PRINCIPAL FINANCIAL GROUP INC
Form 10-K
February 27, 2008

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from ______ to ______

Commission file number 1-16725

PRINCIPAL FINANCIAL GROUP, INC.

(Exact name of Registrant as specified in its charter)

Delaware	**711 High Street, Des Moines, Iowa 50392**	**42-1520346**
(State or other jurisdiction of incorporation or organization)	(Address of principal executive offices)	(I.R.S. Employer Identification Number)

(515) 247-5111

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $0.01	New York Stock Exchange
Series B Non-Cumulative Perpetual Preferred Stock	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
Series A Non-Cumulative Perpetual Preferred Stock

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ý No o

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes o No ý

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 ý No o

Indicate by check mark if disclosure of delinquent filers pursuant Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K. ý

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.

Large accelerated filer ý Accelerated filer o Non-accelerated filer o 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 ý

As of February 20, 2008, there were outstanding 258,359,273 shares of Common Stock, $0.01 par value per share of the Registrant.

The aggregate market value of the shares of the Registrant's common equity held by non-affiliates of the Registrant was $15,503,449,707 based on the closing price of $58.29 per share of Common Stock on the New York Stock Exchange on June 29, 2007.

Documents Incorporated by Reference

The information required to be furnished pursuant to Part III of this Form 10-K is set forth in, and is hereby incorporated by reference herein from, the Registrant's definitive proxy statement for the annual meeting of stockholders to be held on May 20, 2008, to be filed by the Registrant with the United States Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the year ended December 31, 2007.

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NOTE CONCERNING FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains statements which constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements relating to trends in operations and financial results and the business and the products of the Registrant and its subsidiaries, as well as other statements including words such as "anticipate," "believe," "plan," "estimate," "expect," "intend" and other similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

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

PART I

Item 1. Business

The Principal Financial Group is a leading provider of retirement savings, investment and insurance products and services with $311.1 billion in assets under management ("AUM") and approximately nineteen million customers worldwide as of December 31, 2007.

Our U.S. and international operations concentrate primarily on asset accumulation and asset management. In addition, we offer a broad range of individual and group life insurance, group health insurance, individual and group disability insurance and group dental and vision insurance.

We primarily focus on small and medium-sized businesses, which we define as companies with less than 1,000 employees, providing a broad array of retirement and employee benefit solutions to meet the needs of the business, the business owner and their employees. With over 32,000 plans, we are the leading provider of corporate defined contribution plans in the U.S., according to Spectrem Group. We are also the leading employee stock ownership plan consultant. In addition, we are a leading provider of nonqualified plans, defined benefit plans and plan termination annuities. We are also one of the largest providers of non-medical insurance product solutions.

We believe small and medium-sized businesses are an underserved market, offering attractive growth opportunities in the U.S. in retirement services and other employee benefits. We also believe there is a significant opportunity to leverage our U.S. retirement expertise into select international markets that have adopted or are moving toward private sector defined contribution pension systems. This opportunity is particularly compelling as aging populations around the world are driving increased demand for retirement accumulation, retirement asset management and retirement income management solutions.

Our Reportable Segments

Our segment results have been modified to reflect a change in the composition of our reportable segments. Prior to 2007, amounts now reported in the U.S. Asset Accumulation and Global Asset Management segments were reported together in the U.S. Asset Management and Accumulation segment. We now organize our businesses into the following reportable segments:

- U.S. Asset Accumulation;
- Global Asset Management;
- International Asset Management and Accumulation; and
- Life and Health Insurance.

We also have a Corporate and Other segment, which consists of the assets and activities that have not been allocated to any other segment.

See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 19, Segment Information" for financial results of our segments, including our operating revenues for our products and services described in each of the subsequent segment discussions.

U.S. Asset Accumulation Segment

Our asset accumulation activities in the U.S. date back to the 1940s when we first began providing pension plan products and services. We now offer a comprehensive portfolio of asset accumulation products and services for retirement savings and investment:

- To businesses of all sizes with a concentration on small and medium-sized businesses, we offer products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, non-qualified executive benefit plans and employee stock ownership plan ("ESOP") consulting services. For more basic investment needs, we offer SIMPLE IRA and payroll deduction plans;

To large institutional clients, we also offer investment-only products, including guaranteed investment contracts ("GICs") and funding agreements; and

To employees of businesses and other individuals, we offer the ability to accumulate funds for retirement and savings through mutual funds, individual annuities and bank products.

We organize our U.S. asset accumulation operations into six product and service categories: full service accumulation, Principal Funds (our mutual fund business), individual annuities, bank and trust services, investment only and full service payout.

Full Service Accumulation

Products

We offer a wide variety of investment and administrative products for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, non-qualified executive benefit plans and ESOPs. A 403(b) plan is a plan described in Section 403(b) of the Internal Revenue Code that provides retirement benefits for employees of tax-exempt organizations and public schools.

Full service accumulation products respond to the needs of plan sponsors seeking both administrative and investment services for defined contribution plans or defined benefit plans. The investment component of both the defined contribution and defined benefit plans may be in the form of a general account, separate account or a mutual fund offering.

As of December 31, 2007, we provided full service accumulation products to 33,053 defined contribution pension plans, of which 27,076 were 401(k) plans, covering 3.1 million plan participants, and to 2,745 defined benefit pension plans, covering 339,356 plan participants. As of December 31, 2007, approximately 70% of our full service accumulation account values were managed by Principal Global Investors. Third-party asset managers provide asset management services with respect to the remaining assets.

We deliver both administrative and investment services to our defined contribution plan and defined benefit plan customers through annuities and mutual funds. Annuities and the underlying investment options are not required to be registered with the United States Securities and Exchange Commission ("SEC"). Our mutual fund offering is called Principal Advantage. It is a qualified plan product based on our series mutual fund, Principal Investors Fund, and is a registered product with the SEC. We offer investments covering the full range of stable value, equity, fixed income and international investment options managed by our affiliated asset manager, Principal Global Investors, as well as third-party asset managers.

Markets and Distribution

We offer our full service accumulation products and services to employer-sponsored pension plans, including qualified and non-qualified defined contribution plans and defined benefit plans. Our primary target market is plans sponsored by small and medium-sized businesses, which we believe remains under-penetrated. According to Spectrem Group, in 2006, only 15% of businesses with between 5 and 99 employees, and 47% of businesses with between 100 and 500 employees, offered a 401(k) plan. The same study indicates that 63% of employers with between 500 and 1,000 employees; 71% of employers with between 1,000 and 5,000 employees; and 90% of employers with 5,000 or more employees offered a 401(k) plan in 2006.

We distribute our full service accumulation products and services nationally, primarily through a captive retirement services sales force. As of December 31, 2007, approximately 315 retirement services sales representatives in over 42 offices, operating as a wholesale distribution network, maintained relationships with over 8,810 independent brokers, consultants and agents. Retirement services sales representatives are an integral part of the sales process alongside the referring consultant or independent broker. We compensate retirement services sales representatives through a blend of salary and production-based incentives, while we pay independent brokers, consultants and agents a commission or fee.

As of December 31, 2007, we had a separate staff of over 222 service and education specialists located in the sales offices who play a key role in the ongoing servicing of pension plans by: providing local services to our customers, such as reviewing plan performance, investment options and plan design; communicating the customers' needs and feedback to us; and helping employees understand the benefits of their pension plans. The following summarizes our distribution channels:

- We distribute our annuity-based products through sales representatives, agents and brokers who are primarily state licensed individuals.

- Principal Advantage, our mutual fund-based product, is targeted at defined contribution plans through broker/dealer distribution channels. Principal Advantage gives us access to Financial Industry Regulatory Authority (formerly known as the National Association of Securities Dealers)-registered distributors who are not traditional sellers of annuity-based products and broadens opportunities for us in the investment advisor and broker-dealer distribution channels.

- Principal Security Builder Retirement Program Individual 401(k) is the newest retirement plan solution from the Principal Financial Group. It was created for the small business owner giving them a low-cost retirement program that allows them to save on taxes while saving for retirement. The Principal Security Builder Retirement Program Individual 401(k) is available through the group annuity contract.

Through our Retire Secure strategy we provide financial education and assistance to individual investors who are participants/members of employer-based accumulation solutions to help them achieve financial security.

We believe that our approach to full service accumulation plan services distribution gives us a local sales and service presence that differentiates us from many of our competitors. We have also recently established a number of marketing and distribution relationships to increase the sales of our accumulation products with firms such as Bank of America and Smith Barney.

Principal Funds

We have been providing mutual funds to customers since 1969. We offer mutual funds to individuals, businesses and institutional investors for use within variable life and variable annuity contracts, for use in employer-sponsored pension plans, as a rollover investment option, and for general investment purposes.

Products and Services

We were ranked in the top quartile among U.S. mutual fund managers in terms of total mutual fund AUM as of December 31, 2007, according to the Investment Company Institute ("ICI"). At $63.5 billion in AUM, we rank 41 out of 330 according to the ICI. We provide accounting, compliance, corporate governance and product development for all mutual funds we organize. As of December 31, 2007, our mutual fund operations served approximately 1.9 million mutual fund shareholder accounts.

Principal Investors Fund. Principal Investors Fund is a series mutual fund, which as of December 31, 2007, offered 68 investment options. This fund acts as the funding vehicle for Principal Advantage, the defined contribution product described above under "U.S. Asset Accumulation Segment-Full Service Accumulation Products." This fund also offers retail classes of shares to individuals for IRA rollovers ("J shares") and general investment purposes (A, B and C shares) and a class of shares ("I shares") offered primarily to specified institutional investors. As of December 31, 2007, the J share retail class of shares had $5.0 billion in AUM; $1.6 billion of the retail AUM invests in other share classes of Principal Investors Funds. All other share classes of Principal Investors Funds, including seed money, had $51.3 billion of AUM. We report the results for this fund, excluding the retail AUM, under "Full Service Accumulation." We report the results of the retail assets under "Principal Funds."

Principal Variable Contracts Fund. Principal Variable Contracts Fund is a series mutual fund, which, as of December 31, 2007, provided 40 investment options for use as funding choices in variable annuity and variable life insurance contracts issued by Principal Life Insurance Company ("Principal Life") and other insurance companies. As of December 31, 2007, this fund had $7.2 billion in AUM. AUM backing Principal Life variable annuity contracts is reported in this segment under "Individual Annuities." AUM backing Principal Life variable life insurance contracts is reported in the Life and Health Insurance segment.

Principal Managed Portfolio. Principal Managed Portfolio is a wrap product offered by our registered investment advisor, Princor Financial Services Corporation ("Princor"), which only invests in Principal Investors Funds. We started to market this product in mid-2005. Clients are charged a quarterly asset-based fee on this account. As of December 31, 2007, Principal Managed Portfolio had accumulated $676.0 million in assets.

Principal Advisory Select. Principal Advisory Select Program is an investment advisory program that permits the client to invest in a broad array of investments and is a non-discretionary investment advisory program. Clients are charged a quarterly asset-based fee on this account. As of December 31, 2007, Principal Advisory Select had accumulated $1.2 billion in assets.

WM Advisors, Inc. On December 31, 2006, we completed the purchase of WM Advisors, Inc. and its subsidiaries from Washington Mutual, Inc. for a total cost of $741.1 million in cash at the time of closing. WM Advisors, Inc. was the manager of the WM Funds, a family of 40 retail mutual funds and variable trust funds. As of December 31, 2006, the WM Funds acquired had $22.5 billion in AUM. During 2007, the WM Funds were integrated into the Principal Investors Fund and Principal Variable Contracts Fund.

Markets and Distribution

Our markets for retail mutual funds are individuals seeking to accumulate savings for retirement and other purposes and small businesses seeking to use mutual funds as the funding vehicle for pension plans, as well as non-qualified individual savings plans utilizing payroll deductions. We also market our retail mutual funds to participants in pension plans who are departing their plans and reinvesting their retirement assets into individual retirement accounts.

Our retail mutual funds are sold primarily through our affiliated financial representatives, independent brokers registered with our securities broker-dealer, Princor, registered representatives from other broker-dealers, direct deposits from our employees and others and Principal Connection. Princor recruits, trains and supervises registered representatives selling our products. With the WM Advisors, Inc. acquisition, we obtained established relationships with a number of marketing and outside broker dealer distributors to increase the sales of our mutual fund products.

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Individual Annuities

Individual annuities offer a tax-deferred means of accumulating retirement savings, as well as a tax-efficient source of income during the payout period.

Products

We offer both fixed and variable annuities to individuals and pension plans. Individual annuities may be categorized in two ways: (1) deferred, in which case assets accumulate until the contract is surrendered, the customer dies or the customer begins receiving benefits under an annuity payout option, or (2) immediate/payout, in which case payments begin within one year of issue and continue for a fixed period of time or for life.

Fixed Deferred Annuities. Our individual fixed deferred annuities consist of both single premium deferred annuity contracts and flexible premium deferred annuity contracts ("FPDAs"). Some FPDA contracts limit the period of time deposits are allowed (i.e., only one year). For most contracts, the principal amount is guaranteed. We credit the customer's account with a fixed interest rate and for a specified time period, typically one, three or five years. Thereafter, we reset, typically annually, the interest rate credited to the contract based upon our discretion, taking into account market and other conditions. We also offer a fixed deferred annuity where the interest credited is linked to an external equity index, subject to maximum and minimum values. Our major source of income from fixed deferred annuities is the spread between the investment income earned on the underlying general account assets and the interest rate credited to the contracts. We bear the investment risk because, while we credit customers' accounts with a stated interest rate, we cannot be certain the investment income we earn on our general account assets will exceed that rate. Principal Global Investors manages the assets supporting these contracts.

Variable Deferred Annuities. Individual variable deferred annuities are savings vehicles through which the customer makes one or more deposits of varying amounts and intervals. Customers have the flexibility to allocate their deposits to investment sub-accounts managed by Principal Global Investors, or other third-party asset managers. As of December 31, 2007, 66% of our $5.3 billion in variable annuity account balances was allocated to investment sub-accounts and our general account, which are managed by Principal Global Investors and 34% to investment sub-accounts managed by third-party asset managers. Generally speaking, the customers bear the investment risk and have the right to allocate their assets among various separate investment sub-accounts. The value of the annuity fluctuates in accordance with the experience of the investment sub-accounts chosen by the customer. Customers have the option to allocate all or a portion of their account to our general account, in which case we credit interest at rates we determine, subject to contractual minimums. Customers may also elect an enhanced death benefit guarantee (commonly known in the industry as a guaranteed minimum death benefit, or "GMDB") and/or a living benefit guarantee (commonly known in the industry as a guaranteed minimum withdrawal benefit, or "GMWB"). The GMWB feature became available in 2005. Our major source of revenue from variable annuities is mortality and expense fees we charge to the customer, generally determined as a percentage of the market value of the assets held in a separate investment sub-account.

Fixed Immediate Annuities. Our individual fixed immediate annuities consist almost exclusively of single premium immediate annuity contracts ("SPIAs"). SPIAs are products where the customer makes a single deposit, and from which periodic benefit payments are made. Payments may be contingent upon the survival of one or two individuals, or payments may be fixed, meaning payments are contractually guaranteed and do not depend on the continuing survival of any individual. Our major source of income from fixed immediate annuities is the spread between the investment income earned on the underlying general account assets and the interest rate implied in the calculation of annuity benefit payments. We bear the investment risk because we cannot be certain the investment income we earn on our general account assets will exceed the rate implied in the SPIA contracts. Principal Global Investors manages the assets supporting these contracts.

Markets and Distribution

Our target markets for individual annuities include owners, executives and employees of small and medium-sized businesses, and individuals seeking to accumulate and/or eventually receive distributions of assets for retirement. We market both fixed and variable annuities to both qualified and non-qualified pension plans.

We sell our individual annuity products through our affiliated financial representatives, who accounted for 26%, 40% and 43% of annuity sales for the years ended December 31, 2007, 2006 and 2005, respectively. The remaining sales were made through banks, brokerage general agencies, mutual fund companies, Principal Connection and unaffiliated broker-dealer firms. Although the overall percentage of sales from affiliated financial representatives has declined, they continued to be the primary distribution channel of our variable deferred annuities. The overall percentage decline is a result of focused efforts to increase fixed annuity sales through non-affiliated distribution channels.

Bank and Trust Services

Bank and trust services include Principal Bank and Principal Trust Company. Principal Bank, our electronic banking operation, is a federal savings bank that began its activities in February 1998. We offer flexible banking products and

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services via the telephone, Internet, ATM or by mail. Our current products and services include a consumer suite of checking and savings accounts, money market accounts, certificates of deposit, consumer loans, home equity loans, home equity lines of credit, credit cards, debit cards, small account rollovers from qualified retirement plans and health savings accounts. In addition, we offer deposit and loan services to small and medium-sized businesses. As of December 31, 2007, Principal Bank had approximately 181,000 customers and approximately $1.9 billion in assets.

We market our Principal Bank products and services to prospects and our existing customers, through Principal Connection and other means such as the Internet, direct mail and targeted advertising, with a primary focus on deepening existing relationships with customers of Principal Bank and Principal Financial Group, Inc. Through Principal Bank, we also pursue asset retention strategies with our customers who seek to transfer assets from our other asset accumulation products by offering them our banking products and services.

Principal Trust Company is a Delaware state chartered non-deposit trust company. Principal Trust Company, chartered in 1899 as Delaware Charter Guarantee and Trust Company, is one of the largest non-deposit trust companies in the nation. As of December 31, 2007, we served as trustee to over 300,000 accounts and held assets in excess of $65 billion. Principal Trust Company may not accept deposits and cannot make personal or commercial loans.

Principal Trust Company specializes in providing affordable and innovative trust solutions directed at self-directed tax-advantaged savings accounts, such as Individual Retirement Accounts ("IRAs"), Health Savings Accounts ("HSAs") and a full array of employee benefit plans and accounts including 401(k) and 403(b) plans, defined benefit pension plans, non-qualified executive benefit plans and ESOPs. We provide these services to Principal affiliates, brokerage firms, clearing firms, financial advisors and asset managers.

Investment Only

Products

The three primary products for which we provide investment only services are: GICs; funding agreements and other investment only products.

GICs and funding agreements pay a specified rate of return. The rate of return can be a floating rate based on an external market index or a fixed rate. Our investment only products contain provisions disallowing or limiting early surrenders, including penalties for early surrenders and minimum notice requirements.

Deposits to investment only products are predominantly in the form of single payments. As a result, the level of new deposits can fluctuate from one fiscal quarter to another. Assets invested in GICs and funding agreements generate a spread between the investment income earned by us and the amount credited to the customer. Our other investment only products consist of separate accounts invested in either equities or fixed income instruments. Principal Global Investors manages the assets supporting investment only account values.

Markets and Distribution

We market GICs and funding agreements primarily to pension plan sponsors and other institutions. We also offer them as part of our full service accumulation products. We sell our GICs primarily to plan sponsors for funding of tax-qualified retirement plans. We sell our funding agreements directly to institutions that may or may not be pension funds and unconsolidated special purpose vehicles domiciled either in the U.S. or offshore for funding agreement-backed note programs. The funding agreements sold as part of these funding agreement-backed note programs work by having investors purchase debt obligations from the special purpose vehicle which, in turn, purchases the funding agreement from us with terms similar to those of the debt obligations. The strength of this market is dependent on debt capital market conditions. As a result, our sales through this channel can vary widely from one quarter to another. In addition to the special purpose vehicle selling the funding agreement-backed notes to U.S. and foreign institutional investors, the special purpose vehicle may also sell notes to U.S. retail investors through a SEC-registered shelf debt issuance program.

Full Service Payout

Products

Full service payout products respond to the needs of pension plan participants who, upon retirement or termination of their employment, seek a guaranteed income stream. Plan participants who seek these services include those from pension plans we service, as well as pension plans other providers service. We primarily offer single premium group annuities, which are immediate or deferred annuities that provide a current or future specific income amount, fully guaranteed by us. These are available to defined contribution and defined benefit plan participants. We make regular payments to individuals, invest the underlying assets on their behalf and provide tax reporting to them. We also reinsure single premium immediate annuities issued by another insurer.

Single premium group annuities are traditionally used in conjunction with defined benefit plans, particularly those where the plan is being terminated. In such instances, the plan sponsor transfers all its obligations under the plan to an insurer by paying a single premium. Increasingly, these products are purchased by defined contribution plan participants who reach retirement age. Generally, plan sponsors restrict their purchases to insurance companies with superior or excellent financial quality ratings because the Department of Labor has mandated that annuities be purchased only from the "safest available" insurers.

Premium received from full service payout products are generally in the form of single payments. As a result, the level of new premiums can fluctuate depending on the number of retirements and large-scale annuity sales in a particular fiscal quarter. Principal Global Investors manages the assets supporting full service payout account values.

Markets and Distribution

Our primary distribution channel for full service payout products is comprised of several specialized home office sales consultants working through consultants and brokers that specialize in this type of business. Our sales consultants also make sales directly to institutions. Our nationally dispersed retirement services sales representatives act as a secondary distribution channel for these products. Principal Connection also distributes full service payout products to participants in plans we service who are terminating employment or retiring. Principal Connection is our direct response distribution channel for retail financial services products to individuals. Principal Connection's services are available over the phone, on the Internet or by mail.

Global Asset Management Segment

Our Global Asset Management segment consists of Principal Global Investors and its affiliates. We focus on providing a diverse range of asset management services covering a broad range of asset classes, investment styles and portfolio structures to our other segments and third-party institutional clients.

As of December 31, 2007, Principal Global Investors, together with its affiliates, Principal Real Estate Investors, Spectrum Asset Management, Post Advisory Group, Columbus Circle Investors, Edge Asset Management and Morley Financial Services managed $236.0 billion in assets. Morley Financial Services was acquired on August 31, 2007. Edge Asset Management was acquired on December 31, 2006 as part of the WM Advisors, Inc. acquisition. We have offices outside of the U.S. in the United Kingdom, Australia, Singapore and Japan.

Products and Services

Fee Mandate Business

Our fee mandate business provides focused investment advisory services across a broad range of asset classes, investment styles and portfolio structures. These services are provided for a fee as defined by the client mandate. We are diversified across three primary asset classes.

Equity Investments. As of December 31, 2007, Principal Global Investors, along with Columbus Circle Investors and Edge Asset Management managed $68.1 billion in global equity assets. Our equity capabilities encompass large-cap, mid-cap and small-cap stocks in developed and emerging markets worldwide. As of December 31, 2007, 43% of equity AUM was derived from our pension products, 33% from other products of the Principal Financial Group and the remaining 24% from third-party institutional clients.

Fixed Income Investments. Principal Global Investors, along with Spectrum Asset Management, Post Advisory Group, Edge Asset Management and Morley Financial Services managed $122.5 billion in global fixed income assets as of December 31, 2007. Collectively, we provide our clients with access to investment-grade corporate debt, government bonds, mortgage-backed, asset-backed and commercial mortgage-backed securities, high yield and municipal bonds, private and syndicated debt instruments and preferred securities. As of December 31, 2007, 33% of these assets were derived from our pension products, 23% from other products of the Principal Financial Group, and the remaining 44% from third-party institutional clients.

Real Estate Investments. Principal Global Investors, through its affiliate Principal Real Estate Investors, managed a portfolio of primarily U.S. commercial real estate assets of $43.7 billion as of December 31, 2007. Principal Real Estate Investors provides our clients with a broad range of real estate investment options, including private real estate equity, commercial mortgages, credit tenant debt, construction-permanent financing, bridge/mezzanine loans, commercial mortgage-backed securities and real estate investment trusts. As of December 31, 2007, 36% of the commercial real estate portfolio was derived from our pension products, 25% from other products of the Principal Financial Group and the remaining 39% from third-party institutional clients.

Spread and Securitization Business

We also have spread and securitization businesses. Principal Commercial Acceptance offers commercial real estate niche financing opportunities, including bridge/mezzanine loans and land loans. We had $0.4 billion of bridge/mezzanine loans as of December 31, 2007. Principal Commercial Funding in partnership with Principal Real Estate Investors historically had originated commercial mortgage loans, warehoused pool loans and facilitated the issuance of mortgage-backed securities. In 2005, Principal Real Estate Investors and U.S. Bank National Association, the principal banking subsidiary of U.S. Bancorp, created Principal Commercial Funding II, a jointly-owned business that competes in the commercial mortgage-backed securities ("CMBS") market. This company is the CMBS platform for both Principal Real Estate Investors and U.S. Bank National Association and focuses on securitizing commercial mortgages originated by both Principal Real Estate Investors and U.S. Bank National Association on their behalf. Principal Commercial Funding II started contributing collateral to securitizations during the first quarter of 2006.

Markets and Distribution

We employed 122 institutional sales, relationship management and client service professionals as of December 31, 2007, who worked with consultants and directly with large investors to acquire and retain third-party institutional clients. As of December 31, 2007, Principal Global Investors and its affiliates have approximately 460 third-party institutional clients with $87.3 billion of AUM in 25 countries.

International Asset Management and Accumulation Segment

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

The activities of Principal International reflect our efforts to accelerate the growth of our AUM by capitalizing on the international trend toward private sector defined contribution pension systems and individual long-term savings. Through Principal International, we offer retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products.

Products, Markets and Distribution

Brazil. In Brazil we offer pension, retirement and asset accumulation products through a minority-held joint venture arrangement with Banco do Brasil, which has a 3,977 branch network. We are Banco do Brasil's exclusive partner for distributing pension, retirement and long-term asset accumulation products. Our joint venture provides defined contribution products, complementary life protection and annuities for the retirement needs of employers and individuals. Banco do Brasil's employees sell these products directly to individual clients through its bank branches. In addition, our joint venture reaches corporate clients through two wholesale distribution channels: (1) a network of independent brokers who sell to the public, and (2) Banco do Brasil's corporate account executives selling to existing corporate clients. Based upon managed assets, our joint venture ranked third in the private pension market as of December 2007.

Chile. In Chile we offer long-term savings products, retirement annuities, mutual funds, life insurance accumulation products, mortgage loans and institutional asset management services.

We offer retirement annuities to individuals exiting the pre-retirement accumulation system. We distribute our annuity products through a network of brokers and independent agents, of which we had 163 as of December 31, 2007.

We serve the voluntary/complementary long-term savings market by offering "APV plans" (qualified individual solutions). As of September 30, 2007, we ranked first in AUM for mutual fund companies offering these plans. We distribute to retail clients through our proprietary sales force, alliances with financial institutions and the largest retailer in Chile, Falabella.

In addition, we market life insurance accumulation products (qualified and non-qualified) to individuals through brokers; originate, sell and service individual residential mortgage loans in Chile through our proprietary sales force; and offer asset management services to institutional investors and family businesses through our proprietary staff.

China. In China we market mutual funds through a minority-held joint venture with China Construction Bank ("CCB"). We sell mutual funds primarily through our partner bank, CCB. This bank delivers expansive distribution capabilities for the joint venture in terms of brand awareness and the number of outlets, of which we had 13,000 as of December 31, 2007.

Hong Kong. In Hong Kong we sell defined contribution, mutual fund and institutional asset management products.

We have subsidiaries in Hong Kong that actively compete in the defined contribution pension plan market. The government requires both employers and employees to contribute 5% of an employee's income to a Mandatory Provident Fund. We target small and medium-sized employers and distribute products through strategic alliances with insurance companies, mutual funds or banks, direct marketing and through our own sales representatives. Our strategic partners distribute our Mandatory Provident Fund products and services, or use our administrative and investment services in their own products.

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We compete in the Hong Kong mutual fund market distributed primarily through strategic alliances with banks to retail customers. In addition, we have initiated our development of an institutional asset management business distributed primarily through strategic alliances with banks to retail customers.

India. In India we offer mutual funds, insurance brokerage and institutional asset management products.

We compete in the mutual fund market, managing and administering funds for both individuals and corporations. We sell our mutual funds through regional offices and regional bank branches located throughout India. In addition to the current mutual fund business, we are positioning ourselves to compete in the emerging pension and long-term savings market in India.

We have a joint venture agreement with Punjab National Bank ("PNB") and Vijaya Bank, two large Indian commercial banks with a combined branch network of approximately 5,000, to sell mutual funds and related financial services in India.

We have a stake in a company that is a distributor of financial products including mutual fund products for other providers, bonds, retail debt offerings and portfolio management services.

We also have a stake and management control of an insurance brokerage company in India. We broker insurance products through regional offices and regional bank branches located throughout India.

Discussions are taking place with our partners to review the optimal ownership and organizational structure for the future, including distribution.

Malaysia. In Malaysia we offer conventional and Islamic mutual funds through our minority-held joint venture with CIMB Group, a large Malaysian bank holding company with a presence in many southeast Asian countries. The company markets mutual funds through wholesale bank channels and its own sales force of around 5,000 agents. The joint venture's main bank channel is through the 380 CIMB Bank branches. As of September 30, 2007, our joint venture company ranked third in unit trust assets managed and second in Islamic unit trust assets managed in the Malaysian asset management industry. In addition, the company manages a significant amount of institutional asset mandates ranking first among asset management companies as of September 30, 2007. The joint venture began an asset management start-up operation in Singapore, CIMB-Principal Asset Management (S) Pte Ltd, in 2007 and acquired a small asset management operation in Indonesia, PT Niaga Aset Manajem.

Mexico. In Mexico we offer defined contribution pension products, mutual funds, annuities and asset management services to institutional clients.

Through our private pension company, we manage and administer more than 3 million individual retirement accounts under the mandatory privatized social security system for all non-government employees in Mexico. We distribute products and services through a proprietary sales force of sales representatives, of which we had approximately 2,000 as of December 31, 2007, as well as independent brokers, who sell directly to individuals.

Through our mutual fund company, we distribute products and services through a sales force of approximately 100 employees and through distribution agreements with other financial entities. We administer annuities and life products that complement these annuities, which we previously distributed directly to customers who were exiting the pre-retirement accumulation system. We have temporarily suspended sales of our annuity and life products in Mexico due to unfavorable market conditions.

Our focus is on both pre-retirement and post-retirement savings plans. Mexico has also initiated institutional asset management services, offering both domestic and international products.

Life and Health Insurance Segment

Our Life and Health Insurance segment offers (1) individual life insurance (2) group health insurance and (3) specialty benefits, which includes group dental, group vision, group life, group long-term disability, group short-term disability and individual disability insurance throughout the U.S. We focus on providing comprehensive insurance solutions for small and medium-sized businesses.

Individual Life Insurance

We began as an individual life insurer in 1879. Our U.S. operations administer approximately 600,000 individual life insurance policies with $113.2 billion of individual life insurance in force as of December 31, 2007. As of September 30, 2007, our life insurance business was ranked 22nd in the U.S. for annualized sales according to LIMRA.

Products and Services

We offer a variety of individual life insurance products, including universal and variable universal life insurance and term life insurance sold through traditional retail insurance intermediaries. In addition, we have an increasing focus on using these products for nonqualified executive benefits for small and medium-sized businesses.

Nonqualified Executive Benefits. Small and medium-sized companies are challenged with how to build quality benefits packages for executives, how to transition the company's ownership to a partner or family member and how to save for retirement. In addition, executives and other key employees often have personal insurance needs. These needs are the focus of our products within the individual life insurance arena.

We have a growing focus and expertise in providing executive life insurance benefits to companies designated by the Internal Revenue Service ("IRS") as S-corporations, in addition to traditional C-corporation clients. As a growing segment of the small and medium-sized business market, S-corporations require unique plan designs that meet very specific legal requirements.

Universal and Variable Universal Life Insurance. Universal and variable universal life insurance products offer life insurance protection for which both the premium and the death benefit may be adjusted by the policyholder. Universal life insurance usually includes a cash value account that accumulates at a floating interest rate, with a minimum rate guarantee. Variable universal life insurance substitutes various investment options for the single floating interest rate of universal life insurance.

For the year ended December 31, 2007, 88% of individual life insurance annualized first year premium sales have come from universal and variable universal life insurance products. Universal and variable universal life insurance represents 55% of individual life insurance premium and deposits for the year ended December 31, 2007, and 46% of individual life insurance in force as of December 31, 2007. Variable universal life insurance products represented 41% of our universal and variable universal life insurance deposits for the year ended December 31, 2007.

After removing expenses for a policy, we credit net deposits to an account maintained for the policyholder. For universal life contracts, the entire account balance is invested in our general account. Interest is credited to the policyholder's account based on the earnings on general account investments. For variable universal life contracts, the policyholder may allocate the account balance among our general account and a variety of separate account choices. Interest is credited on amounts allocated to the general account in the same manner as for universal life. Net investment performance on separate account investments is allocated directly to the policyholder accounts; the policyholder bears the investment risk. Some of our universal life and variable universal life insurance contracts contain what are commonly referred to as "secondary" or "no-lapse" guarantee provisions. A no-lapse guarantee keeps the contract in force, even if the contractholder's account balance is insufficient to cover all of the contract charges, provided that the contractholder has continually paid a specified minimum premium.

Traditional Life Insurance. Traditional life insurance includes participating whole life, adjustable life products and non-participating term life insurance products. Participating products and non-participating term life insurance products each represented 6% of our individual life insurance annualized first year premium sales for the year ended December 31, 2007, and 28% and 26%, respectively, of individual life insurance in force as of December 31, 2007. Adjustable life insurance products provide a guaranteed benefit in return for the payment of a fixed premium and allow the policyholder to reset the premium and face amount combination. Term insurance products provide a guaranteed death benefit for a specified period of time in return for the payment of a fixed premium. Policyholder dividends are not paid on term insurance.

Group Health Insurance

We began offering group health insurance in 1941. We offer a variety of traditional group medical insurance products, consumer driven high deductible health plans with health savings accounts, administrative services and wellness products. We provide administrative services on a fee-for-service basis for medical, dental, disability, vision and wellness benefits.

Products and Services

Our group health insurance products described below provide appropriate interactions for members along a continuum of care management, from wellness services to acute and chronic care and disease management programs. These programs include care management, a transplant network, chronic disease management, pre-natal assistance and 24-hour access to online health management resources such as symptom checkers, prescription drug information and provider information.

Group Health Insurance. As of December 31, 2007, we provided group medical insurance benefits to more than 19,000 employer customers and their 566,000 employees and dependents. Our traditional group medical insurance plans provide reimbursement of medical expenses for insured employees and their dependents. These members are responsible for deductibles, co-payments and co-insurance. Through our wholly owned subsidiary, HealthRisk Resource Group, LLC., we negotiate discounts with providers on claims for which we have no other pre-arranged discount.

Our consumer-driven health care plans offer greater flexibility for employers and more opportunity for members to take charge of their health and health care. We offer Health Reimbursement Arrangements ("HRA") and HSAs. The Principal HRA is an employer funded benefit plan that allows the employer to design a consumer driven health care program to meet their specific needs. The employer determines if a deductible applies before the HRA, what percentage the HRA reimburses, the maximum benefit, the ability to roll over the funds to future periods and accessibility of the funds when employment has ended. The Principal Health Savings Account ("Principal HSA") can be funded by employers and employee members. Money can be contributed pre-tax and grows tax free. Funds can be used to pay for qualified medical expenses tax free. The account is portable from job to job or from work to retirement. The Principal

HSA is coupled with a high deductible health plan, typically either insured or administered by Principal Life. The Principal HSA features a checking account with a debit card and certificates of deposit through Principal Bank and investment options through Princor Financial Services Corporation. Because of these internal resources and expertise, we are uniquely positioned to offer competitive and high-quality health savings account plans and high deductible health plans.

Fee-for-Service. We offer administration of group medical, dental, disability and vision benefits on a fee-for-service basis to over 360 self-insured employers and their approximately 1.0 million employees and dependents as of December 31, 2007. Effective September 1, 2007, we entered into an agreement with Aetna Signature Administrators to utilize their networks, which has improved our competitive position in a number of markets.

We also recognize the importance of promoting healthy behavior. Principal Wellness Company contributes expertise in providing wellness screenings, counseling and services to employers and their employees, demonstrating health improvement through reduced health insurance claim costs, reduced absenteeism and increased employee productivity. This preventative focus has been integrated into both our fully-insured and fee-for-service offerings. We provide wellness services to over 350 employers and nearly 110,000 employees.

Specialty Benefits

Specialty benefits, which includes group dental, vision and life insurance, as well as individual and group disability insurance, is an important component of the employee benefit offering at small and medium-sized businesses. We offer traditional employer sponsored and voluntary products for group dental, vision, life and disability. We began selling our first specialty benefit products in 1941 with group disability and group life insurance. We began selling individual disability insurance in 1952 and group dental and group vision insurance in the late 1960s.

Products and Services

Group Dental and Vision Insurance. Group dental and vision insurance plans provide partial reimbursement for dental and vision expenses. As of December 31, 2007, we had approximately 37,100 group dental and vision insurance policies in force covering nearly 1 million employee lives. According to LIMRA, we were the 5th largest group dental insurer in terms of number of contracts/employer groups in force in 2006. In addition to indemnity and PPO dental offered on both an employer paid and voluntary basis, we offer a prepaid dental plan in Arizona through our Principal Dental Services, Inc. subsidiary.

Group Life Insurance. Group life insurance provides coverage to employees and their dependents for a specified period. As of December 31, 2007, we had approximately 53,000 group policies providing $125.2 billion of group life insurance in force to approximately 2.3 million employee lives. According to LIMRA in 2006, we were ranked 4th in the U.S. in terms of the number of life insurance contracts in force. We currently sell traditional group life insurance that does not provide for accumulation of cash values on both an employer paid and voluntary basis. Our group life insurance business remains focused on the traditional, annually renewable term product. Group term life and group universal life accounted for 96% and 4% respectively of our total group life insurance in force as of December 31, 2007. We no longer market group universal life insurance to new employer groups.

Group Disability Insurance. Group disability insurance provides a benefit to insured employees who become disabled. Our group disability products include both short-term and long-term disability, offered on both an employer paid and voluntary basis. Long-term disability represents 63% of total group disability premium, while short-term disability represents 37% of total group disability premium. In addition, we provide disability management services, also called rehabilitation services, to assist individuals in returning to work as quickly as possible following disability. We also work with disability claimants to improve the approval rate of Social Security benefits, thereby reducing payment of benefits by the amount of Social Security payments received. As of December 31, 2007, we served approximately 1.5 million employee lives under nearly 32,000 contracts, with our group short-term disability business being ranked 4th and our group long-term disability business being ranked 6th in the U.S. as of December 31, 2006, in terms of number of contracts/employer groups in force, according to LIMRA.

Individual Disability Insurance. Individual disability insurance products provide a benefit to the insured member in the event he/she becomes disabled. In most instances, this benefit is in the form of a monthly income. In addition to income replacement, we offer products to pay business overhead expenses for a disabled business owner, and for the purchase by the other business owners of the disabled business owner's interests in the business. As of December 31, 2007, we served approximately 114,000 individual disability policyholders, with our individual disability business being ranked 7th in the U.S. as of December 31, 2006, in terms of premium in force, according to LIMRA.

Life and Health Markets and Distribution

For each of our products, administration and distribution channels are customized to meet customer needs and expectations for that product.

We sell our individual life and individual disability income products in all 50 states and the District of Columbia, primarily targeting owners and executives of small and medium-sized businesses. Small and medium-sized business sales represented 79% of individual life sales and 64% of individual disability sales for the year ended December 31, 2007, based on first year annualized premium.

We distribute our individual insurance products through our affiliated financial representatives and independent brokers, as well as other marketing and distribution alliances. Affiliated financial representatives were responsible for 42% of individual life insurance sales based on first year annualized premium and 18% of individual disability sales for the year ended December 31, 2007. We had 1,114 affiliated financial representatives in 29 offices. Although they are independent contractors, we have a close tie with affiliated financial representatives and offer them benefits, training and access to tools and expertise. To meet the needs of the various marketing channels, particularly the independent brokers, we employ wholesale distributors Regional Vice Presidents for individual life and Disability Income Regional Vice Presidents for individual disability. A key differentiator in the nonqualified executive benefit sale is our Regional Vice Presidents-Nonqualified Plans, who are not only wholesalers but also consultants and subject-matter experts providing point-of-sale support in closing cases.

We market our group medical, life, disability, dental and vision insurance products to small and medium-sized businesses, primarily targeting our sales toward owners and human resources professionals. We sell our group life, disability and dental products in all 50 states and the District of Columbia. We sell vision coverage in 48 states, plus the District of Columbia. We sell our group medical insurance in 34 states and the District of Columbia with a focus on 13 states that we consider to have the best competitive environments. We continually adapt our products and pricing to meet local market conditions. We market our fee-for-service capabilities to employers that self-insure their employees' benefits. We sell our fee-for-service business in all 50 states and the District of Columbia.

Group insurance and fee-for-service products are distributed through independent benefit brokers, consultants, financial planners and the same channels that sell our U.S. asset accumulation products. To reach these marketers, we employ three types of wholesale distributors: our medical sales representatives, our non-medical sales representatives (for Specialty Benefits products) and an independent wholesale organization, Rogers Benefit Group, dedicated to marketing group medical, life, disability, dental and vision insurance products. We have also formed a number of strategic distribution alliances with national brokerages and regional brokerage agencies.

The non-medical group insurance market continues to see a shift to voluntary/worksite products. In keeping with this market change, which shifts the funding of such products from the employer to the employee, we have enhanced our focus on our voluntary benefits platform. We believe the voluntary/worksite market presents growth opportunities, and we will continue to develop strategies to capitalize on this expanding market.

As of December 31, 2007, we had 125 medical and non-medical sales representatives and 123 service representatives in 40 offices. Our medical and non-medical sales representatives accounted for 74% of our group insurance sales for the year ended December 31, 2007. The group sales force plays a key role in the ongoing servicing of the case by providing local, responsive services to our customers and their brokers, such as renewing contracts, revising plans and solving any administrative issues; communicating the customers' needs and feedback to us; and helping employees understand the benefits of their plans.

Rogers Benefit Group is a marketing and service organization that represents major high quality insurance carriers specializing in group medical, life, disability and dental insurance plans. Our relationship with Rogers Benefit Group dates back to its creation in 1970. It accounted for 24% of our group insurance sales for the year ended December 31, 2007.

Corporate and Other Segment

Our Corporate and Other segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate and Other segment primarily reflect our financing activities (including interest expense 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.

Competition

Competition in our segments is based on a number of factors including: service, product features, price, investment performance, commission structure, distribution capacity, financial strength ratings and name recognition. We compete for customers and distributors with a large number of financial services companies such as banks, mutual funds, broker-dealers, insurers and asset managers. Some of these companies offer a broader array of products, more competitive pricing, greater diversity of distribution sources, better brand recognition or, with respect to insurers, higher financial strength ratings. Some may also have greater financial resources with which to compete or may have better investment performance at various times.

Competition in the retirement services market is very fragmented. Our main competitors in this market include Fidelity, Nationwide, AXA, Mass Mutual and Manulife. We believe the infrastructure and system support needed to meet the needs of the small and medium-sized business market is a significant barrier to entry for our competitors. Many of our competitors in the mutual fund industry are larger, have been established for a longer period of time, offer less expensive products, have deeper penetration in key distribution channels and have more resources than we do. There were over 8,000 mutual funds in the U.S. as of 2006 according to the Investment Company Institute 2007 Investment Company Fact Book. The institutional asset management market has grown at a rapid pace over the last decade. Our primary competitors in this market are large institutional asset management firms, such as J.P. Morgan Chase, Morgan Stanley Investment Management and T. Rowe Price, some of which offer a broader array of investment products and services and are better known. The asset management business has relatively few barriers to entry and continually attracts new entrants. The variable annuity market is also highly competitive. As we expand into additional distribution channels for this product, we will face strong competition from Nationwide and Hartford. Competition in the international markets in which we operate comes primarily from local financial services firms and other international companies operating on a stand-alone basis or in a partnership with local firms, including ING, AXA, Allianz and AIG. In the highly competitive life and health insurance business, our competitors include other insurers such as UNUM, Guardian, Northwestern Mutual Life, Manulife, Blue Cross and Blue Shield organizations and health maintenance organizations such as United Health Care and Aetna. We believe we distinguish ourselves from our competitors through our:

- full service platform;
- strong customer relationships;
- focus on financial performance; and
- performance-oriented culture.

Ratings

Insurance companies are assigned financial strength ratings by rating agencies based upon factors relevant to policyholders. Financial strength ratings are generally defined as opinions as to an insurer's financial strength and ability to meet ongoing obligations to policyholders. Information about ratings provides both industry participants and insurance consumers meaningful insights on specific insurance companies. Higher ratings generally indicate financial stability and a stronger ability to pay claims.

Principal Life has been assigned the following long-term insurance financial strength ratings:

Rating Agency	Financial Strength Rating	Rating Structure
A.M. Best Company, Inc.	A+ ("Superior") with a stable outlook	Second highest of 16 rating levels
Fitch Ratings	AA ("Very Strong") with a stable outlook	Third highest of 21 rating levels
Moody's Investors Service	Aa2 ("Excellent") with a stable outlook	Third highest of 21 rating levels
Standard & Poor's Rating Services	AA ("Very Strong") with a stable outlook	Third highest of 21 rating levels

A.M. Best's ratings for insurance companies range from "A++" to "S". A.M. Best indicates that "A++" and "A+" ratings are assigned to those companies that in A.M. Best's opinion have superior ability to meet ongoing obligations to policyholders. Fitch's ratings for insurance companies range from "AAA" to "C". Fitch "AA" ratings indicate very strong capacity to meet policyholder and contractholder obligations on a timely basis. Moody's ratings for insurance companies range from "Aaa" to "C". Moody's indicates that "Aa" ratings are assigned to those companies that have demonstrated excellent financial security. Standard & Poor's ratings for insurance companies range from "AAA" to "R". Standard & Poor's indicates that "AA" ratings are assigned to those companies that have demonstrated very strong financial security characteristics. In evaluating a company's financial and operating performance, these rating agencies review its profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its policy reserves, the soundness of its risk management programs, the experience and competency of its management and other factors.

We believe that our strong ratings are an important factor in marketing our products to our distributors and customers, since ratings information is broadly disseminated and generally used throughout the industry. Our ratings reflect each rating agency's opinion of our financial strength, operating performance and ability to meet our obligations to policyholders and are not evaluations directed toward the protection of investors. Such ratings are neither a rating of securities nor a recommendation to buy, hold or sell any security, including our common stock.

Risk Management

Like all financial services companies, we are exposed to a wide variety of financial, operational and other risks, as described in Item 1A. "Risk Factors". Effective enterprise risk management is, therefore, a key component of our business model. Enterprise risk management enables us to:

- identify and successfully manage those risks that present profitable growth opportunities, and walk away from those that do not;
- avoid surprises and deliver on the promises that we make; and
- balance the sometimes competing demands of our various stakeholders, meet our customer obligations, satisfy regulatory requirements and optimize shareholder returns relative to the risks we take.

We use a variety of methods to help us identify, monitor, measure, communicate and manage our risks within established limits and risk tolerances.

Our Board of Directors and senior management are knowledgeable of and accountable for key risks. Our Board meets at least quarterly and regularly hears reports from the Chief Executive Officer, the Chief Operating Officer, the business unit Presidents, the Chief Financial Officer and the Chief Investment Officer. The Board has several committees, which include the Audit Committee, the Human Resources Committee and the Nominating and Governance Committee, that meet at least quarterly and address various aspects of risks. In addition, the Board of Directors and senior management receive quarterly updates from the Chief Risk Officer.

We also have several senior management groups and committees that meet on a regular and frequent basis to discuss various issues and risks associated with our businesses. These committees encompass numerous functions such as discussing and setting business unit and company strategy, reviewing and approving potential uses of corporate capital, and setting investment policy and reviewing its implementation. Many key members of senior management serve on multiple committees, allowing them to provide oversight and take a holistic view of our key risks.

Our enterprise risk management program is executed via a federated model. The Chief Risk Officer and the corporate risk units are independent of the business units, and work closely with the business units, providing oversight and integration of all risk management activities. Each business unit is responsible for identifying, monitoring, measuring and managing its risks, as well as monitoring how its risks impact our overall risk exposure. The business units provide risk reports to the Chief Risk Officer quarterly with current risk management information.

We have established risk tolerances from an overall corporate perspective as well as for specific types of risks. All potentially significant actions are considered in terms of the possible impact on our risk profile, including the capital required, the impact on near term and long-term earnings and the ability to meet our targets with respect to return on equity, liquidity, debt/capital, cash coverage and other ratios and metrics. We monitor a variety of risk metrics on an on-going basis and make any necessary adjustments to help us stay within our established risk tolerances. We have developed a Business Continuity Program that identifies critical business functions and includes plans for their protection and recovery in the event of a disaster or other business interruption. We continually monitor emerging risks, and we regularly build upon our already strong risk management practices to incorporate updated modeling tools, processes and metrics which we actively use to better understand and manage our business. We have added three new risk metrics to our enterprise risk management framework:

- Earnings at Risk, which is a measure of the potential reduction in operating earnings relative to baseline operating earnings under relatively adverse business and economic conditions.

- Embedded Value at Risk, which is a measure of the potential reduction in embedded value relative to baseline embedded value under relatively adverse business and economic conditions.

- Economic Total Asset Requirement, which is the total assets required to ensure that we can meet all of our obligations with a high degree of confidence. Economic Total Asset Requirement is the sum of Economic Reserves and Economic Capital.

Employees

As of December 31, 2007, we had 16,585 employees. None of our employees are subject to collective bargaining agreements governing employment with us. We believe that our employee relations are satisfactory.

Internet Website

Our Internet website can be found at www.principal.com. We make available free of charge on or through our Internet website, access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is filed with or furnished to the SEC. Also available free of charge on our Internet website, and in print to any requesting stockholder, is our code of business conduct and ethics, corporate governance guidelines and charters for the audit, human resources and nominating and governance committees of our Board of Directors. Also see Item 10. "Directors, Executive Officers and Corporate Governance."

Item 1A. Risk Factors

This section provides an overview of the risks that may impact our performance in the future. We have included the results of our sensitivity testing for risks that can be objectively and reliably quantified. The sensitivity testing results represent hypothetical scenarios. While these scenarios do not represent our expectations of future experience, they are intended to illustrate the potential impacts of reasonably possible hypothetical changes in experience. These sensitivities are based on our risk exposures at a point in time and may not be representative of future results.

A decline or increased volatility in the securities markets could result in investors withdrawing from the markets or decreasing their rates of investment, either of which could reduce our net income, revenues and AUM.

Favorable performance by the U.S. and international securities markets increases investments in these markets and benefits our asset management and accumulation businesses and increases our AUM. Because the revenues of our asset management businesses are, to a large extent, based on the value of AUM, a decline in these securities markets would decrease our revenues. Turmoil in these securities markets could lead investors to withdraw from these markets, decrease their rates of investment or refrain from making new investments which may reduce our net income, revenues and AUM. Using assumptions and data in effect as of December 31, 2007, we estimate that an immediate 10% drop in the Standard & Poors index, followed by a 2% per quarter increase, would reduce our annual operating earnings by approximately 4% 6%.

Our investment portfolio is subject to several risks which may diminish the value of our invested assets and the investment returns credited to customers, which could reduce our sales, revenues, AUM and net income.

An increase in defaults on our fixed maturity securities portfolio may reduce our profitability.

We are subject to the risk that the issuers of the fixed maturity securities we own will default on principal and interest payments, particularly if a major downturn in economic activity occurs. As of December 31, 2007, our U.S. investment operations held $44.5 billion of fixed maturity securities, or 74% of total U.S. invested assets, of which approximately 4.9% were below investment grade, including $48.2 million, or 0.11% of our total fixed maturity securities which we classified as either "problem," "potential problem," or "restructured." See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Investments U.S. Investment Operations Fixed Maturity Securities." As of December 31, 2007, the international investment operations of our fully consolidated subsidiaries held $2.7 billion, or 67%, of total international invested assets in fixed maturity securities, of which 19% are government bonds. Some non-government bonds have been rated on the basis of the issuer's country credit rating. However, the ratings relationship between national ratings and global ratings is not linear with the U.S. The starting point for national ratings differs by country, which makes the assessment of credit quality more difficult. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Investments International Investment Operations." An increase in defaults on our fixed maturity securities portfolio could harm our financial strength and reduce our profitability.

An increased rate of delinquency and defaults on our commercial mortgage loans, especially those with balloon payments, could decrease our profitability.

Our commercial mortgage loan portfolio faces both delinquency and default risk. Commercial mortgage loans of $10.8 billion represented 17% of our total invested assets as of December 31, 2007. As of December 31, 2007, loans that were in the process of foreclosure totaled $13.0 million, or 0.12% of our commercial mortgage loan portfolio. The performance of our commercial mortgage loan portfolio, however, may fluctuate in the future. An increase in the delinquency rate of our commercial mortgage loan portfolio could harm our financial strength and decrease our profitability.

As of December 31, 2007, approximately $9.1 billion, or 84%, of our commercial mortgage loans before valuation allowance had balloon payment maturities. A balloon maturity is a loan with larger dollar amounts of payments becoming due in the later years of the loan. The default rate on commercial mortgage loans with balloon payment maturities has historically been higher than for commercial mortgage loans with standard repayment schedules. Since most of the principal is being repaid at maturity, the amount of loss on a default is generally greater than on other commercial mortgage loans. An increase in defaults on such loans as a result of the foregoing factors could harm our financial strength and reduce our net income.

We may have difficulty selling our privately placed fixed maturity securities, commercial mortgage loans and real estate investments because they are less liquid than our publicly traded fixed maturity securities.

As of December 31, 2007, our privately placed fixed maturity securities, commercial mortgage loans and real estate investments represented approximately 42% of the value of our invested assets. If we require significant amounts of cash on short notice, we may have difficulty selling these investments at attractive prices, in a timely manner, or both.

Derivative instruments may not be honored by counterparties resulting in ineffective hedging of our risks.

We use derivative instruments to hedge various risks we face in our businesses. See Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." We enter into a variety of derivative instruments, including interest rate swaps, swaptions, futures, currency swaps, currency forwards, credit default swaps, treasury lock agreements, commodity swaps and options, with a number of counterparties. If, however, our counterparties fail to honor their obligations under the derivative instruments, we will have failed to effectively hedge the related risk. That failure may harm our financial strength and reduce our profitability.

Environmental liability exposure may result from our commercial mortgage loan portfolio and real estate investments.

Liability under environmental protection laws resulting from our commercial mortgage loan portfolio and real estate investments may harm our financial strength and reduce our profitability. Under the laws of several states, contamination of a property may give rise to a lien on the property to secure recovery of the costs of cleanup. In some states, this kind of lien has priority over the lien of an existing mortgage against the property, which would impair our ability to foreclose on that property should the related loan be in default. In addition, under the laws of some states and under the federal Comprehensive Environmental Response, Compensation and Liability Act of 1980, we may be liable for costs of addressing releases or threatened releases of hazardous substances that require remedy at a property securing a mortgage loan held by us, if our agents or employees have become sufficiently involved in the hazardous waste aspects of the operations of the related obligor on that loan, regardless of whether or not the environmental damage or threat was caused by the obligor. We also may face this liability after foreclosing on a property securing a mortgage loan held by us. This may harm our financial strength and decrease our profitability.

Regional concentration of our commercial mortgage loan portfolio in California may subject us to economic downturns or losses attributable to earthquakes in that state.

Credit extensions in the state of California accounted for 18%, or $1.9 billion, of our commercial mortgage loan portfolio as of December 31, 2007. Due to this concentration of commercial mortgage loans in California, we are exposed to potential losses resulting from the risk of an economic downturn in California as well as to catastrophes, such as earthquakes, that may affect the region. While we generally do not require earthquake insurance for properties on which we make commercial mortgage loans, we do take into account property specific engineering reports, construction type and geographical concentration by fault lines in our investment underwriting guidelines. If economic conditions in California deteriorate or catastrophes occur, we may experience delinquencies on the portion of our commercial mortgage loan portfolio located in California in the future, which may harm our financial strength and reduce our profitability.

Competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability.

We believe that our ability to compete is based on a number of factors including scale, service, product features, price, investment performance, commission structure, distribution capabilities, financial strength ratings and name recognition. We compete with a large number of financial services companies such as banks, broker-dealers, insurers and asset managers, many of which have advantages over us in one or more of the above competitive factors.

Each of our segments faces strong competition. The primary competitors for our U.S. Asset Accumulation and Global Asset Management segments are asset managers, banks, broker-dealers and insurers. Our ability to increase and retain AUM is directly related to the performance of our investments as measured against market averages and the performance of our competitors. Even when securities prices are generally rising, performance can be affected by investment styles. Also, there is a risk that we may not be able to attract and retain the top talent needed to compete in our industry.

Competition for our International Asset Management and Accumulation segment comes primarily from local financial services firms and other international companies operating on a stand-alone basis or in partnership with local firms. Our Life and Health Insurance segment competes with insurers and health maintenance organizations.

National banks, with their large existing customer bases, may increasingly compete with insurers as a result of court rulings allowing national banks to sell annuity products in some circumstances, and as a result of legislation removing restrictions on bank affiliations with insurers. Specifically, the Gramm-Leach-Bliley Act of 1999 permits mergers that combine commercial banks, insurers and securities firms under one holding company. These developments may increase competition, in particular for our asset management and accumulation businesses, by substantially increasing the number, size and financial strength of potential competitors who may be able to offer, due to economies of scale, more competitive pricing than we can.

A downgrade in our financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors, impact existing liabilities and increase our cost of capital, any of which could adversely affect our profitability and financial condition.

Ratings are important factors in establishing the competitive position of insurance companies. A rating downgrade, or the potential for such a downgrade, could, among other things:

- materially increase the number of policy or contract surrenders for all or a portion of their net cash values and withdrawals by policyholders of cash values from their policies or with respect to general account guaranteed investment contracts and funding agreements purchased by pension plans and other institutions;
- result in the termination of our relationships with broker-dealers, banks, agents, wholesalers and other distributors of our products and services;
- reduce new sales, particularly with respect to general account guaranteed investment contracts and funding agreements purchased by pension plans and other institutions;
- cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations; and
- increase our cost of capital and limit our access to the capital markets.

Any of these consequences could adversely affect our profitability and financial condition.

Unforeseen increases in cash outflows may negatively impact our liquidity.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed adequate to meet anticipated short-term and long-term benefit and expense payment obligations. However, withdrawal and surrender levels may differ from anticipated levels for a variety of reasons, such as changes in the interest rate environment or changes in our claims paying ability and financial strength ratings. For example, a significant increase in interest rates may cause our policyholders to withdraw the cash values of their policies in order to seek more attractive returns elsewhere. A downgrade in our financial strength ratings could also cause an increase in policyholder withdrawals. If policyholder withdrawals significantly exceed our expectations, we may be forced to borrow funds or liquidate investments to raise the funds necessary to fund the withdrawals. Liquidations may result in capital losses, particularly in periods of volatile interest rates. Because volatile interest rates often make it more difficult to sell certain fixed income securities, there is also a risk that we will find it difficult to raise the cash necessary to fund a very large amount of withdrawal activity.

Certain aspects of our businesses help us mitigate potential liquidity risk:

- Our liability portfolio is diverse. Many of our products have fairly predictable cash demands, and where cash demands are less predictable, we have the ability to defer or spread out the cash payments. Importantly, our products have features to discourage surrenders.
- Our asset portfolio is also diverse and spread over many different types of exposures (asset class, credit, geography, industry, etc.).

For further discussion on liquidity risk management, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources."

Our efforts to reduce the impact of interest rate changes on our profitability and retained earnings may not be effective.

We attempt to significantly reduce the impact of changes in interest rates on the profitability and retained earnings of our asset accumulation and life and health insurance operations. We accomplish this reduction primarily by managing the duration of our assets relative to the duration of our liabilities. During a period of rising interest rates, policy surrenders, withdrawals and requests for policy loans may increase as customers seek to achieve higher returns. Despite our efforts to reduce the impact of rising interest rates, we may be required to sell assets to raise the cash necessary to respond to such surrenders, withdrawals and loans, thereby realizing capital losses on the assets sold. An increase in policy surrenders and withdrawals may also require us to accelerate amortization of deferred policy acquisition costs ("DPAC") relating to these contracts, which would further reduce our profitability.

During periods of declining interest rates, borrowers may prepay or redeem mortgages and bonds that we own, which would force us to reinvest the proceeds at lower interest rates. For some of our products, such as guaranteed investment contracts and funding agreements, we are unable to lower the rate we credit to customers in response to the lower return we will earn on our investments. In addition, it may be more difficult for us to maintain our desired spread between the investment income we earn and the interest we credit to our customers during periods of declining interest rates, thereby reducing our profitability.

We estimate that an immediate interest rate decrease of 100 basis points would reduce our operating earnings by less than 1% over the next year. However, if the lower interest rate level continues, the net impact could grow over time, as our existing investments mature and the proceeds are reinvested in lower yielding assets. Total cumulative operating earnings over the next 5 years could be reduced by approximately 1% per year if interest rates were to remain at the lower levels.

For further discussion on interest rate risk management, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk".

If we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced.

We distribute our asset accumulation, asset management and life, health and specialty benefit insurance products and services through a variety of distribution channels, including our own internal sales representatives, independent brokers, banks, broker-dealers and other third-party marketing organizations. We must attract and retain sales representatives to sell our products. Strong competition exists among financial services companies for efficient sales representatives. We compete with other financial services companies for sales representatives primarily on the basis of our financial position, support services and compensation and product features. If we are unable to attract and retain sufficient sales representatives to sell our products, our ability to compete and revenues from new sales would suffer.

Our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses.

Our international businesses are subject to comprehensive regulation and supervision from central and/or local governmental authorities in each country in which we operate. New interpretations of existing laws and regulations or the adoption of new laws and regulations may harm our international businesses and reduce our profitability in those businesses.

Our international businesses face political, legal, operational and other risks that we do not face in our operations in the U.S. We face the risk of discriminatory regulation, nationalization or expropriation of assets, price controls and exchange controls or other restrictions that prevent us from transferring funds from these operations out of the countries in which they operate or converting local currencies we hold into U.S. dollars or other currencies. Some of our international businesses are, and are likely to continue to be, in emerging or potentially volatile markets. In addition, we rely on local staff, including local sales forces, in these countries where there is a risk that we may encounter labor problems with local staff, especially in countries where workers' associations and trade unions are strong. If our business model is not successful in a particular country, we may lose all or most of our investment in that country.

We may face losses if our actual experience differs significantly from our pricing and reserving assumptions.

Our profitability depends significantly upon the extent to which our actual claims experience is consistent with the assumptions used in setting prices for our products and establishing liabilities for future insurance and annuity policy benefits and claims. The premiums that we charge and the liabilities that we hold for future policy benefits are based on assumptions concerning a number of factors, including the amount of premiums that we will receive in the future, rate of return on assets we purchase with premiums received, expected claims, mortality, morbidity, expenses and persistency, which is the measurement of the percentage of insurance policies remaining in force from year to year, as measured by premiums. However, due to the nature of the underlying risks and the high degree of uncertainty associated with the determination of the liabilities for unpaid policy benefits and claims, we cannot determine precisely the amounts we will ultimately pay to settle these liabilities. As a result, we may experience volatility in the level of our profitability and our reserves from period to period, particularly for our health and disability insurance products. To the extent that actual claims experience is less favorable than our underlying assumptions, we could be required to increase our liabilities, which may harm our financial strength and reduce our profitability.

For example, if mortality rates are higher than our pricing assumptions, we will be required to make greater claims payments on our life insurance policies than we had projected. However, this risk is partially offset by our payout annuity business, where an increase in mortality rates will result in a decrease in benefit payments. We estimate that an immediate and sustained 5% increase in all mortality rates above what we are expecting would reduce total company operating earnings by less than 1% over the next year.

Our earnings may also be adversely impacted by an increase in morbidity rates. We estimate that an increase of 5 percentage points in our medical loss ratios above what we are expecting would reduce total company operating earnings by approximately 5-7% over the next year, and an increase of 5 percentage points in our dental, vision and disability loss ratios above what we are expecting would reduce total company operating earnings by approximately 3-4% over the next year.

For additional information on our insurance reserves, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Insurance Reserves."

Our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life.

We are an insurance holding company whose assets include all of the outstanding shares of the common stock of Principal Life and other direct subsidiaries. Our ability to pay dividends to our stockholders and meet our obligations, including paying operating expenses and any debt service, depends upon the receipt of dividends from Principal Life. Iowa insurance laws impose limitations on the ability of Principal Life to pay dividends to us. Any inability of Principal Life to pay dividends to us in the future may cause us to be unable to pay dividends to our stockholders and meet our other obligations. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a discussion of regulatory restrictions on Principal Life's ability to pay us dividends.

The pattern of amortizing our DPAC and other actuarial balances on our investment contract, participating life insurance and universal life-type products may change, impacting both the level of the asset and the timing of our net income.

Amortization of the DPAC asset depends on the actual and expected profits generated by the lines of business that incurred the expenses. Expected profits are dependent on assumptions regarding a number of factors including investment returns, benefit payments, expenses, mortality and policy lapse. Due to the uncertainty associated with establishing these assumptions, we cannot, with precision, determine the exact pattern of profit emergence. As a result, amortization of DPAC will vary from period to period. To the extent that actual experience emerges less favorably than expected, or our expectation for future profits decreases, the DPAC asset may be reduced, reducing our profitability in the current period.

For additional information, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operation Critical Accounting Policies and Estimates Deferred Policy Acquisition Costs and Other Actuarial Balances."

We may need to fund deficiencies in our Closed Block assets.

In connection with its conversion in 1998 into a stock life insurance company, Principal Life established an accounting mechanism, known as a "Closed Block" for the benefit of participating ordinary life insurance policies that had a dividend scale in force on July 1, 1998. Dividend scales are the actuarial formulas used by life insurance companies to determine amounts payable as dividends on participating policies based on experience factors relating to, among other things, investment results, mortality, lapse rates, expenses, premium taxes and policy loan interest and utilization rates. The Closed Block was designed to provide reasonable assurance to policyholders included in the Closed Block that, after the conversion, assets would be available to maintain the aggregate dividend scales in effect for 1997 if the experience underlying such scales were to continue.

We allocated assets to the Closed Block as of July 1, 1998 in an amount such that we expect their cash flows, together with anticipated revenues from the policies in the Closed Block, to be sufficient to support the Closed Block business, including payment of claims, expenses, charges and taxes and to provide for the continuation of aggregate dividend scales in accordance with the 1997 policy dividend scales if the experience underlying such scales continues, and to allow for appropriate adjustments in such scales if the experience changes. We bear the costs of expenses associated with Closed Block policies and, accordingly, these costs were not funded as part of the assets allocated to the Closed Block. Any increase in such costs in the future will be borne by us. As of December 31, 2007, Closed Block assets and liabilities were $4,806.5 million and $5,811.0 million, respectively.

We will continue to pay guaranteed benefits under the policies included in the Closed Block, in accordance with their terms. The Closed Block assets, cash flows generated by the Closed Block assets and anticipated revenues from polices included in the Closed Block may not be sufficient to provide for the benefits guaranteed under these policies. If they are not sufficient, we must fund the shortfall. Even if they are sufficient, we may choose for business reasons to support dividend payments on policies in the Closed Block with our general account funds.

The Closed Block assets, cash flows generated by the Closed Block assets and anticipated revenues from policies in the Closed Block will benefit only the holders of those policies. In addition, to the extent that these amounts are greater than the amounts estimated at the time we funded the Closed Block, dividends payable in respect of the policies included in the Closed Block may be greater than they would have been in the absence of a Closed Block. Any excess earnings will be available for distribution over time to Closed Block policyholders but will not be available to our stockholders.

A pandemic, terrorist attack, or other catastrophic event could adversely affect our net income.

Our mortality and morbidity experience could be adversely impacted by a catastrophic event. In addition, a severe catastrophic event may cause significant volatility in global financial markets, disruptions to commerce and reduced economic activity. The resulting macroeconomic conditions could adversely affect our cash flows, as well as the value and liquidity of our invested assets. We may also experience operational disruptions if our employees are unable or unwilling

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to come to work due to a pandemic or other catastrophe. We have developed extensive contingency plans to minimize the risk of operational disruptions. In addition, our use of reinsurance reduces our exposure to adverse mortality experience. Despite these measures, we may still be exposed to losses in the event of a pandemic, terrorist attack, or other catastrophe.

Our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and profitability.

We cede material amounts of insurance to other insurance companies through reinsurance. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies." However, we remain liable to the policyholder, even if the reinsurer defaults on its obligations with respect to the ceded business. If a reinsurer fails to meet its obligations, we will be forced to cover the claims on the reinsured policies. In addition, a reinsurer insolvency may cause us to lose our reserve credits on the ceded business, in which case we would be required to establish additional reserves.

The premium rates that we charge are based, in part, on the assumption that reinsurance will be available at a certain cost. Some of our reinsurance contracts contain provisions which limit the reinsurer's ability to increase rates on in-force business; however, some do not. If a reinsurer raises the rates that it charges on a block of in-force business, our profitability may be negatively impacted if we are not able to pass the increased costs on to the customer. If reinsurers raise the rates that they charge on new business, we may be forced to raise the premiums that we charge, which could have a negative impact on our competitive position.

To mitigate the risks associated with the use of reinsurance, we carefully select our reinsurers, and we monitor their ratings and financial condition on a regular basis. We also spread our business among several reinsurers, in order to diversify our risk exposure.

We face risks arising from acquisitions of businesses.

We have engaged in acquisitions of businesses in the past, and expect to continue to do so in the future. We face a number of risks arising from acquisition transactions, including difficulties in integrating the acquired business into our operations, difficulties in assimilating and retaining employees and intermediaries, difficulties in retaining the existing customers of the acquired entity, and unforeseen liabilities that arise in connection with the acquired business. These risks may prevent us from realizing the expected benefits from acquisitions.

Changes in laws, regulations or accounting standards may reduce our profitability.

Changes in regulations may reduce our profitability.

Our insurance business is subject to comprehensive state regulation and supervision throughout the U.S and in the international markets in which we operate. We are also impacted by federal legislation and administrative policies in areas such as employee benefit plan regulation, financial services regulations and federal taxation. The primary purpose of state regulation of the insurance business is to protect policyholders, not stockholders. The laws of the various states establish insurance departments with broad powers to regulate such matters as:

- licensing companies to transact business,
- licensing agents,
- admitting statutory assets,
- mandating a number of insurance benefits,
- regulating premium rates,
- approving policy forms,

- regulating unfair trade and claims practices,
- establishing statutory reserve requirements and solvency standards,
- fixing maximum interest rates on life insurance policy loans and minimum rates for accumulation of surrender values,
- restricting various transactions between affiliates, and
- regulating the types, amounts and valuation of investments.

State insurance regulators, federal regulators and the National Association of Insurance Commissioners ("NAIC") continually reexamine existing laws and regulations, and may impose changes in the future.

Federal legislation and administrative policies in areas such as employee benefit plan regulation, financial services regulation and federal taxation can reduce our profitability. For example, Congress has, from time to time, considered legislation relating to changes in the Employee Retirement Income Security Act of 1974 to permit application of state law remedies, such as consequential and punitive damages, in lawsuits for wrongful denial of benefits, which, if adopted, could increase our liability for damages in future litigation. Additionally, new interpretations of existing laws and the passage of new legislation may harm our ability to sell new policies and increase our claims exposure on policies we issued previously. In addition, reductions in contribution levels to defined contribution plans may decrease our profitability.

Changes in tax laws could increase our tax costs and reduce sales of our insurance, annuity and investment products.

Current federal income tax laws generally permit the tax-deferred accumulation of earnings on the premiums paid by the holders of annuities and life insurance products. Taxes, if any, are payable on income attributable to a distribution under the contract for the year in which the distribution is made. Congress has, from time to time, considered legislation that would reduce or eliminate the benefit of such deferral of taxation on the accretion of value within life insurance and non-qualified annuity contracts. Enactment of this legislation, including a simplified "flat tax" income structure with an exemption from taxation for investment income, could result in fewer sales of our insurance, annuity and investment products.

From time to time, Congress, as well as foreign, state and local governments, considers legislation that could increase our tax costs. If such legislation is adopted, our profitability could be negatively impacted.

Repeal or modification of the federal estate tax could reduce our revenues.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (the "Act") amended the federal estate tax laws by increasing the amount of the unified credit beginning in 2002, thereby increasing the amount of property not subject to the estate tax. The Act also gradually reduces the federal estate tax rate over a period of years beginning in 2002, and repeals the tax entirely in 2010. The law in effect prior to the Act, however, is reinstated for years after 2010. Through the year ended December 31, 2007, we received recurring premium of $51.0 million for survivorship life insurance policies we have sold. A significant number of these policies were purchased for the purpose of providing cash to pay federal estate taxes. The reduction of the federal estate tax and temporary repeal could result in policyholders reducing coverage under, or surrendering, these policies.

Changes in federal, state and foreign securities laws may reduce our profitability.

Our asset management and accumulation and life insurance businesses are subject to various levels of regulation under federal, state and foreign securities laws. These laws and regulations are primarily intended to protect investors in the securities markets or investment advisory or brokerage clients and generally grant supervisory agencies broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations. Changes to these laws or regulations that restrict the conduct of our business could reduce our profitability.

Changes in accounting standards may reduce our profitability.

Accounting standards are subject to change and can negatively impact our profitability. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies." In addition to recently issued accounting guidance, the standard setters have a full agenda of topics they plan to review, any of which have the potential to negatively impact our profitability. The results for past accounting periods are not necessarily indicative of the results to be expected for any future accounting period.

A computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our earnings.

We rely on computer systems to conduct business, including customer service, marketing and sales activities, customer relationship management and producing financial statements. While we have policies, procedures, automation and backup plans designed to prevent or limit the effect of failure, our computer systems may be vulnerable to disruptions or breaches as the result of natural disasters, man-made disasters, criminal activity, pandemics, or other events beyond our control. The failure of our computer systems for any reason could disrupt our operations, result in the loss of customer business and adversely impact our profitability.

We retain confidential information on our computer systems, including customer information and proprietary business information. Any compromise of the security of our computer systems that results in the disclosure of personally identifiable customer information could damage our reputation, expose us to litigation, increase regulatory scrutiny and require us to incur significant technical, legal and other expenses.

Results of litigation and regulatory investigations may affect our financial strength or reduce our profitability.

We are a plaintiff or defendant in actions arising out of our insurance businesses and investment operations. We are, from time to time, also involved in various governmental, regulatory and administrative proceedings and inquiries. These factors may affect our financial strength or reduce our profitability. For further discussion on litigation and regulatory investigation risk, see Item 3. "Legal Proceedings."

Fluctuations in foreign currency exchange rates could reduce our profitability.

Principal International generally writes policies denominated in various local currencies and invests the premiums and deposits in local currencies. Although investing in local currencies limits the effect of currency exchange rate fluctuation on local operating results, fluctuations in such rates affect the translation of these results into our consolidated financial statements. For further discussion on foreign currency exchange risk, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk   Foreign Currency Risk."

Applicable laws and our stockholder rights plan, certificate of incorporation and by-laws may discourage takeovers and business combinations that our stockholders might consider in their best interests.

State laws and our certificate of incorporation and by-laws may delay, defer, prevent, or render more difficult a takeover attempt that our stockholders might consider in their best interests. For instance, they may prevent our stockholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

State laws and our certificate of incorporation and by-laws may also make it difficult for stockholders to replace or remove our management. These provisions may facilitate management entrenchment, which may delay, defer or prevent a change in our control, which may not be in the best interests of our stockholders.

The following provisions, included in our certificate of incorporation and by-laws, may also have anti-takeover effects and may delay, defer or prevent a takeover attempt that our stockholders might consider in their best interests. In particular, our certificate of incorporation and by-laws:

- permit our Board of Directors to issue one or more series of preferred stock;
- divide our Board of Directors into three classes;
- limit the ability of stockholders to remove directors;
- prohibit stockholders from filling vacancies on our Board of Directors;
- prohibit stockholders from calling special meetings of stockholders;
- impose advance notice requirements for stockholder proposals and nominations of directors to be considered at stockholder meetings; and
- require the approval by the holders of at least 75% of our outstanding common stock for the amendment of our by-laws and provisions of our certificate of incorporation governing:
  - the classified board,
  - the director's discretion in determining what he or she reasonably believes to be in the best interests of Principal Financial Group, Inc.,

- the liability of directors and
- the elimination of the prohibition on stockholder actions by written consent.

In addition, Section 203 of the General Corporation Law of the State of Delaware may limit the ability of an "interested stockholder" to engage in business combinations with us. An interested stockholder is defined to include persons owning 15% or more of our outstanding voting stock.

Our stockholder rights plan may have anti-takeover effects. The stockholder rights plan is designed to protect our stockholders in the event of unsolicited offers to acquire us and other coercive takeover tactics, which, in the opinion of our Board of Directors, could impair the board's ability to represent stockholder interests. Our stockholder rights plan might render an unsolicited takeover more difficult or less likely to occur, even though such a takeover might offer our stockholders the opportunity to sell their stock at a price above the prevailing market price and may be favored by our stockholders.

Our financial results may be adversely impacted by global climate changes.

Atmospheric concentrations of carbon dioxide and other greenhouse gases have increased dramatically since the industrial revolution, resulting in a gradual increase in global average temperatures and an increase in the frequency and severity of natural disasters. These trends are expected to continue in the future, and have the potential to impact nearly all sectors of the economy to varying degrees. Our initial research indicates that climate change does not pose an imminent or significant threat to our operations or business, but we will continue to monitor new developments in the future.

Potential impacts may include the following:

- Changes in temperatures and air quality may adversely impact our mortality and morbidity rates. For example, increases in the level of pollution and airborne allergens may cause an increase in upper respiratory and cardiovascular diseases, leading to increased claims in our life, health and disability income business. However, the risk of increased mortality on our life insurance business is partly offset by our payout annuity business, where an increase in mortality results in a decrease in benefit payments.

- Climate change may impact asset prices, as well as general economic conditions. For example, rising sea levels may lead to decreases in real estate values in coastal areas. Additionally, government policies to slow climate change (e.g., setting limits on carbon emissions) may have an adverse impact on sectors such as utilities, transportation and manufacturing. Changes in asset prices may impact the value of our fixed income, real estate and commercial mortgage investments. We manage our investment risks by maintaining a well-diversified portfolio, both geographically and by sector. We also monitor our investments on an on-going basis, allowing us to adjust our exposure to sectors and/or geographical areas that face severe risks due to climate change.

- A natural disaster that affects one of our office locations could disrupt our operations and pose a threat to the safety of our employees. However, we have extensive Disaster Recovery programs in place to help mitigate this risk.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own 26 properties in our home office complex in Des Moines, Iowa, and in various other locations. Of these 26 properties, 11 are office buildings, 2 are warehouse facilities, 11 are parking lots and ramps, 1 is a park/green space and 1 is a childcare center that is currently under construction. Of the office and warehouse space, we occupy approximately 90% of the 2.8 million square feet of space in these buildings. The balance of the space in these buildings is rented to commercial tenants or is occupied by the property management company servicing these properties. Of the parking properties there are approximately 5,119 stalls, which does not include additional stalls that will be created once construction of a new parking ramp is completed. We lease office space for various offices located throughout the U.S. and internationally. We believe that our owned and leased properties are suitable and adequate for our current business operations.

Item 3. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 15, Contingencies, Guarantees and Indemnifications" under the caption, "Litigation and Regulatory Contingencies."

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

No matter was submitted to a vote of security holders of Principal Financial Group, Inc. during the fourth quarter of the fiscal year covered by this report.

Executive Officers of the Registrant

The following information is furnished with respect to each of the executive officers of the Company, each of whom is elected by and serves at the pleasure of the Board of Directors.

J. Barry Griswell, 58, has been Chairman and Chief Executive Officer of the Company and Principal Life since 2002, a director of the Company since 2001 and a Principal Life director since 1998. Prior thereto, he had been President of the Company from April 2001 until June 2006, Chief Executive Officer of the Company since April 2001 and President and Chief Executive Officer of Principal Life since January 2000. He is a Chartered Life Underwriter, a Chartered Financial Consultant and a LIMRA Leadership Institute Fellow. Mr. Griswell is a director of Herman Miller, Inc., an office furnishings designer and manufacturer. He is Chairman of the Board and Chair of the Board's Executive Committee.

John E. Aschenbrenner, 58, who heads the Life and Health Insurance division of our operations, has been President, Insurance and Financial Services, of the Company and of Principal Life since December 2003. Prior to that time, he served as Executive Vice President of the Company since April 2001, and Executive Vice President of Principal Life since January 2000. Mr. Aschenbrenner serves as a director of the Principal Mutual Funds.

Michael H. Gersie, 59, has been Executive Vice President and Chief Financial Officer of the Company since April 2001, and Executive Vice President and Chief Financial Officer of Principal Life since January 2000.

Daniel J. Houston, 46, was named Executive Vice President, Retirement and Investor Services, in June 2006. He has served as a Senior Vice President of Principal Life since 2000.

Ellen Z. Lamale, 54, has been Senior Vice President and Chief Actuary of the Company since April 2001, and Senior Vice President and Chief Actuary of Principal Life since June 1999.

Julia M. Lawler, 48, has been Senior Vice President and Chief Investment Officer of the Company and of Principal Life since July 2002. From 2000 - 2002, she was President of the Real Estate Equity Group of Principal Global Investors, LLC. From 1999 - 2000, she was Vice President Capital Markets.

James P. McCaughan, 54, who heads the Global Asset Management division of our operations, has been President, Global Asset Management of the Company and of Principal Life since December 2003. Prior to that time, he served as Executive Vice President and global head of asset management for the Company and Principal Life since April 2002. From 2000 - 2002, he was CEO of the Americas division of Credit Suisse Asset Management in New York, New York.

Mary A. O'Keefe, 51, who heads Corporate Relations and Strategic Development, has been Senior Vice President and Chief Marketing Officer of the Company and Principal Life since February 2005, Senior Vice President of the Company since April 2001, and Senior Vice President of Principal Life since January 1998.

Gary P. Scholten, 50, has been Senior Vice President and Chief Information Officer of the Company and Principal Life since November 2002. From 1998 - 2002, he was Vice President of retail information services of Principal Life.

Karen E. Shaff, 53, has been Executive Vice President and General Counsel of the Company and of Principal Life since February 2004. Prior thereto, she was Senior Vice President and General Counsel of the Company since April 2001, and Senior Vice President and General Counsel of Principal Life since January 2000.

Norman R. Sorensen, 62, has been President of Principal International, Inc. since 1998, Senior Vice President, International Asset Accumulation, of the Company since April 2001, and Senior Vice President of Principal Life since December 1998.

Larry D. Zimpleman, 56, has been President and Chief Operating Officer since June 2006 and oversees all of our global and domestic operations. He was President, Retirement and Investor Services of the Company and of Principal Life from December 2003 to June 2006. Prior thereto, he served as head of our International Asset Accumulation business since January 2003, our U. S. Asset Accumulation business since February 2002, and Executive Vice President of the Company and Principal Life since August 2001. Previously, Mr. Zimpleman was Senior Vice President of Principal Life from June 1999 August 2001. Mr. Zimpleman serves on the Company's Board and as Chairman of the Board and a director of the Principal Mutual Funds.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock began trading on the New York Stock Exchange ("NYSE") under the symbol "PFG" on October 23, 2001. Prior to such date, there was no established public trading market for our common stock. On February 20, 2008, there were 474,032 stockholders of record of our common stock.

The following table presents the high and low prices for our common stock on the NYSE for the periods indicated and the dividends declared per share during such periods.

	High	Low	Dividends
2007			
First quarter	**$ 64.17**	**$ 57.87**	
Second quarter	**$ 64.92**	**$ 56.56**	
Third quarter	**$ 63.24**	**$ 51.52**	
Fourth quarter	**$ 70.85**	**$ 60.55**	**$ 0.90**
2006			
First quarter	$ 50.72	$ 45.91	
Second quarter	$ 55.93	$ 48.51	
Third quarter	$ 56.47	$ 52.62	
Fourth quarter	$ 59.40	$ 53.75	$ 0.80

We declared an annual cash dividend of $0.90 per common share on October 29, 2007, and paid such dividend on December 7, 2007, to stockholders of record on the close of business on November 16, 2007. We declared an annual cash dividend of $0.80 per common share on November 7, 2006, and paid such dividend on December 15, 2006, to stockholders of record on the close of business on November 22, 2006. Future dividend decisions will be based on and affected by a number of factors, including our operating results and financial requirements and the impact of regulatory restrictions. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a discussion of regulatory restrictions on Principal Life's ability to pay us dividends.

The following table presents the amount of our share purchase activity for the periods indicated:

Issuer Purchases of Equity Securities

Period	Total Number of Shares (or Units) Purchased(1)	Average Price Paid per Share (or Unit)	Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs (in millions) (2)(3)(4)
January 1, 2007 January 31, 2007	**530,243**	**$ 59.80**	**530,243**	**$ 218.3**
February 1, 2007 February 28, 2007	**523,900**	**$ 62.86**	**523,900**	**$ 185.4**
March 1, 2007 March 31, 2007	**687,786**	**$ 60.40**	**588,131**	**$ 150.0**
April 1, 2007 April 30, 2007	**588**	**$ 60.23**		**$ 150.0**
May 1, 2007 May 31, 2007	**152,398**	**$ 61.10**	**152,000**	**$ 390.7**
June 1, 2007 June 30, 2007	**1,823,253**	**$ 59.55**	**1,822,600**	**$ 282.2**
July 1, 2007 July 31, 2007	**545,533**	**$ 59.01**	**545,343**	**$ 250.0**
August 1, 2007 August 31, 2007	**1,806,169**	**$ 55.37**	**1,806,000**	**$ 150.0**
September 1, 2007 September 30, 2007	**1,416,961**	**$ 56.43**	**1,416,961**	**$ 70.0**
October 1, 2007 October 31, 2007	**1,099,028**	**$ 63.75**	**1,098,439**	**$**
November 1, 2007 November 30, 2007	**2,917,645**	**$ 85.69(4)**	**2,917,380**	**$ 250.0**
December 1, 2007 December 31, 2007		**$**		**$ 250.0**
Total	**11,503,504**		**11,400,997**	

(1) The number of shares includes shares of common stock utilized to execute certain stock incentive awards in 2007: 99,655 shares in March, 588 shares in April, 398 shares in May, 653 shares in June, 190 shares in July, 169 shares in August, 589 shares in October and 265 shares in November.

(2) On November 28, 2006, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. This program was completed in July 2007. Under this program, we acquired 4.2 million shares in the open market at an aggregate cost of $250.0 million.

(3) On May 22, 2007, our Board of Directors authorized a repurchase program of up to $250.0 million of our outstanding common stock. This program was completed in October 2007. Under this program, we acquired 4.3 million shares in the open market at an aggregate cost of $250.0 million.

(4) During November 2007, our Board of Directors authorized a share repurchase program of up to $500.0 million of our outstanding common stock. On November 30, 2007, we entered into an accelerated common stock repurchase agreement with a third party investment bank for an aggregate purchase price of $250.0 million. On this date, we paid $250.0 million and received the initial delivery of 2.9 million common shares, while retaining the right to receive additional common shares depending on the volume weighted-average price for our common stock over the program's execution period. The program was completed in January 2008, at which time we received 0.9 million additional common shares under this agreement, which were not reflected in the average price. As of December 31, 2007, $250.0 million remained under the November 2007 authorization.

Item 6. Selected Financial Data

The following table sets forth certain selected historical consolidated financial information of Principal Financial Group, Inc. We derived the consolidated financial information (except for amounts referred to as "Other Supplemental Data") for each of the years ended December 31, 2007, 2006 and 2005 and as of December 31, 2007 and 2006 from our audited consolidated financial statements and notes to the financial statements included in this Form 10-K. We derived the consolidated financial information (except for amounts referred to as "Other Supplemental Data") for the years ended December 31, 2004 and 2003 and as of December 31, 2005, 2004 and 2003 from our audited consolidated financial statements not included in this Form 10-K. The following summary of consolidated financial information (except for amounts referred to as "Other Supplemental Data") has been prepared in accordance with U.S. GAAP.

In order to fully understand our consolidated financial information, you should also read Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited consolidated financial statements and the notes to the financial statements included in this Form 10-K. The results for past accounting periods are not necessarily indicative of the results to be expected for any future accounting period.

	As of or for the year ended December 31,				
	2007(1)	**2006(1)**	**2005(1)**	**2004**	**2003**
	($ in millions, except as noted)				
Income Statement Data:					
Revenues:					
Premiums and other considerations	**$ 4,634.1**	$ 4,305.3	$ 3,975.0	$ 3,710.0	$ 3,630.7
Fees and other revenues	**2,634.7**	1,902.5	1,717.8	1,491.7	1,196.5
Net investment income	**3,966.5**	3,620.6	3,358.0	3,223.6	3,228.1
Net realized/unrealized capital gains (losses)	**(328.8)**	44.7	(11.2)	(104.8)	(63.2)
Total revenues	**$ 10,906.5**	$ 9,873.1	$ 9,039.6	$ 8,320.5	$ 7,992.1
Income from continuing operations, net of related income taxes	**$ 840.1**	$ 1,035.4	$ 890.2	$ 700.6	$ 643.6
Income from discontinued operations, net of related income taxes(2)	**20.2**	28.9	28.8	130.7	106.1
Income before cumulative effect of accounting changes	**860.3**	1,064.3	919.0	831.3	749.7
Cumulative effect of accounting changes, net of related income taxes				(5.7)	(3.4)
Net income	**860.3**	1,064.3	919.0	825.6	746.3
Preferred stock dividends(3)	**33.0**	33.0	17.7		
Net income available to common stockholders	**$ 827.3**	$ 1,031.3	$ 901.3	$ 825.6	$ 746.3
Earnings per Share Data:					
Income from continuing operations, net of related income taxes, per share:					
Basic	**$ 3.04**	$ 3.67	$ 3.03	$ 2.24	$ 1.98
Diluted	**$ 3.01**	$ 3.64	$ 3.01	$ 2.23	$ 1.97
Net income per share:					
Basic	**$ 3.12**	$ 3.78	$ 3.13	$ 2.64	$ 2.29
Diluted	**$ 3.09**	$ 3.74	$ 3.11	$ 2.62	$ 2.28
Common shares outstanding at year-end (in millions)	**259.1**	268.4	280.6	300.6	320.7

	As of or for the year ended December 31,				
Weighted-average common shares outstanding for the year (in millions)	**265.4**	272.9	287.9	313.3	326.0
Weighted-average common shares and potential common shares outstanding for the year for computation of diluted earnings per share (in millions)	**268.1**	275.5	289.9	314.7	326.8
Cash dividends per common share	**$ 0.90**	$ 0.80	$ 0.65	$ 0.55	$ 0.45

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	As of or for the year ended December 31,									
		2007(1)		**2006(1)**		**2005(1)**		**2004**		**2003**
					($ in millions, except as noted)					
Balance Sheet Data:										
Total assets	**$**	**154,520.2**	$	143,658.1	$	127,035.4	$	113,798.3	$	107,754.4
Long-term debt	**$**	**1,398.8**	$	1,511.3	$	855.7	$	799.8	$	1,330.1
Series A preferred stock	**$**		$		$		$		$	
Series B preferred stock		**0.1**		0.1		0.1				
Common stock		**3.9**		3.8		3.8		3.8		3.8
Additional paid-in capital		**8,295.4**		8,141.8		8,000.0		7,269.4		7,153.2
Retained earnings		**3,414.3**		2,824.1		2,008.6		1,289.5		630.4
Accumulated other comprehensive income		**420.2**		846.9		994.8		1,313.3		1,171.3
Treasury stock, at cost		**(4,712.2)**		(3,955.9)		(3,200.1)		(2,331.7)		(1,559.1)
Total stockholders' equity	**$**	**7,421.7**	$	7,860.8	$	7,807.2	$	7,544.3	$	7,399.6
Other Supplemental Data:										
AUM ($ in billions)	**$**	**311.1**	$	256.9	$	195.2	$	167.0	$	144.3
Number of employees (actual)		**16,585**		15,289		14,507		13,976		14,976

(1)
For a discussion of items materially affecting the comparability of 2007, 2006 and 2005, please see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Transactions Affecting Comparability of Results of Operations."

(2)
See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 3, Discontinued Operations" for a description of our discontinued operations for 2007, 2006 and 2005. For each of the years ended December 31, 2004 and 2003, income from discontinued operations related to our sale of Principal Residential Mortgage, Inc., the sale of our Argentine companies and operating revenues of real estate properties that qualify for discontinued operations treatment. In addition, income from discontinued operations for the year ended December 31, 2003, related to our sale of BT Financial Group.

(3)
On June 16, 2005, we issued 13.0 million shares of non-cumulative perpetual preferred stock under our shelf registration. We declared preferred stock dividends of $33.0 million in 2007 and 2006 and $17.7 million in 2005.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of December 31, 2007, compared with December 31, 2006, and our consolidated results of operations for the years ended December 31, 2007, 2006 and 2005, and, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our audited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-K.

Forward-Looking Information

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

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

Overview

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

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

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

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

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

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

Economic Factors and Trends

Modest results in the equity markets along with an increase in net cash flow have led to increases in asset accumulation's account values and our asset management's AUM. The credit market disruptions and market illiquidity experienced during the second half of 2007 resulted in an increase in our realized and unrealized capital losses.

In our International Asset Management and Accumulation segment, we continued to grow our existing business through organic growth in our existing subsidiaries and a combination of joint ventures and strategic acquisitions.

Over the past few years, we have shifted our marketing emphasis to universal and variable universal life insurance products from traditional life insurance products in our Life and Health segment. We are also in the early stages of a trend toward voluntary individual life insurance and specialty benefit products sponsored by employers. Our health insurance business has become less competitive, which has led to declines in covered members.

Profitability

Our profitability depends in large part upon our:

- amount of AUM;
- spreads we earn on our policyholders' general account asset accumulation business that result from the difference between what we earn and what we credit;
- ability to generate fee revenues by providing administrative and investment management services;
- ability to price our life and health insurance products at a level that enables us to earn a margin over the cost of providing benefits and the related expenses;
- ability to manage our investment portfolio to maximize investment returns and minimize risks such as interest rate changes or defaults or impairments of invested assets;
- ability to effectively hedge fluctuations in foreign currency to U.S. dollar exchange rates on certain transactions; and
- ability to manage our operating expenses.

Critical Accounting Policies and Estimates

The increasing complexity of the business environment and applicable authoritative accounting guidance requires us to closely monitor our accounting policies. Our significant accounting policies are described in Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies." We have identified five critical accounting policies that are complex and require significant judgment and estimates about matters that are inherently uncertain. A summary of our critical accounting policies is intended to enhance the reader's ability to assess our financial condition and results of operations and the potential volatility due to changes in estimates and changes in guidance. The identification, selection and disclosure of critical accounting estimates and policies have been discussed with the Audit Committee of the Board of Directors.

Valuation of Invested Assets

Fixed Maturities, Available-for-Sale. Fixed maturity securities include bonds, mortgage-backed securities and redeemable preferred stock. We classify our fixed maturity securities as either available-for-sale or trading and, accordingly, carry them at fair value in the statement of financial position. The fair values of our public fixed maturity securities are based on quoted market prices or estimates from independent pricing services. However, 24% of our invested asset portfolio is invested in fixed maturity securities that are private market assets, where there are no readily available market quotes to determine the fair market value. These assets are valued using a spread pricing matrix. Securities are grouped into pricing categories that vary by asset class, sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data or market clearing data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors. Certain market events that could impact the valuation of securities include issuer credit ratings, business climate, management changes, litigation and government actions among others.

Over the past several months, we have seen credit market disruption as the result of widening spreads and illiquid markets. These market conditions have been particularly hard on structured investment transactions where we rely on broker quotes or internal pricing models given the thinly traded markets (approximately 5% of the fixed maturity securities portfolio). We have received broker quotes that are outside a normal range for historical spreads and, in our view, are conservative given the quality of the underlying cash flows. Analysis has been performed to reconcile these external values to our view of the transaction. We view these broker quotes as conservative and at the low end of a reasonable range, and attribute the decreased values to the overall market conditions.

An interest rate increase in the range of 20 to 100 basis points, while holding credit spreads constant, produces total values of $40.2 billion to $38.6 billion, as compared to the recorded amount of $40.5 billion related to our fixed maturity, available-for-sale assets held by the Principal Life general account as of December 31, 2007. This portfolio has a weighted average life of 7 years. An analysis of historical changes in the 7-year Treasury rate supports our belief that an interest rate change of 20 to 100 basis points is reasonably likely.

Investments classified as available-for-sale are subject to impairment reviews. When evaluating a fixed maturity security for impairment, we consider relevant facts and circumstances in evaluating whether a credit or interest-related impairment 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) our ability and intent to hold the security for a period of time that allows for the recovery of value which, in some cases, may extend to maturity. When it is determined that the decline in value is other than temporary the carrying value of the security is reduced to its fair value, with a corresponding charge to net income. The corresponding charge is referred to as an other-than-temporary impairment and is reported in net income in our consolidated statement of operations.

There are a number of significant risks and uncertainties inherent in the process of monitoring impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer; (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated; (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers; and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to hold the security until it recovers in value. Any of these situations could result in a charge to net income in a future period. At December 31, 2007, we had $19,990.4 million in available-for-sale fixed maturity securities with gross unrealized losses totaling $1,187.6 million. Included in the gross unrealized losses are losses attributable to both movements in market interest rates as well as temporary credit issues. Net income would be reduced by approximately $1,187.6 million, on a pre-tax basis, if all the securities were deemed to be other than temporarily impaired.

Mortgage Loans. Mortgage loans consist primarily of commercial mortgage loans on real estate. At December 31, 2007, commercial mortgage loans aggregated to $10,763.5 million. Commercial mortgage loans are generally reported at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances. Commercial mortgage loans held for sale are carried at the lower of cost or fair value, less cost to sell, and reported as mortgage loans in the statements of financial position.

Commercial mortgage loans on real estate are considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine that a loan is impaired, a valuation allowance is established for the difference between the carrying amount of the mortgage loan and the estimated value. Estimated value is based on either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or fair value of the collateral. The change in valuation allowance is reported in net income on our consolidated statements of operations.

The determination of the calculation and the adequacy of the mortgage loan allowance and mortgage impairments are subjective. Our periodic evaluation and assessment of the adequacy of the allowance for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. The calculation for determining loan specific impairment amounts is also subjective, as it requires estimating the amounts and timing of future cash flows expected to be received on impaired loans. Our financial position is sensitive to changes in estimated cash flows from mortgages, the value of the collateral and changes in the economic environment in general. The allowance for losses can be expected to increase when economic conditions worsen and decrease when economic conditions improve.

We have a large experienced commercial real estate staff centrally located in Des Moines, which includes commercial mortgage underwriters, loan closers, loan servicers, engineers, appraisers, credit analysts, research staff, legal staff, information technology personnel and portfolio managers. Experienced commercial real estate senior management adheres to a disciplined process in reviewing all transactions for approval on a consistent basis. The typical commercial mortgage loan for us averages in the mid-60 percent loan-to-value range at origination with a net operating income coverage ratio of 1.7 times the annual debt service and is internally rated A- on a bond equivalent basis. Based on the most recent analysis, our commercial mortgage portfolio has an overall loan-to-value ratio of 59% with a 1.9 times debt service coverage. The large equity cushion and strong debt service coverage in our commercial mortgage investments will help insulate us from stress during times of weak commercial real estate fundamentals.

Deferred Policy Acquisition Costs and Other Actuarial Balances

Commissions and other costs (underwriting, issuance and agency expenses) that vary with and are primarily related to the acquisition of new and renewal insurance policies and investment contract business are capitalized to the extent recoverable. Maintenance costs and acquisition costs that are not deferrable are charged to operations as incurred.

Amortization Based on Estimated Gross Profits. DPAC for universal life-type insurance contracts, participating life insurance policies and certain investment contracts are amortized over the expected lifetime of the policies in relation to estimated gross profits. In addition to DPAC, the following actuarial balances are also amortized in relation to estimated gross profits or contract assessments.

Sales inducement asset Sales inducements are amounts that are credited to the contractholder's account balance as an inducement to increase sales. Like DPAC, the cost of the sales inducement is capitalized and amortized over the expected life of the contract, in proportion to estimated gross profits.

Unearned revenue liability An unearned revenue liability is established when we collect fees or other policyholder assessments that represent compensation for services to be provided in future periods. These revenues are deferred and then amortized over the expected life of the contract, in proportion to estimated gross profits.

Reinsurance asset or liability For universal-life type products that are reinsured, a reinsurance asset or liability is established to spread the net reinsurance costs or profits in proportion to the estimated gross profits on the underlying business.

Present value of future profits ("PVFP") This is an intangible asset that arises in connection with the acquisition of a life insurance company. PVFP is amortized over the expected life of the contracts acquired, in proportion to estimated gross profits.

Additional benefit reserves These are additional liabilities that are established for annuity or universal life-type contracts that provide benefit guarantees, or for contracts that are expected to produce profits followed by losses. The liabilities are accrued in relation to estimated contract assessments.

At issue and each valuation date, we develop an estimate of the expected future gross profits. These estimated gross profits contain assumptions relating to mortality, morbidity, investment yield and expenses. As actual experience emerges, the gross profits may vary from those expected either in magnitude or timing in which case a true-up to actual occurs as a charge or credit to current operations. In addition, we are required to revise our assumptions regarding future experience as soon as the current assumptions are no longer actuarially credible. Both actions, reflecting actual experience and changing future estimates, can change both the current amount and the future amortization pattern of the DPAC asset and related actuarial balances.

For individual variable annuities and group annuities which have separate account equity investment options, we utilize a mean reversion method (reversion to the mean assumption), a common industry practice, to determine the future domestic equity market growth rate assumption used for the calculation of estimated gross profits. If actual equity market performance varies from the 8% assumption, we assume different performance levels over the next 30 quarters such that the mean return equals the long-term assumption. However, our mean reversion process generally limits assumed returns to 4-12% during the 30-quarter mean reversion period.

Internal Replacements. We review polices for modifications that result in the exchange of an existing contract for a new contract. If the new contract is determined to be an internal replacement that is substantially changed from the replaced contract, any unamortized DPAC and actuarial balances are written off and acquisition costs related to the new contract are capitalized as appropriate. If the new contract is substantially unchanged, we continue to amortize the related DPAC and actuarial balances.

Recoverability. DPAC and sales inducement assets are subject to recoverability testing at the time of policy issue and loss recognition testing on an annual basis, or when an event occurs that may warrant loss recognition. Likewise, PVFP is subject to impairment testing on an annual basis, or when an event occurs that may warrant impairment. If loss recognition or impairment is necessary, the asset balances are written off to the extent that it is determined that future policy premiums and investment income or gross profits are not adequate to cover related losses and expenses.

Sensitivities. As of December 31, 2007, the net balance of DPAC and related actuarial balances was a $3,014.7 million asset. We perform sensitivity analyses to assess the impact that certain assumptions have on our DPAC and related actuarial balances. The following table shows the estimated immediate impact of various assumption changes on our DPAC and related actuarial balances.

	Estimated impact to net income(1)
	(in millions)
Reducing the future equity return assumption by 1%	$ (10.4)
Removing the mean reversion methodology from the estimated gross profit calculation	$ (0.4)
A one-time, 10% drop in equity market values	$ (12.5)
Increasing all future lapse rate assumptions by 10% of the baseline assumption (2)	$ (22.9)

(1) Reflects the net impact of changes to the DPAC asset, sales inducement asset, unearned revenue liability, reinsurance asset or liability, PVFP and additional benefit reserves.

(2) This calculation reflects an increase in lapse rates only for products where increasing the lapse rate leads to a write-down of the DPAC asset. Lapse rates were left unchanged for those products where an increase in lapse rates would lead to a write-up of the DPAC asset.

Amortization Based on Premium-paying Period. DPAC of non-participating term life and individual disability insurance policies are amortized over the premium-paying period of the related policies using assumptions consistent with those used in computing policyholder liabilities. Once these assumptions are made for a given policy or group of policies, they will not be changed over the life of the policy unless a loss recognition event occurs.

Insurance Reserves

Reserves are liabilities representing estimates of the amounts that will come due, at some point in the future, to or on behalf of our policyholders. U.S. GAAP, allowing for some degree of managerial judgment, prescribes the methods of establishing reserves.

Future policy benefits and claims include reserves for traditional and group life insurance, accident and health insurance and individual and group annuities that provide periodic income payments, which are computed using assumptions of mortality, morbidity, lapse, investment performance and expense. These assumptions are based on our experience and are periodically reviewed against industry standards to ensure actuarial credibility. For long duration insurance contracts, once these assumptions are made for a given policy or group of policies, they will not be changed over the life of the policy. However, significant changes in experience or assumptions may require us to provide for expected future losses on a product by establishing premium deficiency reserves. Premium deficiency reserves may also be established for short duration contracts to provide for expected future losses. Our reserve levels are reviewed throughout the year using internal analysis including, among other things, experience studies, claim development analysis and annual statutory asset adequacy analysis. To the extent experience indicates potential loss recognition, we recognize losses on certain lines of business. The ultimate accuracy of the assumptions on these long-tailed insurance products cannot be determined until the obligation of the entire block of business on which the assumptions were made is extinguished. Short-term variances of actual results from the assumptions used in the computation of the reserves are reflected in current period net income and can impact quarter-to-quarter net income.

Future policy benefits and claims also include reserves for incurred but unreported health, disability and life insurance claims. We recognize claims costs in the period the service was provided to our policyowners. However, claims costs incurred in a particular period are not known with certainty until after we receive, process and pay the claims. We determine the amount of this liability using actuarial methods based on historical claim payment patterns as well as emerging medical cost trends, where applicable, to determine our estimate of claim liabilities. We also look back to assess how our prior periods' estimates developed. To the extent appropriate, changes in such development are recorded as a change to current period claim expense. Historically, the amount of the claim reserve adjustment made in subsequent reporting periods for prior period estimates was within a reasonable range given our normal claim fluctuations.

Benefit Plans

The reported expense and liability associated with pension and other postretirement benefit plans requires the use of assumptions. Numerous assumptions are made regarding the discount rate, expected long-term rate of return on plan assets, turnover, expected compensation increases, health care claim costs, health care cost trends, retirement rates and mortality. The discount rate and the expected return on plan assets have the most significant impact on the level of cost.

The assumed discount rate is determined by projecting future benefit payments inherent in the Projected Benefit Obligation and discounting those cash flows using a spot yield curve known as the Citigroup Pension Discount Curve. This curve is constructed from the Treasury curve by adding option-adjusted spreads that are drawn from the double-A corporate sector of the Salomon Broad Investment-Grade Bond Index. The bonds with excessive call exposure are excluded, as are securities with option-adjusted spreads that are more than two standard deviations away from the preliminary average. The final spreads are determined using this call-protected sample of double-A corporate bonds. Based on this methodology for 2007 year-end, we set the discount rate at 6.30%. A 0.25% decrease in the discount rate would increase pension benefits Projected Benefit Obligation and the 2008 Net Periodic Pension Cost ("NPPC") by approximately $61.4 million and $9.3 million, respectively. A 0.25% decrease in the discount rate would increase other post-retirement benefits Accumulated Postretirement Benefit Obligation and the 2008 Net Periodic Benefit Cost ("NPBC") by approximately $8.3 million and $0.7 million, respectively. A 0.25% increase in the discount rate would result in decreases in benefit obligations and expenses at a level generally commensurate with those noted above.

The assumed long-term rate of return on plan assets is set at the long-term rate expected to be earned based on the long-term investment policy of the plans and the various classes of the invested funds. Historical and future expected returns of multiple asset classes were analyzed to develop a risk-free real rate of return and risk premiums for each asset class. The overall long-term rate for each asset class was developed by combining a long-term inflation component, the risk free real rate of return and the associated risk premium. A weighted average rate was developed based on long-term returns for each asset class, the plan's target asset allocation policy and the tax structure of the trusts. For the 2007 NPPC and 2007 NPBC, an 8.25% and 7.3% weighted average long-term rate of return was used, respectively. For the 2008 NPPC and 2008 NPBC, an 8.25% and 7.3% weighted average long-term rate of return assumption will be used, respectively. A 0.25% decrease in the assumed long-term rate of return would increase 2008 NPPC by approximately $3.9 million and the 2008 NPBC by approximately $1.3 million. A 0.25% increase in this rate would result in a decrease to expense at the same levels. The assumed return on plan assets is based on the fair market value of plan assets as of September 30, 2007.

The compensation increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation.

Actuarial gains and losses are amortized using a straight-line amortization method over the average remaining service period of employees, which is approximately 8 years for pension costs and approximately 13 years for other postretirement benefit costs.

Prior service costs are amortized on a weighted average basis over approximately 7 years for both pension and other postretirement benefit costs.

Income Taxes

We provide for income taxes based on our estimate of the liability for taxes due. Our tax accounting represents management's best estimate of various events and transactions, such as completion of tax audits, which could have an impact on our estimates and effective tax rate in a particular quarter or annual period.

Inherent in the provision for income taxes are estimates regarding the deductibility of certain items, the timing of income and expense recognition and the realization of certain tax credits. In the event our estimates of the ultimate deductibility of certain items, the timing of the recognition of income and expense or the realization of certain tax credits differ from prior estimates due to the receipt of new information, we may be required to significantly change the provision for income taxes recorded in the consolidated financial statements. Any such change could significantly affect the amounts reported in the consolidated financial statements in the year these estimates change.

In addition, the amount of income taxes paid is subject to audits in various jurisdictions. Tax benefits are recognized for book purposes when the more-likely-than-not threshold is met with regard to the validity of the tax position. Once this threshold is met, for each tax reporting issue, we provide for the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement with the IRS and other income taxing authorities for audits ongoing or not yet commenced. We believe that we have adequate defenses against, or sufficient provisions for, the contested issues, but final resolution of contested issues could take several years while legal remedies are pursued. Consequently, we do not anticipate the ultimate resolution of audits ongoing or not yet commenced to have a material impact on our net income.

Transactions Affecting Comparability of Results of Operations

Acquisitions

We acquired the following businesses, among others, during the past three years:

Morley Financial Services, Inc. On August 31, 2007, we acquired Morley Financial Services, Inc. ("Morley Financial Services") from Nationwide Mutual Insurance Company, for $75.0 million in cash, subject to closing adjustments. Morley Financial Services is a stable value asset manager with approximately $14.0 billion in institutional AUM as of August 31, 2007. The operations of Morley Financial Services are reported and consolidated in our Global Asset Management segment.

WM Advisors, Inc. On December 31, 2006, we acquired WM Advisors, Inc. and its subsidiaries from Washington Mutual, Inc. for a total cost of $741.1 million in cash at the time of closing. As of December 31, 2006, WM Advisors, Inc. had approximately $28.0 billion in AUM and provided investment advisory services to mutual funds, variable trust funds and asset allocation portfolios to approximately 800,000 shareholder accounts nationwide. The operations of WM Advisors, Inc. are reported and consolidated in our U.S. Asset Accumulation and Global Asset Management segments.

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

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

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

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

Dispositions

We entered into disposition agreements or disposed of the following businesses, among others, during the past three years:

Principal Dental Services, Inc. Effective July 1, 2006, we sold five dental offices which were substantially all of the assets of Dental Net Group, one component of Principal Dental Services, Inc. The realized gain was reported in our Life and Health segment.

ING/Principal Pensions Company Ltd. On May 26, 2005, we announced jointly with our partner, ING, the intent to liquidate the ING/Principal Pensions Company, Ltd. operation in Japan. On December 20, 2005, the liquidation process was completed with a formal liquidation filing to the Japanese corporate registry. The results of ING/Principal Pensions Company Ltd. were reported in our International Asset Management and Accumulation segment.

Discontinued Operations. For divestitures that qualify for discontinued operations treatment, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 3, Discontinued Operations."

Other

SBB Mutual Berhad and SBB Asset Management Sdn Bhd. On February 5, 2007, we invested an additional RM$192.4 million Malaysian ringgits ("RM$") (approximately U.S. $55.1 million) to retain our 40% ownership interest in CIMB-Principal, our joint venture company in Malaysia, as a result of its decision to purchase the mutual fund and asset management companies of the former Southern Bank Bhd ("SBB") Mutual Berhad and SBB Asset Management Sdn Bhd.

Senior Note Issuance. During fourth quarter 2006, we issued $600.0 million of senior notes from our shelf registration, which became effective on June 30, 2004. The notes bear interest at a rate of 6.05% per year. Interest on the notes is payable semi-annually on April 15 and October 15, and began on April 15, 2007. The notes will mature on October 15, 2036. A portion of the proceeds was used to fund the acquisition of WM Advisors, Inc., with the remaining proceeds being used for general corporate purposes.

Principal Reinsurance Company of Vermont. In November 2006, Principal Life established a wholly owned reinsurance subsidiary, Principal Reinsurance Company of Vermont ("PVT"), which reinsures a portion of our universal life

"secondary" or "no-lapse" guarantee provisions through an intercompany reinsurance agreement with Principal Life. Effective June 30, 2007, we amended our reinsurance agreement with PVT to include in force and future policy issuances of a current term insurance product. The reinsurance agreement, which was accompanied with a third party letter of credit issued to PVT and guaranteed by PFG, allowed us to redeploy capital for other general corporate purposes.

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

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

Foreign currency exchange rate fluctuations create variances in our financial statement line items but have not had a material impact on our consolidated income from continuing operations. Our consolidated income from continuing operations was positively impacted $5.9 million, $5.4 million and $7.1 million for the years ended December 31, 2007, 2006 and 2005, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates for our foreign operations. For a discussion of our approaches to foreign currency exchange rate risk, see Item 7A. "Quantitative and Qualitative Disclosures about Market Risk."

Stock-Based Compensation Plans

For information related to our Stock-Based Compensation Plans, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 20, Stock-Based Compensation Plans."

Defined Benefit Pension and 401(k) Expense

Effective January 1, 2006, we made changes to our retirement program, including the Principal Select Savings Plan ("401(k)") and the Principal Pension Plan ("Pension Plan") and the corresponding nonqualified plans. The qualified and nonqualified Pension Plans' changes include a reduction to the traditional and cash balance formulas, a change in the early retirement factors and the removal of the cost of living adjustments for traditional benefits earned after January 1, 2006. The qualified and nonqualified 401(k) Plans' company match increased from 50% of a contribution rate up to a maximum 3% of the participant's compensation to 75% of a contribution rate up to a maximum of 6% of the participant's compensation. Employees who were 47 years old, with a minimum of ten years of service as of December 31, 2005, were given the choice to remain under the current pension and 401(k) arrangement or move to the new plan design. The Pension Plan changes reduced the Pension Plan expense in 2006, while the 401(k) changes increased the 401(k) expense.

The 2007 annual pension benefit expense for substantially all of our employees and certain agents was $24.0 million pre-tax, which was a $10.6 million decrease from the 2006 pre-tax pension expense of $34.6 million. This decrease is primarily due to the increase in discount rate. The discount rate used to develop the 2007 expense was raised to 6.15%, up from the 5.75% discount rate used to develop the 2006 expense. The expected long-term return on plan assets assumption remained at 8.25%.

The 2008 annual pension benefit expense for substantially all of our employees and certain agents is expected to be $12.3 million pre-tax, which is an $11.7 million decrease from the 2007 pre-tax pension expense of $24.0 million. This decrease is due to the increase in discount rate and greater than estimated returns on plan assets. The discount rate used to develop the 2008 expense was raised to 6.3%, up from the 6.15% discount rate used to develop the 2007 expense. The long-term asset assumption remained at 8.25%.

Recent Accounting Changes

For recent accounting changes, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies."

Results of Operations

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

	For the year ended December 31,			Increase (decrease)	
	2007	**2006**	**2005**	**2007 vs. 2006**	**2006 vs. 2005**
			(in millions)		
Revenues:					
Premiums and other considerations	**$ 4,634.1**	$ 4,305.3	$ 3,975.0	$ 328.8	$ 330.3
Fees and other revenues	**2,634.7**	1,902.5	1,717.8	732.2	184.7
Net investment income	**3,966.5**	3,620.6	3,358.0	345.9	262.6
Net realized/unrealized capital gains (losses)	**(328.8)**	44.7	(11.2)	(373.5)	55.9
Total revenues	**10,906.5**	9,873.1	9,039.6	1,033.4	833.5
Expenses:					
Benefits, claims and settlement expenses	**6,435.3**	5,692.4	5,282.9	742.9	409.5
Dividends to policyholders	**293.8**	290.7	293.0	3.1	(2.3)
Operating expenses	**3,129.2**	2,558.7	2,342.1	570.5	216.6
Total expenses	**9,858.3**	8,541.8	7,918.0	1,316.5	623.8
Income from continuing operations before income taxes	**1,048.2**	1,331.3	1,121.6	(283.1)	209.7
Income taxes	**208.1**	295.9	231.4	(87.8)	64.5
Income from continuing operations, net of related income taxes	**840.1**	1,035.4	890.2	(195.3)	145.2
Income from discontinued operations, net of related income taxes	**20.2**	28.9	28.8	(8.7)	0.1
Net income	**860.3**	1,064.3	919.0	(204.0)	145.3
Preferred stock dividends	**33.0**	33.0	17.7		15.3
Net income available to common stockholders	**$ 827.3**	$ 1,031.3	$ 901.3	$ (204.0)	$ 130.0

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Net Income Available to Common Stockholders

Net income available to common stockholders for the year ended December 31, 2007, includes $184.6 million of after-tax realized capital losses related to impairments of fixed maturity and equity securities compared to after-tax realized capital losses of $6.2 million for the year ended December 31, 2006. Excluding the impacts of impairments and increased realized/unrealized capital losses associated with derivative activity, net income available to common stockholders increased $28.7 million, as increased earnings in the U.S. Asset Accumulation, International Asset Management and Accumulation and Global Asset Management segments were partially offset by decreases within the Life and Health and Corporate and Other segments. See segment discussion for more details.

Total Revenues

Premiums increased $248.5 million for the U.S. Asset Accumulation segment primarily due to an increase in single premium group annuity sales within our full service payout business and an increase in our individual payout annuities business primarily relating to increased sales from certain distribution channels. In addition, Life and Health Insurance segment premiums increased $72.9 million primarily due to growth in our specialty benefits business.

Fees increased $590.7 million for our U.S. Asset Accumulation segment due to higher management and distribution fees for Principal Funds stemming from an increase in average account values resulting from our December 31, 2006, acquisition of WM Advisors, Inc. In addition, fees from our full service accumulation business increased due to a comprehensive assumption study that was completed during the third quarter 2007 which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the recognition of previously deferred revenue.

Net investment income increased due to a $3,376.8 million increase in average invested assets and cash and an increase in the annualized investment yield. The yield on average invested assets and cash was 6.2% for the year ended December 31, 2007, compared to 6.0% for the year ended December 31, 2006.

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

Total Expenses

Benefits, claims and settlement expenses increased $416.4 million for the U.S. Asset Accumulation segment, primarily due to an increase in reserves related to higher sales of individual payout annuities and higher cost of interest credited related to a growing block in our individual annuities business. In addition, in full service payout, benefit reserves and expense increased primarily due to strong single premium group annuity sales. Benefits, claims and settlement expenses also increased $201.1 million for the Life and Health Insurance segment, primarily due to growth in our specialty benefits business and due to higher medical costs and unfavorable prior year claim development in our health insurance business.

U.S. Asset Accumulation operating expenses increased $461.4 million, primarily due to an increase within Principal Funds relating to higher costs associated with an increase in staff and infrastructure needed to support the growth in the business and the impact from the WM Advisors, Inc. acquisition. In addition, a $108.6 million increase from the Global Asset Management segment, primarily in our fee mandate business, was due to continued growth in staff and staff related costs as a result of continued growth in AUM and the acquisitions of Edge Asset Management and Morley Financial Services.

Income Taxes

The effective income tax rates were 20% and 22% for the years ended December 31, 2007 and 2006, respectively. The effective income tax rate for the year ended December 31, 2007 was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income. The effective income tax rate for the year ended December 31, 2006 was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and tax refinements in Mexico and Chile.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Net Income Available to Common Stockholders

Net income available to common stockholders for our U.S. Asset Accumulation segment increased $69.3 million as solid investment performance and strong net cash flows drove a similar increase in account values within our full service accumulation, individual annuities and Principal Funds businesses. In addition, net income available to common stockholders for our Global Asset Management segment increased $27.1 million as solid investment performance and strong net cash flows increased AUM within our fee mandate business. The Corporate and Other segment's net income available to common stockholders increased $18.6 million primarily due to a gain on the sale of stock of an equity method investment, gains on sales of invested assets largely due to real estate properties and a prior year other than temporary impairment of an equity partnership interest. These increases are offset in part by a change in income tax reserves and associated interest established for IRS tax matters and higher preferred stock dividends as a result of issuing preferred stock in June 2005.

Total Revenues

Premiums increased $331.6 million for the Life and Health segment primarily due to growth in our health insurance and specialty benefits businesses.

Fees increased $155.7 million for our U.S. Asset Accumulation segment due to higher account values for our full service accumulation and Principal Funds businesses.

Net investment income increased due to a $2,333.2 million increase in average invested assets and cash and an increase in the annualized investment yield. The yield on average invested assets and cash was 6.0% for the year ended December 31, 2006, compared to 5.8% for the year ended December 31, 2005.

Net realized/unrealized capital gains (losses) can be volatile due to mark to market adjustments of certain invested assets, our decision to sell appreciated invested assets and other than temporary impairments of invested assets. Net realized/unrealized capital gains increased primarily due to a $44.3 million gain due to the sale of stock of an equity method investment in 2006. For additional information, see "Investments Investment Results."

Total Expenses

Benefits, claims and settlement expenses increased $290.1 million for the Life and Health Insurance segment, primarily due to growth in the our health insurance and specialty benefits businesses. In addition, benefits, claims and settlement expenses increased $130.9 million for the U.S. Asset Accumulation segment, primarily due to an increase in reserves related to higher sales of individual payout annuities and higher cost of interest credited related to a growing block in our individual annuities and investment only businesses.

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U.S. Asset Accumulation operating expenses increased $103.7 million, primarily due to growth in our full service accumulation and individual annuities businesses. The increase in operating expenses was also due to a $39.7 million increase from the Life and Health Insurance segment primarily resulting from growth in our health insurance and specialty benefits businesses partially offset by lower DPAC amortization from the individual life business. In addition, the increase reflected a $33.4 million increase from the Global Asset Management segment, primarily due to continued growth in AUM and an expansion of our U.S. institutional sales function within our fee mandate business and the transition to our joint venture with U.S. Bank.

Income Taxes

The effective income tax rates were 22% and 21% for the years ended December 31, 2006 and 2005, respectively. The effective income tax rate for the year ended December 31, 2006 was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, interest exclusion from taxable income and tax refinements in Mexico and Chile. The effective income tax rate for the year ended December 31, 2005 was lower than the U.S. corporate income tax rate of 35% primarily due to income tax deductions allowed for corporate dividends received, tax credits on our investment in a synthetic fuel production facility and interest exclusion from taxable income.

Results of Operations by Segment

For results of operations by segment see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 19, Segment Information."

U.S. Asset Accumulation Segment

U.S. Asset Accumulation Segment Summary Financial Data

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

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

	For the year ended December 31,		
	2007	**2006**	**2005**
		(in billions)	
Account values, beginning of period	**$ 163.3**	$ 120.3	$ 108.6
Net cash flow	**6.7**	6.9	4.9
Credited investment performance	**10.3**	13.0	7.7
Other	**0.5**	23.1(1)	(0.9)
Account values, end of period	**$ 180.8**	$ 163.3	$ 120.3

(1) Includes $22.5 billion relating to the December 31, 2006, acquisition of WM Advisors, Inc.

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

	For the year ended December 31,			Increase (decrease)	
	2007	**2006**	**2005**	**2007 vs. 2006**	**2006 vs. 2005**
			(in millions)		
Operating revenues:					
Premiums and other considerations	**$ 710.8**	$ 462.3	$ 455.2	$ 248.5	$ 7.1
Fees and other revenues	**1,691.4**	1,105.9	960.7	585.5	145.2
Net investment income	**2,748.0**	2,538.8	2,371.7	209.2	167.1
Total operating revenues	**5,150.2**	4,107.0	3,787.6	1,043.2	319.4
Expenses:					
Benefits, claims and settlement expenses, including dividends to policyholders	**2,812.6**	2,392.1	2,265.3	420.5	126.8
Operating expenses	**1,510.1**	1,040.8	935.7	469.3	105.1
Total expenses	**4,322.7**	3,432.9	3,201.0	889.8	231.9
Operating earnings before income taxes	**827.5**	674.1	586.6	153.4	87.5
Income taxes	**171.7**	131.5	122.2	40.2	9.3
Operating earnings	**$ 655.8**	$ 542.6	$ 464.4	$ 113.2	$ 78.2

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Operating Earnings

Full service accumulation operating earnings increased $68.1 million primarily due to an increase in account values stemming from solid investment performance and strong net cash flows. In addition, the 2007 results benefited from the third quarter 2007 completion of a comprehensive assumption study, which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the recognition of an operating earnings benefit of $30.1 million after-tax. Principal Funds operating earnings increased $23.4 million primarily due to higher net commission income and management fees stemming from an increase in sales and an increase in average account values.

Operating Revenues

Premiums in our full service payout business increased $140.0 million primarily due to an increase in single premium group annuity sales. The single premium group annuity product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. Premiums in our individual payout annuities business increased $108.5 million primarily due to increased sales from certain distribution channels.

Fees in our Principal Funds business increased $346.0 primarily due to higher management and distribution fees stemming from an increase in average account values resulting from our December 31, 2006, acquisition of WM Advisors, Inc. Fees in our full service accumulation business increased $208.6 million primarily due to a comprehensive assumption study that was completed during the third quarter 2007, which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the recognition of previously deferred revenue. Higher fees generated from the increase in account values also contributed to the increase.

Net investment income increased primarily due to a $3,097.4 million increase in average invested assets and cash. Average annualized yield on invested assets and cash, was 5.8% for both the years ended December 31, 2007 and 2006.

Total Expenses

Benefits, claims and settlement expenses increased $195.9 million within our individual annuities business primarily due to an increase in reserves related to higher sales of individual payout annuities. Also, as a result of a growing block of individual annuities, cost of interest credited on fixed deferred annuities increased. In addition, in full service payout, benefit reserves and expense increased $141.9 million, primarily due to strong single premium group annuity sales. Furthermore, our investment only business increased $81.9 million primarily due to an increase in cost of interest credited on this block of business resulting from an increase in account values and higher crediting rates.

Operating expenses increased $305.5 million within Principal Funds primarily due to higher costs associated with an increase in staff and infrastructure needed to support the growth in the business and the impact from the WM Advisors, Inc. acquisition. Operating expenses in our full service accumulation business increased $120.9 million primarily due to a comprehensive assumption study that was completed during the third quarter, which resulted in the unlocking of our unearned revenue and DPAC assumptions and led to the recognition of previously deferred expenses. Also contributing to the increase was growth in the business, which drove increases in staff related costs and management fees paid.

Income Taxes

The effective income tax rates for the segment were 21% and 20% for the years ended December 31, 2007 and 2006, respectively. The effective income tax rates were lower than the U.S. corporate income tax rate of 35%, primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Earnings

Full service accumulation and individual annuities operating earnings increased $43.9 million and $12.7 million, respectively, as solid investment performance and strong net cash flows drove a similar increase in account values for each of these businesses. In addition, earnings within Principal Funds increased $9.1 million primarily due to growth in account values. Also contributing to the increase was higher net commission income stemming from an increase in sales within Principal Funds.

Operating Revenues

Premiums in our individual payout annuities business increased $44.9 million primarily due to increased sales from certain distribution channels. Partially offsetting this increase was a $37.8 million decrease in premium from reduced single premium group annuity sales within our full service payout business.

Fees in our full service accumulation and Principal Funds businesses increased $98.9 million and $29.7 million, respectively, due to higher account values.

Net investment income increased primarily due to an increase in the average annualized yield on invested assets and cash, which was 5.8% for the year ended December 31, 2006, compared to 5.6% for the year ended December 31, 2005. In addition, a $1,962.4 million increase in average invested assets and cash contributed to the increase in net investment income.

Total Expenses

Benefits, claims and settlement expenses increased $82.6 million within our individual annuities business primarily due to an increase in reserves related to higher sales of individual payout annuities. In addition, as a result of a growing block of individual annuities, cost of interest credited on fixed deferred annuities increased. Furthermore, the investment only business increased $68.9 million as a result of higher cost of interest credited associated with the growing block of business and increased crediting rates. These increases were partially offset by a $35.2 million decrease in the full service payout business primarily resulting from a decline in sales of the single premium group annuity product.

Operating expenses increased $66.1 million in our full service accumulation business primarily due to growth in the business, which drove increases in staff related costs, management fees paid and amortization of DPAC. In addition, operating expenses in our individual annuities business increased $15.4 million primarily due to strong growth in this block of business. Furthermore, operating expenses in our Principal Funds business increased $14.4 million primarily due to an increase in management and distribution fees stemming from an increase in average account values.

Income Taxes

The effective income tax rates for the segment were 20% and 21% for the years ended December 31, 2006 and 2005, respectively. The effective income tax rates were lower than the U.S. corporate income tax rate of 35%, primarily due to income tax deductions allowed for corporate dividends received and interest exclusion from taxable income.

Global Asset Management Segment

Global Asset Management Trends

Asset management services have been among the most profitable and rapidly growing sectors of the financial services industry, at both the retail and institutional level. Current trends indicate that both retail and institutional investors embrace specialization. We seek to take advantage of these trends by providing expertise in specialty and niche areas, which command premium fees. We have experienced very good success in winning institutional asset management mandates and expect to see continued growth in this area. Our third-party AUM increased $28.2 billion during 2007.

The following table provides a summary of Global Asset Management's affiliated and third-party AUM as of December 31, 2007, 2006 and 2005:

As of	Principal Global Investors		
	Affiliated AUM	Third-party AUM	Total AUM
	(in billions)		
December 31, 2007	**$ 148.7**	**$ 87.3**	**$ 236.0**
December 31, 2006	132.3	59.1	191.4
December 31, 2005	103.4	41.1	144.5

Global Asset Management Segment Summary Financial Data

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

The following table presents AUM rollforward for assets managed by Global Asset Management for the years indicated:

	For the year ended December 31,		
	2007	2006	2005
	(in billions)		
AUM, beginning of period	**$ 191.4**	$ 144.5	$ 126.4
Net cash flow	**15.8**	12.8	9.1
Investment performance	**12.5**	13.7	7.9
Operations acquired(1)	**13.7**	22.6	3.9
Other	**2.6**	(2.2)	(2.8)
AUM, end of period	**$ 236.0**	$ 191.4	$ 144.5

(1) Includes acquisition of Morley Financial Services in 2007; acquisition of WM Advisors, Inc. in 2006; and acquisition of Columbus Circle Investors in 2005.

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

	For the year ended December 31,			Increase (decrease)	
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005
	(in millions)				
Operating revenues:					
Fees and other revenues	**$ 567.8**	$ 434.9	$ 385.9	$ 132.9	$ 49.0
Net investment income	**35.2**	53.2	31.4	(18.0)	21.8

				Increase (decrease)	
Total operating revenues	**603.0**	488.1	417.3	114.9	70.8
Expenses:					
Total expenses	**435.8**	331.1	303.3	104.7	27.8
Operating earnings before income taxes	**167.2**	157.0	114.0	10.2	43.0
Income taxes	**58.7**	54.5	40.0	4.2	14.5
Operating earnings	**$ 108.5**	$ 102.5	$ 74.0	$ 6.0	$ 28.5

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Operating Earnings

Fee mandate operating earnings increased $28.9 million primarily due to strong net cash flows that drove an increase in AUM. Spread and securitization business operating earnings decreased $22.9 million due to unfavorable CMBS market conditions in the latter part of 2007, as well as the transition of our wholly owned CMBS securitization operation to a joint venture with U.S. Bank.

Operating Revenues

Fees in our fee mandate business increased $142.6 million primarily due to continued growth in management fees across all lines of business, as a result of growth in AUM, in addition to the acquisition of Edge Asset Management and Morley Financial Services.

Net investment income decreased primarily in our spread and securitization business due to unfavorable CMBS market conditions in the latter part of 2007.

Total Expenses

Total expenses increased $104.7 million primarily in our fee mandate business due to growth in staff and staff related costs as a result of continued growth in AUM and the acquisitions of Edge Asset Management and Morley Financial Services.

Income Taxes

The effective income tax rate for the segment was 35% for the years ended December 31, 2007 and 2006.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Earnings

Fee mandate business operating earnings increased $28.1 million as solid investment performance and strong net cash flows increased AUM.

Operating Revenues

Fees in our fee mandate business increased $48.4 million primarily due to continued growth in management and transaction fees across all lines of business as a result of growth in AUM.

Net investment income in our spread and securitization business increased $12.7 million due to income from our CMBS securitization joint venture coupled with an increase in the interest margin. Net investment income in our fee mandate business increased $9.1 million due to earnings on cash and other investments.

Total Expenses

Fee mandate business operating expenses increased $14.7 million due to continued growth in AUM, an expansion of our U.S. institutional sales function and growth in staff and staff related costs in our international operations. Spread and securitization business operating expenses increased $13.1 million due to the transition to our CMBS securitization joint venture.

Income Taxes

The effective income tax rate for the segment was 35% for the years ended December 31, 2006 and 2005.

International Asset Management and Accumulation Segment

International Asset Management and Accumulation Trends

Our international asset management and accumulation businesses focus on countries with favorable demographics and growing long-term savings and defined contribution markets. With variations depending upon the specific country, we have targeted these markets for sales of retirement and related products and services, including defined contribution pension plans, annuities and mutual funds to businesses and individuals. In some of our international markets, we complement our sales of these products with institutional asset management and life insurance accumulation products.

We have pursued our international strategy through a combination of start-ups, acquisitions and joint ventures, which require infusions of capital consistent with our strategy of long-term growth and profitability.

International Asset Management and Accumulation Segment Summary Financial Data

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

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

	For the year ended December 31,		
	2007	2006	2005
		(in billions)	
AUM, beginning of period	**$ 19.1**	$ 15.4	$ 10.2
Net cash flow	**2.1**	2.0	1.3
Investment performance	**3.0**	2.0	1.3
Effect of exchange rates	**2.3**	0.1	1.0
Other(1)	**2.2**	(0.4)	1.6
AUM, end of period	**$ 28.7**	$ 19.1	$ 15.4

(1) Other increases to AUM include $1.8 billion from an additional 10% ownership in Malaysia in 2005 and $2.2 billion from our SBB acquisition in Malaysia in 2007.

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

	For the year ended December 31,			Increase (decrease)	
	2007	2006	2005	2007 vs. 2006	2006 vs. 2005
			(in millions)		
Operating revenues:					
Premiums and other considerations	**$ 246.4**	$ 239.1	$ 247.6	$ 7.3	$ (8.5)
Fees and other revenues	**136.4**	114.0	109.2	22.4	4.8
Net investment income	**413.5**	252.3	247.7	161.2	4.6
Total operating revenues	**796.3**	605.4	604.5	190.9	0.9
Expenses:					
Benefits, claims and settlement expenses	**526.7**	399.1	409.3	127.6	(10.2)
Operating expenses	**141.4**	144.5	128.7	(3.1)	15.8
Total expenses	**668.1**	543.6	538.0	124.5	5.6
Operating earnings before income taxes	**128.2**	61.8	66.5	66.4	(4.7)
Income taxes (benefits)	**17.5**	(10.0)	(4.5)	27.5	(5.5)
Operating earnings	**$ 110.7**	$ 71.8	$ 71.0	$ 38.9	$ 0.8

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Operating Earnings

Operating earnings increased $19.5 million primarily due to higher earnings from our equity method investments in Brazil and China and the strengthening of the Brazilian real versus the U.S. dollar. Operating earnings in Chile and Hong Kong increased primarily due to higher annualized investment yields in Chile and growth in AUM in Hong Kong and Chile.

Operating Revenues

Premiums in Chile increased $31.0 million primarily due to higher sales of single premium annuities with life contingencies. This increase was partially offset by a $23.7 million decrease in Mexico resulting from lower sales of single premium annuities with life contingencies due to our decision to not sell these annuities in Mexico in 2007 due to unfavorable market conditions.

Fees and other revenues in our Hong Kong, Chile and India operations increased primarily due to growth in AUM in these countries. In addition, fees and other revenues increased in Hong Kong due to performance-based fees.

Net investment income increased primarily due to a higher annualized yield on average invested assets and cash, excluding our equity method investments, and to a lesser extent due to a $418.0 million increase in average invested assets and cash, excluding our equity method investments, coupled with higher earnings from our equity method subsidiaries in Brazil, China and Malaysia. The annualized yield on average invested assets and cash, excluding our equity method investments, was 10.3% for the year ended December 31, 2007, compared to 7.1% for the year ended December 31, 2006.

Total Expenses

Benefits, claims and settlement expenses increased $152.1 million in Chile, primarily due to higher interest crediting rates in 2007 and increased sales of single premium annuities with life contingencies.

Operating expenses within our Mexican operations decreased $20.9 million primarily due to the unlocking of assumptions surrounding PVFP related to newly enacted legislation of the mandatory privatized social security system. This decrease was partially offset by higher operating expenses in our other international operations due to continued growth.

Income Taxes

The effective income tax rates for the segment were 14% and -16% for the years ended December 31, 2007 and 2006, respectively. The effective income tax rate for the year ended December 31, 2007, was lower than the U.S. corporate income tax rate of 35%, primarily due to taxes on our share of earnings generated from our equity method investments that are included in net investment income and the lower tax rates of foreign jurisdictions. The effective income tax rate for the year ended December 31, 2006, was lower than the U.S. corporate income tax rate of 35%, primarily due to tax refinements in Mexico and Chile and taxes on our share of earnings generated from our equity method investments that are included in net investment income.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Earnings

Operating earnings increased $8.2 million due to the strengthening of the Brazilian real versus the U.S. dollar and higher earnings from our Brazilian equity method investment driven by growth in AUM. Additionally, operating earnings increased due to increased fees in India, Chile and Hong Kong from growth in AUM. Partially offsetting these increases were operating expense increases due to continued growth in our international operations and decreased earnings due to lower annualized investment yields in Chile.

Operating Revenues

Premiums in Mexico decreased $12.6 million due to decreased sales of single premium annuities with life contingencies as a result of pricing changes in 2006. This decrease was partially offset by a $4.1 million increase in Chile resulting from the strengthening of the peso versus the U.S. dollar, which more than offset decreased sales of single premium annuities with life contingencies compared to 2005.

Fees and other revenues in our India, Hong Kong and Chile operations increased due to growth in AUM in these countries. In addition, fees and other revenues in Chile increased due to growth in the universal life insurance business. Partially offsetting these increases was a $5.7 million decrease in Mexico, primarily due to a refinement of accrued fee income in 2005.

Net investment income increased primarily due to a $367.8 million increase in average invested assets and cash, excluding our equity method investments; the strengthening of the Chilean peso and Brazilian real versus the U.S. dollar; and higher earnings from our Brazilian equity method investment. Partially offsetting the increase was a decrease in the annualized yield on average invested assets and cash, excluding our equity method investments, which was 7.1% for the year ended December 31, 2006, compared to 8.5% for the year ended December 31, 2005.

Total Expenses

Benefits, claims and settlement expenses decreased in our Chile and Mexico operations primarily due to lower interest crediting rates in 2006 and decreased sales of single premium annuities with life contingencies in Mexico and Chile, which was partially offset by the strengthening of the Chilean peso versus U.S. dollar.

Operating expenses increased due to continued growth in our international operations. The operating expenses for our International Asset Management and Accumulation segment grew at approximately half the growth rate of our segment's AUM during the period.

Income Taxes

The effective income tax rates for the segment were -16% and -7% for the years ended December 31, 2006 and 2005, respectively. The effective income tax rate for the year ended December 31, 2006, was lower than the U.S. corporate income tax rate of 35%, primarily due to tax refinements in Mexico and Chile and taxes on our share of earnings generated from our equity method investments that are included in net investment income. The effective income tax rate for the year ended December 31, 2005, was lower than the U.S. corporate income tax rate of 35%, primarily due to a tax benefit received as a result of the liquidation of our Japan joint venture, taxes on our share of earnings generated from our equity method investments that are included in net investment income and the lower tax rates of foreign jurisdictions.

Life and Health Insurance Segment

Individual Life Insurance Trends

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

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

	Universal and variable universal life insurance	Traditional life insurance
For the year ended	**Fee revenues**	**Premiums**
	(in millions)	
December 31, 2007	**$ 282.6**	**$ 611.7**
December 31, 2006	225.3	624.4
December 31, 2005	212.6	645.2

The following table provides a summary of our individual life insurance policyholder liabilities for the years indicated:

	Universal and variable universal life insurance	Traditional life insurance
As of	**Policyholder liabilities(1)**	**Policyholder liabilities**
	(in millions)	
December 31, 2007	**$ 4,544.2**	**$ 5,910.9**
December 31, 2006	3,948.6	5,921.5
December 31, 2005	3,493.8	5,955.4

(1) Includes separate account liabilities for policies with variable investment options.

Health Insurance Trends

In 2006, we experienced modest growth in group medical premium and fees and group medical members due to more competitive pricing and market focus. In mid-2006, we implemented rate increases to improve margins. As a result, membership started to decline during the fourth quarter of 2006 and continued in 2007. We expect this trend to continue.

Our fee-for-service business has also been impacted by our competitive positioning. We have experienced membership declines in this business for the past two years and we expect the declines to continue. Effective September 1, 2007, we made the Aetna Signature Administrators network available to new and renewal fee-for-service customers. This agreement helped us retain members toward the latter part of 2007.

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

	Premium and fees	
For the year ended		**Fee-for-service**

	Premium and fees	
	Group medical insurance	
	(in millions)	
December 31, 2007	**$ 1,808.7**	**$ 167.3**
December 31, 2006	1,861.4	172.5
December 31, 2005	1,676.5	176.6

Our covered medical members were as follows for the years indicated:

	Covered medical members	
As of	**Group medical insurance**	**Fee-for-service**
	(in thousands)	
December 31, 2007	**566.1**	**669.2**
December 31, 2006	642.5	758.0
December 31, 2005	620.1	861.5

Specialty Benefits Insurance Trends

Premium and fee growth for our specialty benefits insurance business is being driven by solid sales and retention. This has been a result of growing, and more focused distribution, supporting these product lines, increasing emphasis on marketing products to individuals at employer worksites ("voluntary/worksite") and the introduction of new products.

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

	Premium and fees			
For the year ended	**Group dental and vision insurance**	**Group life insurance**	**Group disability insurance**	**Individual disability insurance**
	(in millions)			
December 31, 2007	**$ 541.0**	**$ 344.2**	**$ 304.6**	**$ 160.0**
December 31, 2006	496.3	310.4	254.9	141.6
December 31, 2005	434.5	259.9	200.3	130.8

Life and Health Insurance Segment Summary Financial Data

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

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

	For the year ended December 31,			Increase (decrease)	
	2007	**2006**	**2005**	**2007 vs. 2006**	**2006 vs. 2005**
		(in millions)			
Operating revenues:					
Premiums and other considerations	**$ 3,671.6**	$ 3,598.7	$ 3,267.1	$ 72.9	$ 331.6
Fees and other revenues	**495.4**	444.2	444.3	51.2	(0.1)
Net investment income	**690.1**	693.3	676.1	(3.2)	17.2
Total operating revenues	**4,857.1**	4,736.2	4,387.5	120.9	348.7
Expenses:					
Benefits, claims and settlement expenses	**3,110.2**	2,910.3	2,620.2	199.9	290.1
Dividends to policyholders	**290.1**	290.3	288.5	(0.2)	1.8
Operating expenses	**1,129.5**	1,110.8	1,066.3	18.7	44.5
Total expenses	**4,529.8**	4,311.4	3,975.0	218.4	336.4
Operating earnings before income taxes	**327.3**	424.8	412.5	(97.5)	12.3
Income taxes	**106.2**	142.3	138.1	(36.1)	4.2
Operating earnings	**$ 221.1**	$ 282.5	$ 274.4	$ (61.4)	$ 8.1

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Operating Earnings

Health insurance operating earnings decreased $47.7 million due to increases in the cost of medical care, unfavorable prior year claim developments and an overall decline in covered members. These increases in cost were partially offset by increases in premium per member and lower operating expense ratios in our health insurance business. Individual life insurance operating earnings decreased $18.8 million, due to favorable DPAC adjustments in 2006 compared to unfavorable DPAC adjustments in 2007, coupled with a decrease in investment income from a lower asset base related to capital reductions, which more than offset growth in the universal life and variable universal life businesses. Specialty benefits insurance operating earnings increased $5.1 million, as growth in premiums and improvement in expense ratios were partially offset by higher loss ratios.

Operating Revenues

Specialty benefits insurance premiums increased $149.0 million primarily due to growth in the business resulting from solid sales and retention in all product lines. Health insurance premiums decreased $52.7 million, as a reduction in covered members was partially offset by an increase in premium per member. Furthermore, individual life insurance premiums decreased $23.4 million due to the expected continued decline from the decreasing block of traditional life insurance business.

Individual life insurance fees and other revenues increased $59.7 million due to growth in the universal life and variable universal life lines of business. This increase in fees more than offset the decline in individual life insurance premiums.

Total Expenses

Specialty benefits insurance benefits, claims and settlement expenses increased $132.4 million primarily due to growth in the business. Health insurance benefits, claims and settlement expenses increased $51.2 million, as higher claims costs per member and unfavorable prior year claim development were partially offset by a decrease in covered members.

Individual life insurance operating expenses increased $40.1 million primarily due to an increase in DPAC amortization, which was largely the result of unfavorable unlocking relative to 2006 and higher amortization in 2007 due to growth in the business and higher lapses early in the year. Specialty benefits insurance operating expenses increased $14.8 million due to continued growth in the business. Health insurance operating expenses decreased $36.2 million primarily due to staff and other reductions associated with the decline in insured medical and fee-for-service medical covered members.

Income Taxes

The effective income tax rates for the segment were 32% and 33% for the years ended December 31, 2007 and 2006, respectively. The effective income tax rates were lower than the U.S. corporate income tax rate of 35% as a result of interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Earnings

Specialty benefits insurance operating earnings increased $14.2 million due to reserve refinements in the long-term disability line, favorable claims experience in the dental/vision product line and growth in all product lines. Health insurance operating earnings increased $1.5 million due to positive reserve refinements partially offset by higher expense ratios in our fee for service business. Offsetting the increases was a $7.6 million decline of operating earnings within the individual life insurance business, primarily due to more favorable DPAC unlocking in 2005 and changes in claims experience in 2006.

Operating Revenues

Health insurance premiums increased $185.8 million, primarily from increased covered medical members and higher premium per member. Specialty benefits insurance premiums increased $180.4 million primarily due to strong sales and stable retention.

Total Expenses

Health insurance benefits, claims and settlement expenses increased $155.1 million primarily due to higher claim costs per member and growth, partially offset by reserve refinements. Despite generally lower loss ratios, specialty benefits insurance benefits, claims and settlement expenses increased $115.7 million, primarily due to growth in the business.

Specialty benefits insurance and health insurance operating expenses increased $46.1 million and $25.5 million, respectively, due to growth in the businesses. Partially offsetting these increases was a $27.1 million decrease in the individual life insurance operating expenses primarily due to lower sales and changes in claims experience in 2006.

Income Taxes

The effective income tax rate for the segment was 33% for the each of the years ended December 31, 2006 and 2005. The effective income tax rates were lower than the U.S. corporate income tax rate of 35% primarily due to interest exclusion from taxable income.

Corporate and Other Segment

Corporate and Other Segment Summary Financial Data

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

	For the year ended December 31,			Increase (decrease)	
	2007	**2006**	**2005**	**2007 vs. 2006**	**2006 vs. 2005**
			(in millions)		
Operating revenues:					
Total operating revenues	**$ (156.8)**	$ (110.9)	$ (130.2)	$ (45.9)	$ 19.3
Expenses:					
Total expenses	**(120.8)**	(94.9)	(78.0)	(25.9)	(16.9)
Operating loss before income taxes and preferred stock dividends	**(36.0)**	(16.0)	(52.2)	(20.0)	36.2
Income tax benefits	**(31.3)**	(21.7)	(48.5)	(9.6)	26.8
Preferred stock dividends	**33.0**	33.0	17.7		15.3
Operating loss	**$ (37.7)**	$ (27.3)	$ (21.4)	$ (10.4)	$ (5.9)

Year Ended December 31, 2007 Compared to Year Ended December 31, 2006

Operating Loss

Operating loss increased primarily due to higher interest expense, largely related to the issuance of corporate debt in the fourth quarter of 2006, partially offset by higher annualized investment yields driven by the joint venture real estate portfolio.

Operating Revenues

Operating revenues decreased primarily due to an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses. This decrease was partially offset by an increase in average annualized investment yields driven by the joint venture real estate portfolio.

Total Expenses

Total expenses decreased primarily due to an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in operating revenues. This decrease was partially offset by an increase in interest expense on corporate debt and interest expense related to federal income tax activities.

Income Taxes

Income tax benefits increased primarily due to an increase in operating loss before income taxes.

Year Ended December 31, 2006 Compared to Year Ended December 31, 2005

Operating Loss

Operating loss increased primarily due to a full year of preferred stock dividend payments in 2006 related to the June 2005 issuance of preferred stock. Also contributing to the increase in operating loss was higher interest expense incurred on corporate debt. These operating losses were offset by a decrease in interest expense related to federal income tax activities, a change in income tax reserves established for IRS tax matters and higher average annualized investment yields.

Operating Revenues

Operating revenues increased primarily due to an increase in average annualized investment yields, which were largely the result of a decrease in investment expenses related to a variable interest in a synthetic fuel production facility. The decrease in investment expense from this investment corresponds to an increase in income taxes due to fewer estimated synthetic fuel tax credits generated from fuel production. Partially offsetting the increase in operating revenues was an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in total expenses. Further offsetting the increase in operating revenues was a decrease in fee revenue for transitional services provided to CitiMortgage, Inc. in 2005 related to the sale of Principal Residential Mortgage, Inc., which is mostly offset by a corresponding change in total expense.

Total Expenses

Total expenses decreased primarily due to an increase in inter-segment eliminations included in this segment, which was offset by a corresponding change in operating revenues. Further contributing to the decrease in total expenses was a decrease in interest expense related to federal income tax activities and transitional services provided to CitiMortgage, Inc. in 2005 related to the sale of Principal Residential Mortgage, Inc., which is mostly offset in operating revenues. The decrease in total expenses was partially offset by additional interest on corporate debt.

Income Taxes

Income tax benefits decreased primarily due to a decrease in the estimated synthetic fuel tax credits in 2006, as well as a decrease in operating loss before income taxes. Partially offsetting the decrease in income tax benefits was a change in income tax reserves established for IRS tax matters.

Liquidity and Capital Resources

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

Liquidity

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

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

Iowa law gives the Commissioner discretion to disapprove requests for dividends in excess of these limits. Based on this limitation and 2007 statutory results, Principal Life could pay approximately $686.5 million in stockholder dividends in 2008 without exceeding the statutory limitation.

Principal Life could have paid approximately $660.4 million in statutory dividends in 2007 based on its 2006 statutory financial results without being subject to the restrictions on payment of stockholder dividends. Total stockholder dividends paid by Principal Life to its parent company in 2007 were $650.0 million.

Principal Life could have paid approximately $630.7 million in statutory dividends in 2006 based on its 2005 statutory financial results without being subject to the restrictions on payment of stockholder dividends. The ordinary stockholder dividends paid by Principal Life to its parent company in 2006 were $426.2 million. In addition, Principal Life requested and received permission from the Commissioner to pay an extraordinary dividend in the amount of $750.0 million. The extraordinary stockholder dividends paid by Principal Life to its parent in 2006 were $750.0 million.

Principal Life could have paid approximately $591.1 million in statutory dividends in 2005 based on its 2004 statutory financial results without being subject to the restrictions on payment of stockholder dividends. Total stockholder dividends paid by Principal Life to its parent company in 2005 were $200.0 million.

Operations. Historically, our primary consolidated cash flow sources have been premiums from life and health insurance products, pension and annuity deposits, asset management fee revenues, administrative services fee revenues, income from investments and proceeds from the sales or maturity of investments. Cash outflows consist primarily of payment of benefits to policyholders and beneficiaries, income and other taxes, current operating expenses, payment of dividends to policyholders, payments in connection with investments acquired, payments made to acquire subsidiaries, payments relating to policy and contract surrenders, withdrawals, policy loans, interest expense and repayment of short-term debt and long-term debt. Our investment strategies are generally intended to provide adequate funds to pay benefits without forced sales of investments. For a discussion of our investment objectives, strategies and a discussion of duration matching, see "Investments" as well as Item 7A. "Quantitative and Qualitative Disclosures about Market Risk Interest Rate Risk".

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

	For the year ended December 31,		
Cash flows attributable to discontinued operations:	**2007**	**2006**	**2005**
		(in millions)	
Net cash provided by operating activities	**$ 2.5**	$ 1.9	$ 126.0
Net cash used in investing activities	**(1.3)**	(3.4)	(127.0)
Net cash used in financing activities	**(0.5)**	(0.6)	(0.5)

Net cash provided by operating activities was $2,960.0 million, $2,275.5 million and $2,125.3 million for the years ended December 31, 2007, 2006 and 2005, respectively. The increase in cash provided by operating activities in 2007 compared to 2006 was primarily related to fluctuations in operational receivables and payables. The increase in cash provided by operating activities in 2006 compared to 2005 was primarily related to the payment in 2005 of an IRS deficiency related to the examination for 1999 - 2001. Also contributing to the increase in cash provided by operating activities was an increase in proceeds in the net mortgage loans held for sale activity, due to the transition of our CMBS platform from Principal Commercial Funding to a newly created entity, Principal Commercial Funding II, which is accounted for under the equity method of accounting. This increase in cash was partially offset by a decrease related to fluctuations in operational receivables and payables.

Net cash used in investing activities was $4,499.2 million, $3,910.4 million and $1,481.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. The increase in cash used in investing activities in 2007 compared to 2006 was primarily due to an increase in net purchases of mortgage loans, available-for-sale securities and real estate as well as additional contributions in 2007 to an equity method investment with no corresponding activity in 2006. This increase was partially offset by larger acquisitions in 2006 relative to 2007. The increase in cash used in investing activities in 2006 compared to 2005 was primarily due to a decrease in sales and fewer maturities of available-for-sale securities, partially offset by a decrease in purchases of available-for-sale securities. Also contributing to the increase was an increase in mortgage loans acquired and a decrease in mortgage loans sold. The acquisition of WM Advisors, Inc. in the fourth quarter of 2006 also contributed to the increase in cash used in investing activities.

Net cash provided by financing activities was $1,292.1 million, $1,586.5 million and $546.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. The decrease in cash provided by financing activities in 2007 compared to 2006 was primarily due to the issuance of $600.0 million of senior notes from our shelf registration in 2006, with no corresponding activity in 2007 as well as a decrease in net deposits of investment contracts, offset in part by proceeds from short term debt in the current year, compared to payments of short term debt in the previous year. The increase in cash provided by financing activities in 2006 compared to 2005 was primarily due to the issuance of senior notes from our shelf registration in 2006 in addition to an increase in net deposits of investment contracts and a decrease in treasury stock acquisitions in 2006 compared to 2005. Offsetting these increases in cash provided were repayments of short-term debt, as well as the preferred stock issuance in 2005, with no corresponding activity in 2006.

Shelf Registration. We filed a shelf registration statement with the Securities and Exchange Commission, which became effective on June 30, 2004. The shelf registration totals $3.0 billion, with the ability to issue debt securities, preferred stock, common stock, warrants, stock purchase contracts and stock purchase units of PFG and trust preferred securities of three subsidiary trusts. If we issue additional securities, we intend to use the proceeds from the sale of the securities for general corporate purposes, including working capital, capital expenditures, investments in subsidiaries, share repurchase, acquisitions and refinancing of debt, including commercial paper and other short-term indebtedness. Principal Financial Services, Inc. unconditionally guarantees our obligations with respect to one or more series of debt securities described in the shelf registration statement. As of December 31, 2007, there is $1.85 billion remaining under the shelf registration. For information on senior notes issued from our shelf registration, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Debt".

Short-Term Debt and Long-Term Debt. For debt information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Debt."

Stockholders' Equity. Proceeds from the issuance of our common stock were $73.6 million and $66.2 million in 2007 and 2006, respectively.

The following table summarizes our return of capital to common stockholders in 2007, 2006 and 2005.

	For the year ended December 31,		
	2007	**2006**	**2005**
		(in millions)	
Dividends to stockholders	**$ 235.6**	$ 214.7	$ 182.2
Repurchase of common stock	**756.3**	755.8	952.4
Total cash returned to stockholders	**$ 991.9**	$ 970.5	$ 1,134.6
Number of shares repurchased	**11.5**	14.5	22.2

For additional stockholders' equity information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 16, Stockholders' Equity."

Capitalization

Our capital structure as of December 31, 2007 and 2006 consisted of debt and equity summarized as follows:

	December 31,	
	2007	**2006**
	(in millions)	
Debt:		
Short-term debt	**$ 290.8**	$ 84.1
Long-term debt	**1,398.8**	1,511.3

	December 31,	
Total debt	**1,689.6**	1,595.4
Stockholders' equity:		
Equity excluding accumulated other comprehensive income, net of tax	**7,001.5**	7,013.9
Accumulated other comprehensive income, net of tax	**420.2**	846.9
Total stockholders' equity	**7,421.7**	7,860.8
Total capitalization including accumulated other comprehensive income	**$ 9,111.3**	$ 9,456.2
Debt to equity	**23%**	20%
Debt to capitalization	**19%**	17%

Contractual Obligations

The following table presents payments due by period for long-term contractual obligations as of December 31, 2007:

Contractual Obligations(1)	Total Payments	Payments due in year ending 2008	2009-2010	2011-2012	2013 and thereafter
			(in millions)		
Contractholder funds(2)	$ 59,012.9	$ 7,448.6	$ 13,563.8	$ 9,774.6	$ 28,225.9
Future policy benefits and claims(3)	39,089.0	2,045.8	3,410.0	3,272.3	30,360.9
Long-term debt(4)	1,398.8	83.4	482.6	105.5	727.3
Certificates of deposit(5)	1,069.0	610.5	389.0	64.4	5.1
Other long-term liabilities(6)	926.5	677.0			249.5
Capital leases	11.3	5.4	5.5	0.4	
Long-term debt interest	1,431.7	94.0	125.9	95.9	1,115.9
Operating leases(7)	197.9	51.8	76.9	37.1	32.1
Purchase obligations(8)	597.2	541.4	43.2	12.6	
Total contractual obligations	$ 103,734.3	$ 11,557.9	$ 18,096.9	$ 13,362.8	$ 60,716.7

(1) Excludes short-term liabilities, other policyholder funds, taxes and short-term debt as these are not long-term and/or not contractual in nature. Also excludes obligations under our pension and other postretirement benefit plans as benefit payments will be made under a funded plan and will not require company contributions or payments within a five-year period. In addition, separate account liabilities are excluded. Separate account liabilities represent the fair market value of funds that are separately administered by us. Generally, the separate account contract owner, rather than us, bears the investment risk of these funds. The separate account liabilities are legally segregated and are not subject to claims that arise out of any other business of ours. Net deposits, net investment income and realized and unrealized capital gains and losses on the separate accounts are not reflected in the consolidated statement of operations. The separate account obligations will be fully funded by cash flows from the separate account assets.

(2) Includes GICs, funding agreements, individual fixed annuities, universal life insurance and other investment-type contracts. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 11, Insurance Liabilities" for additional information.

Amounts included in the contractholder funds line item reflect estimated cash payments to be made to policyholders. The sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount included in our consolidated financial statements as of December 31, 2007. The liability amount in our consolidated financial statements reflects estimated cash payments to policyholders, assumptions with regard to the timing of cash payments and discounting for interest.

(3) Amounts included in the future policy benefits and claims line item reflect estimated cash payments to be made to policyholders. The sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount included in our consolidated financial statements as of December 31, 2007. The liability amount in our consolidated financial statements reflects estimated cash payments to policyholders, reductions for expected future premiums, assumptions with regard to the timing of cash payments and discounting for interest.

(4) For long term debt information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Debt".

(5) Amounts included in the certificates of deposit line item reflect estimated cash payments to be made, including expected interest payments. Certificates of deposit are reported as other liabilities on our consolidated statement of financial position.

(6) Other long-term liabilities include other liabilities reflected in the consolidated statement of financial position that are contractual, non-cancelable and long-term in nature. This line item excludes accruals and short-term items in the amount of $3,072.4 million.

(7) As a lessee, we lease office space, data processing equipment and office furniture and equipment under various operating leases.

(8) Purchase obligations include material contracts where we have a non-cancelable commitment to purchase goods and services in addition to commitments to originate loans and purchase investments.

Contractual Commitments

In connection with our banking business, we make additional commitments to extend credit, which are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A majority of these commitments are lines of credit and are expected to expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash funding requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The total commitments to fund loans were $319.4 million as of December 31, 2007.

Off-Balance Sheet Arrangements

Variable Interest Entities. We have relationships with various types of special purpose entities and other entities where we have a variable interest as described in Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 5, Variable Interest Entities." We do not have a direct or contingent obligation related to our unconsolidated variable interest entities ("VIE") other than described below.

Retained Interests in Securitized Assets. We, along with other contributors, sell commercial mortgage loans in securitization transactions to trusts. As these trusts are classified as a qualifying special purpose entity, they are not subject to the VIE consolidation rules. We may retain interests in the securitization transaction. At December 31, 2007 and 2006, the fair values of retained interests related to the securitizations of commercial mortgage loans were $315.8 million and $345.3 million, respectively. The investors and the securitization entities have no recourse to our assets for failure of debtors to pay when due. The value of our retained interests is subject primarily to credit risk.

Guarantees and Indemnifications. For guarantee and indemnification information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 15, Contingencies, Guarantees and Indemnifications" under the caption, "Guarantees and Indemnifications".

Financial Rating and Strength

Our ratings are influenced by many factors including our operating and financial performance, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), risk exposures, operating leverage, ratings and other factors.

State laws specify regulatory actions if an insurer's risk-based capital ("RBC"), a measure of an insurer's solvency, falls below certain levels. The NAIC has a standard formula for annually assessing RBC. The formulas for calculating RBC for life insurance companies takes into account factors relating to insurance, business, asset and interest rate risks. For additional rating information refer to Item 1. "Business, Ratings."

Impacts of Income Taxes

The IRS has completed examinations of the U.S. consolidated federal income tax returns for 2003 and prior years. The IRS's completion of the examinations for the years 1999 - 2001 resulted in notices of deficiency dated December 29, 2004, and March 1, 2005. We paid the deficiencies (approximately $444.0 million for 1999 and 2000, and $1.3 million for 2001, including interest) in the first quarter of 2005 and have filed, or will file, claims for refund relating to the disputed adjustments. The examination for the years 2002 and 2003 resulted in a refund of approximately $176.7 million (including interest) of which $161.5 million related to deficiencies previously paid as a result of the 1999-2001 examination. We believe that we have adequate defenses against, or sufficient provisions for, the contested issues, but final resolution of the contested issues could take several years while legal remedies are pursued. Consequently, we do not expect the ultimate resolution of issues in tax years 1999 - 2003 to have a material impact on our net income. Similarly, we believe there are adequate defenses against, or sufficient provisions for, any challenges that might arise in tax years subsequent to 2003.

In August 2007, the IRS issued Revenue Ruling 2007-54, which provides guidance on the methodology that life insurance companies use to calculate the dividends received deduction relating to variable life insurance and variable annuity contracts. The deduction for dividends received reduces the amount of dividend income subject to tax and is a significant component of the difference between our periodic effective income tax rate and the U.S. corporate income tax rate of 35%. In September 2007, the IRS issued Revenue Ruling 2007-61, which suspended Revenue Ruling 2007-54, and indicated it would issue regulations to address the issues. No regulations have been proposed and we cannot predict whether any such regulations would affect our deduction for dividends received by insurance company affiliates with respect to variable contracts.

On October 22, 2004, the American Jobs Creation Act of 2004 ("American Jobs Creation Act") was signed into law. The American Jobs Creation Act included a repatriation provision granting U.S. corporations a special deduction of 85% of certain qualifying dividends from their foreign subsidiaries. A company could elect to apply this provision to qualifying earnings that were repatriated in its 2005 tax year. Pursuant to the American Jobs Creation Act, we implemented two domestic reinvestment plans in 2005. In accordance with the provisions of the Internal Revenue Code, we elected an 85% dividend received deduction on eligible cash dividends totaling $28.8 million.

Investments

We had total consolidated assets as of December 31, 2007, of $154.5 billion, of which $64.4 billion were invested assets. The rest of our total consolidated assets are comprised primarily of separate account assets for which we do not bear investment risk. Because we generally do not bear any investment risk on assets held in separate accounts, the discussion and financial information below does not include such assets.

Overall Composition of Invested Assets

Invested assets as of December 31, 2007, were predominantly of high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of invested assets are fixed maturity securities and commercial mortgages. The remainder is invested in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets.

Invested Assets

	December 31, 2007		December 31, 2006	
	Carrying amount	% of total	Carrying amount	% of total
	($ in millions)			
Fixed maturity securities:				
Public	**$ 32,215.0**	**50%**	$ 31,075.5	52%
Private	**15,053.2**	**24**	13,651.4	23
Equity securities	**586.2**	**1**	847.6	1
Mortgage loans:				
Commercial	**10,763.5**	**17**	10,090.3	17
Residential	**1,896.1**	**3**	1,573.6	3
Real estate held for sale	**82.4**		118.2	
Real estate held for investment	**780.1**	**1**	695.4	1
Policy loans	**869.9**	**1**	850.7	1
Other investments	**2,118.6**	**3**	1,410.7	2
Total invested assets	**$ 64,365.0**	**100%**	60,313.4	100%
Cash and cash equivalents	**1,344.4**		1,591.5	
Total invested assets and cash	**$ 65,709.4**		$ 61,904.9	

Investment Results

The following tables present the yield and investment income, excluding net realized/unrealized gains and losses for our invested assets. The annualized yield on invested assets and on cash and cash equivalents was 6.2% for the year ended December 31, 2007, compared to 6.0% for the year ended December 31, 2006. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period.

Invested Assets
Investment Income Yields by Asset Type

	For the year ended December 31,			
	2007		2006	
	Yield	Amount	Yield	Amount

	For the year ended December 31,			
	($ in millions)			
Fixed maturity securities	**6.2%**	**$ 2,869.2**	6.1%	$ 2,636.4
Equity securities	**3.8**	**27.0**	7.0	58.0
Mortgage loans commercial	**6.6**	**688.9**	6.5	653.6
Mortgage loans residential	**7.5**	**129.7**	5.7	90.7
Real estate	**8.9**	**74.9**	7.6	63.2
Policy loans	**6.1**	**52.6**	6.1	50.9
Cash and cash equivalents	**7.2**	**105.9**	4.0	64.4
Other investments	**9.3**	**165.1**	10.5	132.2
Total before investment expenses	**6.4**	**4,113.3**	6.2	3,749.4
Investment expenses	**0.2**	**(146.8)**	0.2	(128.8)
Net investment income	**6.2%**	**$ 3,966.5**	6.0%	$ 3,620.6

The following tables present the contributors to net realized/unrealized gains and losses for our invested assets for the years ended December 31, 2007 and 2006.

	For the year ended December 31, 2007			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)
	(in millions)			
Fixed maturity securities(1)	$ (262.8)	$ 17.1	$ 151.8	$ (93.9)
Fixed maturity securities, trading		1.7		1.7
Equity securities(2)	(51.3)	5.0		(46.3)
Equity securities, trading		23.0		23.0
Mortgage loans on real estate(3)	(7.1)			(7.1)
Derivatives(4)			(269.2)	(269.2)
Other(5)		34.6	28.4	63.0
Total	$ (321.2)	$ 81.4	$ (89.0)	$ (328.8)

(1) Impairments include $215.7 million of credit impairment write-downs and $8.4 million in realized credit recoveries on the sale of previously impaired assets. Certain fixed maturity securities moved into a loss position during the second quarter of 2007, and we determined that we did not have the ability and intent to hold these securities. As a result, we recognized impairment losses on these securities of $24.5 million, net of recoveries on the subsequent sale, primarily due to a change in interest rates. Credit losses include $32.3 million in realized losses and $2.0 million in realized gains related to credit triggered sales.

(2) Impairments include $52.6 million of credit impairment write-downs and $1.3 million in realized credit recoveries on the sale of previously impaired assets.

(3) Impairments include $2.7 million in realized gains that resulted from the sale of a commercial mortgage loan for which we had credit concerns and a $9.8 million increase in the commercial mortgage valuation allowance.

(4) Derivatives include $153.5 million of net unrealized losses related to mark to market adjustments on derivatives used in fair value hedges of fixed maturity securities. The remainder of the net loss resulted primarily from mark to market adjustments on derivatives not designated as hedging instruments, with the largest component being $81.1 million of net losses on credit default swaps and the remainder relating to risk management activities.

(5) Other gains (losses) include a $24.6 million realized gain on the sale of stock of an equity method investment and mark to market of net realized/unrealized gains on certain seed money investments.

	For the year ended December 31, 2006			
	Impairments and credit losses	Other gains (losses)	Hedging adjustments	Net realized/ unrealized capital gains (losses)

	For the year ended December 31, 2006			
	(in millions)			
Fixed maturity securities(1)	$ (32.1)	$ 10.0	$ (14.6)	$ (36.7)
Fixed maturity securities, trading		1.0		1.0
Equity securities(2)	1.0	0.6		1.6
Equity securities, trading		21.8		21.8
Mortgage loans on real estate(3)	2.4			2.4
Derivatives			(4.7)	(4.7)
Other(4)		64.3	(5.0)	59.3
Total	$ (28.7)	$ 97.7	$ (24.3)	$ 44.7

(1) Impairments include $14.6 million of credit impairment write-downs and $16.5 million in realized credit recoveries on the sale of previously impaired assets. As the result of the need to fund the acquisition of WM Advisors, Inc., impairments also include $12.4 million of write-downs that resulted from our determination that we no longer had the ability and intent to hold certain fixed maturity securities until they recovered in value. This loss is net of the recovery realized on the subsequent sale of the securities. Credit losses include $0.6 million in realized gains and $22.2 million in realized losses related to credit triggered sales.

(2) Impairments include $1.0 million in realized recoveries on the sale of previously impaired assets.

(3) Impairments include $2.5 million in realized losses due to the sale of commercial mortgage loans, $3.6 million in realized recoveries on the sale of previously impaired commercial mortgage loans, a $2.1 million decrease in the

commercial mortgage valuation allowance and a $0.7 million increase in the residential mortgage valuation allowance held by our international operations.

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

U.S. Investment Operations

Of our invested assets, $60.3 billion were held by our U.S. operations. Our U.S. invested assets are managed by Principal Global Investors, a subsidiary of Principal Life. Our primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters. We seek to protect policyholders' benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing the credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification. We are exposed to three primary sources of investment risk:

- credit risk, relating to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest;
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves; and
- equity risk, relating to adverse fluctuations in a particular common stock.

Our ability to manage credit risk is essential to our business and our profitability. We devote considerable resources to the credit analysis of each new investment. We manage credit risk through industry, issuer and asset class diversification. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing all investment policies and approving or authorizing all investments, except the Executive Committee of the Board must approve any investment transaction exceeding $500.0 million. As of December 31, 2007, there are ten members on the Investment Committee, two of whom are members of our Board of Directors. The remaining members are senior management members representing various areas of our company.

We also seek to reduce call or prepayment risk arising from changes in interest rates in individual investments. We limit our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer, and we require additional yield on these investments to compensate for the risk that the issuer will exercise such option. We assess option risk in all investments we make and, when we take that risk, we price for it accordingly.

Our Fixed Income Securities Committee, consisting of fixed income securities senior management members, approves the credit rating for the fixed maturity securities we purchase. Teams of security analysts, organized by industry, focus either on the public or private markets and analyze and monitor these investments. In addition, we have teams who specialize in residential mortgage-backed securities, CMBS, asset-backed securities ("ABS") and public below investment grade securities. We establish a credit reviewed list of approved public issuers to provide an efficient way for our portfolio managers to purchase liquid bonds for which credit review has already been completed. Issuers remain on the list for one year unless removed by our analysts. Our analysts monitor issuers on the list on a continuous basis with a formal review documented annually or more frequently if material events affect the issuer. The analysis includes both fundamental and technical factors. The fundamental analysis encompasses both quantitative and qualitative analysis of the issuer.

The qualitative analysis includes an assessment of both accounting and management aggressiveness. In addition, technical indicators such as stock price volatility and credit default swap levels are monitored.

Our Fixed Income Securities Committee also reviews private transactions on a continuous basis to assess the quality ratings of our privately placed investments. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

- material declines in the issuer's revenues or margins;
- significant management or organizational changes;

- significant uncertainty regarding the issuer's industry;
- debt service coverage or cash flow ratios that fall below industry-specific thresholds;
- violation of financial covenants; and
- other business factors that relate to the issuer.

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering the origination of new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying security, conduct a comprehensive market analysis and compare against industry lending practices. We use a proprietary risk rating model to evaluate all new and a majority of existing loans within the portfolio. The proprietary risk model is designed to stress projected cash flows under simulated economic and market downturns.

Our lending guidelines are designed to encourage 75% or less loan-to-value ratios and a debt service coverage ratio of at least 1.2 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The weighted average loan-to-value ratio at origination for brick and mortar commercial mortgages in our portfolio was 65% and the debt service coverage ratio at loan inception was 1.7 times as of December 31, 2007.

We have limited exposure to equity risk in our common stock portfolio. Equity securities accounted for only 1% of our U.S. invested assets as of December 31, 2007.

Our investment decisions and objectives are a function of the underlying risks and product profiles of each primary business operation. In addition, we diversify our product portfolio offerings to include products that contain features that will protect us against fluctuations in interest rates. Those features include adjustable crediting rates, policy surrender charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 7A. "Quantitative and Qualitative Disclosures about Market Risk."

Overall Composition of U.S. Invested Assets

U.S. invested assets as of December 31, 2007, were predominantly of high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of U.S. invested assets are fixed maturity securities and commercial mortgages. The remainder is invested in residential mortgage loans, real estate, equity securities and other assets. In addition, policy loans are included in our invested assets. The following discussion analyzes the composition of U.S. invested assets, but excludes invested assets of the participating separate accounts.

U.S. Invested Assets

	December 31, 2007		December 31, 2006	
	Carrying amount	% of total	Carrying amount	% of total
	($ in millions)			
Fixed maturity securities:				
Public	**$ 29,495.5**	**49%**	$ 28,772.4	51%
Private	**15,053.2**	**25**	13,651.4	24
Equity securities	**533.5**	**1**	795.7	1
Mortgage loans:				
Commercial	**10,763.5**	**18**	10,090.3	18
Residential	**1,337.5**	**2**	1,051.6	2
Real estate held for sale	**82.4**		118.2	
Real estate held for investment	**777.2**	**1**	683.2	1
Policy loans	**853.7**	**2**	850.7	1
Other investments	**1,391.4**	**2**	972.6	2
Total invested assets	**60,287.9**	**100%**	56,986.1	100%
Cash and cash equivalents	**1,261.5**		1,536.5	
Total invested assets and cash	**$ 61,549.4**		$ 58,522.6	

Fixed Maturity Securities

Fixed maturity securities consist of short-term investments, publicly traded debt securities, privately placed debt securities and redeemable preferred stock, and represented 74% and 75% of total U.S. invested assets as of December 31, 2007 and 2006, respectively. The fixed maturity securities portfolio was comprised, based on carrying amount, of 66% in publicly traded fixed maturity securities and 34% in privately placed fixed maturity securities as of December 31, 2007, and 68% in publicly traded fixed maturity securities and 32% in privately placed fixed maturity securities as of December 31, 2006. Included in the privately placed category as of December 31, 2007 and 2006, were $8.4 billion and $7.6 billion, respectively, of securities eligible for resale to qualified institutional buyers under Rule 144A under the Securities Act of 1933. Fixed maturity securities were diversified by category of issuer as of December 31, 2007 and 2006, as shown in the following table:

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

	December 31, 2007		December 31, 2006	
	Carrying amount	% of total	Carrying amount	% of total
	($ in millions)			
U.S. Government and agencies	**$ 672.3**	**1%**	$ 551.6	1%
States and political subdivisions	**2,071.5**	**5**	1,663.5	4
Non-U.S. governments	**453.9**	**1**	420.7	1
Corporate public	**19,875.2**	**45**	19,791.1	47
Corporate private	**11,813.1**	**27**	10,596.5	25
Residential pass-through securities	**1,496.1**	**3**	1,557.6	4
Commercial mortgage-backed securities	**4,665.6**	**10**	4,297.0	10
Residential collateralized mortgage obligations	**936.9**	**2**	940.4	2
Asset-backed securities	**2,564.1**	**6**	2,605.4	6
Total fixed maturities	**$ 44,548.7**	**100%**	$ 42,423.8	100%

We held $9,662.7 million of mortgage-backed and ABS as of December 31, 2007, and $9,400.4 million as of December 31, 2006.

We believe that it is desirable to hold residential mortgage-backed pass-through securities due to their credit quality and liquidity as well as portfolio diversification characteristics. Our portfolio is comprised of GNMA, FNMA and FHLMC pass-through securities. In addition, our residential collateralized mortgage obligation portfolio offers structural features that allow cash flows to be matched to our liabilities.

CMBS provide high levels of credit protection, diversification, reduced event risk and enhanced liquidity. CMBS are predominantly comprised of rated large pool securitizations that are individually and collectively diverse by property type, borrower and geographic dispersion.

We purchase ABS to diversify the overall credit risks of the fixed maturity securities portfolio and to provide attractive returns. The principal risks in holding ABS are structural and credit risks. Structural risks include the security's priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from the collateral and the potential for prepayments. Credit risks involve issuer/servicer risk where collateral values can become impaired in the event of servicer credit deterioration.

Our ABS portfolio is diversified both by type of asset and by issuer. We actively monitor holdings of ABS to ensure that the risk profile of each security improves or remains consistent. Prepayments in the ABS portfolio are, in general, insensitive to changes in interest rates or are insulated to such changes by call protection features. In the event that we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we diversify the risks of ABS by holding a diverse class of securities, which limits our exposure to any one security.

The international exposure in our U.S. fixed maturity securities totaled $10,046.5 million, or 23% of total fixed maturity securities, as of December 31, 2007, comprised of corporate and foreign government fixed maturity securities. Of the $10,046.5 million as of December 31, 2007, investments totaled $2,843.1 million in the continental European Union, $2,641.7 million in the United Kingdom, $1,059.0 million in Asia, $954.1 million in Australia, $594.6 million in South America, $340.3 million in Mexico and $59.4 million in Japan. The remaining $1,554.3 million is invested in 24 other countries. All international fixed maturity securities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturity securities investments to 18% of total statutory general account assets with a 4% limit in emerging markets. Exposure to Canada is not included in our international exposure. As of December 31, 2007, our investments in Canada totaled $1,576.4 million.

The following tables present the amortized cost of our top ten exposures including approved counterparty exposure limits as of December 31, 2007 and 2006.

	December 31, 2007
	Amortized cost
	(in millions)
Bank of America Corp.(1)	$ 360.7
MBIA Inc.(2)	323.6
American International Group Inc.(1)	270.1
General Electric Co	259.6
AT&T Inc.	250.9
Royal Bank of Scotland Group PLC(1)	240.9
JP Morgan Chase & Co.(1)	237.6
Ambac Financial Group Inc.(3)	235.3
Citigroup Inc.(1)	233.2
Deutsche Bank AG(1)	203.7
Total top ten exposures	$ 2,615.6

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

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

(3) Of the Ambac Financial Group Inc. exposure, 84% is comprised of the guarantee of underlying securities that are predominantly rated A- equivalent or better by the rating agencies on a stand-alone basis. The Ambac Financial Group Inc. wrap guarantees performance in the event of default of the underlying securities, bringing the combined rating to AAA.

	December 31, 2006
	Amortized cost
	(in millions)
HSBC Holdings PLC(1)	$ 387.1
American International Group Inc.(2)	329.5
Bank of America Corp.(2)	328.3
MBIA Inc.(3)	311.5
AT&T Inc.	272.9
JP Morgan Chase & Co.(2)	271.7
Royal Bank of Scotland Group PLC(2)	255.6
Deutsche Bank AG(2)	255.0

	December 31, 2006
General Electric Co	239.2
ABN AMRO Holding NV(2)	229.6
Total top ten exposures	$ 2,880.4

(1) Includes a $238.0 million investment classified as an equity security for U.S. GAAP. The investment issuer engages in managing investment grade third party bond investments and HSBC paper. All non-HSBC paper has the ultimate benefit of price support protection provided by HSBC Bank, PLC. Since Principal Life Insurance Company has senior priority in the issuer, we believe many third party bonds could be liquidated to satisfy our claim. While we calculate our exposure on a gross basis, the value we attribute to the underlying collateral is $125.0 million.

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

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

Our top ten exposures were rated an "A" equivalent or better by the rating agencies as of December 31, 2007 and 2006. As of December 31, 2007 and 2006, no individual non-government issuer represented more than 1% of U.S. invested assets. HSBC Holdings PLC is no longer included in our top ten exposures due to the redemption of a $238.0 million investment in January 2007.

Valuation techniques for the fixed maturity securities portfolio vary by security type and the availability of market data. Pricing models and their underlying assumptions impact the amount and timing of unrealized gains and losses recognized, and the use of different pricing models or assumptions could produce different financial results. Interactive Data Corporation or direct broker quotes are our sources for external prices for our public bonds and those private placement securities that are actively traded in the secondary market. In cases where quoted market prices are not available, a matrix pricing valuation approach is used. Securities are grouped into pricing categories that vary by asset class, sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data or market clearing data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors. Certain market events that could impact the valuation of securities include issuer credit ratings, business climate, management changes, litigation and government actions among others. The resulting prices are then reviewed by pricing analysts. All loans placed on the "watch list" are valued individually by the investment analysts or the analysts that focus on troubled securities ("Workout Group"). Although we believe our estimates reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other factors involve significant assumptions and may not reflect those of an active market. To the extent that bonds have longer maturity dates, management's estimate of fair value may involve greater subjectivity since they involve judgment about events well into the future. Every month, there is a comprehensive review of all impaired securities and problem loans by a group consisting of the Chief Investment Officer, the Portfolio Managers and the Workout Group. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. If the company is likely to continue operations, the estimate of future cash flows is typically based on the expected operating cash flows of the company that are available to make payments on the bonds. If the company is likely to liquidate, the estimate of future cash flows is based on an estimate of the liquidation value of its net assets.

The Securities Valuation Office ("SVO") of the NAIC evaluates most of the fixed maturity securities that we and other U.S. insurance companies hold. The SVO evaluates the bond investments of insurers for regulatory reporting purposes and assigns securities to one of six investment categories. The NAIC designations closely mirror the nationally recognized securities rating organizations' credit ratings for marketable bonds. NAIC designations 1 and 2 include bonds considered investment grade by such rating organizations. Bonds are considered investment grade when rated "Baa3" or higher by Moody's, or "BBB-" or higher by Standard & Poor's. NAIC designations 3 through 6 are referred to as below investment grade. Bonds are considered below investment grade when rated "Ba1" or lower by Moody's, or "BB+" or lower by Standard & Poor's. As of December 31, 2007, the percentage, based on estimated fair value, of total publicly traded and privately placed fixed maturity securities that were investment grade with an NAIC designation 1 or 2 was 95%.

We also monitor the credit drift of our corporate fixed maturity securities portfolio. Credit drift is defined as the ratio of the percentage of rating downgrades, including defaults, divided by the percentage of rating upgrades. We measure credit drift once each fiscal year, assessing the changes in our internally developed credit ratings that have occurred during the year. Standard & Poor's annual credit ratings drift ratio measures the credit rating change, within a specific year, of companies that have been assigned ratings by Standard & Poor's. The annual internal credit drift ratio on corporate fixed maturity securities we held in our general account was 0.89 times compared to the Standard & Poor's drift ratio of 0.69 times, as of December 31, 2007.

The following table presents our total fixed maturity securities by NAIC designation and the equivalent ratings of the nationally recognized securities rating organizations as of December 31, 2007 and 2006, as well as the percentage, based on estimated fair value, that each designation comprises:

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

		December 31, 2007			December 31, 2006		
NAIC rating	**Rating agency equivalent**	**Amortized cost**	**Carrying amount**	**% of total carrying amount**	**Amortized cost**	**Carrying amount**	**% of total carrying amount**
				($ in millions)			
1	Aaa/Aa/A	**$ 25,635.0**	**$ 25,644.1**	**57%**	$ 23,716.0	$ 24,231.9	57%
2	Baa	**16,661.8**	**16,742.0**	**38**	15,769.9	16,205.5	38
3	Ba	**1,904.7**	**1,872.1**	**4**	1,586.8	1,657.1	4
4	B	**179.0**	**179.4**	**1**	290.5	302.6	1
5	Caa and lower	**103.1**	**99.2**		19.1	19.5	
6	In or near default	**12.0**	**11.9**		5.5	7.2	
	Total fixed maturities	**$ 44,495.6**	**$ 44,548.7**	**100%**	$ 41,387.8	$ 42,423.8	100%

(1) Includes 56 securities with an amortized cost of $541.3 million, gross gains of $5.8 million, gross losses of $14.1 million and a carrying amount of $533.0 million as of December 31, 2007, that are still pending a review and assignment of a rating by the SVO. Due to the timing of when fixed maturity securities are purchased, legal documents are filed and the review by the SVO, there will always be securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent rating is assigned based on our fixed income analyst's assessment.

The following tables present credit quality and year of issuance ("vintage") for our CMBS portfolio and our ABS home equity portfolio backed by subprime first lien mortgages. As of December 31, 2007, based on amortized cost, 86% of our CMBS portfolio had ratings of A or higher and 71% was issued in 2005 or before and 99% of our ABS home equity portfolio had ratings of A or higher and 87% was issued in 2005 or before.

U.S. Invested Assets
Commercial Mortgage-Backed Securities by Rating and Vintage

	December 31, 2007		December 31, 2006	
	Amortized cost	**Carrying amount**	**Amortized cost**	**Carrying amount**
		(in millions)		
Lowest agency rating				
AAA(1)	**$ 2,818.8**	**$ 2,829.6**	$ 2,583.0	$ 2,609.5
AA	**645.3**	**631.3**	541.5	549.4
A	**636.4**	**601.4**	513.8	526.1
BBB	**569.8**	**504.8**	423.1	446.1
BB and below	**84.1**	**98.5**	134.9	165.9

	December 31, 2007		December 31, 2006	
Total by lowest agency rating	**$ 4,754.4**	**$ 4,665.6**	$ 4,196.3	$ 4,297.0
Vintage				
2003 and prior	**$ 2,092.9**	**$ 2,174.9**	$ 2,400.3	$ 2,512.8
2004	**545.6**	**523.4**	584.3	574.8
2005	**716.2**	**683.4**	841.0	835.9
2006	**428.2**	**389.7**	370.7	373.5
2007	**971.5**	**894.2**		
Total by vintage	**$ 4,754.4**	**$ 4,665.6**	$ 4,196.3	$ 4,297.0

(1) Includes leveraged interest-only CMBS for which our fixed income analysts internally rate as BBB-, but the agencies rate as AAA.

U.S. Invested Assets
Asset-Backed Securities Home Equity by Rating and Vintage

	December 31, 2007		December 31, 2006	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount
	(in millions)			
Lowest agency rating				
AAA	**$ 454.4**	**$ 434.1**	$ 469.4	$ 465.0
AA	**105.1**	**90.9**	155.5	155.7
A	**31.4**	**27.4**	16.0	16.1
BBB	**8.1**	**4.6**		
BB and below				
Total by lowest agency rating	**$ 599.0**	**$ 557.0**	$ 640.9	$ 636.8
Vintage				
2003 and prior	**$ 307.6**	**$ 290.2**	$ 376.6	$ 375.3
2004	**104.3**	**100.2**	120.2	118.0
2005	**107.6**	**97.6**	115.3	114.2
2006	**16.3**	**15.7**	28.8	29.3
2007	**63.2**	**53.3**		
Total by vintage	**$ 599.0**	**$ 557.0**	$ 640.9	$ 636.8

We believe that our long-term fixed maturity securities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturity securities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 7% of cash flow. As of December 31, 2007, we had invested 3.7% of new cash flow for the year in below investment grade assets. While the general account investment returns have improved due to the below investment grade asset class, we manage its growth strategically by limiting it to 10% of the total fixed maturity securities portfolios.

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

The following table shows the carrying amount of our corporate fixed maturity securities by Salomon industry category, as well as the percentage of the total corporate portfolio that each Salomon industry category comprises as of December 31, 2007 and 2006.

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

	December 31, 2007		December 31, 2006	
	Carrying amount	% of total	Carrying amount	% of total
	($ in millions)			

	December 31, 2007		December 31, 2006	
Industry class				
Finance Bank	$ **4,125.7**	**13%**	$ 3,659.2	12%
Finance Insurance	**3,147.8**	**10**	3,119.1	10
Finance Other	**4,770.1**	**15**	4,792.2	16
Industrial Consumer	**1,241.3**	**4**	1,100.0	4
Industrial Energy	**3,143.0**	**10**	2,683.2	9
Industrial Manufacturing	**5,638.7**	**18**	5,518.4	18
Industrial Other	**171.4**	**1**	105.3	
Industrial Service	**4,432.1**	**14**	4,462.3	15
Industrial Transport	**1,020.1**	**3**	836.9	3
Utility Electric	**2,325.5**	**7**	2,417.9	8
Utility Other	**46.5**		47.6	
Utility Telecom	**1,626.1**	**5**	1,645.5	5
Total	$ **31,688.3**	**100%**	$ 30,387.6	100%

We monitor any decline in the credit quality of fixed maturity securities through the designation of "problem securities", "potential problem securities" and "restructured securities". We define problem securities in our fixed maturity portfolio as securities: (i) as to which principal and/or interest payments are in default or where default is perceived to be imminent in the near term, or (ii) issued by a company that went into bankruptcy subsequent to the acquisition of such securities. We define potential problem securities in our fixed maturity portfolio as securities included on an internal "watch list" for which management has concerns as to the ability of the issuer to comply with the present debt payment terms and which may result in the security becoming a problem or being restructured. The decision whether to classify a performing fixed maturity security as a potential problem involves significant subjective judgments by our management as to the likely future industry conditions and developments with respect to the issuer. We define restructured securities in our fixed maturity portfolio as securities where a concession has been granted to the borrower related to the borrower's financial difficulties that would not have otherwise been considered. We determine that restructures should occur in those instances where greater economic value will be realized under the new terms than through liquidation or other disposition and may involve a change in contractual cash flows. If at the time of restructure, the present value of the new future cash flows is less than the current cost of the asset being restructured, a realized capital loss is recorded in net income and a new cost basis is established.

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

Every month, a group of individuals including the Chief Investment Officer, our Portfolio Managers, members of our Workout Group and representatives from Investment Accounting review all securities to determine whether an other than temporary decline in value exists and whether losses should be recognized. The analysis focuses on each issuer's ability to service its debts in a timely fashion and the length of time the security has been trading below cost. Formal documentation of the analysis and our decision is prepared and approved by management.

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) our ability and intent to hold the security for a period of time that allows for the recovery in value which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other than temporarily impaired, the difference between amortized cost and fair value would be charged to net income.

There are a number of significant risks and uncertainties inherent in the process of monitoring credit impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to hold the security to maturity or until it recovers in value. Any of these situations could result in a charge to earnings in a future period.

Due to the credit disruption in the last half of 2007 that led to reduced liquidity and wider credit spreads, we saw an increase in realized and unrealized losses in our securities portfolio. The losses were more pronounced in structured products such as collateralized debt obligations and ABS. The decline in value in large part reflects the illiquid markets.

The net realized loss relating to other than temporary credit impairments of fixed maturity securities was $207.3 million for the year ended December 31, 2007. The largest portion of this loss relates to collateralized debt obligations with sub-prime exposure and certain structured residual interest securities. Certain fixed maturity securities moved into a loss position during the second quarter of 2007, and we determined that we did not have the ability and intent to hold these securities. As a result, we recognized impairment losses on these securities of $24.5 million, net of recoveries on the subsequent sale, primarily due to a change in interest rates.

For the year ended December 31, 2007, we realized $34.6 million of gross losses upon disposal of bonds excluding hedging adjustments. Included in this $34.6 million is $32.3 million related to sales of forty-two credit impaired and credit related names. We generally intend to hold securities in unrealized loss positions until they mature or recover. However, we do sell bonds under certain circumstances such as when we have evidence of a significant deterioration in the issuer's creditworthiness, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities. Sales generate both gains and losses.

The following tables present our fixed maturity securities available-for-sale by industry category and the associated gross unrealized gains and losses as of December 31, 2007 and 2006.

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

	December 31, 2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance Bank	$ 4,226.4	$ 46.0	$ 176.7	$ 4,095.7
Finance Insurance	3,115.6	100.6	68.4	3,147.8
Finance Other	4,784.1	133.4	147.4	4,770.1
Industrial Consumer	1,230.2	30.2	19.1	1,241.3
Industrial Energy	3,012.3	153.7	23.0	3,143.0
Industrial Manufacturing	5,601.8	145.0	108.1	5,638.7
Industrial Other	169.9	2.5	1.0	171.4
Industrial Service	4,341.6	137.2	46.7	4,432.1
Industrial Transport	1,001.4	42.2	23.5	1,020.1
Utility Electric	2,268.6	79.9	23.0	2,325.5
Utility Other	41.0	5.5		46.5
Utility Telecom	1,558.9	86.3	19.1	1,626.1
Total corporate securities	31,351.8	962.5	656.0	31,658.3
Residential pass-through securities	1,481.5	23.6	9.0	1,496.1
Commercial mortgage-backed securities	4,754.4	107.4	196.2	4,665.6
Residential collateralized mortgage obligations	947.7	3.3	14.1	936.9
Asset-backed securities Home equity	599.0	0.1	42.1	557.0
Asset-backed securities All other	892.6	19.1	8.3	903.4
Collateralized debt obligations Credit	735.4	0.1	123.6	611.9
Collateralized debt obligations CMBS	332.7	1.4	71.6	262.5
Collateralized debt obligations Loans	88.8		5.7	83.1
Collateralized debt obligations ABS	94.1		30.1	64.0
Total mortgage-backed and other asset-backed securities	9,926.2	155.0	500.7	9,580.5
U.S. Government and agencies	628.5	29.0	0.1	657.4
States and political subdivisions	1,867.6	39.1	10.2	1,896.5
Non-U.S. governments	419.4	35.7	1.2	453.9
Total fixed maturity securities, available-for-sale	$ 44,193.5	$ 1,221.3	$ 1,168.2	$ 44,246.6

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

	December 31, 2006			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance Bank	$ 3,592.1	$ 78.3	$ 21.9	$ 3,648.5
Finance Insurance	3,057.4	83.0	21.8	3,118.6
Finance Other	4,661.3	166.9	36.5	4,791.7
Industrial Consumer	1,082.1	29.1	11.3	1,099.9
Industrial Energy	2,552.2	145.5	15.7	2,682.0
Industrial Manufacturing	5,406.1	155.8	44.0	5,517.9
Industrial Other	104.7	1.3	0.7	105.3
Industrial Service	4,344.3	143.9	26.9	4,461.3
Industrial Transport	796.0	46.2	5.3	836.9
Utility Electric	2,343.5	91.9	17.7	2,417.7
Utility Other	41.0	6.6		47.6
Utility Telecom	1,569.0	87.6	11.3	1,645.3
Total corporate securities	29,549.7	1,036.1	213.1	30,372.7
Residential pass-through securities	1,557.9	19.9	20.2	1,557.6
Commercial mortgage-backed securities	4,121.1	133.9	33.2	4,221.8
Residential collateralized mortgage obligations	951.5	0.9	13.9	938.5
Asset-backed securities Home equity	638.5	1.5	5.6	634.4
Asset-backed securities All other	994.0	50.9	2.2	1,042.7
Collateralized debt obligations Credit	527.5	0.9	0.4	528.0
Collateralized debt obligations CMBS	197.9	8.5	1.8	204.6
Collateralized debt obligations Loans	53.9	0.7	0.5	54.1
Collateralized debt obligations ABS	123.3	0.2		123.5
Total mortgage-backed and other asset-backed securities	9,165.6	217.4	77.8	9,305.2
U.S. Government and agencies	530.8	0.8	3.8	527.8
States and political subdivisions	1,557.7	45.4	4.9	1,598.2
Non-U.S. governments	384.9	36.1	0.3	420.7
Total fixed maturity securities, available-for-sale	$ 41,188.7	$ 1,335.8	$ 299.9	$ 42,224.6

The total unrealized losses on our fixed maturity securities available-for-sale were $1,168.2 million and $299.9 million as of December 31, 2007 and 2006, respectively. Of the $1,168.2 million in gross unrealized losses as of December 31, 2007, there were $9.5 million in losses attributed to securities scheduled to mature in one year or less, $107.3 million attributed to securities scheduled to mature between one to five years, $255.3 million attributed to securities scheduled to mature between five to ten years, $295.4 million attributed to securities scheduled to mature after ten years and $500.7 million related to mortgage-backed and other ABS. The gross unrealized losses as of December 31, 2007 were concentrated primarily in the Commercial mortgage-backed securities, Financial Bank, Financial Other, Collateralized debt obligations Credit and Industrial Manufacturing sectors. The gross unrealized losses as of December 31, 2006 were concentrated primarily in the Industrial Manufacturing, Financial Other, Commercial mortgage-backed securities and Industrial Services sectors.

The following tables present our fixed maturity securities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses as of December 31, 2007 and 2006.

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

	December 31, 2007			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Investment grade:				
Public	$ 27,966.9	$ 752.8	$ 577.5	$ 28,142.2
Private	14,027.8	410.3	496.3	13,941.8
Below investment grade:				
Public	1,149.9	27.4	63.8	1,113.5
Private	1,048.9	30.8	30.6	1,049.1
Total fixed maturity securities, available-for-sale	$ 44,193.5	$ 1,221.3	$ 1,168.2	$ 44,246.6

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

	December 31, 2006			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Investment grade:				
Public	$ 26,995.7	$ 770.7	$ 201.5	$ 27,564.9
Private	12,292.4	469.5	87.3	12,674.6
Below investment grade:				
Public	1,070.5	44.2	6.0	1,108.7
Private	830.1	51.4	5.1	876.4
Total fixed maturity securities, available-for-sale	$ 41,188.7	$ 1,335.8	$ 299.9	$ 42,224.6

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

	December 31, 2007					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses

	December 31, 2007					
			(in millions)			
Three months or less	$ 2,858.8	$ 71.9	$ 1,556.3	$ 36.0	$ 4,415.1	$ 107.9
Greater than three to six months	1,249.7	89.4	1,058.8	120.0	2,308.5	209.4
Greater than six to nine months	1,502.7	114.7	1,243.8	117.7	2,746.5	232.4
Greater than nine to twelve months	993.2	74.6	719.4	107.1	1,712.6	181.7
Greater than twelve to twenty-four months	1,545.8	100.8	580.2	45.4	2,126.0	146.2
Greater than twenty-four to thirty-six months	3,054.3	104.5	1,114.9	57.8	4,169.2	162.3
Greater than thirty-six months	617.9	21.6	354.2	12.3	972.1	33.9
Total fixed maturities, available-for-sale	$ 11,822.4	$ 577.5	$ 6,627.6	$ 496.3	$ 18,450.0	$ 1,073.8

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

	December 31, 2006					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	$ 2,730.4	$ 17.6	$ 1,471.2	$ 9.1	$ 4,201.6	$ 26.7
Greater than three to six months	30.3	0.4	22.7	0.3	53.0	0.7
Greater than six to nine months	224.8	1.6	107.1	1.3	331.9	2.9
Greater than nine to twelve months	1,502.6	28.2	549.9	8.2	2,052.5	36.4
Greater than twelve to twenty-four months	5,688.9	126.0	1,938.1	52.2	7,627.0	178.2
Greater than twenty-four to thirty-six months	843.4	22.9	365.5	10.2	1,208.9	33.1
Greater than thirty-six months	101.5	4.8	113.9	6.0	215.4	10.8
Total fixed maturities, available-for-sale	$ 11,121.9	$ 201.5	$ 4,568.4	$ 87.3	$ 15,690.3	$ 288.8

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

	December 31, 2007					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	**$ 95.4**	**$ 4.0**	**$ 187.0**	**$ 5.5**	**$ 282.4**	**$ 9.5**
Greater than three to six months	**62.8**	**2.6**	**115.6**	**5.4**	**178.4**	**8.0**
Greater than six to nine months	**130.5**	**22.8**	**91.3**	**3.0**	**221.8**	**25.8**
Greater than nine to twelve months	**91.5**	**11.3**	**17.3**	**0.7**	**108.8**	**12.0**
Greater than twelve to twenty-four months	**57.0**	**11.1**	**21.7**	**13.0**	**78.7**	**24.1**
Greater than twenty-four to thirty-six months	**138.3**	**11.4**	**72.9**	**2.1**	**211.2**	**13.5**
Greater than thirty-six months	**16.5**	**0.6**	**26.6**	**0.9**	**43.1**	**1.5**
Total fixed maturities, available-for-sale	**$ 592.0**	**$ 63.8**	**$ 532.4**	**$ 30.6**	**$ 1,124.4**	**$ 94.4**

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

December 31, 2006

	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	$ 64.0	$ 0.2	$ 83.5	$ 0.5	$ 147.5	$ 0.7
Greater than three to six months						
Greater than six to nine months	38.7	1.0			38.7	1.0
Greater than nine to twelve months	56.6	1.3			56.6	1.3
Greater than twelve to twenty-four months	152.8	3.5	117.8	3.0	270.6	6.5
Greater than twenty-four to thirty-six months			27.3	1.5	27.3	1.5
Greater than thirty-six months			0.6	0.1	0.6	0.1
Total fixed maturities, available-for-sale	$ 312.1	$ 6.0	$ 229.2	$ 5.1	$ 541.3	$ 11.1

Of total gross unrealized losses as of December 31, 2007 and 2006, $1,073.8 million and $288.8 million were related to investment grade securities, respectively. Gross unrealized losses related to below investment grade securities were $94.4 million and $11.1 million as of December 31, 2007 and 2006, respectively.

The following tables present the carrying amount and gross unrealized losses on fixed maturity securities available-for-sale, where the estimated fair value has declined and remained below amortized cost by 20% or more as of December 31, 2007 and 2006.

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

	December 31, 2007					
	Problem, potential problem, and restructured		All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	$	$	$ 670.2	$ 240.2	$ 670.2	$ 240.2
Greater than three to six months			110.7	80.9	110.7	80.9
Greater than six to nine months			0.5	0.3	0.5	0.3
Greater than nine to twelve months						
Greater than twelve months						
Total fixed maturity securities, available-for-sale	$	$	$ 781.4	$ 321.4	$ 781.4	$ 321.4

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

December 31, 2006		
Problem, potential problem, and restructured	All other fixed maturity securities	Total

. The obligations of Parent, FNIS and Merger Sub to consummate the Merger are subject to the satisfaction or waiver (where permissible) of the following additional conditions:

(a) Representations and Warranties. Each of the representations and warranties of the Company contained in this Agreement shall be true and correct in all respects (1) as of the date of this Agreement and (2) as of the Effective Time, as though made at and as of the Effective Time (except to the extent expressly made as of an earlier date, in which case such representations and warranties shall be true and correct as of such date), except, in the case of clauses (1) and (2), for such failures to be true and correct that do not individually or in the aggregate constitute a Company Material Adverse Effect; provided, however, that the representations and warranties contained in Section 4.03 shall be true and correct in all material respects as of such dates and times. For purposes of determining the accuracy of all representations and warranties under this Section 8.02(a), (1) all Knowledge qualifications, Material Adverse Effect qualifications and other qualifications based on the word material or similar phrases contained in such representations and warranties shall be disregarded and (2) any update of or modification to the Company Disclosure Letter made or purported to have been made after the date of this

Agreement shall be disregarded. Parent shall have received a certificate of the Company signed by its Chief Executive Officer and Treasurer with respect to the foregoing.

(b) Agreements and Covenants. The Company shall have performed or complied in all material respects with all agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Effective Time, and Parent shall have received a certificate of the Company signed by its Chief Executive Officer and Treasurer to that effect.

(c) [Intentionally Omitted].

(d) Material Adverse Effect. Since December 31, 2003, except as disclosed in Schedule 4.09 of the Company Disclosure Letter, there shall not have been any event, change or condition that, individually or in the aggregate, has had or would reasonably be expected to have a Company Material Adverse Effect.

(e) Third Party Consents. All consents from third parties under any agreement, contract, license, lease or other instrument to which the Company is a party shall have been obtained on terms reasonably acceptable to Parent, except where the failure to obtain such consent(s) (individually or in the aggregate) would not reasonably be likely to have, individually or in the aggregate, a Company Material Adverse Effect.

(f) [Intentionally Omitted].

(g) No Litigation. No Governmental Entity shall have enacted, issued, promulgated, enforced or entered any Order which would, or would reasonably be likely to, (i) (x) prohibit the acquisition by Parent, FNIS or Merger Sub of any Company Common Stock, (y) restrain or prohibit the consummation of the Merger or any other transaction contemplated hereunder or (z) require, in connection with or as a result of the consummation of the Merger or

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any other transaction contemplated hereunder, payment by the Company, Parent or any of their respective Subsidiaries of any damages that are material in relation to the Company and Company Subsidiaries taken as a whole; (ii) prohibit or limit the ownership or operation by the Company, Parent or any of their respective Subsidiaries of any material portion of the business or assets of the Company, Parent or any of their respective Subsidiaries or compel the Company, Parent or any of their respective Subsidiaries to dispose of or hold separate any material portion of the business or assets of the Company, Parent or any of their respective Subsidiaries, as a result of the Merger or any other transaction contemplated hereunder; (iii) impose limitations on the ability of Parent or any Subsidiary of Parent to acquire or hold, or exercise full rights of ownership of, any shares of the Company Common Stock, including the right to vote the Company Common Stock purchased by it on all matters properly presented to the shareholders of the Company; (iv) prohibit Parent or any of its Subsidiaries from effectively controlling in any material respect the business or operations of the Company and the Company Subsidiaries; or (v) have a Company Material Adverse Effect; and there shall not be (A) pending or threatened in writing any suit, action or proceeding by any Governmental Entity or (B) pending any suit, action or proceeding by any other Person that has a reasonable likelihood of success, in the case of either (A) or (B) which could lead to any Order described in this Section 8.02(g).

SECTION 8.03 Conditions to the Obligations of the Company. The obligations of the Company to consummate the Merger are subject to the satisfaction or waiver (where permissible) of the following additional conditions:

(a) Representations and Warranties. Each of the representations and warranties of Parent, FNIS and Merger Sub contained in this Agreement shall be true and correct in all respects (1) as of the date of this Agreement and (2) as of the Effective Time (except to the extent expressly made as of an earlier date, in which case such representations and warranties shall be true and correct as of such date), as though made at and as of the Effective Time, except, in the case of clauses (1) and (2), for such failures to be true and correct that do not individually or in the aggregate constitute a Parent Material Adverse Effect; provided, however, that the representations and warranties contained in Section 5.03 shall be true and correct in all material respects as of such dates and times. For purposes of determining the accuracy of all representations and warranties under this Section 8.03(a), (1) all Knowledge qualifications, Material Adverse Effect qualifications and other qualifications based on the word material or similar phrases contained in such representations and warranties shall be disregarded and (2) any update of or modification to the Parent Disclosure Letter made or purported to have been made after the date of this Agreement shall be disregarded. The Company shall have received a certificate of Parent signed by an authorized senior officer with respect to the foregoing.

(b) Agreements and Covenants. Parent, FNIS and Merger Sub shall have performed or complied in all material respects with all agreements and covenants required by this Agreement to be performed or complied with by it on or prior to the Effective Time, and the Company shall have received a certificate of Parent signed by an authorized senior officer to that effect.

(c) Material Adverse Effect. Since December 31, 2003, except as disclosed in Schedule 5.12 of the Parent Disclosure Letter, there shall not have been any event, change or condition that, individually or in the aggregate, has had or would reasonably be expected to have a Parent Material Adverse Effect.

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ARTICLE 9

TERMINATION, AMENDMENT AND WAIVER

SECTION 9.01 Termination. This Agreement may be terminated and the Merger and the other transactions contemplated by this Agreement may be abandoned at any time prior to the Effective Time, notwithstanding any requisite approval and adoption of this Agreement and the transactions contemplated by this Agreement, as follows:

(a) by mutual written consent duly authorized by the Boards of Directors of each of Parent and the Company;

(b) by either Parent or the Company:

(1) if the Effective Time shall not have occurred on or before February 21, 2005; provided, however, that the right to terminate this Agreement under this Section 9.01(b)(1) shall not be available to any party whose failure to perform any of its obligations under this Agreement has caused the failure of the Merger to occur on or before such date;

(2) if there shall be any Order which is final and nonappealable preventing the consummation of the Merger; or

(3) if the Company Common Shareholder Approval shall not have been obtained at the Company Shareholders Meeting or any adjournment or postponement thereof.

(c) by Parent if:

(1) the board of directors of the Company or any committee thereof withholds, withdraws, amends, modifies or changes its recommendation of the adoption of this Agreement or the approval of the Merger or the other transactions contemplated hereby in a manner adverse to Parent or shall have resolved to do so;

(2) the board of directors of the Company or any committee thereof shall have recommended to the shareholders of the Company a Competing Transaction or shall have entered into any letter of intent or similar document or any agreement, contract or commitment accepting any Competing Transaction;

(3) the Company shall have failed to include in the Proxy Statement the recommendation of the Company s board of directors in favor of the approval of the Merger or this Agreement;

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(4) the Company shall have breached (other than inadvertent immaterial breaches) its obligations under Section 7.04; or

(5) a tender offer or exchange offer for 15% or more of the outstanding shares of stock of the Company is commenced, and the board of directors of the Company fails to recommend within 10 Business Days against acceptance of such tender offer or exchange offer by its shareholders (including by taking no position with respect to the acceptance of such tender offer or exchange offer by its shareholders);

(d) by Parent upon a breach of any representation, warranty, covenant or agreement on the part of the Company set forth in this Agreement, or if any representation or warranty of the Company shall have become untrue, in either case such (and only such) that the conditions set forth either in Section 8.02(a) or (b) would not be satisfied (**Terminating Company Breach**); provided, however, that if such Terminating Company Breach is curable by the Company within 30 days of the occurrence of such Terminating Company Breach through the exercise of its reasonable best efforts and for as long as the Company continues to exercise such reasonable best efforts, Parent may not terminate this Agreement under this Section 9.01(d) until the expiration of such 30-day period;

(e) by the Company in accordance with Section 7.01(c);

(f) by the Company upon a breach of any representation, warranty, covenant or agreement on the part of Parent, FNIS and Merger Sub set forth in this Agreement, or if any representation or warranty of Parent, FNIS and Merger Sub shall have become untrue, in either case such (and only such) that the conditions set forth either in Section 8.03(a) or (b) would not be satisfied (**Terminating Parent Breach**); provided, however, that if such Terminating Parent Breach is curable by Parent, FNIS and Merger Sub within 30 days of the occurrence of such Terminating Parent Breach through the exercise of their respective reasonable best efforts and for as long as Parent, FNIS and Merger Sub continue to exercise such reasonable best efforts, the Company may not terminate this Agreement under this Section 9.01(f) until the expiration of such 30-day period; or

(g) by Parent if any Order described in Section 8.02(g)(i) through (v) shall have been enacted, issued, promulgated, enforced or entered (and not withdrawn, terminated or cancelled).

SECTION 9.02 Effect of Termination. Except as provided in this Section 9.02, in Sections 7.03(b) and 9.05 and in Article 10, in the event of termination of this Agreement pursuant to Section 9.01, this Agreement shall forthwith become void, there shall be no liability under this Agreement on the part of Parent, FNIS, Merger Sub or the Company or any of their respective officers or directors, and all rights and obligations of each party hereto shall cease. Notwithstanding the foregoing, nothing herein shall relieve any party from liability for the willful breach of any of its representations and warranties or the willful breach of any of its covenants or agreements set forth in this Agreement; provided, however, that in the event of any such willful breach by Parent or any of its Affiliates under this Agreement, the sole recourse of the Company in respect of such willful breach shall be to take either or both of the following

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actions, at the Company s election: (i) to terminate this Agreement pursuant to Section 9.01(f) (subject to the terms thereof) and, if payable pursuant to Section 9.05(c), receive the Termination Fee and the Company s Expense Reimbursement, and the parties agree that such amounts will constitute liquidated damages in respect of any and all liability that Parent or any Affiliate may have in respect of any and all breaches, and the Company shall have no further recourse against Parent or any of its Affiliates to recover damages with respect thereto; and (ii) to exercise its rights under Section 10.05.

SECTION 9.03 Amendment. This Agreement may be amended by the parties hereto to the fullest extent permitted by law (and if applicable, by the articles of incorporation and bylaws of the Company) by action taken by or on behalf of their respective Boards of Directors at any time prior to the Effective Time; provided, however, that, after the adoption of this Agreement by the shareholders of the Company, no amendment may be made that would require the approval of the shareholders of the Company under applicable law or under the Company s articles of incorporation without such approval. This Agreement may not be amended, except by an instrument in writing signed by each of the parties hereto.

SECTION 9.04 Waiver. At any time prior to the Effective Time, any party hereto may (a) extend the time for the performance of any obligation or other act of any other party hereto, (b) waive any inaccuracy in the representations and warranties contained herein or in any document delivered pursuant hereto and (c) subject to Section 9.03, waive compliance with any agreement or condition contained herein. Any such extension or waiver shall be valid if set forth in an instrument in writing signed by the party or parties to be bound thereby.

SECTION 9.05 Fees and Expenses.

(a) Except as set forth in this Section 9.05, all Expenses incurred in connection with this Agreement, the Merger and the other transactions contemplated by this Agreement shall be paid by the party incurring such expenses, whether or not the Merger or any other transaction is consummated, except that the Company and Parent each shall pay one-half of all Expenses relating to printing, filing with Governmental Entities and mailing the Proxy Statement and all filing fees incurred in connection with all filings to be made under the HSR Act.

(b) The Company agrees to pay to Parent the Termination Fee and the Parent s Expense Reimbursement (each as defined below) as follows:

(1) if Parent shall terminate this Agreement pursuant to Section 9.01(c);

(2) if the Company shall terminate this Agreement pursuant to Section 9.01(e);

(3) if an offer or proposal for a Competing Transaction is received or publicly disclosed after the date hereof and prior to the termination of this Agreement, and thereafter the Company or Parent shall terminate this Agreement pursuant to either Section 9.01(b)(1) or Section 9.01(b)(3), and within 12 months

December 31, 2006

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of the date of such termination a Competing Transaction shall have been consummated or the Company shall have entered into a definitive agreement for a Competing Transaction; or

(4) if an offer or proposal for a Competing Transaction is received or publicly disclosed after the date hereof and prior to the termination of this Agreement, and thereafter Parent shall terminate this Agreement pursuant to Section 9.01(d), and within 12 months of the date of such termination a Competing Transaction shall have been consummated or the Company shall have entered into a definitive agreement for a Competing Transaction.

The Company shall pay the Parent s Expense Reimbursement to Parent if Parent shall terminate this Agreement pursuant to Section 9.01(d), whether or not an offer or proposal for a Competing Transaction is received or publicly disclosed after the date hereof.

(c) Parent shall pay to the Company the Termination Fee and the Company s Expense Reimbursement (as defined below) if the Company shall terminate this Agreement pursuant to Section 9.01(f) as a result of a willful breach by Parent, FNIS or Merger Sub of any representation, warranty, covenant or agreement hereunder; provided, that Parent would not have had the right to terminate this Agreement at the time of any such termination by the Company.

(d) For the purposes hereof **Termination Fee** shall mean $15,000,000. For purposes hereof, the **Company s Expense Reimbursement** or the **Parent s Expense Reimbursement** shall be an amount equal to such party s out-of-pocket expenses incurred in connection with this Agreement and the transactions contemplated hereby (including, without limitation, all attorneys , accountants and investment bankers fees and expenses), but not to exceed $2,000,000.

(e) Payment of the Termination Fee shall be made no later than the First Business Day following termination, except as provided in Section 7.01(c). Any payment of the Parent s Expense Reimbursement or Company s Expense Reimbursement required to be made pursuant to Section 9.05(b) or (c) shall be made to the receiving party not later than two Business Days after delivery to the paying party of notice of demand for payment and an itemization setting forth in reasonable detail all expenses (which itemization may be supplemented and updated from time to time until the 60th day after the delivery of such notice of demand for payment), and shall be made by wire transfer of immediately available funds to an account designated by the receiving party. Payment of the fees described in Section 9.05(b) (other than as described in the following sentence) shall not be in lieu of damages incurred in the event of the willful breach of the representations and warranties set forth in this Agreement or the willful breach of any of the covenants or agreements set forth in this Agreement. Payment of the fees described in Section 9.05(b) that are made as a result of Parent s termination of this Agreement under Section 9.01(c) for actions that are in accordance with Section 7.01(c) shall be in lieu of damages incurred in the event of the willful breach of the representations and warranties set forth in this Agreement or the willful breach of any of the covenants or agreements set forth in this Agreement. Payment of the fees described in Section 9.05(c) shall be in lieu of damages incurred in the event of the willful breach of the representations and warranties set forth in this Agreement or the willful breach of any of the covenants or agreements set forth in this Agreement.

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(f) If either party hereto fails to pay when due any amount due pursuant to this Section 9.05 (the **Payor**), and, in order to obtain such payment, the party entitled to receive such payment (the **Payee**) commences a suit which results in a judgment against the Payor for the fee set forth in this Section 9.05, the Payor shall pay the Payee an amount equal to the Payee s costs and expenses (including reasonable attorneys fees and expenses) incurred in connection with such suit, together with interest on the amount of the fee at the prime rate of Citibank, N.A. in effect on the date such payment was required to be made.

ARTICLE 10

GENERAL PROVISIONS

SECTION 10.01 Non-Survival of Representations, Warranties and Agreements. The representations, warranties and agreements in this Agreement and in any certificate delivered pursuant hereto shall terminate at the Effective Time, except that the agreements set forth in Articles 2 and 3, Sections 7.06, 7.16, 7.17 and 7.19 and this Article 10 shall survive the Effective Time.

SECTION 10.02 Notices. All notices, requests, claims, demands and other communications hereunder shall be in writing and shall be given (and shall be deemed to have been duly given upon receipt) by delivery in person, by facsimile, by registered or certified mail (postage prepaid, return receipt requested) or by nationally recognized overnight courier to the respective parties at the following addresses (or at such other address for a party as shall be specified in a notice given in accordance with this Section 10.02):

if to Parent, FNIS or Merger Sub:

Fidelity National Financial, Inc.

601 Riverside Avenue, 12th Floor

Jacksonville, FL 32204

Facsimile No.: (904) 357-1026

Attention: Christopher A. Rose, Senior Vice President

with a copy (which shall not constitute notice) to:

LeBoeuf, Lamb, Greene & MacRae, L.L.P.

125 West 55^{th} Street

New York, NY 10019

Facsimile No.: (212) 424-8500

Attention: Robert S. Rachofsky

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if to the Company:

InterCept, Inc.

3150 Holcomb Bridge Road

Suite 200

Norcross, GA 30071-1370

Facsimile No.: (770) 840-2701

Attention: John W. Collins, Chairman of the Board and Chief Executive Officer

with a copy (which shall not constitute notice) to:

Nelson Mullins Riley & Scarborough LLP

14th Floor

999 Peachtree Street N.E.

Atlanta, GA 30309

Facsimile No.: (404) 817-6050

Attention: Charles D. Vaughn

SECTION 10.03 Severability. If any term or other provision of this Agreement is invalid, illegal or incapable of being enforced by any rule of Law or public policy, all other conditions and provisions of this Agreement shall nevertheless remain in full force and effect as long as the economic or legal substance of the transactions contemplated by this Agreement is not affected in any manner materially adverse to any party. Upon such determination that any term or other provision is invalid, illegal or incapable of being enforced, the parties hereto shall negotiate in good faith to modify this Agreement so as to effect the original intent of the parties as closely as possible in a mutually acceptable manner in order that the transactions contemplated by this Agreement be consummated as originally contemplated to the fullest extent possible.

SECTION 10.04 Assignment; Binding Effect; Benefit. Neither this Agreement nor any of the rights, interests or obligations hereunder shall be assigned by any of the parties hereto (other than by operation of law following the Effective Time) without the prior written consent of the other parties. Subject to the preceding sentence, this Agreement shall be binding upon and shall inure to the benefit of the parties hereto and their respective successors and assigns. Nothing in this Agreement, expressed or implied, is intended to confer on any Person other than the parties hereto or their respective successors and assigns any rights, remedies, obligations or liabilities under or by reason of this Agreement, other than as provided in Section 7.06. For the avoidance of doubt, nothing in this Agreement other than as provided in Section 7.06 should be construed to give any Company Beneficiary any legal or equitable right, remedy or claim under or in respect of this Agreement or any provision contained herein.

SECTION 10.05 Specific Performance. The parties hereto agree that irreparable damage would occur in the event any provision of this Agreement was not performed in accordance with the terms hereof and that the parties shall be entitled to specific performance of the terms hereof, in addition to any other remedy at law or in equity.

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SECTION 10.06 Governing Law; Forum.

(a) This Agreement shall be governed by, and construed in accordance with, the laws of the State of Georgia, without giving effect to the principles of conflicts of law thereof.

(b) Each party hereby irrevocably submits to the exclusive jurisdiction of the federal and state courts in the City of Jacksonville, the State of Florida, in any action, suit or proceeding arising in connection with this Agreement, and agrees that any such action, suit or proceeding shall be brought only in such court (and waives any objection based on forum non conveniens or any other objection to venue therein); provided, however, that such consent to jurisdiction is solely for the purpose referred to in this Section 10.06(b) and shall not be deemed to be a general submission to the jurisdiction of such court or in the State of Florida other than for such purposes.

SECTION 10.07 Waiver of Jury Trial. EACH OF PARENT, THE COMPANY, FNIS AND MERGER SUB HEREBY IRREVOCABLY WAIVES ALL RIGHT TO TRIAL BY JURY IN ANY ACTION, PROCEEDING OR COUNTERCLAIM (WHETHER BASED ON CONTRACT, TORT OR OTHERWISE) ARISING OUT OF OR RELATING TO THIS AGREEMENT OR THE ACTIONS OF PARENT, THE COMPANY, FNIS OR MERGER SUB IN THE NEGOTIATION, ADMINISTRATION, PERFORMANCE AND ENFORCEMENT THEREOF.

SECTION 10.08 Headings. The descriptive headings contained in this Agreement are included for convenience of reference only and shall not affect in any way the meaning or interpretation of this Agreement.

SECTION 10.09 Counterparts. This Agreement may be executed and delivered (including by facsimile transmission) in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed and delivered shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

SECTION 10.10 Interpretation. Each party hereto has participated in the drafting of this Agreement, which each party acknowledges is the result of extensive negotiations between the parties. Whenever the words include, includes or including are used in this Agreement, they shall be deemed to be followed by the words without limitation.

SECTION 10.11 Entire Agreement. This Agreement (including the Exhibits, the Company Disclosure Letter and the Parent Disclosure Letter), and the Non-Disclosure Agreement constitute the entire agreement among the parties with respect to the subject matter hereof and supersede all prior agreements and understandings among the parties with respect thereto. No addition to or modification of any provision of this Agreement shall be binding upon any party hereto unless made in writing and signed by all parties hereto.

[signature page follows]

December 31, 2006

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IN WITNESS WHEREOF, Parent, FNIS, Merger Sub and the Company have caused this Agreement to be executed as of the date first written above by their respective officers thereunto duly authorized.

FIDELITY NATIONAL FINANCIAL, INC.

By: /s/ Alan L. Stinson

Name: Alan L. Stinson
Title: Executive Vice President & CFO

FIDELITY NATIONAL INFORMATION SERVICES, INC.

By: /s/ Alan L. Stinson

Name: Alan L. Stinson
Title: Executive Vice President & CFO

FUSCIA MERGER SUB, INC.

By: /s/ Alan L. Stinson

Name: Alan L. Stinson
Title: Executive Vice President

INTERCEPT, INC.

By: /s/ G. Lynn Boggs

Name: G. Lynn Boggs
Title: President

SIGNATURE PAGE TO AMENDED AND RESTATED AGREEMENT AND PLAN OF MERGER

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APPENDIX B

September 8, 2004

The Board of Directors

InterCept, Inc.

3150 Holcomb Bridge Road

Suite 200

Norcross, GA 30071

Members of the Board of Directors:

InterCept, Inc. (InterCept or the Company) has retained us to deliver to you our opinion as to the fairness, from a financial point of view, of the consideration to be received by the holders of common stock, no par value, of the Company in connection with the merger of a subsidiary (Merger Sub) of Fidelity National Information Services, Inc. (FNIS), a wholly owned subsidiary of Fidelity National Financial, Inc. (FNF or the Buyer), with and into the Company pursuant to the terms of the Agreement and Plan of Merger dated as of September 8, 2004 (the Agreement), by and among InterCept, FNF, FNIS and Merger Sub (the Transaction).

As more fully set forth in the Agreement, each share of InterCept common stock will be converted into the right to receive, subject to the limitations set forth and as provided in the Agreement, shares of FNF common stock, par value $0.0001 per share, and cash that have a combined value of $18.90 per share (such aggregate consideration of $18.90 per share is referred to herein as the Consideration). In aggregate, 25.0% of the Consideration will be made up of FNF common stock and 75.0% of the Consideration will be made up of cash, with individual stockholders electing their desired mix of stock and cash, subject to proration, provided that, FNF may elect to pay 100% of the Consideration in cash, as set forth in the Agreement.

Jefferies & Company, Inc., as part of our investment banking business, is regularly engaged in the evaluation of capital structures and the valuation of businesses and their securities in connection with mergers and acquisitions, negotiated underwritings, competitive biddings, secondary distributions of listed and unlisted securities, private placements, financial restructurings and other financial services. InterCept retained us pursuant to an engagement agreement dated June 11, 2004 (the Engagement Letter) regarding the potential sale of the Company. Pursuant to the terms of the Engagement Letter, we assisted InterCept in soliciting and assessing expressions of interest in the Company. The solicitations generated interest from multiple parties and, ultimately, culminated with the Agreement with the Buyer. We will receive fees from the Company in connection with the advisory services we have provided pursuant to the Engagement Letter, including a fee that is contingent upon the completion of a transaction involving the Company. As part of our retention, we will receive a non-refundable fee from InterCept for rendering this opinion. This latter fee is not contingent upon the completion of the

Transaction. In addition, InterCept has agreed to indemnify us for certain liabilities arising out of our engagement.

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We have in the past provided investment banking services to, and received compensation from the Company and FNF on matters unrelated to the proposed acquisition. In the ordinary course of our business, we have published research reports regarding the securities of InterCept and we and our affiliates may publish research reports regarding the securities of InterCept s affiliates, may trade or hold such securities for our own accounts and for the accounts of our customers and, accordingly, may at any time hold long or short positions in those securities.

In connection with this opinion, we have, among other things:

(i) Performed comprehensive marketing of the Company to potential buyers whose possible interest in a transaction was solicited and considered by the Company and us;

(ii) Evaluated and assessed all offers submitted;

(iii) Reviewed a draft Agreement dated September 8, 2004;

(iv) Reviewed certain financial and other information about the Company and the Buyer that was publicly available;

(v) Reviewed certain internal financial and operating information, including financial forecasts and projections and certain of the Company s contracts, that were provided to us by the Company, taking into account (a) the growth prospects of the Company and the various market segments in which it competes, (b) the Company s historical financial performance, (c) the Company s ability to meet its financial forecasts and projections, and (d) the effects on the Company s business of the Company s contracts that we reviewed;

(vi) Met with InterCept s and the Buyer s managements regarding the business prospects, financial outlooks and operating plans of their respective companies and held discussions concerning the impact on InterCept, the Buyer and their respective prospects of the economy and their industries, including the effect of the current economic environment;

(vii) Reviewed certain estimates of cost savings and other combination benefits expected to result from the Transaction, prepared and provided to us by InterCept s management;

(viii) Reviewed certain change-of-control and non-compete agreements between the Company and certain executive officers of the Company that would cause cash payments and other benefits to accrue to such executive officers as a result of the Transaction;

(ix) Reviewed the historical prices, trading multiples and trading volumes of the common shares of InterCept and the Buyer;

(x) Compared the financial characteristics and valuations in the public market of companies that we deemed similar to that of the Company and the Buyer, respectively, in markets, services offered and size;

(xi) Reviewed public information with respect to recent acquisition transactions that we deemed comparable to the Transaction;

(xii) Reviewed the premiums to pre-announcement stock prices paid in recent acquisition transactions that were similar in size to the Transaction;

(xiii) Performed a discounted cash flow analysis to analyze the present value of the future cash flow streams that the Company has indicated it expects to generate; and

(xiv) Reviewed the pro forma financial results of the Buyer giving effect to the Transaction.

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In addition to the foregoing, we performed such other studies, analyses and investigations and considered such other financial, economic and market criteria as we considered appropriate in arriving at our opinion. Our analyses must be considered as a whole. Considering any portion of such analyses or the factors considered, without considering all analyses and factors, could create a misleading or incomplete view of the process underlying the conclusions expressed herein.

In rendering this opinion, we have, with your permission, assumed and relied upon the accuracy and completeness of all of the financial information, forecasts and other information provided to us by the Company and the Buyer or that was publicly available to us, and we have not assumed any responsibility for independent verification of any such information. This opinion is expressly conditioned upon such information (whether written or oral) being complete, accurate and fair in all respects. With respect to the financial projections and financial models provided to and examined by us, we note that projecting future results of any company is inherently subject to uncertainty. InterCept has informed us, however, and we have assumed with their and your permission, that such projections and models were reasonably prepared on bases reflecting the best currently available estimates and good faith judgments of the management of the Company as to the future performance of the Company. We express no opinion as to the Company s financial projections or the assumptions upon which they are based. In addition, in rendering this opinion, we have assumed that the Company will perform in accordance with such projections and models for all periods specified therein. Although such projections and models did not form the principal basis for our opinion but rather constituted one of many factors that we considered, changes to such projections and models could affect the opinion rendered herein.

We have assumed that there have been no material changes in the Company s or the Buyer s respective assets, financial condition, results of operations, business or prospects since the most recent financial statements made available to us. In addition, we have not conducted a physical inspection of the properties and facilities of the Company or the Buyer and have not made or obtained an independent valuation or appraisal of the assets or liabilities (contingent or otherwise) of the Company or the Buyer, nor have we been furnished with any reports of inspection, valuations or appraisals of the Company or the Buyer, nor do we assume any responsibility to obtain any such inspections, valuations or appraisals of the Company or the Buyer. In addition, in preparing our opinion, we have not taken into account any tax consequences of the Transaction to either the Company or the Buyer, nor to any of the stockholders of the Company or the Buyer.

We have made no independent investigation of any legal or accounting matters affecting the Company, and we have assumed the correctness of all legal and accounting advice given to the Company and the Board of Directors, including, without limitation, advice as to the legal, accounting and tax consequences of the terms of and transactions contemplated by the Agreement to the Company and its stockholders. We have assumed that the Transaction will be consummated in a manner that complies in all respects with the applicable provisions of the Securities Act of 1933, as amended, and all other applicable federal and state statutes, rules and regulations. We have further assumed, with your permission, that (i) the Transaction will be consummated in accordance with the terms described in the Agreement, without any amendments thereto, and without waiver by the Company of any of the conditions to the Buyer s obligations and have assumed that the final form of the Agreement will be substantially similar to the last draft reviewed by us; (ii) there is not now, and there will not as a result of the consummation of the transactions contemplated by the Agreement be, any default, or event of

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default, under any indenture, credit agreement or other material agreement or instrument to which the Company or any of its subsidiaries or affiliates is a party; and (iii) all material assets and liabilities (contingent or otherwise, known or unknown) of the Company and the Buyer are as set forth in the respective consolidated financial statements reviewed by us regarding the Company and the Buyer.

This opinion is for the benefit and use of the Board of Directors of InterCept in its consideration of the Transaction and may not be reproduced, disseminated, quoted or referred to at any time, in any manner or for any purpose without our prior written consent. This opinion does not address the merits of the decision of the Board of Directors or InterCept to enter into the Agreement as compared to any alternative business transaction that might be available to InterCept, nor does it address the underlying business decision of the Board of Directors or InterCept to engage in the Transaction or the terms of the Agreement. Further, this opinion addresses only the fairness as of the date hereof of the Consideration to be received by the common stockholders of InterCept from a financial point of view and does not address any other aspect of the Transaction. This opinion does not constitute a recommendation to any stockholder as to how such stockholder should vote on the Transaction or any matter related to the Transaction. We have not been engaged to prepare, and have not prepared, a valuation of the Company or the Buyer and our opinion should not be construed as such. This opinion is based on the economic, market and other conditions as they exist and as evaluated on the date hereof, and we disclaim any undertaking or obligation to advise any person of any change in any fact or matter affecting this opinion after the date hereof. We express no opinion as to the price at which the Company s common stock or FNF s common stock will trade at any future time, including upon announcement and consummation of the Transaction.

Based upon and subject to the foregoing, we are of the opinion that as of the date hereof, the Consideration to be received by the common stockholders of InterCept in the Transaction is fair, from a financial point of view, to such stockholders.

Very truly yours,

/s/ Jeffries & Company, Inc.

JEFFERIES & COMPANY, INC.

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APPENDIX C

TITLE 14. CORPORATIONS, PARTNERSHIPS, AND ASSOCIATIONS

CHAPTER 2. BUSINESS CORPORATIONS

ARTICLE 13. DISSENTERS RIGHTS

PART 1. RIGHT TO DISSENT AND OBTAIN PAYMENT FOR SHARES

§14-2-1301. Definitions

As used in this article, the term:

(1) Beneficial shareholder means the person who is a beneficial owner of shares held in a voting trust or by a nominee as the record shareholder.

(2) Corporate action means the transaction or other action by the corporation that creates dissenters rights under *Code Section 14-2-1302*.

(3) Corporation means the issuer of shares held by a dissenter before the corporate action, or the surviving or acquiring corporation by merger or share exchange of that issuer.

(4) Dissenter means a shareholder who is entitled to dissent from corporate action under *Code Section 14-2-1302* and who exercises that right when and in the manner required by *Code Sections 14-2-1320* through 14-2-1327.

(5) Fair value, with respect to a dissenter s shares, means the value of the shares immediately before the effectuation of the corporate action to which the dissenter objects, excluding any appreciation or depreciation in anticipation of the corporate action.

(6) Interest means interest from the effective date of the corporate action until the date of payment, at a rate that is fair and equitable under all the circumstances.

(7) Record shareholder means the person in whose name shares are registered in the records of a corporation or the beneficial owner of shares to the extent of the rights granted by a nominee certificate on file with a corporation.

(8) Shareholder means the record shareholder or the beneficial shareholder.

§14-2-1302. Right to dissent

(a) A record shareholder of the corporation is entitled to dissent from, and obtain payment of the fair value of his or her shares in the event of, any of the following corporate actions:

(1) Consummation of a plan of merger to which the corporation is a party:

(A) If approval of the shareholders of the corporation is required for the merger by *Code Section 14-2-1103* or the articles of incorporation and the shareholder is entitled to vote on the merger, unless:

(i) The corporation is merging into a subsidiary corporation pursuant to *Code Section 14-2-1104*;

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(ii) Each shareholder of the corporation whose shares were outstanding immediately prior to the effective time of the merger shall receive a like number of shares of the surviving corporation, with designations, preferences, limitations, and relative rights identical to those previously held by each shareholder; and

(iii) The number and kind of shares of the surviving corporation outstanding immediately following the effective time of the merger, plus the number and kind of shares issuable as a result of the merger and by conversion of securities issued pursuant to the merger, shall not exceed the total number and kind of shares of the corporation authorized by its articles of incorporation immediately prior to the effective time of the merger; or

(B) If the corporation is a subsidiary that is merged with its parent under *Code Section 14-2-1104*;

(2) Consummation of a plan of share exchange to which the corporation is a party as the corporation whose shares will be acquired, if the shareholder is entitled to vote on the plan;

(3) Consummation of a sale or exchange of all or substantially all of the property of the corporation if a shareholder vote is required on the sale or exchange pursuant to *Code Section 14-2-1202*, but not including a sale pursuant to court order or a sale for cash pursuant to a plan by which all or substantially all of the net proceeds of the sale will be distributed to the shareholders within one year after the date of sale;

(4) An amendment of the articles of incorporation with respect to a class or series of shares that reduces the number of shares of a class or series owned by the shareholder to a fraction of a share if the fractional share so created is to be acquired for cash under *Code Section 14-2-604*; or

(5) Any corporate action taken pursuant to a shareholder vote to the extent that Article 9 of this chapter, the articles of incorporation, bylaws, or a resolution of the board of directors provides that voting or nonvoting shareholders are entitled to dissent and obtain payment for their shares.

(b) A shareholder entitled to dissent and obtain payment for his or her shares under this article may not challenge the corporate action creating his or her entitlement unless the corporate action fails to comply with procedural requirements of this chapter or the articles of incorporation or bylaws of the corporation or the vote required to obtain approval of the corporate action was obtained by fraudulent and deceptive means, regardless of whether the shareholder has exercised dissenter s rights.

(c) Notwithstanding any other provision of this article, there shall be no right of dissent in favor of the holder of shares of any class or series which, at the record date fixed to determine the shareholders entitled to receive notice of and to vote at a meeting at which a plan of merger or share exchange or a sale or exchange of property or an amendment of the articles of incorporation is to be acted on, were either listed on a national securities exchange or held of record by more than 2,000 shareholders, unless:

(1) In the case of a plan of merger or share exchange, the holders of shares of the class or series are required under the plan of merger or share exchange to accept for their shares anything except shares of the surviving corporation or another publicly held corporation which at the effective date of the merger or share exchange are either listed on a national securities exchange or held of record by more than 2,000 shareholders, except for scrip or cash payments in lieu of fractional shares; or

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(2) The articles of incorporation or a resolution of the board of directors approving the transaction provides otherwise.

§14-2-1303. Dissent by nominees and beneficial owners

A record shareholder may assert dissenters rights as to fewer than all the shares registered in his name only if he dissents with respect to all shares beneficially owned by any one beneficial shareholder and notifies the corporation in writing of the name and address of each person on whose behalf he asserts dissenters rights. The rights of a partial dissenter under this Code section are determined as if the shares as to which he dissents and his other shares were registered in the names of different shareholders.

PART 2. PROCEDURE FOR EXERCISE OF DISSENTERS RIGHTS

§14-2-1320. Notice of dissenters rights

(a) If proposed corporate action creating dissenters rights under *Code Section 14-2-1302* is submitted to a vote at a shareholders meeting, the meeting notice must state that shareholders are or may be entitled to assert dissenters rights under this article and be accompanied by a copy of this article.

(b) If corporate action creating dissenters rights under *Code Section 14-2-1302* is taken without a vote of shareholders, the corporation shall notify in writing all shareholders entitled to assert dissenters rights that the action was taken and send them the dissenters notice described in *Code Section 14-2-1322* no later than ten days after the corporate action was taken.

§14-2-1321. Notice of intent to demand payment

(a) If proposed corporate action creating dissenters rights under *Code Section 14-2-1302* is submitted to a vote at a shareholders meeting, a record shareholder who wishes to assert dissenters rights:

(1) Must deliver to the corporation before the vote is taken written notice of his intent to demand payment for his shares if the proposed action is effectuated; and

(2) Must not vote his shares in favor of the proposed action.

(b) A record shareholder who does not satisfy the requirements of subsection (a) of this Code section is not entitled to payment for his shares under this article.

§14-2-1322. Dissenters notice

(a) If proposed corporate action creating dissenters rights under *Code Section 14-2-1302* is authorized at a shareholders meeting, the corporation shall deliver a written dissenters notice to all shareholders who satisfied the requirements of *Code Section 14-2-1321*.

(b) The dissenters notice must be sent no later than ten days after the corporate action was taken and must:

(1) State where the payment demand must be sent and where and when certificates for certificated shares must be deposited;

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(2) Inform holders of uncertificated shares to what extent transfer of the shares will be restricted after the payment demand is received;

(3) Set a date by which the corporation must receive the payment demand, which date may not be fewer than 30 nor more than 60 days after the date the notice required in subsection (a) of this Code section is delivered; and

(4) Be accompanied by a copy of this article.

§14-2-1323. Duty to demand payment

(a) A record shareholder sent a dissenters notice described in *Code Section 14-2-1322* must demand payment and deposit his certificates in accordance with the terms of the notice.

(b) A record shareholder who demands payment and deposits his shares under subsection (a) of this Code section retains all other rights of a shareholder until these rights are canceled or modified by the taking of the proposed corporate action.

(c) A record shareholder who does not demand payment or deposit his share certificates where required, each by the date set in the dissenters notice, is not entitled to payment for his shares under this article.

§14-2-1324. Share restrictions

(a) The corporation may restrict the transfer of uncertificated shares from the date the demand for their payment is received until the proposed corporate action is taken or the restrictions released under *Code Section 14-2-1326*.

(b) The person for whom dissenters rights are asserted as to uncertificated shares retains all other rights of a shareholder until these rights are canceled or modified by the taking of the proposed corporate action.

§14-2-1325. Offer of payment

(a) Except as provided in *Code Section 14-2-1327*, within ten days of the later of the date the proposed corporate action is taken or receipt of a payment demand, the corporation shall by notice to each dissenter who complied with *Code Section 14-2-1323* offer to pay to such dissenter the amount the corporation estimates to be the fair value of his or her shares, plus accrued interest.

(b) The offer of payment must be accompanied by:

(1) The corporation s balance sheet as of the end of a fiscal year ending not more than 16 months before the date of payment, an income statement for that year, a statement of changes in shareholders equity for that year, and the latest available interim financial statements, if any;

(2) A statement of the corporation s estimate of the fair value of the shares;

(3) An explanation of how the interest was calculated;

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(4) A statement of the dissenter s right to demand payment under *Code Section 14-2-1327*; and

(5) A copy of this article.

(c) If the shareholder accepts the corporation s offer by written notice to the corporation within 30 days after the corporation s offer or is deemed to have accepted such offer by failure to respond within said 30 days, payment for his or her shares shall be made within 60 days after the making of the offer or the taking of the proposed corporate action, whichever is later.

§14-2-1326. Failure to take action

(a) If the corporation does not take the proposed action within 60 days after the date set for demanding payment and depositing share certificates, the corporation shall return the deposited certificates and release the transfer restrictions imposed on uncertificated shares.

(b) If, after returning deposited certificates and releasing transfer restrictions, the corporation takes the proposed action, it must send a new dissenters notice under *Code Section 14-2-1322* and repeat the payment demand procedure.

§14-2-1327. Procedure if shareholder dissatisfied with payment or offer

(a) A dissenter may notify the corporation in writing of his own estimate of the fair value of his shares and amount of interest due, and demand payment of his estimate of the fair value of his shares and interest due, if:

(1) The dissenter believes that the amount offered under *Code Section 14-2-1325* is less than the fair value of his shares or that the interest due is incorrectly calculated; or

(2) The corporation, having failed to take the proposed action, does not return the deposited certificates or release the transfer restrictions imposed on uncertificated shares within 60 days after the date set for demanding payment.

(b) A dissenter waives his or her right to demand payment under this Code section and is deemed to have accepted the corporation s offer unless he or she notifies the corporation of his or her demand in writing under subsection (a) of this Code section within 30 days after the corporation offered payment for his or her shares, as provided in *Code Section 14-2-1325*.

(c) If the corporation does not offer payment within the time set forth in subsection (a) of *Code Section 14-2-1325*:

(1) The shareholder may demand the information required under subsection (b) of *Code Section 14-2-1325*, and the corporation shall provide the information to the shareholder within ten days after receipt of a written demand for the information; and

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(2) The shareholder may at any time, subject to the limitations period of *Code Section 14-2-1332*, notify the corporation of his own estimate of the fair value of his shares and the amount of interest due and demand payment of his estimate of the fair value of his shares and interest due.

PART 3. JUDICIAL APPRAISAL OF SHARES

§14-2-1330. Court action

(a) If a demand for payment under *Code Section 14-2-1327* remains unsettled, the corporation shall commence a proceeding within 60 days after receiving the payment demand and petition the court to determine the fair value of the shares and accrued interest. If the corporation does not commence the proceeding within the 60 day period, it shall pay each dissenter whose demand remains unsettled the amount demanded.

(b) The corporation shall commence the proceeding, which shall be a nonjury equitable valuation proceeding, in the superior court of the county where a corporation s registered office is located. If the surviving corporation is a foreign corporation without a registered office in this state, it shall commence the proceeding in the county in this state where the registered office of the domestic corporation merged with or whose shares were acquired by the foreign corporation was located.

(c) The corporation shall make all dissenters, whether or not residents of this state, whose demands remain unsettled parties to the proceeding, which shall have the effect of an action quasi in rem against their shares. The corporation shall serve a copy of the petition in the proceeding upon each dissenting shareholder who is a resident of this state in the manner provided by law for the service of a summons and complaint, and upon each nonresident dissenting shareholder either by registered or certified mail or statutory overnight delivery or by publication, or in any other manner permitted by law.

(d) The jurisdiction of the court in which the proceeding is commenced under subsection (b) of this Code section is plenary and exclusive. The court may appoint one or more persons as appraisers to receive evidence and recommend decision on the question of fair value. The appraisers have the powers described in the order appointing them or in any amendment to it. Except as otherwise provided in this chapter, Chapter 11 of Title 9, known as the Georgia Civil Practice Act, applies to any proceeding with respect to dissenters rights under this chapter.

(e) Each dissenter made a party to the proceeding is entitled to judgment for the amount which the court finds to be the fair value of his shares, plus interest to the date of judgment.

§14-2-1331. Court costs and counsel fees

(a) The court in an appraisal proceeding commenced under *Code Section 14-2-1330* shall determine all costs of the proceeding, including the reasonable compensation and expenses of appraisers appointed by the court, but not including fees and expenses of attorneys and experts for the respective parties. The court shall assess the costs against the corporation, except that the court may assess the costs against all or some of the dissenters, in amounts the court finds equitable, to the extent the court finds the dissenters acted arbitrarily, vexatiously, or not in good faith in demanding payment under *Code Section 14-2-1327*.

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(b) The court may also assess the fees and expenses of attorneys and experts for the respective parties, in amounts the court finds equitable:

(1) Against the corporation and in favor of any or all dissenters if the court finds the corporation did not substantially comply with the requirements of *Code Sections 14-2-1320* through 14-2-1327; or

(2) Against either the corporation or a dissenter, in favor of any other party, if the court finds that the party against whom the fees and expenses are assessed acted arbitrarily, vexatiously, or not in good faith with respect to the rights provided by this article.

(c) If the court finds that the services of attorneys for any dissenter were of substantial benefit to other dissenters similarly situated, and that the fees for those services should not be assessed against the corporation, the court may award to these attorneys reasonable fees to be paid out of the amounts awarded the dissenters who were benefited.

§14-2-1332. Limitation of actions

No action by any dissenter to enforce dissenters rights shall be brought more than three years after the corporate action was taken, regardless of whether notice of the corporate action and of the right to dissent was given by the corporation in compliance with the provisions of *Code Section 14-2-1320* and *Code Section 14-2-1322*.

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APPENDIX D

SHAREHOLDER S AGREEMENT

SHAREHOLDER S AGREEMENT, dated as of September 8, 2004 (this **Agreement**), between FIDELITY NATIONAL FINANCIAL, INC., a Delaware corporation (**Parent**) and ________________________ (the **Shareholder**), a shareholder of INTERCEPT, INC., a Georgia corporation (the **Company**).

W I T N E S S E T H

WHEREAS, Parent, FUSCIA MERGER SUB, INC., a Delaware corporation and a wholly owned indirect subsidiary of Parent (**Merger Sub**), FIDELITY NATIONAL INFORMATION SERVICES, INC., a Delaware corporation and a wholly owned subsidiary of Parent, and the Company propose to enter into, simultaneously herewith, an Agreement and Plan of Merger (the **Merger Agreement**) pursuant to which Merger Sub will merge with and into the Company (the **Merger**);

WHEREAS, as of the date hereof, subject to any liens and security interests securing current or future margin loans or other obligations (a Share Lien) in favor of a third party (a Lien Holder) (any indebtedness secured by any Share Lien is herein referred to as **Share Indebtedness**), the Shareholder owns beneficially or of record or has the power to vote, or direct the vote of, the number of shares of common stock, no par value, of the Company (the **Company Common Stock**), as set forth on the signature page hereto (all such Company Common Stock and any shares of Company Common Stock of which ownership of record or beneficially or the power to vote is hereafter acquired by the Shareholder prior to the termination of this Agreement being referred to herein as the **Shares**) (capitalized terms not otherwise defined in this Agreement shall have the same meaning as in the Merger Agreement); and

WHEREAS, as a condition of and inducement to Parent s execution of the Merger Agreement, the Shareholder has agreed to enter into this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth in this Agreement and in the Merger Agreement, and for other good and valid consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound, the parties hereto agree as follows:

ARTICLE I.

TRANSFER AND VOTING OF SHARES

Section 1.1. Transfer of Shares. The Shareholder agrees that it shall not, directly or indirectly, (a) sell, pledge, encumber, transfer or otherwise voluntarily dispose of (including by gift) any or all of the Shareholder s Shares or any interest in such Shares, except pursuant to the Merger Agreement, (b) deposit any Shares or any interest in such Shares into a voting trust or enter into a voting agreement or arrangement with respect to any Shares or grant any proxy with respect thereto (other than as contemplated hereunder), or (c) enter into any contract, commitment, option or other arrangement or undertaking (other than the Merger Agreement) with respect to the direct or indirect acquisition or sale, assignment, pledge, encumbrance, transfer or other disposition of any Shares (each of the above, a **Transfer**); provided, the foregoing shall not be

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deemed to prohibit any Share Liens otherwise permitted hereunder. Notwithstanding anything contained herein to the contrary, during the term of this Agreement the Shareholder shall be permitted to exercise options, warrants or other rights to acquire shares of Company Common Stock (any shares so acquired, the Option Common Stock). In addition, notwithstanding anything herein to the contrary, neither the Transfer of Shares in connection with the terms of any Share Indebtedness nor the Transfer of Option Common Stock shall be subject to the restrictions on Transfer set forth in this Section 1.1 (such Transfers referred to herein as the **Permitted Transfers**).

Section 1.2. Vote in Favor of Merger. During the period commencing on the date hereof and terminating on the Termination Date (as defined in Section 4.12), and subject to the Proxy (hereinafter defined) granted to Parent as contemplated by Section 1.3 hereof and the right of Parent to vote the Shares pursuant thereto, the Shareholder (solely in the Shareholder s capacity as a shareholder of the Company and without limiting any action that the Shareholder might take as an officer of the Company (including at the direction of the Board of Directors of the Company) or a director of the Company or as a member of any committee of the Board of Directors of the Company (including voting on any matter), other than any such limits as are imposed by the Merger Agreement) agrees to vote (or cause to be voted) all of the Shares that Shareholder has the power to vote at any meeting of the shareholders of the Company or any adjournment thereof, and in any action by written consent of the shareholders of the Company, in each case to the extent that such matter is presented for shareholder approval: (a) in favor of the adoption of the Merger Agreement by the Company and in favor of the other transactions contemplated by the Merger Agreement, and (b) against any merger, consolidation, sale of assets, recapitalization or other business combination involving the Company (other than the Merger) or any other action or agreement that would result in a breach of any covenant, representation or warranty or any other obligation or agreement of the Company under the Merger Agreement or which would result in any of the conditions to the Company s or Parent s obligations under the Merger Agreement not being fulfilled, and (c) in favor of any other matter relating to and necessary for the consummation of the transactions contemplated by the Merger Agreement.

Section 1.3. Grant of Irrevocable Proxy. Concurrently with the execution of this Agreement, the Shareholder agrees to deliver to Parent a proxy with respect to the Shares in the form attached hereto as Exhibit A (the **Proxy**), which shall be irrevocable to the fullest extent permissible by law.

ARTICLE II.

REPRESENTATIONS AND WARRANTIES OF SHAREHOLDER

The Shareholder hereby represents and warrants to Parent as follows:

Section 2.1. Authorization; Binding Agreement. The Shareholder has all legal right, power, authority and capacity to execute and deliver this Agreement and the Proxy and to consummate the transactions contemplated hereby and thereby. This Agreement and the Proxy have been duly and validly authorized, executed and delivered by or on behalf of the Shareholder, and, assuming due authorization, execution and delivery by Parent, each constitutes a legal, valid and binding obligation of the Shareholder, enforceable against the Shareholder in accordance with its terms, subject to (i) the effect of any applicable bankruptcy, insolvency, moratorium or similar law affecting creditors rights generally and (ii) rules of law governing specific performance, injunctive relief and other equitable remedies.

December 31, 2006

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Section 2.2. No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder does not, and the performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder will not, (i) conflict with or violate any law, rule, regulation, order, judgment or decree applicable to the Shareholder or by which the Shareholder or any of the Shareholder s material properties is bound or affected, (ii) in case the Shareholder is a corporation or other entity, violate or conflict with the certificate of incorporation, bylaws, articles of organization, limited liability company operating agreement, trust agreement or other equivalent organizational documents of the Shareholder (if any), or (iii) result in or constitute (with or without notice or lapse of time or both) any breach of or default under, or give to another party any right of termination, amendment, acceleration or cancellation of, or result in the creation of any lien or encumbrance or restriction on any of the material property or assets of the Shareholder pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Shareholder is a party or by which the Shareholder or any of the Shareholder s material properties is bound or affected. There is no beneficiary or holder of a voting trust certificate or other interest of any trust of which the Shareholder is a trustee whose consent is required for the execution and delivery of this Agreement or the consummation by the Shareholder of the transactions contemplated by this Agreement.

(b) The execution, delivery and performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder do not and will not require any consent, approval, authorization or permit of, or filing with or notification by the Shareholder to, any third party or any governmental or regulatory authority, domestic or foreign, except (i) for applicable requirements, if any, of the Securities Exchange Act of 1934, as amended (the **Exchange Act**) and (ii) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, could not prevent or delay the performance by the Shareholder of its obligations under this Agreement. Other than this Agreement, the Shareholder does not have any understanding in effect with respect to the voting or transfer of any Shares. The Shareholder is not required to make any filing with or notify any governmental or regulatory authority in connection with this Agreement, the Merger Agreement or the transactions contemplated hereby or thereby pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, and the rules and regulations promulgated thereunder (the **HSR Act**).

Section 2.3. Title to Shares. The Shareholder is the record or beneficial owner of the Shares free and clear of all encumbrances, proxies or voting restrictions other than pursuant to this Agreement and the Proxy and other than any Share Liens otherwise permitted under the terms hereof (none of which Share Liens impose any limit on the right of the Shareholder to vote or grant a proxy with respect to the Shares). The shares of Company Common Stock, including options, warrants or other rights to acquire such stock, set forth on the signature page hereto, are all the securities of the Company owned, directly or indirectly, of record or beneficially by the Shareholder on the date of this Agreement.

Section 2.4. Accuracy of Representations. The representations and warranties contained in this Agreement are accurate in all respects as of the date of this Agreement, will be accurate in all respects at all times until termination of this Agreement and will be accurate in all respects as of the date of the consummation of the Merger as if made on that date.

ARTICLE III.

COVENANTS OF SHAREHOLDER

Section 3.1. Further Assurances. From time to time and without additional consideration, the Shareholder shall (at the Shareholder s sole expense) execute and deliver, or cause to be executed and delivered, such additional transfers, assignments, endorsements, proxies, consents, waivers and other instruments, and shall (at the Shareholder s sole expense) take such further actions, as Parent may reasonably request for the purpose of giving effect to this Agreement. The Shareholder shall use its reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the transactions contemplated by this Agreement.

Section 3.2. Legending of Shares. If requested by Parent, the Shareholder agrees that the Shares shall bear a legend stating that they are subject to this Agreement and to the Proxy in accordance with Section 7.14 of the Merger Agreement. The Shareholder agrees that the Shareholder will not request the Company to register the transfer (book-entry or otherwise) of any certificate or uncertificated interest representing any of the Shares, unless such transfer is made in compliance with this Agreement.

Section 3.3. No Solicitation of Transactions. The Shareholder, subject to the last sentence of this Section 3.3, agrees that from the date of this Agreement until the Termination Date, the Shareholder shall not, directly or indirectly, nor, in case the Shareholder is a corporation or other entity, shall it authorize or permit any of its directors, officers or employees or any investment banker, financial advisor, attorney, accountant or other representative retained by it or any of its Subsidiaries (collectively, the **Representatives**) to, directly or indirectly, solicit, initiate or encourage (including by means of furnishing nonpublic information), or take any other action to facilitate, any inquiries or the making of any proposal or offer with respect to, or that reasonably may be expected to lead to a proposal or offer for, any Competing Transaction (as defined in the Merger Agreement), or enter into or maintain or continue discussions or negotiate with any person or entity in furtherance of such inquiries or to obtain a Competing Transaction, or agree to or endorse any Competing Transaction, other than with Parent or an affiliate of Parent. The Shareholder shall promptly (but in any event within 24 hours) notify Parent if any proposal or offer, or any inquiry or contact, constituting or regarding a Competing Transaction is made, and the Shareholder shall promptly inform Parent as to the material details of any such proposal, offer, inquiry or contact, including the identity of the party making any such proposal, offer, inquiry or contact, and, if in writing, promptly deliver or cause to be delivered to Parent a copy of such proposal, offer, inquiry or contact and any other written material reasonably relating thereto. The Shareholder immediately shall cease and cause to be terminated all existing discussions or negotiations with any parties conducted heretofore with respect to a Competing Transaction. Notwithstanding the provisions of this Section 3.3, a Shareholder who is also a director or officer of the Company may take any action in his capacity as such (including complying with or exercising his fiduciary duties as a member of the Board of Directors of the Company) as is not limited by the terms of the Merger Agreement.

December 31, 2006

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Section 3.4. Disclosure. The Shareholder and Parent each agrees to permit the other party hereto to publish and disclose in the Registration Statement and the Proxy Statement (including all documents and schedules filed with the SEC), and in any press release or other disclosure document in which it reasonably determines in its good faith judgment that such disclosure is required by law, including the rules and regulations of the SEC, or appropriate, in connection with the Merger and any transactions related thereto, the identity of the Shareholder and Parent and the Shareholder s ownership of the Shares and the nature of the Shareholder s or Parent s, as the case may be, commitments, arrangements and understandings under this Agreement. The Shareholder and Parent each agrees to provide a reasonable opportunity to review such disclosure proposed by the other.

Section 3.5. Public Announcement. The Shareholder, solely in the Shareholder s capacity as a shareholder of the Company, agrees to not make any public announcement in opposition to, or in competition with, the Merger Agreement or the consummation of the Merger, except as required by applicable law.

Section 3.6. Additional Shares. In the event that the Shareholder acquires record or beneficial ownership of, or the power to vote or direct the voting of, any additional Shares, such Shares shall, without further action of the parties, be subject to the provisions of this Agreement and the Proxy, and the number of Shares set forth on the signature page hereto and thereto will be deemed amended accordingly. The Shareholder shall promptly notify Parent of any such event.

Section 3.7. Grant of Option.

(a) The Shareholder hereby grants to Parent an irrevocable option (the **Option**) to purchase all, but not less than all, of the Shares with respect to which the Shareholder has the power of disposition (the **Option Shares**) at a purchase price per share equal to $18.90 (the **Exercise Price**), in the manner set forth in this Section 3.7, with such price proportionately adjusted to give effect to future splits, consolidations, reorganizations, recapitalizations (whether by merger or otherwise, other than the Merger itself) or similar transactions occurring with respect to the Company Common Stock after the date of this Agreement. In addition to the Exercise Price, in the event of any exercise of the Option, Parent will pay the Shareholder an amount equal to 50% of the profit of Parent realized on the Option Shares from the consummation of any Competing Transaction that is consummated or with respect to which a definitive agreement is entered into within 12 months after the applicable Qualifying Termination (as defined below). Such payment shall be made within 2 business days of the receipt by Parent of the consideration paid to Parent pursuant to the terms of such Competing Transaction. Such profit shall be calculated in the manner described for calculation of the profit of the Shareholder set forth in Section 3.7(f), with all references in Section 3.7(f)(ii) to the Shareholder to be deemed references to Parent. For purposes of such calculation, in the event that (i) Parent has also acquired shares of Company Common Stock from any other stockholder of the Company under an agreement comparable to this Agreement (Other Shares) and (ii) Parent sells the Option Shares and Other Shares in more than one transaction, then in each such sale Parent shall be deemed to have sold a pro rata portion of the total Option Shares and Other Shares owned by Parent.

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(b) Parent or its designee may exercise the Option in whole and not in part, at any time after the Merger Agreement is terminated under circumstances in which the Termination Fee is or may become payable to Parent (a **Qualifying Termination**) and prior to the date that is 10 business days after such termination (the **Option Exercise Period**).

(c) In the event that Parent wishes to exercise the Option, Parent must give written notice (the **Option Notice**, with the date of the Option Notice being hereinafter called the **Notice Date**) to the Shareholder during the Option Exercise Period that it will purchase the Option Shares pursuant to the Option. The Option Notice shall specify a place (which, if the Shareholder is then an officer or director of the Company, shall be the principal executive offices of the Company) and a date (the **Option Closing Date**) (not later than 10 business days from the Notice Date subject to extension as set forth below) for closing such purchase (a **Closing**). Parent s obligation to purchase the Option Shares upon any exercise of the Option, and the Shareholder s obligation to sell the Option Shares upon any exercise of the Option, is subject (at the election of each of Parent or Shareholder) to the conditions that (i) no preliminary or permanent injunction or other order against the purchase of the Option Shares issued by any federal, state or foreign court of competent jurisdiction shall be in effect (and no action or proceeding by any Governmental Entity (as defined in the Merger Agreement) shall have been commenced or threatened for purposes of obtaining such injunction or order) and (ii) any applicable waiting period under the HSR Act shall have expired or been terminated. If there shall be in effect any such injunction or order or all HSR Act waiting periods shall not have expired or been terminated, in each case on the Option Closing Date specified in the Option Notice, then at Parent s election, the Option Closing Date may be extended until the later of (i) 10 business days after the Option Closing Date so specified or (ii) the earlier of (A) three business days after expiration or termination of all HSR Act waiting periods or (B) 60 calendar days after the Notice Date. Parent s obligation to purchase the Option Shares upon any exercise of the Option is further subject (at Parent s election) to the condition that there shall have been no material breach of the representations, warranties, covenants or agreements of the Shareholder contained in this Agreement or of the Company contained in the Merger Agreement which is not known by Parent at or prior to its exercise of the Option.

(d) At any Closing, (i) the Shareholder will deliver to Parent the certificate or certificates representing the Option Shares in proper form for transfer upon exercise of the Option and (ii) Parent shall pay the aggregate purchase price for the Option Shares by wire transfer of immediately available funds to an account or accounts, which account or accounts shall be designated in writing to Parent within five days after receipt of the Option Notice, in the amount of the Exercise Price times the number of Option Shares.

(e) The Shareholder has granted the Option to Parent in order to induce Parent to enter into and consummate the transactions contemplated by the Merger Agreement.

(f) (i) As an alternative to Parent s exercise of the Option, in the event of a Qualifying Termination, at Parent s election, the Shareholder shall pay to Parent on demand an amount equal to 50% of the profit of the Shareholder from the consummation of any Competing Transaction that is consummated or with respect to which a definitive agreement is entered into within 12 months of such termination. Such payment shall be made within 2 business days of the receipt by the Shareholder of the consideration paid to the Shareholder pursuant to the terms of such Competing Transaction. To exercise its rights under this Section 3.7(f), Parent s demand must be made within 10 business days following the consummation of such Competing Transaction.

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(ii) For purposes of this Section 3.7(f), the profit of the Shareholder from any Competing Transaction shall equal (a) the aggregate consideration received by the Shareholder (either directly or with respect to repayment of Share Indebtedness) in consideration of the Shares pursuant to such Competing Transaction, valuing any non-cash consideration (including any residual interest in the Company) at its Fair Market Value (defined below in Section 3.7(f)(iii)) on the date of consummation of such Competing Transaction plus (b) the aggregate consideration received by the Shareholder (either directly or with respect to repayment of Share Indebtedness) in respect of all Shares the Shareholder disposed of after the termination of the Merger Agreement and prior to the date of consummation of such Competing Transaction less (c) the Exercise Price times the aggregate number of Shares of Company Common Stock disposed of by the Shareholder as referred to in clauses (a) and (b) of this Section 3.7(f)(ii).

(iii) For purposes of this Section 3.7(f), the Fair Market Value of any non-cash consideration consisting of: (a) securities listed on a national securities exchange or traded on the NASDAQ/NMS shall be equal to the average closing price per share of such security as reported on such exchange or NASDAQ/NMS for the five trading days after the date of determination; and (b) consideration which is other than cash or securities in clause (a) above shall be determined by a nationally recognized independent investment banking firm mutually agreed upon by the parties within 10 business days of the event requiring selection of such banking firm; provided, however, that if the parties are unable to agree within two business days after the date of such event as to the investment banking firm, then the parties shall each select one firm, and those firms shall select a third investment banking firm, which third firm shall make such determination.

(iv) Any payment of profit under this Section 3.7(f) shall be paid by wire transfer of same day funds to an account designated by Parent.

(g) Notwithstanding any provision of this Section 3.7 to the contrary, in the event that Parent or the Shareholder receives consideration pursuant to a Competing Transaction in respect of the Option Shares other than in cash, then any payment of profit required to be made under this Section 3.7 by Parent or the Shareholder may be made, at the option of the payor, using the form of consideration so received; provided that if more than one form of consideration is received by the payor pursuant to a Competing Transaction, any payment of profit (other than a payment entirely in cash) shall be made in the respective proportions in which such forms of consideration were received by the payor pursuant to the Competing Transaction.

Section 3.8. No Dissenters Rights. The Shareholder, acting solely in such Shareholder s capacity as a shareholder of the Company, hereby consents to and approves the actions taken by the Company s board of directors in approving the Merger Agreement, the Merger and the other transactions contemplated thereby. The Shareholder hereby waives, and agrees not to exercise or assert, any dissenter s rights under Section 1302 of the GBCC in connection with the Merger.

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Section 3.9. Share Indebtedness. The Shareholder agrees that he shall take all actions necessary to remain in compliance with the terms of any Share Indebtedness and avoid the foreclosure of any Share Lien. The Shareholder agrees that he will not create any Share Lien after the date hereof in favor of any Person which, individually or as part of a group, intends to make or has made a proposal or offer in respect of a Competing Transaction. The Shareholder further agrees that, within one Business Day after receiving any Option Notice, he shall identify all Lien Holders and the amounts of all Share Indebtedness so that Parent may repay all such Share Indebtedness upon the Option Closing Date, with a corresponding reduction in the Exercise Price payable to the Shareholder.

ARTICLE IV.

GENERAL PROVISIONS

Section 4.1. Payment of Merger Consideration. Parent and Merger Sub hereby agree that the aggregate Per Share Merger Consideration (as defined in the Merger Agreement) that is due and owing to the Shareholder as a result of the Merger will be paid and delivered to the Shareholder at the Effective Time (as defined in the Merger Agreement). Parent and Merger Sub understand and acknowledge that the Shareholder is entering into this Agreement in reliance upon the foregoing agreement.

Section 4.2. Entire Agreement. This Agreement constitutes the entire agreement of the parties and supersedes all prior agreements and undertakings, both written and oral, between the parties, or any of them, with respect to the subject matter hereof. This Agreement may not be amended or modified except in an instrument in writing signed by, or on behalf of, the parties hereto.

Section 4.3. Survival of Representations and Warranties. All representations and warranties made by the Shareholder in this Agreement shall survive until the Termination Date.

Section 4.4. Assignment. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns; provided that any assignment, delegation or attempted transfer of any rights, interests or obligations under this Agreement by the Shareholder without the prior written consent of Parent shall be void.

Section 4.5. Fees and Expenses. All costs and expenses (including, without limitation, all fees and disbursements of counsel, accountants, investment bankers, experts and consultants to a party) incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such costs and expenses; provided, however, that the Company may pay or reimburse the Shareholder for such costs and expenses of the Shareholder.

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Section 4.6. Notices. All notices and other communications given or made pursuant hereto shall be in writing and shall be deemed effectively given: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed electronic mail or facsimile if sent during normal business hours of the recipient; if not, then on the next business day, (c) five days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the respective parties at the following addresses (or at such other addresses as shall be specified by notice given in accordance with this Section 4.6):

(a) if to Parent:

Fidelity National Financial, Inc.

601 Riverside Avenue, 12th Floor

Jacksonville, FL 32204

Attention: Christopher A. Rose

Senior Vice President

Telephone: (904) 854-8544

Facsimile: (904) 357-1026

with a copy to:

LeBoeuf, Lamb, Greene & MacRae, L.L.P.

125 West 55th Street

New York, NY 10019

Attention: Robert S. Rachofsky

Telephone: (212) 424-8088

Facsimile: (212) 649-9479

(b) If to the Shareholder to:

____

InterCept, Inc.

3150 Holcomb Bridge Road

Suite 200

Norcross, GA 30071-1370

Facsimile No.: (770) 840-2701

with a copy to:

Rogers & Hardin

229 Peachtree St. NE

2700 International Tower

Atlanta, GA 30303

Attention: Alan Leet

Section 4.7. Headings. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

Section 4.8. Specific Performance. The parties agree that irreparable damage would occur if any of the provisions of this Agreement is not performed in accordance with its specific terms or is otherwise breached. The Shareholder agrees that, following any breach or threatened breach by the Shareholder of any covenant or obligation contained in this Agreement, Parent shall be entitled (in addition to any other remedy that may be available to it, including monetary damages) to seek and obtain (a) a decree or order of specific performance to enforce the observance and performance of such covenant or obligation and (b) an injunction restraining such breach or threatened breach.

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Section 4.9. Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York, except that the law of the State of Georgia shall be applicable to any matters that involve the internal affairs of the Company, in each case without giving effect to the principles of conflicts of law of the State of New York or the State of Georgia.

Section 4.10. No Waiver. No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. The parties hereto shall not be deemed to have waived any claim available to them arising out of this Agreement, or any right, power or privilege hereunder, unless the waiver is expressly set forth in writing duly executed and delivered on behalf of such party. The rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by law.

Section 4.11. Counterparts; Facsimile Signature. This Agreement may be executed by facsimile signature and in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

Section 4.12. Termination. The rights and obligations of the parties under this Agreement shall terminate on the earlier of (i) January 31, 2005, (ii) the date upon which the Merger Agreement is terminated in accordance with its terms or (iii) the Effective Time (as defined in the Merger Agreement) (the **Termination Date**); provided, that if the Merger Agreement is terminated pursuant to a Qualifying Termination, then Sections 1.1, 3.1, 3.6, 3.7 and 3.9 and Article 4 hereof shall survive the Termination Date and shall terminate upon the later of (x) the termination of the Option Exercise Period or, if the Option is exercised prior to such time, then upon the occurrence of the related Closing (subject to the Shareholder s right to receive any profit to which such Shareholder is entitled under Section 3.7(a)) or (y) if Parent shall instead elect to receive profits of the Shareholder under Section 3.7(f), upon the payment thereof; provided, however, that Section 1.1 shall not survive beyond the time specified by clause (x) of this Section 4.12.

Section 4.13. Change in Company Shares. In the event of a stock dividend or distribution, or any change in the Company Common Stock by reason of any stock dividend, split-up, recapitalization, combination, exchange of shares or the like other than pursuant to the Merger, the term **Shares** will be deemed to refer to and include the shares of the Company Common Stock as well as all such stock dividends and distributions and any shares or other securities into which or for which any or all of the Shares may be changed or exchanged and appropriate adjustments shall be made to the terms and provisions of this Agreement and the Proxy.

Section 4.14. Capacity of Directors and Officers. The Shareholder is entering into this Agreement solely in the Shareholder s capacity as a shareholder of the Company, and nothing herein shall be construed to limit or otherwise restrict the Shareholder (or its affiliates, representatives or agents who may be directors or officers of the Company or any of its Subsidiaries) in taking or not taking any action in the Shareholder s (or any such affiliate s, representative s or agent s) capacity as a director or officer of the Company or any of its Subsidiaries.

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IN WITNESS WHEREOF, each of Parent and the Shareholder has executed or has caused this Agreement to be executed by its duly authorized officer as of the date first written above.

FIDELITY NATIONAL FINANCIAL, INC.

By: ____________________________

Name: William P. Foley, II
Title: Chairman and CEO

By: ____________________________

Name:

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EXHIBIT A

IRREVOCABLE PROXY

The undersigned shareholder (**Shareholder**) of InterCept, Inc., a Georgia corporation (the **Company**), hereby irrevocably (to the fullest extent permitted by law) appoints Brent B. Bickett, Executive Vice President of Fidelity National Financial, Inc., a Delaware corporation (**Parent**), and any other officer of Parent as Brent B. Bickett may designate, and each of them, as the sole and exclusive attorneys and proxies of the undersigned, with full power of substitution and resubstitution, to vote and exercise all voting and consent rights (to the full extent that the undersigned is entitled to do so) with respect to all of the shares of capital stock of the Company that now are or hereafter may be beneficially owned by the undersigned, and any and all other shares or securities of the Company issued or issuable in respect thereof on or after the date hereof (collectively, the **Shares**) in accordance with the terms of this Proxy until the Termination Date (as defined in that certain Shareholder s Agreement of even date herewith by and among Parent and Shareholder (the **Shareholder s Agreement**)). The Shares beneficially owned by the undersigned Shareholder of the Company as of the date of this Proxy are listed on the final page of this Proxy. Upon the undersigned s execution of this Proxy, any and all prior proxies given by the undersigned with respect to any Shares are hereby revoked and the undersigned agrees not to grant any subsequent proxies with respect to the Shares until after the Termination Date.

This Proxy is irrevocable (to the fullest extent permitted by law), is coupled with an interest and is granted pursuant to the Shareholder s Agreement, and is granted in consideration of Parent entering into that certain Agreement and Plan of Merger (the **Merger Agreement**), among Parent, Fuscia Merger Sub, Inc., a Delaware corporation and a wholly owned indirect subsidiary of Parent (**Merger Sub**), Fidelity National Information Services, Inc., a Delaware corporation and wholly owned subsidiary of Parent, and the Company. The Merger Agreement provides for the merger of Merger Sub with and into the Company (the **Merger**).

The attorneys and proxies named above, and each of them, are hereby authorized and empowered by the undersigned, at any time prior to the Termination Date, to act as the undersigned s attorney and proxy to vote the Shares, and to exercise all voting, consent and similar rights of the undersigned with respect to the Shares (including, without limitation, the power to execute and deliver written consents) at every annual, special or adjourned meeting of Shareholders of the Company and in every written consent in lieu of such meeting (a) in favor of the adoption of the Merger Agreement by the Company and in favor of the other transactions contemplated by the Merger Agreement and (b) against any merger, consolidation, sale of assets, recapitalization or other business combination involving the Company (other than the Merger) or any other action or agreement that would result in a breach of any covenant, representation or warranty or any other obligation or agreement of the Company under the Merger Agreement or which would result in any of the conditions to the Company s obligations under the Merger Agreement not being fulfilled, and (c) in favor of any other matter relating to and necessary for the consummation of the transactions contemplated by the Merger Agreement. Notwithstanding the provisions of this paragraph, if the Shareholder is also a director or officer of the Company or any Subsidiaries (as defined in the Merger Agreement) of the Company, he may take any action in his capacity as such (including complying with or exercising his fiduciary duties as an officer or a member of the Board of Directors of the Company or of a Subsidiary of the Company) as is not limited by the terms of the Merger Agreement.

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The attorneys and proxies named above may not exercise this Proxy on any other matter except as provided above. Shareholder may vote the Shares on all other matters. Any obligation of Shareholder hereunder shall be binding upon the successors and assigns of Shareholder.

This Proxy is irrevocable (to the fullest extent permitted by law). This Proxy shall terminate, and be of no further force and effect, automatically upon the Termination Date.

Dated: September 8, 2004

By: ______________________

Signature of Shareholder:
Print Name of Shareholder:

Shares beneficially owned:

___________shares of Company Common Stock

___________shares of Company Common Stock issuable

upon exercise of outstanding options or warrants

Signature Page to Irrevocable Proxy

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APPENDIX E

SHAREHOLDER S AGREEMENT

SHAREHOLDER S AGREEMENT, dated as of September 8, 2004 (this **Agreement**), between FIDELITY NATIONAL FINANCIAL, INC., a Delaware corporation (**Parent**) and _______________ (the **Shareholder**), a shareholder of INTERCEPT, INC., a Georgia corporation (the **Company**).

W I T N E S S E T H

WHEREAS, Parent, FUSCIA MERGER SUB, INC., a Delaware corporation and a wholly owned indirect subsidiary of Parent (**Merger Sub**), FIDELITY NATIONAL INFORMATION SERVICES, INC., a Delaware corporation and a wholly owned subsidiary of Parent, and the Company propose to enter into, simultaneously herewith, an Agreement and Plan of Merger (the **Merger Agreement**) pursuant to which Merger Sub will merge with and into the Company (the **Merger**);

WHEREAS, as of the date hereof, subject to (i) the liens and interests in existence on the date hereof, if any, which have been described in a letter dated the date hereof from the Shareholder to Parent (the Existing Share Liens) in favor of the party identified in such letter (the Existing Lien Holder) (it being understood that if no such letter has been delivered then there are no Existing Share Liens) and (ii) any additional lien or interest securing a broker margin loan entered into in the future consistent with the provisions of this Agreement (a Future Lien and, together with the Existing Share Liens, the Share Liens) in favor of a broker-dealer (a Future Lien Holder and, together with the Existing Lien Holder, the Lien Holders) (any indebtedness secured by any Share Lien is herein referred to as **Share Indebtedness**), the Shareholder owns beneficially or of record or has the power to vote, or direct the vote of, the number of shares of common stock, no par value, of the Company (the **Company Common Stock**), as set forth on the signature page hereto (all such Company Common Stock and any shares of Company Common Stock of which ownership of record or beneficially or the power to vote is hereafter acquired by the Shareholder prior to the termination of this Agreement being referred to herein as the **Shares**) (capitalized terms not otherwise defined in this Agreement shall have the same meaning as in the Merger Agreement); and

WHEREAS, as a condition of and inducement to Parent s execution of the Merger Agreement, the Shareholder has agreed to enter into this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth in this Agreement and in the Merger Agreement, and for other good and valid consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound, the parties hereto agree as follows:

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ARTICLE I.

TRANSFER AND VOTING OF SHARES

Section 1.1. Transfer of Shares. The Shareholder agrees that it shall not, directly or indirectly, (a) sell, pledge, encumber, transfer or otherwise voluntarily dispose of (including by gift) any or all of the Shareholder s Shares or any interest in such Shares, except pursuant to the Merger Agreement, (b) deposit any Shares or any interest in such Shares into a voting trust or enter into a voting agreement or arrangement with respect to any Shares or grant any proxy with respect thereto (other than as contemplated hereunder), or (c) enter into any contract, commitment, option or other arrangement or undertaking (other than the Merger Agreement) with respect to the direct or indirect acquisition or sale, assignment, pledge, encumbrance, transfer or other disposition of any Shares (each of the above, a **Transfer**); provided, the foregoing shall not be deemed to prohibit any Share Liens otherwise permitted hereunder. Notwithstanding anything contained herein to the contrary, during the term of this Agreement the Shareholder shall be permitted to exercise options, warrants or other rights to acquire shares of Company Common Stock (any shares so acquired, the Option Common Stock). In addition, notwithstanding anything herein to the contrary, neither the Transfer of Shares in connection with the terms of any Share Indebtedness nor the Transfer of Option Common Stock shall be subject to the restrictions on Transfer set forth in this Section 1.1 (such Transfers referred to herein as the **Permitted Transfers**).

Section 1.2. Vote in Favor of Merger. During the period commencing on the date hereof and terminating on the Termination Date (as defined in Section 4.12), and subject to the Proxy (hereinafter defined) granted to Parent as contemplated by Section 1.3 hereof and the right of Parent to vote the Shares pursuant thereto, the Shareholder (solely in the Shareholder s capacity as a shareholder of the Company and without limiting any action that the Shareholder might take as an officer of the Company (including at the direction of the Board of Directors of the Company) or a director of the Company or as a member of any committee of the Board of Directors of the Company (including voting on any matter), other than any such limits as are imposed by the Merger Agreement) agrees to vote (or cause to be voted) all of the Shares that Shareholder has the power to vote at any meeting of the shareholders of the Company or any adjournment thereof, and in any action by written consent of the shareholders of the Company, in each case to the extent that such matter is presented for shareholder approval: (a) in favor of the adoption of the Merger Agreement by the Company and in favor of the other transactions contemplated by the Merger Agreement, and (b) against any merger, consolidation, sale of assets, recapitalization or other business combination involving the Company (other than the Merger) or any other action or agreement that would result in a breach of any covenant, representation or warranty or any other obligation or agreement of the Company under the Merger Agreement or which would result in any of the conditions to the Company s or Parent s obligations under the Merger Agreement not being fulfilled, and (c) in favor of any other matter relating to and necessary for the consummation of the transactions contemplated by the Merger Agreement.

Section 1.3. Grant of Irrevocable Proxy. Concurrently with the execution of this Agreement, the Shareholder agrees to deliver to Parent a proxy with respect to the Shares in the form attached hereto as Exhibit A (the **Proxy**), which shall be irrevocable to the fullest extent permissible by law.

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ARTICLE II.

REPRESENTATIONS AND WARRANTIES OF SHAREHOLDER

The Shareholder hereby represents and warrants to Parent as follows:

Section 2.1. Authorization; Binding Agreement. The Shareholder has all legal right, power, authority and capacity to execute and deliver this Agreement and the Proxy and to consummate the transactions contemplated hereby and thereby. This Agreement and the Proxy have been duly and validly authorized, executed and delivered by or on behalf of the Shareholder, and, assuming due authorization, execution and delivery by Parent, each constitutes a legal, valid and binding obligation of the Shareholder, enforceable against the Shareholder in accordance with its terms, subject to (i) the effect of any applicable bankruptcy, insolvency, moratorium or similar law affecting creditors rights generally and (ii) rules of law governing specific performance, injunctive relief and other equitable remedies.

Section 2.2. No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder does not, and the performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder will not, (i) conflict with or violate any law, rule, regulation, order, judgment or decree applicable to the Shareholder or by which the Shareholder or any of the Shareholder s material properties is bound or affected, (ii) in case the Shareholder is a corporation or other entity, violate or conflict with the certificate of incorporation, bylaws, articles of organization, limited liability company operating agreement, trust agreement or other equivalent organizational documents of the Shareholder (if any), or (iii) result in or constitute (with or without notice or lapse of time or both) any breach of or default under, or give to another party any right of termination, amendment, acceleration or cancellation of, or result in the creation of any lien or encumbrance or restriction on any of the material property or assets of the Shareholder pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Shareholder is a party or by which the Shareholder or any of the Shareholder s material properties is bound or affected. There is no beneficiary or holder of a voting trust certificate or other interest of any trust of which the Shareholder is a trustee whose consent is required for the execution and delivery of this Agreement or the consummation by the Shareholder of the transactions contemplated by this Agreement.

(b) The execution, delivery and performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder do not and will not require any consent, approval, authorization or permit of, or filing with or notification by the Shareholder to, any third party or any governmental or regulatory authority, domestic or foreign, except (i) for applicable requirements, if any, of the Securities Exchange Act of 1934, as amended (the **Exchange Act**) and (ii) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, could not prevent or delay the performance by the Shareholder of its obligations under this Agreement. Other than this Agreement, the Shareholder does not have any understanding in effect with respect to the voting or transfer of any Shares. The Shareholder is not required to make any filing with or notify any governmental or regulatory authority in connection with this Agreement, the Merger Agreement or the transactions contemplated hereby or thereby pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, and the rules and regulations promulgated thereunder (the **HSR Act**).

December 31, 2006

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Section 2.3. Title to Shares. The Shareholder is the record or beneficial owner of the Shares free and clear of all encumbrances, proxies or voting restrictions other than pursuant to this Agreement and the Proxy and other than any Share Liens otherwise permitted under the terms hereof (none of which Share Liens impose any limit on the right of the Shareholder to vote or grant a proxy with respect to the Shares). The shares of Company Common Stock, including options, warrants or other rights to acquire such stock, set forth on the signature page hereto, are all the securities of the Company owned, directly or indirectly, of record or beneficially by the Shareholder on the date of this Agreement.

Section 2.4. Accuracy of Representations. The representations and warranties contained in this Agreement are accurate in all respects as of the date of this Agreement, will be accurate in all respects at all times until termination of this Agreement and will be accurate in all respects as of the date of the consummation of the Merger as if made on that date.

ARTICLE III.

COVENANTS OF SHAREHOLDER

Section 3.1. Further Assurances. From time to time and without additional consideration, the Shareholder shall (at the Shareholder s sole expense) execute and deliver, or cause to be executed and delivered, such additional transfers, assignments, endorsements, proxies, consents, waivers and other instruments, and shall (at the Shareholder s sole expense) take such further actions, as Parent may reasonably request for the purpose of giving effect to this Agreement. The Shareholder shall use its reasonable best efforts to take, or cause to be taken, all actions, and to do, or cause to be done, and to assist and cooperate with the other parties in doing, all things necessary, proper or advisable to consummate and make effective, in the most expeditious manner practicable, the transactions contemplated by this Agreement.

Section 3.2. Legending of Shares. If requested by Parent, the Shareholder agrees that the Shares shall bear a legend stating that they are subject to this Agreement and to the Proxy in accordance with Section 7.14 of the Merger Agreement. The Shareholder agrees that the Shareholder will not request the Company to register the transfer (book-entry or otherwise) of any certificate or uncertificated interest representing any of the Shares, unless such transfer is made in compliance with this Agreement.

Section 3.3. No Solicitation of Transactions. The Shareholder, subject to the last sentence of this Section 3.3, agrees that from the date of this Agreement until the Termination Date, the Shareholder shall not, directly or indirectly, nor, in case the Shareholder is a corporation or other entity, shall it authorize or permit any of its directors, officers or employees or any investment banker, financial advisor, attorney, accountant or other representative retained by it or any of its Subsidiaries (collectively, the **Representatives**) to, directly or indirectly, solicit, initiate or encourage (including by means of furnishing nonpublic information), or take any other action to facilitate, any inquiries or the making of any proposal or offer with respect to, or that reasonably may be expected to lead to a proposal or offer for, any Competing Transaction (as defined in the Merger Agreement), or enter into or maintain or continue discussions or negotiate with any person or entity in furtherance of such inquiries or to obtain a Competing Transaction, or agree

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to or endorse any Competing Transaction, other than with Parent or an affiliate of Parent. The Shareholder shall promptly (but in any event within 24 hours) notify Parent if any proposal or offer, or any inquiry or contact, constituting or regarding a Competing Transaction is made, and the Shareholder shall promptly inform Parent as to the material details of any such proposal, offer, inquiry or contact, including the identity of the party making any such proposal, offer, inquiry or contact, and, if in writing, promptly deliver or cause to be delivered to Parent a copy of such proposal, offer, inquiry or contact and any other written material reasonably relating thereto. The Shareholder immediately shall cease and cause to be terminated all existing discussions or negotiations with any parties conducted heretofore with respect to a Competing Transaction. Notwithstanding the provisions of this Section 3.3, a Shareholder who is also a director or officer of the Company may take any action in his capacity as such (including complying with or exercising his fiduciary duties as a member of the Board of Directors of the Company) as is not limited by the terms of the Merger Agreement.

Section 3.4. Disclosure. The Shareholder and Parent each agrees to permit the other party hereto to publish and disclose in the Registration Statement and the Proxy Statement (including all documents and schedules filed with the SEC), and in any press release or other disclosure document in which it reasonably determines in its good faith judgment that such disclosure is required by law, including the rules and regulations of the SEC, or appropriate, in connection with the Merger and any transactions related thereto, the identity of the Shareholder and Parent and the Shareholder s ownership of the Shares and the nature of the Shareholder s or Parent s, as the case may be, commitments, arrangements and understandings under this Agreement. The Shareholder and Parent each agrees to provide a reasonable opportunity to review such disclosure proposed by the other.

Section 3.5. Public Announcement. The Shareholder, solely in the Shareholder s capacity as a shareholder of the Company, agrees to not make any public announcement in opposition to, or in competition with, the Merger Agreement or the consummation of the Merger, except as required by applicable law.

Section 3.6. Additional Shares. In the event that the Shareholder acquires record or beneficial ownership of, or the power to vote or direct the voting of, any additional Shares, such Shares shall, without further action of the parties, be subject to the provisions of this Agreement and the Proxy, and the number of Shares set forth on the signature page hereto and thereto will be deemed amended accordingly. The Shareholder shall promptly notify Parent of any such event.

Section 3.7. Grant of Option.

(a) The Shareholder hereby grants to Parent an irrevocable option (the **Option**) to purchase all, but not less than all, of the Shares with respect to which the Shareholder has the power of disposition (the **Option Shares**) at a purchase price per share equal to $18.90 (the **Exercise Price**), in the manner set forth in this Section 3.7, with such price proportionately adjusted to give effect to future splits, consolidations, reorganizations, recapitalizations (whether by merger or otherwise, other than the Merger itself) or similar transactions occurring with respect to the Company Common Stock after the date of this Agreement. In addition to the Exercise Price, in the event of any exercise of the Option, Parent will pay the Shareholder an amount equal to 50% of the profit of Parent realized on the Option Shares from the consummation of any Competing Transaction that is consummated or with respect to which a definitive agreement is entered into within 12 months after the applicable

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Qualifying Termination (as defined below). Such payment shall be made within 2 business days of the receipt by Parent of the consideration paid to Parent pursuant to the terms of such Competing Transaction. Such profit shall be calculated in the manner described for calculation of the profit of the Shareholder set forth in Section 3.7(f), with all references in Section 3.7(f)(ii) to the Shareholder to be deemed references to Parent. For purposes of such calculation, in the event that (i) Parent has also acquired shares of Company Common Stock from any other stockholder of the Company under an agreement comparable to this Agreement (Other Shares) and (ii) Parent sells the Option Shares and Other Shares in more than one transaction, then in each such sale Parent shall be deemed to have sold a pro rata portion of the total Option Shares and Other Shares owned by Parent.

(b) Parent or its designee may exercise the Option in whole and not in part, at any time after the Merger Agreement is terminated under circumstances in which the Termination Fee is or may become payable to Parent (a **Qualifying Termination**) and prior to the date that is 10 business days after such termination (the **Option Exercise Period**).

(c) In the event that Parent wishes to exercise the Option, Parent must give written notice (the **Option Notice**, with the date of the Option Notice being hereinafter called the **Notice Date**) to the Shareholder during the Option Exercise Period that it will purchase the Option Shares pursuant to the Option. The Option Notice shall specify a place (which, if the Shareholder is then an officer or director of the Company, shall be the principal executive offices of the Company) and a date (the **Option Closing Date**) (not later than 10 business days from the Notice Date subject to extension as set forth below) for closing such purchase (a **Closing**). Parent s obligation to purchase the Option Shares upon any exercise of the Option, and the Shareholder s obligation to sell the Option Shares upon any exercise of the Option, is subject (at the election of each of Parent or Shareholder) to the conditions that (i) no preliminary or permanent injunction or other order against the purchase of the Option Shares issued by any federal, state or foreign court of competent jurisdiction shall be in effect (and no action or proceeding by any Governmental Entity (as defined in the Merger Agreement) shall have been commenced or threatened for purposes of obtaining such injunction or order) and (ii) any applicable waiting period under the HSR Act shall have expired or been terminated. If there shall be in effect any such injunction or order or all HSR Act waiting periods shall not have expired or been terminated, in each case on the Option Closing Date specified in the Option Notice, then at Parent s election, the Option Closing Date may be extended until the later of (i) 10 business days after the Option Closing Date so specified or (ii) the earlier of (A) three business days after expiration or termination of all HSR Act waiting periods or (B) 60 calendar days after the Notice Date. Parent s obligation to purchase the Option Shares upon any exercise of the Option is further subject (at Parent s election) to the condition that there shall have been no material breach of the representations, warranties, covenants or agreements of the Shareholder contained in this Agreement or of the Company contained in the Merger Agreement which is not known by Parent at or prior to its exercise of the Option.

(d) At any Closing, (i) the Shareholder will deliver to Parent the certificate or certificates representing the Option Shares in proper form for transfer upon exercise of the Option and (ii) Parent shall pay the aggregate purchase price for the Option Shares by wire transfer of immediately available funds to an account or accounts, which account or accounts shall be designated in writing to Parent within five days after receipt of the Option Notice, in the amount of the Exercise Price times the number of Option Shares.

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(e) The Shareholder has granted the Option to Parent in order to induce Parent to enter into and consummate the transactions contemplated by the Merger Agreement.

(f) (i) As an alternative to Parent s exercise of the Option, in the event of a Qualifying Termination, at Parent s election, the Shareholder shall pay to Parent on demand an amount equal to 50% of the profit of the Shareholder from the consummation of any Competing Transaction that is consummated or with respect to which a definitive agreement is entered into within 12 months of such termination. Such payment shall be made within 2 business days of the receipt by the Shareholder of the consideration paid to the Shareholder pursuant to the terms of such Competing Transaction. To exercise its rights under this Section 3.7(f), Parent s demand must be made within 10 business days following the consummation of such Competing Transaction.

(ii) For purposes of this Section 3.7(f), the profit of the Shareholder from any Competing Transaction shall equal (a) the aggregate consideration received by the Shareholder (either directly or with respect to repayment of Share Indebtedness) in consideration of the Shares pursuant to such Competing Transaction, valuing any non-cash consideration (including any residual interest in the Company) at its Fair Market Value (defined below in Section 3.7(f)(iii)) on the date of consummation of such Competing Transaction plus (b) the aggregate consideration received by the Shareholder (either directly or with respect to repayment of Share Indebtedness) in respect of all Shares the Shareholder disposed of after the termination of the Merger Agreement and prior to the date of consummation of such Competing Transaction less (c) the Exercise Price times the aggregate number of Shares of Company Common Stock disposed of by the Shareholder as referred to in clauses (a) and (b) of this Section 3.7(f)(ii).

(iii) For purposes of this Section 3.7(f), the Fair Market Value of any non-cash consideration consisting of: (a) securities listed on a national securities exchange or traded on the NASDAQ/NMS shall be equal to the average closing price per share of such security as reported on such exchange or NASDAQ/NMS for the five trading days after the date of determination; and (b) consideration which is other than cash or securities in clause (a) above shall be determined by a nationally recognized independent investment banking firm mutually agreed upon by the parties within 10 business days of the event requiring selection of such banking firm; provided, however, that if the parties are unable to agree within two business days after the date of such event as to the investment banking firm, then the parties shall each select one firm, and those firms shall select a third investment banking firm, which third firm shall make such determination.

(iv) Any payment of profit under this Section 3.7(f) shall be paid by wire transfer of same day funds to an account designated by Parent.

(g) Notwithstanding any provision of this Section 3.7 to the contrary, in the event that Parent or the Shareholder receives consideration pursuant to a Competing Transaction in respect of the Option Shares other than in cash, then any payment of profit required to be made under this Section 3.7 by Parent or the Shareholder may be made, at the option of the payor, using the form of consideration so received; provided that if more than one form of consideration is received by the payor pursuant to a Competing Transaction, any payment of profit (other than a payment entirely in cash) shall be made in the respective proportions in which such forms of consideration were received by the payor pursuant to the Competing Transaction.

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Section 3.8. No Dissenters Rights. The Shareholder, acting solely in such Shareholder s capacity as a shareholder of the Company, hereby consents to and approves the actions taken by the Company s board of directors in approving the Merger Agreement, the Merger and the other transactions contemplated thereby. The Shareholder hereby waives, and agrees not to exercise or assert, any dissenter s rights under Section 1302 of the GBCC in connection with the Merger.

Section 3.9. Share Indebtedness. The Shareholder agrees that at no time during the term of this Agreement shall the amount of Share Indebtedness in respect of any Shares exceed 40% of the then current fair market value of the Shares subject to such Share Indebtedness. The Shareholder further agrees that such Shareholder shall take all actions necessary to remain in compliance with the terms of any Share Indebtedness and avoid the foreclosure of any Share Lien.

ARTICLE IV.

GENERAL PROVISIONS

Section 4.1. Payment of Merger Consideration. Parent and Merger Sub hereby agree that the aggregate Per Share Merger Consideration (as defined in the Merger Agreement) that is due and owing to the Shareholder as a result of the Merger will be paid and delivered to the Shareholder at the Effective Time (as defined in the Merger Agreement). Parent and Merger Sub understand and acknowledge that the Shareholder is entering into this Agreement in reliance upon the foregoing agreement.

Section 4.2. Entire Agreement. This Agreement constitutes the entire agreement of the parties and supersedes all prior agreements and undertakings, both written and oral, between the parties, or any of them, with respect to the subject matter hereof. This Agreement may not be amended or modified except in an instrument in writing signed by, or on behalf of, the parties hereto.

Section 4.3. Survival of Representations and Warranties. All representations and warranties made by the Shareholder in this Agreement shall survive until the Termination Date.

Section 4.4. Assignment. The provisions of this Agreement shall be binding upon and inure to the benefit of the parties hereto and their respective successors and permitted assigns; provided that any assignment, delegation or attempted transfer of any rights, interests or obligations under this Agreement by the Shareholder without the prior written consent of Parent shall be void.

Section 4.5. Fees and Expenses. All costs and expenses (including, without limitation, all fees and disbursements of counsel, accountants, investment bankers, experts and consultants to a party) incurred in connection with this Agreement and the transactions contemplated hereby shall be paid by the party incurring such costs and expenses; provided, however, that the Company may pay or reimburse the Shareholder for such costs and expenses of the Shareholder.

Section 4.6. Notices. All notices and other communications given or made pursuant hereto shall be in writing and shall be deemed effectively given: (a) upon personal delivery to the party to be notified, (b) when sent by confirmed electronic mail or facsimile if sent during normal

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business hours of the recipient; if not, then on the next business day, (c) five days after having been sent by registered or certified mail, return receipt requested, postage prepaid, or (d) one day after deposit with a nationally recognized overnight courier, specifying next day delivery, with written verification of receipt. All communications shall be sent to the respective parties at the following addresses (or at such other addresses as shall be specified by notice given in accordance with this Section 4.6):

(a) if to Parent:

Fidelity National Financial, Inc.

601 Riverside Avenue, 12th Floor

Jacksonville, FL 32204

Attention: Christopher A. Rose

Senior Vice President

Telephone: (904) 854-8544

Facsimile: (904) 357-1026

with a copy to:

LeBoeuf, Lamb, Greene & MacRae, L.L.P.

125 West 55th Street

New York, NY 10019

Attention: Robert S. Rachofsky

Telephone: (212) 424-8088

Facsimile: (212) 649-9479

(b) If to the Shareholder to:

____

InterCept, Inc.

3150 Holcomb Bridge Road

Suite 200

Norcross, GA 30071-1370

Facsimile No.: (770) 840-2701

with a copy to:

Rodgers & Hardin

229 Peachtree St. NE

2700 International Tower

Atlanta, GA 30303

Attention: Alan Leet

Section 4.7. Headings. The headings contained in this Agreement are for reference purposes only and shall not affect in any way the meaning or interpretation of this Agreement.

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Section 4.8. Specific Performance. The parties agree that irreparable damage would occur if any of the provisions of this Agreement is not performed in accordance with its specific terms or is otherwise breached. The Shareholder agrees that, following any breach or threatened breach by the Shareholder of any covenant or obligation contained in this Agreement, Parent shall be entitled (in addition to any other remedy that may be available to it, including monetary damages) to seek and obtain (a) a decree or order of specific performance to enforce the observance and performance of such covenant or obligation and (b) an injunction restraining such breach or threatened breach.

Section 4.9. Governing Law. This Agreement shall be governed by, and construed in accordance with, the laws of the State of New York, except that the law of the State of Georgia shall be applicable to any matters that involve the internal affairs of the Company, in each case without giving effect to the principles of conflicts of law of the State of New York or the State of Georgia.

Section 4.10. No Waiver. No failure or delay by any party in exercising any right, power or privilege hereunder shall operate as a waiver thereof, nor shall any single or partial exercise thereof preclude any other or further exercise thereof or the exercise of any other right, power or privilege. The parties hereto shall not be deemed to have waived any claim available to them arising out of this Agreement, or any right, power or privilege hereunder, unless the waiver is expressly set forth in writing duly executed and delivered on behalf of such party. The rights and remedies herein provided shall be cumulative and not exclusive of any rights or remedies provided by law.

Section 4.11. Counterparts; Facsimile Signature. This Agreement may be executed by facsimile signature and in one or more counterparts, and by the different parties hereto in separate counterparts, each of which when executed shall be deemed to be an original but all of which taken together shall constitute one and the same agreement.

Section 4.12. Termination. The rights and obligations of the parties under this Agreement shall terminate on the earlier of (i) January 31, 2005, (ii) the date upon which the Merger Agreement is terminated in accordance with its terms or (iii) the Effective Time (as defined in the Merger Agreement) (the **Termination Date**); provided, that if the Merger Agreement is terminated pursuant to a Qualifying Termination, then Sections 1.1, 3.1, 3.6, 3.7 and 3.9 and Article 4 hereof shall survive the Termination Date and shall terminate upon the later of (x) the termination of the Option Exercise Period or, if the Option is exercised prior to such time, then upon the occurrence of the related Closing (subject to the Shareholder s right to receive any profit to which such Shareholder is entitled under Section 3.7(a)) or (y) if Parent shall instead elect to receive profits of the Shareholder under Section 3.7(f), upon the payment thereof; provided, however, that Section 1.1 shall not survive beyond the time specified by clause (x) of this Section 4.12.

Section 4.13. Change in Company Shares. In the event of a stock dividend or distribution, or any change in the Company Common Stock by reason of any stock dividend, split-up, recapitalization, combination, exchange of shares or the like other than pursuant to the Merger, the term **Shares** will be deemed to refer to and include the shares of the Company Common Stock as well as all such stock dividends and distributions and any shares or other securities into which or for which any or all of the Shares may be changed or exchanged and appropriate adjustments shall be made to the terms and provisions of this Agreement and the Proxy.

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Section 4.14. Effectiveness of Option. The effectiveness of the grant of the Option hereunder shall be conditioned upon either (i) the written consent thereto of the Existing Lien Holder (which Shareholder agrees to use reasonable best efforts to obtain as promptly as practicable after the date hereof) or (ii) after the Merger Agreement is terminated under circumstances such that the Option may become exercisable hereunder, the repayment by Parent of all amounts owing to the Existing Lien Holder in connection with the Share Indebtedness, provided that in such case Parent s sole recourse against the Shareholder on account of such repayment shall be an offset to the aggregate Exercise Price of the Option in an equivalent amount. The Shareholder shall not grant any Future Lien unless the prior written consent of the proposed Future Lien Holder to the grant of the Option hereunder shall have first been obtained.

Section 4.15. Capacity of Directors and Officers. The Shareholder is entering into this Agreement solely in the Shareholder s capacity as a shareholder of the Company, and nothing herein shall be construed to limit or otherwise restrict the Shareholder (or its affiliates, representatives or agents who may be directors or officers of the Company or any of its Subsidiaries) in taking or not taking any action in the Shareholder s (or any such affiliate s, representative s or agent s) capacity as a director or officer of the Company or any of its Subsidiaries.

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IN WITNESS WHEREOF, each of Parent and the Shareholder has executed or has caused this Agreement to be executed by its duly authorized officer as of the date first written above.

FIDELITY NATIONAL FINANCIAL, INC.

By: /s/ William P. Foley, II

Name: William P. Foley, II
Title: Chairman and CEO

By:

Name:

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EXHIBIT A

IRREVOCABLE PROXY

The undersigned shareholder (**Shareholder**) of InterCept, Inc., a Georgia corporation (the **Company**), hereby irrevocably (to the fullest extent permitted by law) appoints Brent B. Bickett, Executive Vice President of Fidelity National Financial, Inc., a Delaware corporation (**Parent**), and any other officer of Parent as Brent B. Bickett may designate, and each of them, as the sole and exclusive attorneys and proxies of the undersigned, with full power of substitution and resubstitution, to vote and exercise all voting and consent rights (to the full extent that the undersigned is entitled to do so) with respect to all of the shares of capital stock of the Company that now are or hereafter may be beneficially owned by the undersigned, and any and all other shares or securities of the Company issued or issuable in respect thereof on or after the date hereof (collectively, the **Shares**) in accordance with the terms of this Proxy until the Termination Date (as defined in that certain Shareholder s Agreement of even date herewith by and among Parent and Shareholder (the **Shareholder s Agreement**)). The Shares beneficially owned by the undersigned Shareholder of the Company as of the date of this Proxy are listed on the final page of this Proxy. Upon the undersigned s execution of this Proxy, any and all prior proxies given by the undersigned with respect to any Shares are hereby revoked and the undersigned agrees not to grant any subsequent proxies with respect to the Shares until after the Termination Date.

This Proxy is irrevocable (to the fullest extent permitted by law), is coupled with an interest and is granted pursuant to the Shareholder s Agreement, and is granted in consideration of Parent entering into that certain Agreement and Plan of Merger (the **Merger Agreement**), among Parent, Fuscia Merger Sub, Inc., a Delaware corporation and a wholly owned indirect subsidiary of Parent (**Merger Sub**), Fidelity National Information Services, Inc., a Delaware corporation and wholly owned subsidiary of Parent, and the Company. The Merger Agreement provides for the merger of Merger Sub with and into the Company (the **Merger**).

The attorneys and proxies named above, and each of them, are hereby authorized and empowered by the undersigned, at any time prior to the Termination Date, to act as the undersigned s attorney and proxy to vote the Shares, and to exercise all voting, consent and similar rights of the undersigned with respect to the Shares (including, without limitation, the power to execute and deliver written consents) at every annual, special or adjourned meeting of Shareholders of the Company and in every written consent in lieu of such meeting (a) in favor of the adoption of the Merger Agreement by the Company and in favor of the other transactions contemplated by the Merger Agreement and (b) against any merger, consolidation, sale of assets, recapitalization or other business combination involving the Company (other than the Merger) or any other action or agreement that would result in a breach of any covenant, representation or warranty or any other obligation or agreement of the Company under the Merger Agreement or which would result in any of the conditions to the Company s obligations under the Merger Agreement not being fulfilled, and (c) in favor of any other matter relating to and necessary for the consummation of the transactions contemplated by the Merger Agreement. Notwithstanding the provisions of this paragraph, if the Shareholder is also a director or officer of the Company or any Subsidiaries (as defined in the Merger Agreement) of the Company, he may take any action in his capacity as such (including complying with or exercising his fiduciary duties as an officer or a member of the Board of Directors of the Company or of a Subsidiary of the Company) as is not limited by the terms of the Merger Agreement.

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The attorneys and proxies named above may not exercise this Proxy on any other matter except as provided above. Shareholder may vote the Shares on all other matters. Any obligation of Shareholder hereunder shall be binding upon the successors and assigns of Shareholder.

This Proxy is irrevocable (to the fullest extent permitted by law). This Proxy shall terminate, and be of no further force and effect, automatically upon the Termination Date.

Dated: September 8, 2004

By: ______________________

Signature of Shareholder:
Print Name of Shareholder:

Shares beneficially owned:

__________shares of Company Common Stock

__________shares of Company Common Stock issuable

upon exercise of outstanding options or warrants

Signature Page to Irrevocable Proxy

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APPENDIX F

SHAREHOLDER S AGREEMENT

SHAREHOLDER S AGREEMENT, dated as of September 8, 2004 (this **Agreement**), between FIDELITY NATIONAL FINANCIAL, INC., a Delaware corporation (**Parent**) and JANA MASTER FUND, LTD. (the **Shareholder**), a shareholder of INTERCEPT, INC., a Georgia corporation (the **Company**).

W I T N E S S E T H

WHEREAS, Parent, FUSCIA MERGER SUB, INC., a Delaware corporation and a wholly owned indirect subsidiary of Parent (**Merger Sub**), FIDELITY NATIONAL INFORMATION SERVICES, INC., a Delaware corporation and a wholly owned subsidiary of Parent, and the Company propose to enter into, simultaneously herewith, an Agreement and Plan of Merger (the **Merger Agreement**) pursuant to which Merger Sub will merge with and into the Company (the **Merger**);

WHEREAS, as of the date hereof, subject to any liens and security interests securing current or future margin loans or other obligations (a Share Lien) in favor of a third party (a Lien Holder) (any indebtedness secured by any Share Lien is herein referred to as **Share Indebtedness**), the Shareholder owns beneficially or of record or has the power to vote, or direct the vote of, the number of shares of common stock, no par value, of the Company (the **Company Common Stock**), as set forth on the signature page hereto (all such Company Common Stock and any shares of Company Common Stock of which ownership of record or beneficially or the power to vote is hereafter acquired by the Shareholder prior to the termination of this Agreement being referred to herein as the **Shares**) (capitalized terms not otherwise defined in this Agreement shall have the same meaning as in the Merger Agreement); and

WHEREAS, as a condition of and inducement to Parent s execution of the Merger Agreement, the Shareholder has agreed to enter into this Agreement.

NOW, THEREFORE, in consideration of the foregoing and the respective representations, warranties, covenants and agreements set forth in this Agreement and in the Merger Agreement, and for other good and valid consideration, the receipt and sufficiency of which are hereby acknowledged, and intending to be legally bound, the parties hereto agree as follows:

ARTICLE I.

TRANSFER AND VOTING OF SHARES

Section 1.1. Transfer of Shares. The Shareholder agrees that it shall not, directly or indirectly, (a) sell, pledge, encumber, transfer or otherwise voluntarily dispose of (including by gift) any or all of the Shareholder s Shares or any interest in such Shares, except pursuant to the Merger Agreement, (b) deposit any Shares or any interest in such Shares into a voting trust or enter into a voting agreement or arrangement with respect to any Shares or grant any proxy with respect thereto (other than as contemplated hereunder), or (c) enter into any contract, commitment, option or other arrangement or undertaking (other than the Merger Agreement) with respect to

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the direct or indirect acquisition or sale, assignment, pledge, encumbrance, transfer or other disposition of any Shares (each of the above, a **Transfer**); provided, the foregoing shall not be deemed to prohibit any Share Liens otherwise permitted hereunder. Notwithstanding anything contained herein to the contrary, during the term of this Agreement the Shareholder shall be permitted to exercise options, warrants or other rights to acquire shares of Company Common Stock (any shares so acquired, the Option Common Stock). In addition, notwithstanding anything herein to the contrary, neither the Transfer of Shares in connection with the terms of any Share Indebtedness nor the Transfer of Option Common Stock shall be subject to the restrictions on Transfer set forth in this Section 1.1 (such Transfers referred to herein as the **Permitted Transfers**).

Section 1.2. Vote in Favor of Merger. During the period commencing on the date hereof and terminating on the Termination Date (as defined in Section 4.12), and subject to the Proxy (hereinafter defined) granted to Parent as contemplated by Section 1.3 hereof and the right of Parent to vote the Shares pursuant thereto, the Shareholder (solely in the Shareholder s capacity as a shareholder of the Company and without limiting any action that the Shareholder might take as an officer of the Company (including at the direction of the Board of Directors of the Company) or a director of the Company or as a member of any committee of the Board of Directors of the Company (including voting on any matter), other than any such limits as are imposed by the Merger Agreement) agrees to vote (or cause to be voted) all of the Shares that Shareholder has the power to vote at any meeting of the shareholders of the Company or any adjournment thereof, and in any action by written consent of the shareholders of the Company, in each case to the extent that such matter is presented for shareholder approval: (a) in favor of the adoption of the Merger Agreement by the Company and in favor of the other transactions contemplated by the Merger Agreement, and (b) against any merger, consolidation, sale of assets, recapitalization or other business combination involving the Company (other than the Merger) or any other action or agreement that would result in a breach of any covenant, representation or warranty or any other obligation or agreement of the Company under the Merger Agreement or which would result in any of the conditions to the Company s or Parent s obligations under the Merger Agreement not being fulfilled, and (c) in favor of any other matter relating to and necessary for the consummation of the transactions contemplated by the Merger Agreement.

Section 1.3. Grant of Irrevocable Proxy. Concurrently with the execution of this Agreement, the Shareholder agrees to deliver to Parent a proxy with respect to the Shares in the form attached hereto as Exhibit A (the **Proxy**), which shall be irrevocable to the fullest extent permissible by law.

ARTICLE II.

REPRESENTATIONS AND WARRANTIES OF SHAREHOLDER

The Shareholder hereby represents and warrants to Parent as follows:

Section 2.1. Authorization; Binding Agreement. The Shareholder has all legal right, power, authority and capacity to execute and deliver this Agreement and the Proxy and to consummate the transactions contemplated hereby and thereby. This Agreement and the Proxy have been duly and validly authorized, executed and delivered by or on behalf of the Shareholder, and, assuming due authorization, execution and delivery by Parent, each constitutes a legal, valid and binding

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obligation of the Shareholder, enforceable against the Shareholder in accordance with its terms, subject to (i) the effect of any applicable bankruptcy, insolvency, moratorium or similar law affecting creditors rights generally and (ii) rules of law governing specific performance, injunctive relief and other equitable remedies.

Section 2.2. No Conflict; Required Filings and Consents.

(a) The execution and delivery of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder does not, and the performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder will not, (i) conflict with or violate any law, rule, regulation, order, judgment or decree applicable to the Shareholder or by which the Shareholder or any of the Shareholder s material properties is bound or affected, (ii) in case the Shareholder is a corporation or other entity, violate or conflict with the certificate of incorporation, bylaws, articles of organization, limited liability company operating agreement, trust agreement or other equivalent organizational documents of the Shareholder (if any), or (iii) result in or constitute (with or without notice or lapse of time or both) any breach of or default under, or give to another party any right of termination, amendment, acceleration or cancellation of, or result in the creation of any lien or encumbrance or restriction on any of the material property or assets of the Shareholder pursuant to, any note, bond, mortgage, indenture, contract, agreement, lease, license, permit, franchise or other instrument or obligation to which the Shareholder is a party or by which the Shareholder or any of the Shareholder s material properties is bound or affected. There is no beneficiary or holder of a voting trust certificate or other interest of any trust of which the Shareholder is a trustee whose consent is required for the execution and delivery of this Agreement or the consummation by the Shareholder of the transactions contemplated by this Agreement.

(b) The execution, delivery and performance of this Agreement by the Shareholder and the grant of the Proxy to Parent by the Shareholder do not and will not require any consent, approval, authorization or permit of, or filing with or notification by the Shareholder to, any third party or any governmental or regulatory authority, domestic or foreign, except (i) for applicable requirements, if any, of the Securities Exchange Act of 1934, as amended (the **Exchange Act**) and (ii) where the failure to obtain such consents, approvals, authorizations or permits, or to make such filings or notifications, could not prevent or delay the performance by the Shareholder of its obligations under this Agreement. Other than this Agreement, the Shareholder does not have any understanding in effect with respect to the voting or transfer of any Shares. The Shareholder is not required to make any filing with or notify any governmental or regulatory authority in connection with this Agreement, the Merger Agreement or the transactions contemplated hereby or thereby pursuant to the requirements of the Hart-Scott-Rodino Antitrust Improvement Act of 1976, as amended, and the rules and regulations promulgated thereunder (the **HSR Act**).

Section 2.3. Title to Shares. The Shareholder is the record or beneficial owner of the Shares free and clear of all encumbrances, proxies or voting restrictions other than pursuant to this Agreement and the Proxy and other than any Share Liens otherwise permitted under the terms hereof (none of which Share Liens impose any limit on the right of the Shareholder to vote or grant a proxy with respect to the Shares). The shares of Company Common Stock, including options, warrants or other rights to acquire such stock, set forth on the signature page hereto, are all the securities of the Company owned, directly or indirectly, of record or beneficially by the Shareholder on the date of this Agreement.

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