



Defined Benefit Plans

Defined Benefit (DB) plans were still one of the most efficient ways to provide an anticipated retirement benefit for employees for the dollar contributed. They remained an important part of a total retirement program and were one of the most valued and appreciated¹ benefits.

¹ Facts from EBRI June 2007; <http://www.ebri.org/pdf/publications/facts/0607fact.pdf>

Defined Benefit Plans Remain Highly Valued

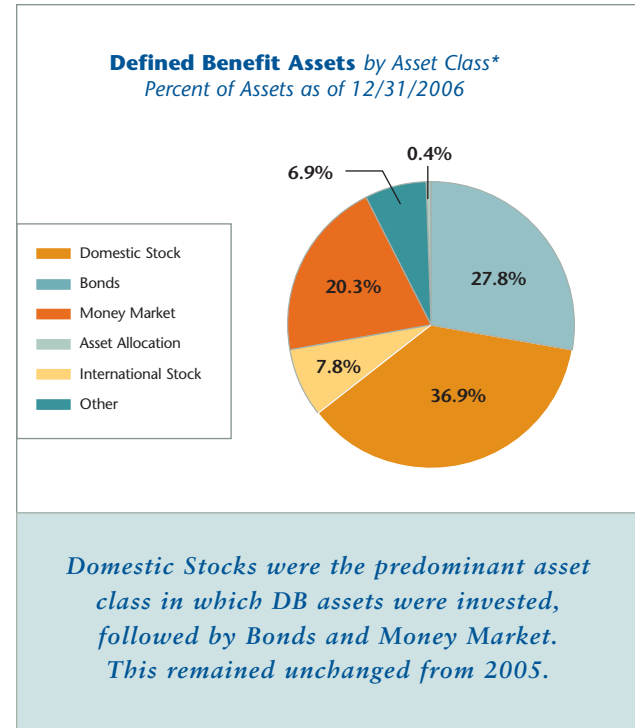
Although regulations have been slow in coming, passage of the landmark Pension Protection Act of 2006 (PPA) made it an exciting time for DB plan sponsors, largely because one of the main goals of the legislation was simplifying DB funding rules to allow for funding flexibility.

Today many DB plan sponsors find themselves reviewing their plans in light of PPA and upcoming FASB changes. While some plan sponsors will undoubtedly freeze or terminate their DB plans, many other plan sponsors have chosen to wait for clarification from the IRS and DOL before taking any action. Another issue is that Pension Benefit Guaranty Corporation (PBGC) solvency concerns have not been eliminated. As some very large employers drift towards Chapter 11, further large liabilities may be transferred to the PBGC.

Forecast: Alternatives are Re-Emerging

New DB plan formation is still generally limited to professional corporations, self-employed individuals, and select not-for-profit organizations. However, **plan sponsors are revisiting tried-and-tested alternatives. Thanks to the legitimization of hybrid plans through PPA, options such as Cash Balance designs are once again becoming viable options** to help balance the risk of maintaining DB benefits, while at the same time providing retirement income security for employees.

While employers continue to look for answers to their lingering questions about their retirement programs, they may increasingly be on the lookout to coordinate all their retirement plan needs with a single-source service provider.



* Percentages in graphs are rounded to the nearest integer percentages in order to increase readability and may not total exactly 100%.

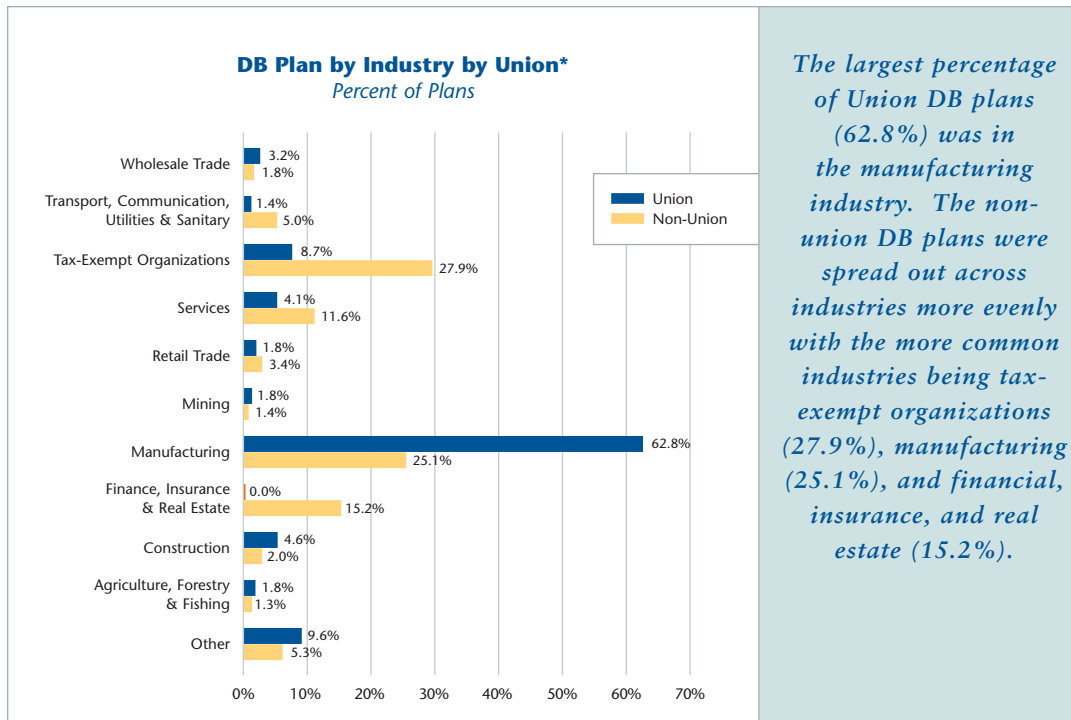
Fast Fact

During 2006, DB plans totaling over \$760 million in plan assets transferred their retirement plans to the Principal Financial Group for administrative services.

Fast Facts

Even though the number of DB plans in the marketplace declined, the assets held in DB plans still represented 35% of all retirement assets.¹

The Principal worked with clients to freeze a total of 56 DB plans in 2006, representing \$265 million in assets.



* Percentages in graphs are rounded to the nearest integer percentages in order to increase readability and may not total exactly 100%.

In a study conducted by Hewitt Associates², the top reasons that DB plan sponsors cited for not making changes to their plan were that:

- 1 Employees valued and appreciated the DB plan.*
- 2 The DB plan was an efficient vehicle for delivering retirement benefits.*



Promoting the DB plan to employees

In addition to the total retirement statement participants received, many organizations also utilized these resources to help communicate the value of the DB plan to employees (according to Hewitt Associates³):

Regular written communications

Online communications or website, and

Employee education meetings.

Fast Fact

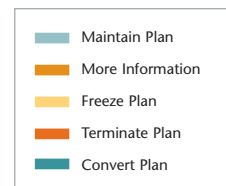
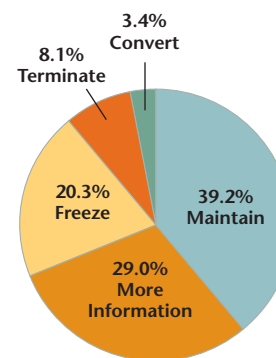
DB plan sponsors cited cost (volatility and amount) as the top reasons for closing participation, freezing accruals, or terminating plans.⁴

¹ SPARK 2007 Marketplace Update

² PLANSPONSOR 2006 DB Survey - Too Little, Too Late

³ Hewitt: Hot Topics in Retirement 2006

⁴ 2007 Principal Financial Group Survey



In an online study regarding the impact of PPA (conducted by the Principal Financial Group with a sample of our retirement plan sponsors), 39% of DB plan sponsors indicated they will maintain their plan, 29% indicated they needed more information before taking any actions, 20% were likely to freeze their plan, while 8% will terminate their plan, and 3% planned to convert their DB plan into a cash balance plan.⁴

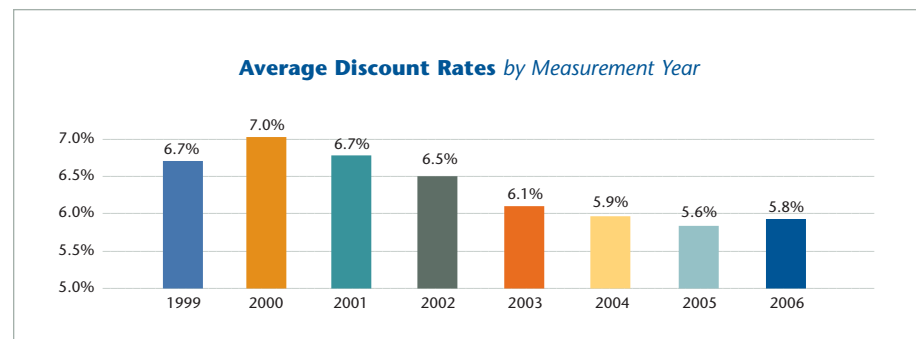
Accounting for Defined Benefit Plans

A DB plan's funded status is generally a comparison of plan assets and liabilities. Liabilities for accounting purposes include all benefits based on service accrued to date along with a projection of future salary increases to the benefit commencement date. A discount rate is used to calculate the value of plan liabilities. This rate is determined by the plan sponsor and based on current economic conditions. As discounts drop, plan liabilities rise.

The good news for DB plan sponsors is that average funding levels improved. Among DB plans with plan services provided by The Principal, the 2006 average funded status was 89 percent – an increase from 83 percent in 2005.

While the 2006 funded status returned to the 2002 level, it had not yet reached the 96 percent funded peak experienced in 2000. As the funded status percentages improved, so did the percentage of plans that were at or above 100 percent funded. **In 2006, 22 percent of plans with services provided by The Principal were at or above 100 percent funding, a significant improvement from 2005.**

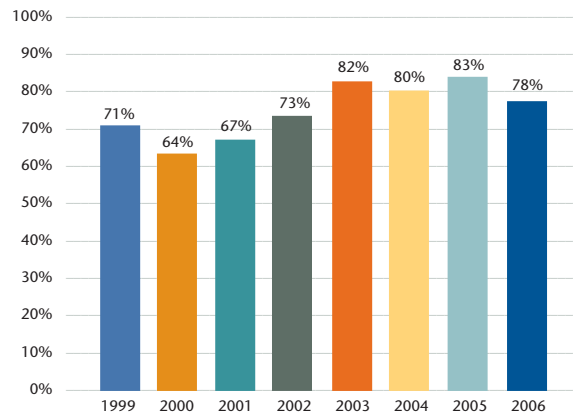
The average discount rate increased from its lowest level in 2005 of 5.6 percent to 5.8 percent, but still remains far below its highest level in 2000 of 7.0 percent.



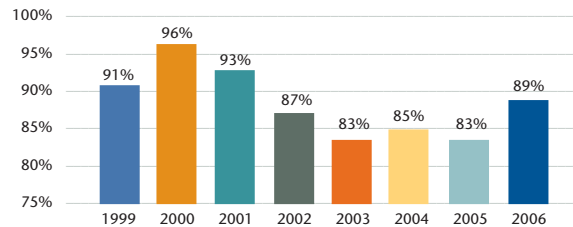
Fast Fact

In 2006, the Principal Financial Group made DB retirement payments in excess of \$1 billion to just over 210,000 retirees.

Less Than 100% Funded Status
Percent of Plans

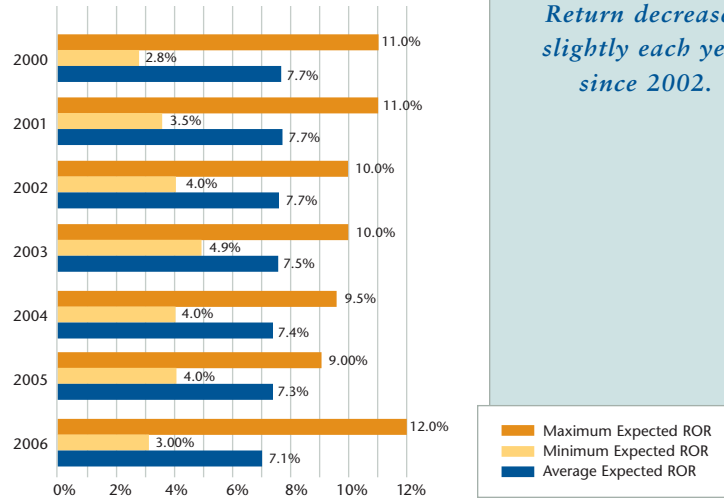


Average Funded Status



Average funded status increased to 89% in 2006. Since the measurement of both assets and liabilities were based on a market value basis, the funded status results were quite volatile.

Average Expected Long Term Rate of Return on Assets



The Average Expected Long Term Rate of Return decreased slightly each year since 2002.

Fast Fact

The Principal provided administrative services to approximately 1,600 DB plans with 319,000 participants totaling more than \$11.4 billion in assets.



Funding for Defined Benefit Plans

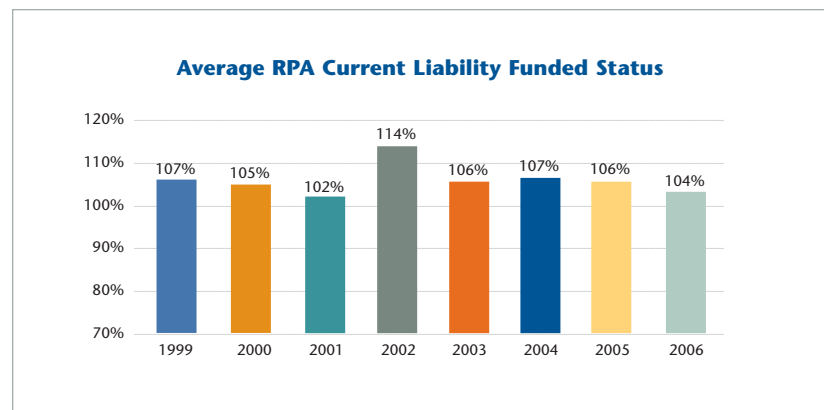
One method to measure a plan's funded status is to compare the actuarial value of plan assets to the Retirement Protection Act of 1994 (RPA) current liability. The RPA current liability, for plans complying with ERISA, is the present value of accrued plan benefits based on the interest and mortality rates set by RPA.

The average RPA current liability funded status declined slightly from 106 percent in 2005 to 104 percent in 2006.

The average RPA interest rate declined from 6.0% in 2005 to 5.8% in 2006.

Beginning in 2008, a plan's funded status will be used to determine required contributions, whether any benefit payment restrictions apply, and if plan benefit improvements can be made. A poorly funded plan (less than 60 percent funded) can even be forced to freeze benefit accruals.

The ultimate goal of the Pension Protection Act (PPA) is for plan sponsors to fund 100 percent of the current market value of accrued benefits.



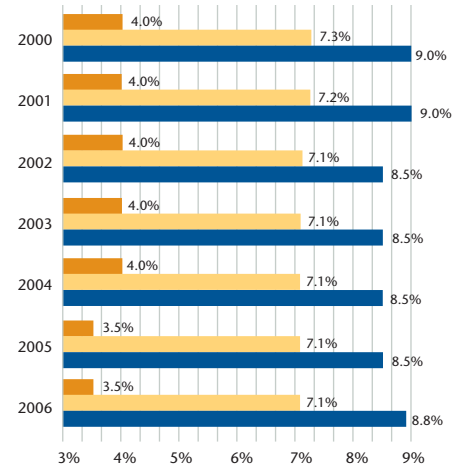
Interest Rates

One major assumption used in determining the required annual funding is the interest rate, which helps estimate the value of plan liabilities. The pre-retirement rate reflects what plan assets are expected to earn, while the post-retirement rate can reflect either the expected return on plan assets for benefits paid monthly from the fund, or the interest rate used to set the purchase price or single sum distribution at retirement.

The average pre-retirement interest rate remained nearly unchanged from 2005 at 7.1%. The maximum increased slightly from 8.5% to 8.8% while the minimum remained unchanged at 3.5%.

Minimum
Average
Maximum

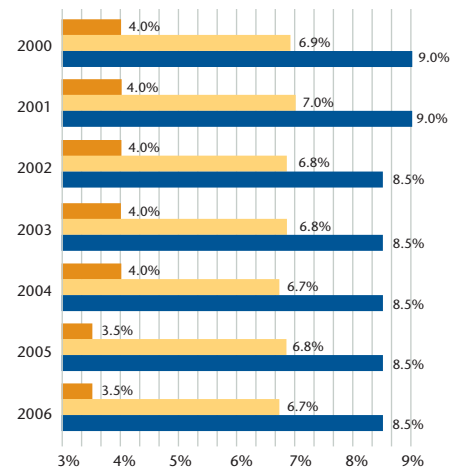
Pre-Retirement Interest Rate
by Valuation Year



The minimum post-retirement interest rate was the same as the pre-retirement rate; however, the average post-retirement interest rate was lower at 6.7% and the maximum was 8.5%.

Minimum
Average
Maximum

Post-Retirement Interest Rate
by Valuation Year



DB plan data shown under accounting and funding for 2006 was collected from approximately 700 DB plans for which The Principal provided actuarial services