolidated VIEs for which it was not practicable for us to determine the carrying value. The fair value option was elected for commercial mortgage loans reported with other investments and obligations reported with other liabilities in the consolidated statements of financial position. The changes in fair value of these items are reported in net realized capital gains (losses) on the consolidated statements of operations.

The fair value and aggregate contractual principal amounts of commercial mortgage loans for which the fair value option has been elected were $129.1 million and $128.0 million, respectively, as of September 30, 2010. The change in fair value of the loans resulted in a $2.2 million and $23.1 million pre-tax gain for the three and nine months ended September 30, 2010, respectively, none of which related to instrument-specific credit risk. None of these loans were more than 90 days past due or in nonaccrual status. Interest income on these commercial mortgage loans is included in net investment income on the consolidated statements of operations and is recorded based on the effective interest rates as determined at the closing of the loan. For the three and nine months ended September 30, 2010, we recorded $2.6 million and $8.0 million of interest income on these commercial mortgage loans, respectively.

The fair value and aggregate unpaid principal amounts of obligations for which the fair value option has been elected were $111.4 million and $220.1 million, respectively, as of September 30, 2010. The change in fair value of the obligations resulted in a $4.4 million and $10.1 million

pre-tax gain, which includes a $5.2 million and $16.0 million pre-tax gain related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings for the three and nine months ended September 30, 2010, respectively. Interest expense recorded on these obligations is included in operating expenses on the consolidated statements of operations and was $2.2 million and $6.8 million for the three and nine months ended September 30, 2010, respectively.

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Principal Financial Group, Inc.
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11. 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 U.S. Insurance Solutions. In addition, there is a Corporate 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 third quarter 2010, amounts now reported in the U.S. Insurance Solutions segment and amounts for our group medical insurance business now reported in the Corporate segment were reported together in the Life and Health Insurance segment. This change was made due to our decision to exit the group medical insurance business (insured and administrative services only) and has no impact on our consolidated financial statements for any period presented. Our segment results for 2009 have been restated to conform to the current segment presentation. With the exception of corporate overhead, amounts related to our group medical insurance business previously included in segment operating earnings have been removed from operating earnings for all periods presented and are reported as other after-tax adjustments.

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 business, our insurance operations, the Corporate 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 Special Administrative Region, India, Indonesia, Malaysia, Mexico, Singapore and Thailand. We focus on countries with large middle classes, favorable demographics and growing long-term savings, ideally with defined contribution markets. We entered these countries through acquisitions, start-up operations and joint ventures.

The U.S. Insurance Solutions segment provides individual life insurance and specialty benefits, which consists of group dental and vision insurance, individual and group disability insurance and group life insurance, throughout the United States.

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

Management uses segment operating earnings 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 for net realized capital gains (losses), as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized capital gains (losses), as adjusted, are net of income taxes, related changes in the amortization pattern of 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, noncontrolling interest capital gains and losses and certain market value adjustments to fee revenues. Net realized capital gains (losses), as adjusted, exclude periodic settlements and accruals on derivative instruments not designated as hedging instruments and exclude certain market value adjustments of embedded derivatives and realized capital gains (losses) associated with our exited group medical insurance business. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on derivatives not designated as hedging instruments), including their impact on recognition of front-end fee revenues and certain market value adjustments to fee revenues, revenue from our exited group medical insurance business 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 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 segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

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

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

	September 30, 2010	December 31, 2009
	(in millions)	
Assets:		
U.S. Asset Accumulation	**$ 108,811.3**	$ 106,881.9
Global Asset Management	**1,302.6**	1,276.7
International Asset Management and Accumulation	**12,307.4**	10,301.7
U.S. Insurance Solutions	**16,144.6**	15,097.7
Corporate	**4,890.7**	4,201.4
Total consolidated assets	**$ 143,456.6**	$ 137,759.4

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
Operating revenues by segment:				
U.S. Asset Accumulation	**$ 997.0**	$ 1,025.6	**$ 3,031.0**	$ 3,024.4
Global Asset Management	**118.0**	111.3	**346.1**	319.0
International Asset Management and Accumulation	**200.1**	156.1	**569.4**	381.8
U.S. Insurance Solutions	**690.7**	701.4	**2,070.1**	2,106.6
Corporate	**(19.1)**	(33.4)	**(81.2)**	(103.2)
Total segment operating revenues	**1,986.7**	1,961.0	**5,935.4**	5,728.6
Net realized capital losses (except periodic settlements and accruals on derivatives not designated as hedging instruments), including recognition of front-end fee revenues and certain market value adjustments to fee revenues	**(42.3)**	(86.1)	**(199.5)**	(336.6)
Exited group medical insurance business	**344.1**	396.0	**1,050.2**	1,225.4
Terminated commercial mortgage securities issuance operation		(0.6)		(0.7)
Total revenues per consolidated statements of operations	**$ 2,288.5**	$ 2,270.3	**$ 6,786.1**	$ 6,616.7
Operating earnings (losses) by segment, net of related income taxes:				
U.S. Asset Accumulation	**$ 147.4**	$ 154.6	**$ 433.4**	$ 385.1
Global Asset Management	**15.0**	10.5	**39.3**	25.5
International Asset Management and Accumulation	**33.1**	33.1	**106.0**	79.4
U.S. Insurance Solutions	**47.3**	56.2	**141.4**	148.1
Corporate	**(23.9)**	(35.3)	**(89.4)**	(108.7)

Total segment operating earnings, net of related income taxes	**218.9**	219.1	**630.7**	529.4
Net realized capital losses, as adjusted (1)	**(30.9)**	(53.4)	**(156.9)**	(154.6)
Other after-tax adjustments (2)	**(45.8)**	19.0	**(6.8)**	73.0
Net income available to common stockholders per consolidated statements of operations	**$ 142.2**	$ 184.7	**$ 467.0**	$ 447.8

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11. Segment Information (continued)

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	**2010**	2009
	(in millions)			
Net realized capital losses	**$ (20.7)**	$ (66.6)	**$ (132.6)**	$ (285.1)
Periodic settlements and accruals on derivatives not designated as hedging instruments	**(20.5)**	(20.2)	**(69.8)**	(47.9)
Certain market value adjustments to fee revenues	**(2.3)**		**(2.3)**	(1.5)
Recognition of front-end fee revenues	**1.2**	0.7	**5.2**	(2.1)
Net realized capital losses, net of related revenue adjustments	**(42.3)**	(86.1)	**(199.5)**	(336.6)
Amortization of deferred policy acquisition and sales inducement costs	**(26.7)**	16.7	**(71.3)**	106.3
Capital (gains) losses distributed	**0.1**	(7.5)	**(2.2)**	(14.4)
Certain market value adjustments of embedded derivatives	**0.9**	2.3	**6.7**	8.8
Net realized capital (gains) losses associated with exited group medical insurance business	**1.8**		**2.4**	(0.1)
Noncontrolling interest capital (gains) losses	**0.6**	(9.9)	**(4.1)**	(15.5)
Income tax effect	**34.7**	31.1	**111.1**	96.9
Net realized capital losses, as adjusted	**$ (30.9)**	$ (53.4)	**$ (156.9)**	$ (154.6)

(2) For the three months ended September 30, 2010, other after-tax adjustments included the negative effect of losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended September 30, 2009, other after-tax adjustments included the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP ($19.5 million) and the negative effect of losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP ($0.5 million).

For the nine months ended September 30, 2010, other after-tax adjustments included the negative effect resulting from the tax impact of healthcare reform, which eliminates the tax deductibility of retiree prescription drug expenses related to our employees incurred after 2012 ($7.8 million) and the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP ($1.0 million).

For the nine months ended September 30, 2009, other after-tax adjustments included the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP ($73.8 million) and the negative effect of losses associated with our terminated commercial mortgage securities issuance operation that has been exited but does not qualify for discontinued operations accounting treatment under U.S. GAAP ($0.8 million).

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

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2010	2009	2010	2009
	(in millions)			
U.S. Asset Accumulation:				
Full service accumulation	**$ 328.8**	$ 329.3	**$ 991.8**	$ 952.2
Principal Funds	**123.7**	113.1	**372.3**	324.0
Individual annuities	**253.2**	247.2	**759.5**	713.3
Bank and trust services	**23.5**	22.2	**68.4**	61.3
Eliminations				