

Funding for Defined Benefit Plans

The Principal currently provides actuarial services on approximately 1,100 defined benefit plans. The information that follows provides details on pension funding results prepared for plan sponsors of The Principal.

The true cost of a defined benefit plan is the benefits paid plus expenses less investment return. Actuarial assumptions are used to determine funding or “budgeting” the projected estimated cost over the lifetime of the plan. The funding assumptions are determined by the plan actuary and represent the best estimate of anticipated experience under the plan. Actuarial Standards of Practice require each assumption to be reasonable.

The information below includes results for those qualified plans required to comply with ERISA minimum funding. Local and state government plans not subject to ERISA may be regulated by other rules dictated by the state. Both ERISA plans and non-ERISA plans are included in the analysis below.

Interest Rate

One significant assumption is the interest rate. The interest rate can vary based on how plan assets are invested and how benefits are paid from the plan. The interest rate is used to determine the value of plan liabilities. The preretirement interest assumption may differ from the post-retirement rate that is used to value liabilities on or after retirement. The preretirement rate reflects what plan assets are expected to earn. The postretirement interest rate reflects the value of the liability at retirement. The retirement liability recognizes how plan benefits are expected to be provided - purchased annuity, lump sum cash benefit amounts, or direct fund benefit payments.

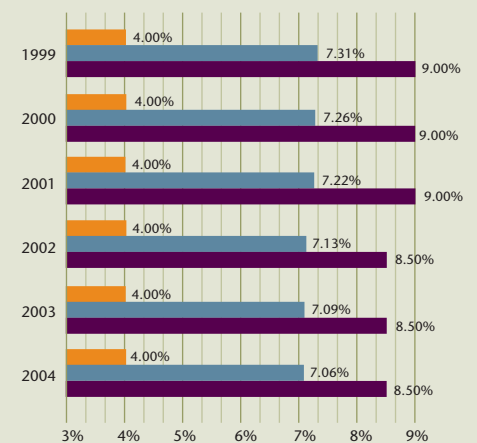
Preretirement Interest Rate

The average preretirement interest rate has decreased 25 basis points, from 7.31 percent in 1999 to 7.06 percent in 2004. The average preretirement interest rate for larger plans is generally higher than the pre-retirement rate for smaller plans. Smaller plans tend to have less diversified investments, with a greater percentage of assets in fixed income funds.

The lowest preretirement interest rate used was 4% with a maximum interest rate of 8.5% for the 2004 year.

Minimum
Average
Maximum

PRERETIREMENT INTEREST RATE by Valuation Year



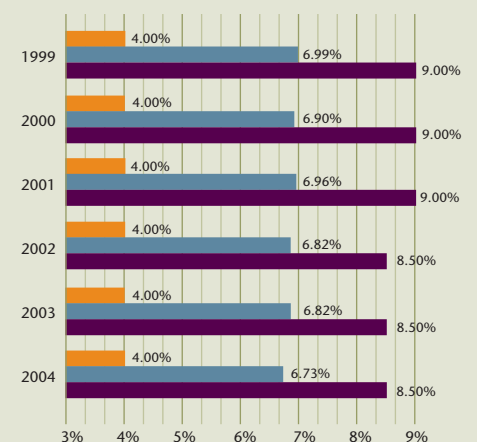
Postretirement Interest Rate

The average postretirement interest rate has decreased from 6.99 percent in 1999 to 6.73 percent in 2004, a decrease of 26 basis points. Smaller plans tend to have lower postretirement interest rates than larger plans. One reason may be that they are more likely to have annuities purchased under their plan design – the retired life liability is moved from the employer to the insurance company.

The lowest interest rate used was 4% with a maximum interest rate of 8.5% for the 2004 year.

Minimum
Average
Maximum

POSTRETIREMENT INTEREST RATE by Valuation Year



Solutions

Review actuarial assumptions. Discuss the actuarial assumptions with your actuary to better understand the appropriateness and the effects of various assumptions.

Project plan funding. Your actuary can assist you with your budgeting process by preparing a projection of your plan's funding requirements.

Consider an asset liability study. This study may help you and your investment advisors select an investment portfolio that minimizes contribution volatility.

Liability Funded Status

RPA Current Liability Funded Status

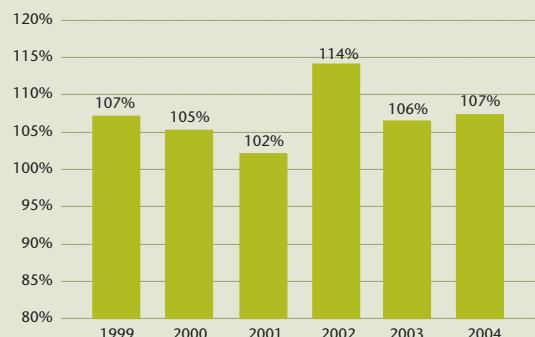
One way to measure a plan's funded status is to compare the actuarial value of plan assets to the RPA current liability. The RPA current liability, for plans complying with ERISA, is the present value of accrued plan benefits based on the interest and mortality rates prescribed by the Retirement Protection Act of 1994 (RPA). The mortality required is 1983 Group Annuity Mortality and the interest rate used must be within a permissible range as outlined in the table below.

YEARS	PERMISSIBLE CURRENT LIABILITY INTEREST RATE
1999 through 2001	90% to 105% of the weighted average of annual yield on 30 year Treasury Securities over a 4 year period.
2002 and 2003	Based on the Job Creation and Workers Assistance Act (JCWAA) 90% to 120% of the weighted average of annual yield on 30 year Treasury Securities over a 4 year period.
2004 and 2005	Based on the Pension Funding Equity Act of 2004 (PFEA) 90% to 100% of the Corporate Bond Weighted Average.

The interest rate basis has changed three times over recent years. The most recent change was the Pension Funding Equity Act of 2002 (PFEA), which changed the interest rate basis for the 2004 and 2005 plan years. The interest rate for January 2004 was 6.55 percent. Without PFEA, the rate would have been 5.51 percent, greatly increasing liabilities from 2003 to 2004 and generating substantially higher funding levels for under-funded plans.

The decline in interest rates in 2000 and 2001 resulted in a decrease in average funding ratio. An increase in interest rate in 2002 – along with the investment gain due to the Principal Life Insurance Company demutualization plan proceeds – increased the 2002 ratio.

AVERAGE RPA CURRENT LIABILITY FUNDED STATUS



Fast Facts

The RPA current liability interest rate was initially based on the 30-year Treasury bond rate. Although the Department of Treasury is no longer issuing 30-year bonds, the IRS continues to publish a 30-year rate that has decreased significantly.

Pension relief was granted by the Job Creation and Workers Assistance Act (JCWAA) for the 2002 and 2003 years. Without this relief, the allowable RPA interest rate would have continued to decrease. The Pension Funding Equity Act of 2004 (PFEA) then changed the basis of the current liability rate to a Corporate Bond Weighted Average for the 2004 and 2005 years.

Plans that have a current liability funded status below 90 percent are subject to an additional funding requirement.