Anheuser-Busch InBev SA/NV
Form 424B5
January 10, 2019
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**Filed pursuant to Rule 424(b)(5)**
**Registration Statement No. 333-223774**

**The Information in this preliminary Prospectus Supplement is not complete and may be changed. We are not using this Prospectus Supplement or the attached Prospectus to offer to sell these securities or to solicit offers to buy these securities in any jurisdiction where the offer or sale is not permitted.**

Subject to Completion dated 10 January 2019

**Preliminary Prospectus Supplement**

**(To Prospectus dated 19 March 2018) (the Prospectus )**

**Anheuser-Busch InBev Worldwide Inc.**

**$ % Notes due 2025**

**$ % Notes due 2029**

**$ % Notes due 2031**

**$ % Notes due 2039**

**$ % Notes due 2049**

**$ % Notes due 2059**

**Fully and unconditionally guaranteed by**

**Anheuser-Busch InBev SA/NV**

**Anheuser-Busch InBev Finance Inc.**

**Brandbev S.à r.l.**

**Brandbrew S.A.**

**Cobrew NV**

**Anheuser-Busch Companies, LLC**

The fixed rate notes due 2025 (the **2025 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2029 (the **2029 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2031 (the **2031 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2039 (the **2039 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2049 (the **2049 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2059 (the **2059 Notes,** and together with the 2025 Notes, the 2029 Notes, the 2031 Notes, the 2039 Notes and the 2049 Notes, the **Notes** ) will bear interest at a rate of % per year. Interest on the Notes will be payable semi-annually in arrears on and of each year, commencing on . The 2025 Notes will mature on 2025, the 2029 Notes will mature on 2029, the 2031 Notes will mature on 2031, the 2039 Notes will mature on 2039, the 2049 Notes will mature on 2049 and the 2059 Notes will mature on 2059. The Notes will be issued by Anheuser-Busch InBev Worldwide Inc. (the **Issuer** ) and will be fully and unconditionally guaranteed by Anheuser-Busch InBev SA/NV (the **Parent Guarantor** ), Anheuser-Busch InBev Finance Inc., Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, and Anheuser-Busch Companies, LLC (the **Subsidiary Guarantors,** and together with the Parent Guarantor, the **Guarantors** ). Application will be made to list each series of Notes on the New York Stock Exchange. There can be no assurance that any series of Notes will be listed.

The Issuer may, at its option, redeem each series of Notes in whole or in part, at any time as further provided in Description of the Notes Optional Redemption. The Issuer may also redeem each series of the Notes at the Issuer s (or, if applicable, the Parent Guarantor s) option, in whole but not in part, at 100% of the principal amount then outstanding plus accrued interest if certain tax events occur as described in Description of the Notes Optional Tax Redemption.

**Investing in the Notes involves risks. See Risk Factors beginning on page 2 of the accompanying Prospectus. Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this Prospectus Supplement or the accompanying Prospectus. Any representation to the contrary is a criminal offense.**

| | **Public offering price[(1)]** | **Underwriting discount** | **Proceeds, before expenses, to the Issuer** |
|---|---|---|---|
| Per 2025 Note | % | % | % |
| Total for 2025 Notes | $ | $ | $ |
| Per 2029 Note | % | % | % |
| Total for 2029 Notes | $ | $ | $ |
| Per 2031 Note | % | % | % |
| Total for 2031 Notes | $ | $ | $ |
| Per 2039 Note | % | % | % |
| Total for 2039 Notes | $ | $ | $ |
| Per 2049 Note | % | % | % |
| Total for 2049 Notes | $ | $ | $ |
| Per 2059 Note | % | % | % |
| Total for 2059 Notes | $ | $ | $ |

(1) Plus accrued interest, if any, from and including 2019.

The underwriters expect to deliver the Notes to purchasers in book-entry form only through the facilities of The Depository Trust Company and its direct and indirect participants (including Euroclear S.A./N.V. and Clearstream Banking, *société anonyme*) on or about 2019.

***Joint Bookrunners***

**BofA Merrill Lynch** **Barclays** **Citigroup** **Deutsche Bank Securities** **J.P. Morgan**

**The date of this Prospectus Supplement is 2019.**

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## PROSPECTUS


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## THE OFFERING

*This section outlines the specific financial and legal terms of the Notes that are described in greater detail under Description of the Notes beginning on page S-17 of this Prospectus Supplement and under Description of Debt Securities and Guarantees beginning on page 18 of the accompanying Prospectus. If anything described in this section is inconsistent with the terms described under Description of the Notes in this Prospectus Supplement or in Description of Debt Securities and Guarantees in the accompanying Prospectus, the terms described below shall prevail. References to $ or USD in this Prospectus Supplement are to U.S. dollars, and references to or EUR are to euros. References to we, us and our are, as the context requires, to Anheuser-Busch InBev SA/NV or Anheuser-Busch InBev SA/NV and the group of companies owned and/or controlled by Anheuser-Busch InBev SA/NV as more fully described on page 1 of the accompanying Prospectus.*

| | |
|---|---|
| **Issuer** | Anheuser-Busch InBev Worldwide Inc., a Delaware corporation (the **Issuer** ). |
| **Parent Guarantor** | Anheuser-Busch InBev SA/NV, a Belgian public limited liability company (the **Parent Guarantor** ). |
| **Subsidiary Guarantors** | Anheuser-Busch InBev Finance Inc., Brandbev S.à r.l., Brandbrew S.A., Cobrew NV and Anheuser-Busch Companies, LLC (each a **Subsidiary Guarantor** and together with the Parent Guarantor, the **Guarantors** ), will, along with the Parent Guarantor, jointly and severally guarantee the Notes on an unconditional, full and irrevocable basis, subject to certain limitations described in Description of Debt Securities and Guarantees in the accompanying Prospectus. |
| **Securities Offered** | $ aggregate principal amount of % notes due 2025 (the **2025 Notes** ). The 2025 Notes will mature on 2025. |
| | $ aggregate principal amount of % notes due 2029 (the **2029 Notes** ). The 2029 Notes will mature on 2029. |
| | $ aggregate principal amount of % notes due 2031 (the **2031 Notes** ). The 2031 Notes will mature on 2031. |
| | $ aggregate principal amount of % notes due 2039 (the **2039 Notes** ). The 2039 Notes will mature on 2039. |

| | |
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| | $ aggregate principal amount of % notes due 2049 (the **2049 Notes** ). The 2049 Notes will mature on 2049. |
| | $ aggregate principal amount of % notes due 2059 (the **2059 Notes** ). The 2059 Notes will mature on 2059. |
| | The Notes are redeemable prior to maturity as described in Description of the Notes Optional Redemption and will be redeemable prior to maturity as described under Description of the Notes Optional Tax Redemption. |
| **Price to Public** | % of the principal amount of the 2025 Notes, plus accrued interest, if any, from and including 2019. |
| | % of the principal amount of the 2029 Notes, plus accrued interest, if any, from and including 2019. |
| | % of the principal amount of the 2031 Notes, plus accrued interest, if any, from and including 2019. |

| | |
|---|---|
| | % of the principal amount of the 2039 Notes, plus accrued interest, if any, from and including 2019. |
| | % of the principal amount of the 2049 Notes, plus accrued interest, if any, from and including 2019. |
| | % of the principal amount of the 2059 Notes, plus accrued interest, if any, from and including 2019. |
| **Ranking of the Notes** | The Notes will be senior unsecured obligations of the Issuer and will rank equally among themselves, and with all other existing and future unsecured and unsubordinated debt obligations of the Issuer. |
| **Ranking of the Guarantees** | Subject to certain limitations described in Description of Debt Securities and Guarantees in the accompanying Prospectus, each Note will be jointly and severally guaranteed by each of the Guarantors, on an unconditional, full and irrevocable basis (each a **Guarantee** and collectively the **Guarantees** ). The Guarantees will be the direct, unconditional, unsecured and unsubordinated general obligations of the Guarantors. The Guarantees will rank *pari passu* among themselves, without any preference of one over the other by reason of priority of date of issue or otherwise, and *pari passu* with all other existing and future unsecured and unsubordinated general obligations of the Guarantors. Each of the Guarantors other than the Parent Guarantor shall be entitled to terminate its Guarantee in certain circumstances as further described under Description of Debt Securities and Guarantees in the accompanying Prospectus. |
| **Minimum Denomination** | The Notes will be issued in denominations of $1,000 and integral multiples of $1,000 in excess thereof. |
| **Payment of Principal and Interest on the Notes** | The principal amount of the 2025 Notes is $ and the 2025 Notes will bear interest at the rate per annum of %. |
| | The principal amount of the 2029 Notes is $ and the 2029 Notes will bear interest at the rate per annum of %. |
| | The principal amount of the 2031 Notes is $ and the 2031 Notes will bear interest at the rate per annum of %. |

The principal amount of the 2039 Notes is $ and the 2039 Notes will bear interest at the rate per annum of %.

The principal amount of the 2049 Notes is $ and the 2049 Notes will bear interest at the rate per annum of %.

The principal amount of the 2059 Notes is $ and the 2059 Notes will bear interest at the rate per annum of %.

Interest on the Notes will be payable semi-annually in arrears on and of each year, commencing on 2019. Interest on the Notes will accrue from 2019.

If the date of such interest payment is not a Business Day, then payment will be made on the next succeeding Business Day and no interest shall accrue on the payment so deferred. Interest will accrue on the Notes until the principal of the applicable Notes is paid or duly made available for payment. Interest on the Notes will be calculated on the basis of a 360-day year consisting of twelve 30-day months.

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Interest on the Notes will be paid to the persons in whose names such Notes (or one or more predecessor notes) are registered at the close of business on the and immediately preceding the applicable interest payment date, whether or not such date is a Business Day.

If the date of maturity of principal of any Note or the date fixed for redemption or payment in connection with an acceleration of any Note is not a Business Day, then payment of interest or principal need not be made on such date, but may be made on the next succeeding Business Day with the same force and effect as if made on the date of maturity or the date fixed for redemption or payment in connection with an acceleration, and no interest shall accrue as a result of the delayed payment.

**Business Day**

A day on which commercial banks and exchange markets are open, or not authorized to close, in the City of New York, London and Brussels.

**Additional Amounts**

To the extent any Guarantor is required to make payments in respect of the Notes, such Guarantor will make all payments in respect of the Notes without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by way of withholding or deduction at source by or on behalf of any jurisdiction in which such Guarantor is incorporated, organized, or otherwise tax resident or any political subdivision or any authority thereof or therein having power to tax (the **Relevant Taxing Jurisdiction** ) unless such withholding or deduction is required by law, in which event, such Guarantor will pay to the Holders such additional amounts (the **Additional Amounts** ) as shall be necessary in order that the net amounts received by the Holders, after such withholding or deduction, shall equal the respective amounts of principal and interest which would otherwise have been receivable in the absence of such withholding or deduction, except that no such Additional Amounts shall be payable on account of any taxes or duties only in the circumstances described under Description of Debt Securities and Guarantees Additional Amounts in the accompanying Prospectus.

References to principal or interest in respect of the Notes include any Additional Amounts, which may be payable as set forth in the Indenture (as defined herein).

The covenant regarding Additional Amounts will not apply to any Guarantor at any time when such Guarantor is incorporated in a jurisdiction in the United States, but shall apply to the Issuer at any time that the Issuer is incorporated in any jurisdiction outside the United States.

**Optional Redemption**

Prior to (i) with respect to the 2025 Notes, 2024 (one month prior to the maturity date of the 2025 Notes), (ii) with respect to the 2029 Notes, 2028 (three months prior to the maturity date of the 2029 Notes), (iii) with

respect to the 2031 Notes, 2030 (three months prior to the maturity date of the 2031 Notes); (iv) with respect to the 2039 Notes, 2038 (six months prior to the maturity date of the 2039 Notes), (v) with respect to the 2049 Notes, 2048 (six months prior to the maturity date of the 2049 Notes), (vi) with respect to the 2059 Notes, 2058 (six months prior to the maturity date of the 2059 Notes), each series of Notes may be redeemed at any time, at the Issuer s option, as a whole or in part, upon not less than 10 nor more than 60 days prior notice, at a redemption price equal to the greater of:

100% of the aggregate principal amount of the Notes to be redeemed; and

as determined by the Independent Investment Banker (as defined below), the sum of the present values of the remaining scheduled payments of principal and interest on the Notes to be redeemed as if the Notes to be redeemed matured on the applicable Par Call Date (as defined herein) (not including any portion of such payments of interest accrued to the date of redemption) discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus the applicable Spread (as defined herein) for such series of Notes;

plus, in each case described above, accrued and unpaid interest on the principal amount being redeemed to (but excluding) the redemption date.

On or after, with respect to the 2025 Notes, 2024 (one month prior to the maturity date of the 2025 Notes), (ii) with respect to the 2029 Notes, 2028 (three months prior to the maturity date of the 2029 Notes), (iii) with respect to the 2031 Notes, 2030 (three months prior to the maturity date of the 2031 Notes); (iv) with respect to the 2039 Notes, 2038 (six months prior to the maturity date of the 2039 Notes), (v) with respect to the 2049 Notes, 2048 (six months prior to the maturity date of the 2049 Notes) and (vi) with respect to the 2059 Notes, 2058 (six months prior to the maturity date of the 2059 Notes), each series of Notes will be redeemable as a whole or in part, at the Issuer s option at any time and from time to time at a redemption price equal to 100% of the principal amount of the Notes being redeemed, plus accrued and unpaid interest to, but excluding, the date of redemption.

**Optional Tax Redemption**

Each series of Notes may be redeemed at any time, at the Issuer s or the Parent Guarantor s option, as a whole, but not in part, upon not less than 10 nor more than 60 days prior notice, at a redemption price equal to 100% of the principal amount of the Notes of such series then outstanding plus accrued and unpaid interest on the principal amount being redeemed (and all Additional Amounts (see Description of Debt Securities and Guarantees Additional Amounts in the accompanying Prospectus), if any) to (but excluding) the redemption date, if (i) as a result of any change in, or amendment to, the laws, treaties, regulations or rulings of a jurisdiction in which the Issuer or any Guarantor is incorporated, organized, or otherwise tax resident or any political subdivision or any authority thereof or therein having power to tax, or in the interpretation, application or administration of any such laws, treaties, regulations or rulings (including a holding,

judgment or order by a court of competent jurisdiction) which becomes effective on or after the date of this prospectus supplement (any such change or amendment, a **Change in Tax Law** ), the Issuer (or if a payment were then due under a Guarantee, the relevant Guarantor) would be required to pay Additional Amounts and (ii) such obligation cannot be avoided by the Issuer (or the relevant Guarantor) taking reasonable measures available to it, *provided*, *however*, that any series of Notes may not be redeemed to the extent such Additional Amounts arise solely as a result of the Issuer assigning its obligations under such Notes to a Substitute Issuer (as defined in Description of the Notes ), unless this assignment to a Substitute Issuer is undertaken as part of a plan of merger by the Parent Guarantor.

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No notice of redemption may be given earlier than 90 days prior to the earliest date on which the Issuer or the Guarantor would be obligated to pay the Additional Amounts if a payment in respect of such series of Notes were then due.

**Use of Proceeds**

The Issuer intends to apply substantially all of the net proceeds (estimated to be $ million before expenses) from the sale of the Notes for general corporate purposes, including the repayment of upcoming debt maturities in 2021 to 2024 and 2026.

Specifically, Issuer and the Parent Guarantor intend to use the net proceeds, after deducting the initial purchasers discount and other estimated offering expenses payable by the Issuer, from this offering to purchase for cash up to $11 billion aggregate purchase price the following outstanding notes, issued by either the Issuer, Anheuser-Busch Companies, LLC or Anheuser-Busch InBev Finance Inc., subject to the terms of an offer to purchase, dated as of the date of this prospectus supplement:

| Title of Security | CUSIP/ISIN Number | Principal Amount Outstanding | Issuer |
|---|---|---|---|
| 2.650% Notes due 2021 | 035242 AJ5 / US035242 AJ52 | $ 4,967,588,000 | Anheuser-Busch InBev Finance Inc. ( **ABIFI** ) |
| Floating Rate Notes due 2021 | 035242 AK2 / US035242 AK26 | $ 500,000,000 | ABIFI |
| 4.375% Notes due 2021 | 03523TBB3 / US03523T BB35 | $ 500,000,000 | Anheuser-Busch InBev Worldwide Inc. ( **ABIWW** ) |
| 3.750% Notes due 2022 | 035240 AD2 / US035240 AD27 | $ 2,350,039,000 | ABIWW |
| 2.500% Notes due 2022 | 03523TBP2 / US03523T BP21 | $ 3,000,000,000 | ABIWW |
| 2.625% Notes due 2023 | 035242 AA4 / US035242 AA44 | $ 1,250,000,000 | ABIFI |
| 3.300% Notes due 2023 | 035242 AL0 / US035242 AL09 | $ 6,000,000,000 | ABIFI |
| Floating Rate Notes due 2024 | 035240AK6 / | $ 500,000,000 | ABIWW |

| | | | |
|---|---|---|---|
| | US035240 AK69 | | |
| 3.500% Notes due 2024 | 035240AJ9 / US035240 AJ96 | $ 1,500,000,000 | ABIWW |
| 3.700% Notes due 2024 | 03524B AE6 / US03524B AE65 | $ 1,400,000,000 | ABIFI |
| 3.650% Notes due 2026 | 035242 AP1 / US035242 AP13 | $ 2,444,837,000 | ABIFI |
| 3.650% Notes due 2026 | 03522A AD2 / U00323 AD4 / US03522A AD28 / USU00323 AD40 | $ 8,555,163,000 | ABIWW and Anheuser-Busch Companies, LLC ( **ABC** ) |

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|---|---|
| | The 3.500% Notes due 2024 and Floating Rate Notes due 2024 were issued on 4 April 2018, and the funds from that issuance were used for general corporate purposes, including the repayment of debt maturities in 2019 and 2020. |
| | The Floating Rate Notes due 2021 bear interest at a floating rate per year equal to the 3-month U.S. dollar London Interbank Offered Rate ( **LIBOR** ), plus 1.260%, and for the current interest period ending on February 1, 2019, such rate is equal to 3.81850% per annum. The Floating Rate Notes due 2024 bear interest at a floating rate per year equal to the 3-month U.S. dollar LIBOR, plus 0.74%, and for the current interest period ending on January 12, 2019, such rate is equal to 3.16519% per annum. |
| | One or more of the initial purchasers or their respective affiliates may own notes in the aforementioned tender offers and be eligible to participate in the offer to purchase. As a result, one or more of the initial purchasers or their respective affiliates may receive a portion of the net proceeds from this offering. |
| | This offering is not conditioned upon the consummation of the aforementioned tender offers. In the event that such tender offers are not consummated, we intend to use the net proceeds from this offering for general corporate purposes, including the repayment of upcoming debt maturities in 2021 to 2024 and 2026. |
| **Listing and Trading** | Application will be made for each series of the Notes to be admitted to listing on the New York Stock Exchange ( **NYSE** ). No assurance can be given that such application will be approved. |
| **Name of Depositary** | The Depository Trust Company ( **DTC** ). |
| **Book-Entry Form** | The Notes will initially be issued to investors in book-entry form only. Fully-registered global notes representing the total aggregate principal amount of the Notes of each series will be issued and registered in the name of a nominee for DTC, the securities depositary for the Notes, for credit to accounts of direct or indirect participants in DTC, including Euroclear S.A./N.V. ( **Euroclear** ) and Clearstream Banking, *société anonyme* ( **Clearstream** ). Unless and until Notes in definitive certificated form are issued, the only holder will be Cede & Co., as nominee of DTC, or the nominee of a successor depositary. Except as described in this Prospectus Supplement or accompanying Prospectus, a beneficial owner of any interest in a global note will not be entitled to receive physical delivery of definitive Notes. Accordingly, each beneficial owner of any interest in a global note |

must rely on the procedures of DTC, Euroclear, Clearstream, or their participants, as applicable, to exercise any rights under the Notes.

| | |
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| **Taxation** | For a discussion of the United States, Belgian and Luxembourg tax consequences associated with the Notes, see Taxation Supplemental Discussion of United States Taxation, Taxation Belgian Taxation and Taxation Luxembourg Taxation in this Prospectus Supplement and Tax Considerations in the accompanying Prospectus. Investors should consult their own tax advisors in determining the non-United States, United States federal, state, local and any other tax consequences to them of the purchase, ownership and disposition of the Notes. |

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| **Governing Law** | The Notes, the Guarantees and the Indenture related thereto, will be governed by, and construed in accordance with, the laws of the State of New York. |
| **Additional Notes** | The Issuer may, from time to time, without notice to or the consent of the Holders, create and issue, pursuant to the Indenture and in accordance with applicable laws and regulations, additional Notes of a series (the **Additional Notes** ) maturing on the same maturity date as the other Notes of that series and having the same terms and conditions under the Indenture (including with respect to the Guarantors and the Guarantees) as the previously outstanding Notes of that series in all respects (or in all respects except for the issue date and the principal amount and, in some cases, the date of the first payment of interest thereon) so that such Additional Notes shall be consolidated and form a single series with the previously outstanding Notes of that series, *provided* that either (i) such Additional Notes are fungible with the Notes of such series offered hereby for U.S. federal income tax purposes or (ii) such Additional Notes shall have a separate CUSIP number. Without limiting the foregoing, the Issuer may, from time to time, without notice to or the consent of the Holders, create and issue, pursuant to the Indenture and in accordance with applicable laws and regulations, additional series of notes with additional or different terms and maturity dates than the Notes. |
| **Trustee, Principal Paying Agent, Transfer Agent and Registrar** | The Trustee, principal paying agent, transfer agent and registrar is The Bank of New York Mellon Trust Company, N.A. ( **Trustee** ). |
| **CUSIPs:** | 2025 Notes:<br>2029 Notes:<br>2031 Notes:<br>2039 Notes:<br>2049 Notes:<br>2059 Notes: |
| **ISINs:** | 2025 Notes:<br>2029 Notes:<br>2031 Notes:<br>2039 Notes:<br>2049 Notes:<br>2059 Notes: |

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## CONCURRENT DEBT TENDER OFFERS

*Concurrent with this offering and conditioned on the completion of this offering in an amount satisfactory to the Issuer (unless waived), we have made offers to purchase for cash (together, the* **Offer to Purchase** *) up to an aggregate purchase price of $11 billion the following series of outstanding notes (together, the* **Tender Offer Notes** *), issued by either the Issuer, Anheuser-Busch Companies, LLC or Anheuser-Busch InBev Finance Inc., subject to the terms of an offer to purchase, dated as of the date of this prospectus supplement:*

| Title of Security | CUSIP/ISIN Number | Principal Amount Outstanding | Issuer |
|---|---|---|---|
| 2.650% Notes due 2021 | 035242 AJ5 / US035242 AJ52 | $ 4,967,588,000 | Anheuser-Busch InBev Finance Inc. ( **ABIFI** ) |
| Floating Rate Notes due 2021 | 035242 AK2 / US035242 AK26 | $ 500,000,000 | ABIFI |
| 4.375% Notes due 2021 | 03523TBB3 / US03523T BB35 | $ 500,000,000 | Anheuser-Busch InBev Worldwide Inc. ( **ABIWW** ) |
| 3.750% Notes due 2022 | 035240 AD2 / US035240 AD27 | $ 2,350,039,000 | ABIWW |
| 2.500% Notes due 2022 | 03523TBP2 / US03523T BP21 | $ 3,000,000,000 | ABIWW |
| 2.625% Notes due 2023 | 035242 AA4 / US035242 AA44 | $ 1,250,000,000 | ABIFI |
| 3.300% Notes due 2023 | 035242 AL0 / US035242 AL09 | $ 6,000,000,000 | ABIFI |
| Floating Rate Notes due 2024 | 035240AK6 / US035240 AK69 | $ 500,000,000 | ABIWW |
| 3.500% Notes due 2024 | 035240AJ9 / US035240 AJ96 | $ 1,500,000,000 | ABIWW |
| 3.700% Notes due 2024 | 03524B AE6 / US03524B AE65 | $ 1,400,000,000 | ABIFI |
| 3.650% Notes due 2026 | 035242 AP1 / US035242 AP13 | $ 2,444,837,000 | ABIFI |
| 3.650% Notes due 2026 | 03522A AD2 / | $ 8,555,163,000 | |

| | | |
|---|---|---|
| | U00323 AD4 /<br>US03522A AD28 /<br>USU00323 AD40 | ABIWW and Anheuser-Busch Companies, LLC ( **ABC** ) |

The 3.500% Notes due 2024 and Floating Rate Notes due 2024 were issued on 4 April 2018, and the funds from that issuance were used for general corporate purposes, including the repayment of debt maturities in 2019 and 2020.

The Floating Rate Notes due 2021 bear interest at a floating rate per year equal to the 3-month U.S. dollar London Interbank Offered Rate ( **LIBOR** ), plus 1.260%, and for the current interest period ending on February 1, 2019, such rate is equal to 3.81850% per annum. The Floating Rate Notes due 2024 bear interest at a floating rate per year equal to the 3-month U.S. dollar LIBOR, plus 0.74%, and for the current interest period ending on January 12, 2019, such rate is equal to 3.16519% per annum.

One or more of the initial purchasers or their respective affiliates may own Tender Offer Notes and be eligible to participate in the Offer to Purchase. As a result, one or more of the initial purchasers or their respective affiliates may receive a portion of the net proceeds from this offering. The Offer to Purchase is conditioned upon the satisfaction or waiver of certain specified conditions, and we cannot assure you that the Offer to Purchase will be consummated in accordance with its respective terms, or at all, or that the Tender Offer Notes will be tendered and purchased in the Offer to Purchase. This offering is not conditioned upon the consummation of the Offer to Purchase.

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## ABOUT THIS PROSPECTUS SUPPLEMENT

Prospective investors should rely on the information provided in this Prospectus Supplement, the accompanying Prospectus and the documents incorporated by reference in this Prospectus Supplement and the accompanying Prospectus. No person is authorized to make any representation or give any information not contained in this Prospectus Supplement, the accompanying Prospectus or the documents incorporated by reference in this Prospectus Supplement and the accompanying Prospectus. Any such representation or information not contained in this Prospectus Supplement, the accompanying Prospectus or the documents incorporated by reference in this Prospectus Supplement and the accompanying Prospectus must not be relied upon as having been authorized by us or the underwriters. Please see Incorporation of Certain Information by Reference in this Prospectus Supplement and the accompanying Prospectus for information about the documents that are incorporated by reference.

We are not offering to sell or soliciting offers to buy any securities other than the Notes offered under this Prospectus Supplement, nor are we offering to sell or soliciting offers to buy the Notes in places where such offers are not permitted by applicable law. You should not assume that the information in this Prospectus Supplement or the accompanying Prospectus, or the information we have previously filed with the U.S. Securities and Exchange Commission ( **SEC** ) and incorporated by reference in this Prospectus Supplement and the accompanying Prospectus, is accurate as of any date other than their respective dates.

The Notes described in this Prospectus Supplement are the Issuer s debt securities being offered under registration statement no. 333-223774 filed with the SEC, under the U.S. Securities Act of 1933, as amended (the **Securities Act** ). The accompanying Prospectus is part of that registration statement. The accompanying Prospectus provides you with a general description of the securities that we may offer, and this Prospectus Supplement contains specific information about the terms of this offering and the Notes. This Prospectus Supplement also adds, updates or changes information provided or incorporated by reference in the accompanying Prospectus. Consequently, before you invest, you should read this Prospectus Supplement together with the accompanying Prospectus as well as the documents incorporated by reference in this Prospectus Supplement and the accompanying Prospectus. Those documents contain information about us, the Notes and other matters. Our shelf registration statement, any post-effective amendments thereto, the various exhibits thereto, and the documents incorporated therein and herein by reference, contain additional information about us and the Notes. Our SEC filings are also available to the public on the SEC s website at http://www.sec.gov. Certain terms used but not defined in this Prospectus Supplement are defined in the Prospectus.

References to $ or USD in this Prospectus Supplement are to U.S. dollars, and references to or EUR are to euros.

The distribution of this Prospectus Supplement and the accompanying Prospectus and the offering of the Notes in certain jurisdictions may be restricted by law. Persons who receive copies of this Prospectus Supplement and the accompanying Prospectus should inform themselves about and observe those restrictions. See Underwriting in this Prospectus Supplement.

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## FORWARD-LOOKING STATEMENTS

This Prospectus Supplement, including documents that are filed with the SEC and incorporated by reference herein, and the accompanying Prospectus, may contain statements that include the words or phrases *will likely result* , *are expected to* , *will continue* , *is anticipated* , *anticipate* , *estimate* , *project* , *may* , *might* , *could* , *believe* , *potential* , *we aim* , *our goal* , *our vision* , *we intend* or similar expressions that are forward-looking statements. These statements are subject to certain risks and uncertainties. Actual results may differ materially from those suggested by these statements due to, among others, the risks or uncertainties listed below. See also Risk Factors beginning on page 2 of the accompanying Prospectus for further discussion of risks and uncertainties that could impact our business.

These forward-looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors, many of which are outside our control and are difficult to predict, that may cause actual results or developments to differ materially from any future results or developments expressed or implied by the forward-looking statements. Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include, among others:

- local, regional, national and international economic conditions, including the risks of a global recession or a recession in one or more of our key markets, and the impact they may have on us and our customers and our assessment of that impact;

- financial risks, such as interest rate risk, foreign exchange rate risk (in particular as against the U.S. dollar, our reporting currency), commodity risk, asset price risk, equity market risk, counterparty risk, sovereign risk, liquidity risk, inflation or deflation;

- continued geopolitical instability, which may result in, among other things, economic and political sanctions and currency exchange rate volatility, and which may have a substantial impact on the economies of one or more of our key markets;

- changes in government policies and currency controls;

- continued availability of financing and our ability to achieve our targeted coverage and debt levels and terms, including the risk of constraints on financing in the event of a credit rating downgrade;

- the monetary and interest rate policies of central banks, in particular the European Central Bank, the Board of Governors of the U.S. Federal Reserve System, the Bank of England, *Banco Central do Brasil*, *Banco Central de la República Argentina*, the Central Bank of China, the South African Reserve Bank, *Banco de la República* in Colombia and other central banks;

changes in applicable laws, regulations and taxes in jurisdictions in which we operate, including the laws and regulations governing our operations and changes to tax benefit programs, as well as actions or decisions of courts and regulators;

limitations on our ability to contain costs and expenses;

our expectations with respect to expansion plans, premium growth, accretion to reported earnings, working capital improvements and investment income or cash flow projections;

our ability to continue to introduce competitive new products and services on a timely, cost-effective basis;

the effects of competition and consolidation in the markets in which we operate, which may be influenced by regulation, deregulation or enforcement policies;

changes in consumer spending;

changes in pricing environments;

volatility in the prices of raw materials, commodities and energy;

difficulties in maintaining relationships with employees;

- regional or general changes in asset valuations;
- greater than expected costs (including taxes) and expenses;
- the risk of unexpected consequences resulting from acquisitions, joint ventures, strategic alliances, corporate reorganizations or divestiture plans, and our ability to successfully and cost-effectively implement these transactions and integrate the operations of businesses or other assets we have acquired;
- an inability to realize synergies from the combination with ABI SAB Group Holding Limited (formerly SABMiller Limited and prior to that SABMiller plc) ( **SAB** );
- the outcome of pending and future litigation, investigations and governmental proceedings;
- natural and other disasters;
- any inability to economically hedge certain risks;
- inadequate impairment provisions and loss reserves;
- technological changes and threats to cybersecurity;
- our success in managing the risks involved in the foregoing; and
- other statements contained in or incorporated by reference in this Prospectus Supplement that are not historical.

Our statements regarding financial risks, including interest rate risk, foreign exchange rate risk, commodity risk, asset price risk, equity market risk, counterparty risk, sovereign risk, inflation and deflation, are subject to uncertainty. For example, certain market and financial risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market or financial risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

Certain of the cost savings and synergies information related to the combination with SAB set forth in the 2017 Annual Report on Form 20-F incorporated by reference herein constitute forward-looking statements and may not be representative of the actual cost savings and synergies that will result from the combination with SAB. Such information included in the 2017 Annual Report on Form 20-F incorporated by reference herein reflects potential opportunities for savings and synergies identified by us based on estimates and assumptions that are inherently subject to significant uncertainties which are difficult to predict, and accordingly there can be no assurance that these cost

savings and synergies will be realized. The statements relating to the synergies, cost savings and business growth opportunities we expect to continue to achieve following the combination with SAB are based on assumptions. However, these expected synergies, cost savings and business growth opportunities may not be achieved. There can be no assurance that we will be able to continue to implement successfully the strategic and operational initiatives that are intended.

We caution that the forward-looking statements in this Prospectus Supplement are further qualified by the risks described beginning on page 2 of the accompanying Prospectus, including in documents incorporated by reference therein, elsewhere in this Prospectus Supplement or accompanying Prospectus or in the 2017 Annual Report on Form 20-F incorporated by reference herein that could cause actual results to differ materially from those in the forward-looking statements. Subject to our obligations under Belgian and U.S. law in relation to disclosure and ongoing information, we undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## INCORPORATION OF CERTAIN INFORMATION BY REFERENCE

The SEC allows us to incorporate by reference in the Prospectus Supplement information contained in documents that we file with the SEC. The information that we incorporate by reference is an important part of this Prospectus Supplement and the accompanying Prospectus. We incorporate by reference in this Prospectus Supplement, after the date of this Prospectus Supplement and until we complete the offerings using this Prospectus Supplement and accompanying Prospectus, any future filings that we make with the SEC under Sections 13(a), 13(c), 14 and 15(d) of the Securities Exchange Act of 1934, as amended, and reports on Form 6-K we furnish to the SEC to the extent we designate therein.

We filed our Annual Report on Form 20-F for the fiscal year ended 31 December 2017 (the **Annual Report** ) with the SEC on 19 March 2018. We also filed an amendment to the Annual Report on 4 April 2018 in order to incorporate the XBRL filing of our financial results. We are incorporating the Annual Report, as amended, by reference into this prospectus. We are also incorporating the Form F-4 (File No. 333-213328) filed with the Commission on 26 August 2016 solely with respect to the audited consolidated financial statements of ABI SAB Group Holding Limited as of 31 March 2016 and 2015 and for the years ended 31 March 2016, 2015 and 2014, appearing on pages F-1 to F-78 of such Form F-4. We are also incorporating our Current Reports on Form 6-K filed with the SEC on each of the following dates:

- 10 May 2018, containing our unaudited interim report for the three-month period ended 31 March 2018;
- 26 July 2018, regarding organizational changes;
- 27 July 2018, containing our unaudited interim report for the six-month period ended 30 June 2018;
- 25 October 2018, containing our unaudited interim report for the nine-month period ended 30 September 2018;
- 14 November 2018, regarding the November 2018 U.S. exchange and tender offers, and containing the indenture, first supplemental indenture, second supplemental indenture and third supplemental indenture, all dated as of 13 November 2018;
- 28 November 2018; regarding the early results and pricing of the November 2018 U.S. tender offer; and
- 20 December 2018, regarding our research partnership with Tilray Inc.

The information that we file with the SEC, including future filings, automatically updates and supersedes information in documents filed at earlier dates. All information appearing in this Prospectus Supplement is qualified in its entirety by the information and financial statements, including the notes, contained in the documents that we incorporate by reference in this Prospectus Supplement.

You may request a copy of the filings referred to above, at no cost, upon written or oral request. You should direct your requests to Anheuser-Busch InBev SA/NV, Brouwerijplein 1, 3000 Leuven, Belgium (telephone: +32 (0)1 627 6111).

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## USE OF PROCEEDS

The Issuer intends to apply substantially all of the net proceeds (estimated to be $ million before expenses) from the sale of the Notes for general corporate purposes, including the repayment of upcoming debt maturities in 2021 to 2024 and 2026.

Specifically, Issuer and the Parent Guarantor intend to use the net proceeds, after deducting the initial purchasers discount and other estimated offering expenses payable by the Issuer, from this offering to purchase for cash up to $11 billion aggregate purchase price the following outstanding notes, issued by either the Issuer, Anheuser-Busch Companies, LLC or Anheuser-Busch InBev Finance Inc., subject to the terms of an offer to purchase, dated as of the date of this prospectus supplement:

| Title of Security | CUSIP/ISIN Number | Principal Amount Outstanding | Issuer |
|---|---|---|---|
| 2.650% Notes due 2021 | 035242 AJ5 / US035242 AJ52 | $ 4,967,588,000 | ABIFI |
| Floating Rate Notes due 2021 | 035242 AK2 / US035242 AK26 | $ 500,000,000 | ABIFI |
| 4.375% Notes due 2021 | 03523TBB3 / US03523T BB35 | $ 500,000,000 | ABIWW |
| 3.750% Notes due 2022 | 035240 AD2 / US035240 AD27 | $ 2,350,039,000 | ABIWW |
| 2.500% Notes due 2022 | 03523TBP2 / US03523T BP21 | $ 3,000,000,000 | ABIWW |
| 2.625% Notes due 2023 | 035242 AA4 / US035242 AA44 | $ 1,250,000,000 | ABIFI |
| 3.300% Notes due 2023 | 035242 AL0 / US035242 AL09 | $ 6,000,000,000 | ABIFI |
| Floating Rate Notes due 2024 | 035240AK6 / US035240 AK69 | $ 500,000,000 | ABIWW |
| 3.500% Notes due 2024 | 035240AJ9 / US035240 AJ96 | $ 1,500,000,000 | ABIWW |
| 3.700% Notes due 2024 | 03524B AE6 / US03524B AE65 | $ 1,400,000,000 | ABIFI |
| 3.650% Notes due 2026 | 035242 AP1 / | $ 2,444,837,000 | ABIFI |

| | | | |
|---|---|---|---|
| | US035242 AP13 | | |
| 3.650% Notes due 2026 | 03522A AD2 / U00323 AD4 / US03522A AD28 / USU00323 AD40 | $ 8,555,163,000 | ABIWW and ABC |

The 3.500% Notes due 2024 and Floating Rate Notes due 2024 were issued on 4 April 2018, and the funds from that issuance were used for general corporate purposes, including the repayment of debt maturities in 2019 and 2020.

The Floating Rate Notes due 2021 bear interest at a floating rate per year equal to the 3-month U.S. dollar LIBOR, plus 1.260%, and for the current interest period ending on February 1, 2019, such rate is equal to 3.81850% per annum. The Floating Rate Notes due 2024 bear interest at a floating rate per year equal to the 3-month U.S. dollar LIBOR, plus 0.74%, and for the current interest period ending on January 12, 2019, such rate is equal to 3.16519% per annum.

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One or more of the initial purchasers or their respective affiliates may own notes in the aforementioned tender offers and be eligible to participate in the offer to purchase. As a result, one or more of the initial purchasers or their respective affiliates may receive a portion of the net proceeds from this offering.

This offering is not conditioned upon the consummation of the aforementioned tender offers. In the event that such tender offers are not consummated, we intend to use the net proceeds from this offering for general corporate purposes, including the repayment of upcoming debt maturities in 2021 to 2024 and 2026.

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## CAPITALIZATION

The following table shows our cash and cash equivalents and capitalization as of 30 June 2018 and on an as adjusted basis to give effect to (i) this offering, (ii) the tender offers settled on 13 December 2018 by Anheuser-Busch InBev Finance Inc. for $2.5 billion aggregate principal amount of bonds (the **December 2018 Tender Offers** ), (iii) the net borrowing of $74 million of commercial paper and (iv) after giving effect to the concurrent debt tender offers as described under Use of Proceeds (the **Concurrent Debt Tender Offers** ), and reflecting the assumptions described below. This information reflects only the adjustments detailed in the foregoing sentence and should be read in conjunction with the consolidated financial statements and the accompanying notes of AB InBev incorporated by reference into this prospectus and the unaudited pro forma condensed combined financial information included in this prospectus.

| | **As of 30 June 2018**<br>*(USD million, unaudited)* | **As adjusted**<br>*(USD million, unaudited)* |
|---|---|---|
| Cash and cash equivalents, less bank overdrafts[(1)(2)(3)] | 7 898 | |
| **Current interest-bearing liabilities** | | |
| Secured bank loans | 1 405 | |
| Commercial papers[(3)] | 1 801 | |
| Unsecured bank loans | 126 | |
| Unsecured bond issues | 2 604 | |
| Unsecured other loans | 13 | |
| Finance lease liabilities | 25 | |
| **Non-current interest-bearing liabilities** | | |
| Secured bank loans | 135 | |
| Unsecured bank loans | 128 | |
| Unsecured bond issues[(1)(2)] | 110 459 | |
| Unsecured other loans | 52 | |
| Finance lease liabilities | 175 | |
| **Total interest-bearing liabilities** | **116 923** | |
| Equity attributable to our equity holders | 68 510 | |
| Non-controlling interests | 7 054 | |
| **Total Capitalization:** | **192 487** | |

Notes:

(1) We intend to use the estimated net proceeds from this offering of $ million (see cover page of this Prospectus Supplement) for general corporate purposes, including the Concurrent Debt Tender Offers. For illustrative purposes, this table has been prepared based on the assumption that this offering will increase our non-current unsecured bond issues by $ million, and that the Concurrent Debt Tender Offers will decrease our non-current unsecured bond issues by $ million and will decrease our cash and cash equivalents, less bank overdrafts, by $ million. For the purposes of this capitalization table, we assume a 100% participation rate in the Concurrent Debt Tender Offers and the hypothetical pricing contained in the offer to purchase, dated as of the date of this prospectus supplement.

(2) After 30 June 2018, we completed the December 2018 Tender Offers, which decreased our non-current unsecured bond issues by $2,532 million and our cash and cash equivalents, less bank overdrafts, by $2,525 million.

(3) After 30 June 2018, as a result of repayments/issuances, as of November 30, 2018, our commercial paper was increased by a net amount of $74 million and our cash and cash equivalents, less bank overdrafts increased by $74 million.

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## DESCRIPTION OF THE NOTES

### General

The fixed rate notes due 2025 (the **2025 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2029 (the **2029 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2031 (the **2031 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2039 (the **2039 Notes** ) will bear interest at a rate of % per year, the fixed rate notes due 2049 (the **2049 Notes** ) will bear interest at a rate of % per year and the fixed rate notes due 2059 (the **2059 Notes** and together with the 2025 Notes, the 2029 Notes, the 2039 Notes, and the 2049 Notes, the **Notes** ) will bear interest at a rate of % per year. The Notes will be issued by Anheuser-Busch InBev Worldwide Inc. (the **Issuer** ) and will be fully and unconditionally guaranteed by Anheuser-Busch InBev SA/NV (the **Parent Guarantor** ), Anheuser-Busch InBev Finance Inc., Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, and Anheuser-Busch Companies, LLC (the **Subsidiary Guarantors,** and together with the Parent Guarantor, the **Guarantors** ). Application will be made to list each series of Notes on the New York Stock Exchange. There can be no assurance that any series of Notes will be listed.

Each series of the Notes will be issued under a separate supplemental indenture to the indenture dated as of April 4, 2018 (the **Indenture** ), to be entered into among the Issuer, each of the Guarantors and The Bank of New York Mellon Trust Company, N.A., as trustee, principal paying agent, transfer agent and registrar (the **Trustee** ). The information below on certain provisions of the Notes and the Indenture should be read together with Description of Debt Securities and Guarantees in the accompanying Prospectus. This information, however, does not purport to be complete and is subject to, and is qualified in its entirety by reference to, all the provisions of the Notes and the Indenture, including the definitions of certain terms contained therein. The Indenture is by its terms subject to and governed by the Trust Indenture Act of 1939, as amended. The following description of the particular terms of the Notes offered hereby supplements and replaces any inconsistent information set forth in the description of the general terms and provisions of the debt securities set forth in the accompanying Prospectus.

The Notes will be senior unsecured obligations of the Issuer and will rank equally with all other existing and future unsecured and unsubordinated debt obligations of the Issuer. The Notes will be repaid at maturity in U.S. dollars at a price equal to 100% of the principal amount thereof. The Notes will be issued in denominations of $1,000 and integral multiples of $1,000 in excess thereof. The Notes do not provide for any sinking fund. The Notes will be recorded on, and transferred through, the records maintained by DTC and its direct and indirect participants, including Euroclear S.A./N.V. ( **Euroclear** ) and Clearstream Banking, *société anonyme* ( **Clearstream** ).

**Business Day** means a day on which commercial banks and exchange markets are open, or not authorized to close, in the City of New York, London and Brussels.

The 2025 Notes will be initially limited to $ aggregate principal amount and will mature on 2025. The 2029 Notes will be initially limited to $ aggregate principal amount and will mature on 2029. The 2031 Notes will be initially limited to $ aggregate principal amount and will mature on 2031. The 2039 Notes will be initially limited to $ aggregate principal amount and will mature on 2039. The 2049 Notes will be initially limited to $ aggregate principal amount and will mature on 2049. The 2059 Notes will be initially limited to $ aggregate principal amount and will mature on 2059. The Notes will be senior unsecured obligations of the Issuer and will rank equally with all other existing and future unsecured and unsubordinated debt obligations of the Issuer.

Interest will accrue on the Notes of each series until the principal of such Notes is paid or duly made available for payment. Interest on the Notes will be calculated on the basis of a 360-day year consisting of twelve 30-day months. If the date of maturity of interest on or principal of any Note or the date fixed for redemption or payment in connection

with an acceleration of any Note is not a Business Day, then payment of interest or principal need not be made on such date, but may be made on the next succeeding Business Day with the same force and effect as if made on the date of maturity or the date fixed for redemption or payment in connection with an acceleration, and no interest shall accrue as a result of the delayed payment.

Interest on the Notes will be paid to the persons in whose names the Notes are registered at the close of business on the and immediately preceding the applicable interest payment date, whether or not such date is a Business Day. The Notes may, in addition, be redeemed at any time prior to maturity in the circumstances described under Optional Redemption and may be redeemed prior to maturity in the circumstances described under Optional Tax Redemption.

### Regarding the Trustee, Paying Agent, Transfer Agent and Registrar

For a description of the duties and the immunities and rights of the Trustee, paying agent, transfer agent or registrar under the Indenture, reference is made to the Indenture, and the obligations of the Trustee, paying agent, transfer agent and registrar to the Holders of the Notes are subject to such immunities and rights.

The Issuer may at any time appoint new paying agents or transfer agents without prior notice to Holders.

### Additional Notes

The Notes will be issued in the initial aggregate principal amount set forth above. The Issuer may, from time to time, without notice to or the consent of the Holders, create and issue, pursuant to the Indenture and in accordance with applicable laws and regulations, additional Notes (the **Additional Notes** ) maturing on the same maturity date as the other Notes of a series and having the same terms and conditions under the Indenture (including with respect to the Guarantors and the Guarantees) as the previously outstanding Notes of that series in all respects (or in all respects except for the issue date and the principal amount and, in some cases, the date of the first payment of interest thereon) so that such Additional Notes shall be consolidated and form a single series with the previously outstanding Notes of that series, *provided* that either (i) such Additional Notes are fungible with the Notes of such series offered hereby for U.S. federal income tax purposes or (ii) such Additional Notes shall have a separate CUSIP number. Without limiting the foregoing, the Issuer may, from time to time, without notice to or the consent of the Holders, create and issue, pursuant to the Indenture and in accordance with applicable laws and regulations, additional series of notes with additional or different terms and maturity dates than the Notes.

### Optional Redemption

The Issuer may, at its option, redeem each series of Notes, as a whole or in part at any time prior to the applicable Par Call Date (as set forth in the table below), upon not less than 10 nor more than 60 days prior notice, at a redemption price equal to the greater of:

- 100% of the aggregate principal amount of the Notes to be redeemed; and

- as determined by the Independent Investment Banker (as defined below), the sum of the present values of the remaining scheduled payments of principal and interest on the Notes to be redeemed as if the Notes to be redeemed matured on the applicable Par Call Date (as defined herein) (not including any portion of such payments of interest accrued to the date of redemption) discounted to the redemption date on a semi-annual basis (assuming a 360-day year consisting of twelve 30-day months) at the Treasury Rate plus the applicable Spread (as defined herein) for such series of Notes;

plus, in each case described above, accrued and unpaid interest on the principal amount being redeemed to (but excluding) the redemption date.

Each of the Notes will be redeemable in whole or in part, at the Issuer s option at any time and from time to time on or after the applicable Par Call Date, at a redemption price equal to 100% of the principal amount of the Notes being redeemed, plus accrued and unpaid interest to, but excluding the date of redemption.

| Series | Par Call Date | Spread |
| --- | --- | --- |
| 2025 Notes | 2024 (one month prior to maturity) | bps |
| 2029 Notes | 2028 (three months prior to maturity) | bps |
| 2031 Notes | 2030 (three months prior to maturity) | bps |
| 2039 Notes | 2038 (six months prior to maturity) | bps |
| 2049 Notes | 2048 (six months prior to maturity) | bps |
| 2059 Notes | 2058 (six months prior to maturity) | bps |

**Treasury Rate** means, with respect to any Redemption Date, the rate per annum equal to the semiannual equivalent yield to maturity of the Comparable Treasury Issue, calculated using a price for the Comparable Treasury Issue (expressed as a percentage of its principal amount) equal to the Comparable Treasury Price for such Redemption Date.

The Treasury Rate will be calculated on the third Business Day preceding such redemption date.

**Comparable Treasury Issue** means the U.S. Treasury security (not inflation-indexed) selected by an Independent Investment Banker as if such Notes had matured on the applicable Par Call Date that would be utilized, at the time of selection and in accordance with customary financial practice, in pricing new issues of corporate debt securities of comparable maturity to the remaining term of such Notes through the applicable Par Call Date.

**Comparable Treasury Price** means, with respect to a redemption date, (i) the average of five Reference Treasury Dealer Quotations for such redemption date, after excluding the highest and lowest Reference Treasury Dealer Quotations, or (ii) if the Independent Investment Banker obtains fewer than five such Reference Treasury Dealer Quotations, the average of all such quotations.

**Independent Investment Banker** means Barclays Capital Inc., Citigroup Global Markets Inc., Deutsche Bank Securities Inc., J.P. Morgan Securities LLC or Merrill Lynch, Pierce, Fenner & Smith Incorporated, as specified by the Issuer, or if all of these firms are unwilling or unable to serve in that capacity, an independent investment banking institution of national standing in the United States appointed by the Issuer.

**Reference Treasury Dealer** means (i) Barclays Capital Inc., Citigroup Global Markets Inc., Deutsche Bank Securities Inc., J.P. Morgan Securities LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated, and their respective successors, *provided*, *however*, that if any of the foregoing shall cease to be a primary U.S. government securities dealer in the City of New York (a **Primary Treasury Dealer** ), the Issuer will substitute therefor another Primary Treasury Dealer and (ii) any three other Primary Treasury Dealers selected by the Issuer after consultation with an Independent Investment Banker.

**Reference Treasury Dealer Quotations** means, with respect to each Reference Treasury Dealer and any redemption date, the average, as determined by the Independent Investment Banker, of the bid and asked prices for the Comparable Treasury Issue (expressed in each case as a percentage of its principal amount) quoted in writing to the Independent Investment Banker at 5:00 p.m., New York City time, on the third Business Day preceding such redemption date.

A notice of redemption may, at the discretion of the Issuer, be subject to one or more conditions precedent, including, but not limited to, completion of an equity offering, a financing, or other corporate transaction. In addition, if such redemption or notice is subject to satisfaction of one or more conditions precedent, such notice shall state that, in our discretion, the redemption date may be postponed until up to 60 days following the notice of redemption, and such notice may be rescinded in the event that any or all such conditions shall not have been satisfied by the redemption date (including as it may be postponed).

Unless the Issuer (and/or the Guarantors) defaults on payment of the redemption price, from and after the redemption date interest will cease to accrue on the Notes or portions thereof called for redemption. On the redemption date, the Issuer will deposit with the Trustee or with one or more paying agents (or, if the Issuer is acting as its own paying agent, set aside, segregate and hold in trust as provided in the Indenture) money sufficient to pay the redemption price of and accrued interest on the Notes to be redeemed on such date. If fewer than all of the Notes of any series are to be redeemed, the Trustee will select, not more than 60 days prior to the redemption date, the particular Notes of such series or portions thereof for redemption from the outstanding Notes of that series not previously called for

redemption, on a pro rata basis across such series, or by such method as the Trustee deems fair and appropriate, *provided* that if the Notes of a series are represented by one or more global notes, interests in such global notes shall be selected for redemption by DTC in accordance with its standard procedures therefor.

**Optional Tax Redemption**

A series of Notes may be redeemed at any time, at the Issuer s or the Parent Guarantor s option, as a whole, but not in part, upon not less than 10 nor more than 60 days prior notice, at a redemption price equal to 100% of the principal amount of the Notes of such series then outstanding plus accrued and unpaid interest on the principal amount being redeemed (and all Additional Amounts (see Description of Debt Securities and Guarantees in the accompanying Prospectus), if any) to (but excluding) the redemption date, if (i) as a result of any change in, or amendment to, the laws, treaties, regulations or rulings of a jurisdiction in which the Issuer or any Guarantor is incorporated, organized, or otherwise tax resident or any political subdivision or any authority thereof or therein having power to tax, or in the interpretation, application or administration of any such laws, treaties, regulations or rulings (including a holding, judgment or order by a court of competent jurisdiction) which becomes effective on or after the date of this prospectus supplement (any such change or amendment, a **Change in Tax Law** ), the Issuer (or if a payment were then due under a Guarantee, the relevant Guarantor) would be required to pay Additional Amounts, with respect to the Notes of such series and (ii) such obligation

cannot be avoided by the Issuer (or the relevant Guarantor) taking reasonable measures available to it. Additional Amounts are payable by the Issuer under the circumstances described under Description of Debt Securities and Guarantees Additional Amounts in the accompanying Prospectus; *provided, however*, that the Notes of such series may not be redeemed to the extent such Additional Amounts arise solely as a result of the Issuer assigning its obligations under the Notes of such series to a Substitute Issuer, unless this assignment to a Substitute Issuer is undertaken as part of a plan of merger by Parent Guarantor.

Prior to the mailing of any notice of redemption pursuant to the foregoing, the Issuer or the relevant Guarantor will deliver to the Trustee an opinion of independent tax counsel of recognized standing to the effect that the Issuer or the relevant Guarantor is or would be obligated to pay such Additional Amounts as a result of a Change in Tax Law.

No notice of redemption may be given earlier than 90 days prior to the earliest date on which the Issuer or the relevant Guarantor would be obligated to pay Additional Amounts if a payment in respect of the Notes were then due.

The foregoing provisions shall apply *mutatis mutandis* to any successor person, after such successor person becomes a party to the Indenture.

**Events of Default**

The occurrence and continuance of one or more of the following events will constitute an **Event of Default** under the Indenture and under the Notes:

(a) *payment default* (i) the Issuer or a Guarantor fails to pay interest within 30 days from the relevant due date, or (ii) the Issuer or a Guarantor fails to pay the principal (or premium, if any) due on the Notes at maturity; *provided* that to the extent any such failure to pay principal or premium is caused by a technical or administrative error, delay in processing payments or events beyond the control of the Issuer or Guarantors, no Event of Default shall occur for three days following such failure to pay; *provided further* that, in the case of a redemption payment, no Event of Default shall occur for 30 days following a failure to make such payment;

(b) *breach of other material obligations* the Issuer or a Guarantor defaults in the performance or observance of any of its other material obligations under or in respect of the Notes or the Indenture and such default remains unremedied for 90 days after a written notice has been given to the Issuer and the Parent Guarantor by the Trustee or to the Issuer, the Parent Guarantor and the Trustee by the Holders of at least 25% in principal amount of the outstanding Notes of the applicable series affected thereby, specifying such default or breach and requiring it to be remedied and stating that such notice is a **Notice of Default** under the Notes;

(c) *bankruptcy or insolvency* a court of competent jurisdiction commences bankruptcy or other insolvency proceedings against the Issuer, the Parent Guarantor or a Guarantor that is a Significant Subsidiary under the applicable laws of their respective jurisdictions of incorporation, or the Issuer, the Parent Guarantor or a Guarantor that is a Significant Subsidiary applies for or institutes such proceedings or offers or makes an assignment for the benefit of its creditors generally, or a third party institutes bankruptcy or insolvency proceedings against the Issuer, the Parent Guarantor or a Guarantor that is a

Significant Subsidiary and such proceedings are not discharged or stayed within 90 days;

(d) *impossibility due to government action* any governmental order, decree or enactment shall be made in or by Belgium or the jurisdiction of incorporation of a Guarantor that is a Significant Subsidiary whereby the Issuer, the Parent Guarantor, or such Guarantor that is a Significant Subsidiary is prevented from observing and performing in full its obligations as set forth in the terms and conditions of the Notes and the Guarantees, respectively, and this situation is not cured within 90 days; or

(e) *invalidity of the Guarantees* the Guarantees provided by the Parent Guarantor or a Guarantor that is a Significant Subsidiary cease to be valid and legally binding for any reason whatsoever or the Parent Guarantor or a Guarantor that is a Significant Subsidiary seeks to deny or disaffirm its obligations under the Guarantee.

If an Event of Default occurs and is continuing with respect to the Notes, then, unless the principal of all of the Notes shall already have become due and payable (in which case no action is required for the acceleration of the Notes), the Holders of not less than 25% in aggregate principal amount of Notes then outstanding, by written notice to the Issuer, the Parent Guarantor and the Trustee as provided in the Indenture, may declare the entire principal of all the Notes of such series, and the interest accrued thereon, to be due and payable immediately, *provided*, *however*, that if an Event of Default specified in paragraph (c) above with respect to the

Notes at the time outstanding occurs, the principal amount of that series shall automatically, and without any declaration or other action on the part of the Trustee or any Holder, become immediately due and payable. Under certain circumstances, the Holders of a majority in aggregate principal amount of the Notes then outstanding may, by written notice to the Issuer and the Trustee as provided in the Indenture, waive all defaults and rescind and annul such declaration and its consequences, but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default or shall impair any right consequent thereon.

Except in cases of default, where the Trustee has some special duties, the Trustee is not required to take any action under the Indenture at the request of any Holders unless the Holders offer the Trustee reasonable protection from costs, expenses and liability. This protection is called an indemnity. If reasonable indemnity is provided, the Holders of a majority in principal amount of the outstanding Notes may direct the time, method and place of conducting any proceeding seeking any remedy available to the Trustee. These majority Holders may also direct the Trustee in performing any other action under the Indenture, so long as such direction would not involve the Trustee in personal liability.

Before you bypass the Trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the Notes, the following must occur:

- The Trustee must be given written notice that an event of default has occurred and remains uncured.

- The Holders of not less than 25% in principal amount of all outstanding Notes of the relevant series must make a written request that the Trustee institute proceedings because of the default, and must offer indemnity and/or security satisfactory to the Trustee against the costs, expenses and liabilities of taking such request.

- The Trustee must have not taken action for 60 days after receipt of the above notice, request and offer of indemnity.

- No direction inconsistent with such written request has been given to the Trustee during such 60-day period by the holders of the majority in principal amount of the outstanding Notes of that series.

- However, you are entitled at any time to bring a lawsuit for the payment of money due on your security on or after its due date.

We will furnish to the Trustee every year a written statement of certain of our officers and directors, certifying that, to their knowledge, we are in compliance with the Indenture and the Notes, or else specifying any default.

***Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the Trustee and to make or cancel a declaration of acceleration.***

**Legal Status of the Issuer**

The Issuer may at any time, in its sole discretion, convert from a Delaware corporation to a Delaware limited liability company pursuant to Section 266 of the Delaware General Corporation Law or any other applicable Delaware law that provides that the limited liability company resulting from such conversion shall be deemed to be the same entity as the corporation. The Issuer may so convert without being required to give any notice to Holders or advance notice to the Trustee.

**Modifications and Amendment**

The Issuer, the Guarantors and the Trustee may execute agreements adding any provisions to or changing in any manner or eliminating any of the provisions of the Indenture or of any supplemental agreement or modifying in any manner the rights of the Holders under the Notes or the Guarantees only with the consent of the Holders of not less than a majority in aggregate principal amount of the notes then outstanding (irrespective of series) that would be affected by the proposed modification or amendment; *provided* that no such agreement shall (a) change the maturity of the principal of, or any installment of interest on, any Note, or reduce the principal amount or the interest thereof, or extend the time of payment of any installment of interest thereon, or change the currency of payment of principal of, or interest on, any Note, or change the Issuer s or a Guarantor s obligation to pay Additional Amounts, impair or affect the right of any Holder to institute suit for the enforcement of any such payment on or after the due date thereof (or in the case of redemption on or after the redemption date) or change in any manner adverse to the interests of the Holders the terms and provisions of the Guarantees in respect of the due and punctual payment of principal amount of the Notes then outstanding plus accrued and unpaid interest (and all Additional Amounts, if any) without the consent of the Holder of each Note so affected; or (b) reduce the aforesaid percentage of notes, the consent of the Holders of which is required for any such agreement, without the consent of all of the Holders of the affected series of the notes then outstanding. To the extent that any changes directly affect fewer than all the series of the notes issued under the Indenture, only the consent of the Holders of notes of the relevant series (in the respective percentages set forth above) will be required.

The Issuer, the Guarantors and the Trustee may, without the consent of the Holders, from time to time execute agreements or amendments or enter into an indenture or indentures supplemental thereto (including in respect of one series of notes only) for one or more of the following purposes:

to convey, transfer, assign, mortgage or pledge any property or assets to the Trustee or another person as security for the Notes;

to evidence the succession of another person to the Issuer or any Guarantors, or successive successions, and the assumption by the successor person of the covenants of the Issuer or any of the Guarantors, pursuant to the Indenture and the Notes;

to evidence and provide for the acceptance of appointment of a successor or successors to the Trustee in any of its capacities and to add to or change any of the provisions of the Indenture to facilitate the administration of the trusts created thereunder by more than one trustee;

to add to the covenants of the Issuer or the Guarantors, for the benefit of the Holders of the Notes issued under the Indenture, or to surrender any rights or powers conferred on the Issuer or the Guarantors in the Indenture;

to add any additional events of default for the benefit of the Holders of the Notes;

to add to, change or eliminate any of the provisions of the Indenture in respect of the Notes, *provided* that any such addition, change or elimination (A) shall neither (i) apply to any Note created prior to the execution of such supplemental indenture and entitled to the benefit of such provision nor (ii) modify the rights of the Holder of any such Note with respect to such provision or (B) shall become effective only when there is no such Note outstanding;

to modify the restrictions on and procedures for, resale and other transfers of the Notes pursuant to law, regulation or practice relating to the resale or transfer of restricted securities generally;

to provide for the issues of securities in exchange for one or more series of outstanding debt securities;

to provide for the issuance and terms of any particular series of securities, the rights and obligations of the Guarantors and the holders of the securities of such series, the form or forms of the securities of such series and such other matters in connection therewith as the Issuer and the Guarantors shall consider appropriate, including, without limitation, provisions for (a) additional or different covenants, restrictions or conditions applicable to such series, (b) additional or different events of default in respect of such series, (c) a longer or shorter period of grace and/or notice in respect of any provision

applicable to such series than is otherwise provided, (d) immediate enforcement of any event of default in respect of such series or (e) limitations upon the remedies available in respect of any events of default in respect of such series or upon the rights of the holders of securities of such series to waive any such event of default;

(a) to cure any ambiguity or to correct or supplement any provision contained in the Indenture, the Notes or the Guarantees, or in any supplemental agreement, which may be defective or inconsistent with any other provision contained therein or in any supplemental agreement, (b) to eliminate any conflict between the terms thereof and the Trust Indenture Act or (c) to make such other provision in regard to matters or questions arising under the Indenture or under any supplemental agreement as the Issuer may deem necessary or desirable and which will not adversely affect the interests of the Holders to which such provision relates in any material respect;

to reopen the Notes and create and issue additional Notes having identical terms and conditions as the Notes (or in all respects except for the issue date, issue price, first interest accrual date and first interest payment date) so that the additional notes are consolidated and form a single series with the outstanding Notes;

to add any Subsidiary of the Parent Guarantor as a Guarantor or a co-Issuer with respect to any series of notes, or to convert a Guarantor into a co-Issuer with respect to any series of notes, subject to applicable regulatory or contractual limitations relating to such subsidiary s Guarantee and provided in each case that the obligations of any co-Issuer will be joint and several with the Issuer;

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- to provide for the release and termination of any Subsidiary Guarantor s Guarantee in the circumstances described under Description of Debt Securities and Guarantees Guarantees in the Prospectus;

- to provide for any amendment, modification or alteration of any Subsidiary Guarantor s Guarantee and the limitations applicable thereto in the circumstances described under Description of Debt Securities and Guarantees Guarantees in the Prospectus; or

- to make any other change that does not materially adversely affect the interests of the holders of the notes affected thereby.

***Street name and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change the Indenture or the Notes or request a waiver.***

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## UNDERWRITING

Barclays Capital Inc., Citigroup Global Markets Inc., Deutsche Bank Securities Inc., J.P. Morgan Securities LLC and Merrill Lynch, Pierce, Fenner & Smith Incorporated are acting as representatives of each of the underwriters set forth below. Each underwriter named below has severally agreed, subject to the terms and conditions of the pricing agreement with us, dated the date of this Prospectus Supplement (the **Pricing Agreement** ), to purchase the principal amount of Notes set forth below opposite its name below.

| Underwriter | 2025 Notes | 2029 Notes | 2031 Notes | 2039 Notes | 2049 Notes | 2059 Notes |
|---|---|---|---|---|---|---|
| Barclays Capital Inc. | $ | $ | $ | $ | $ | $ |
| Citigroup Global Markets Inc. | $ | $ | $ | $ | $ | $ |
| Deutsche Bank Securities Inc. | $ | $ | $ | $ | $ | $ |
| J.P. Morgan Securities LLC | $ | $ | $ | $ | $ | $ |
| Merrill Lynch, Pierce, Fenner & Smith | $ | $ | $ | $ | $ | $ |
| **Total** | $ | $ | $ | $ | $ | $ |

The underwriters have agreed to purchase all of the Notes being sold pursuant to the Pricing Agreement if any of such Notes are purchased, subject to certain conditions. If an underwriter defaults, the Pricing Agreement provides that the underwriting commitments of the non-defaulting underwriters, depending on conditions specified in the Pricing Agreement, may be increased or the Pricing Agreement may be terminated.

The Notes are a new issue of securities with no established trading market. Application will be made to list each series of Notes on the New York Stock Exchange, although no assurance can be given that the Notes will be listed on the New York Stock Exchange, and if so listed, the listing does not assure that a trading market for the Notes will develop. We have been advised by the underwriters that the underwriters intend to make a market in each series of Notes but are not obligated to do so and may discontinue market making at any time without notice. No assurance can be given as to the liquidity of, or trading markets for, the Notes.

The Issuer and the Parent Guarantor have agreed to indemnify the several underwriters against certain liabilities, including liabilities under the Securities Act.

The underwriters propose to offer the Notes initially at the public offering prices on the cover page of this Prospectus Supplement. The underwriters may sell Notes to securities dealers at a discount from the initial public offering price of up to: (i) in the case of the 2025 Notes, % of the principal amount of the 2025 Notes, (ii) in the case of the 2029 Notes, % of the principal amount of the 2029 Notes, (iii) in the case of the 2031 Notes, % of the principal amount of the 2031 Notes, (iv) in the case of the 2039 Notes, % of the principal amount of the 2039 Notes, (v) in the case of the 2049 Notes, % of the principal amount of the 2049 Notes and (vi) in the case of the 2059 Notes, % of the principal amount of the 2059 Notes. These securities dealers may resell any Notes purchased from the underwriters to other brokers or dealers at a discount from the initial public offering price of up to: (i) in the case of the 2025 Notes, % of the principal amount of the 2025 Notes, (ii) in the case of the 2029 Notes, % of the principal amount of the 2029 Notes, (iii) in the case of the 2031 Notes, % of the principal amount of the 2031 Notes, (iv) in the case of the 2039 Notes, % of the principal amount of the 2039 Notes, (v) in the case of the 2049 Notes, % of the principal amount of the 2049 Notes and (vi) in the case of the 2059 Notes, % of the principal amount of the 2059 Notes. The offering of the Notes by the underwriters is subject to receipt and acceptance and subject to each underwriter s right to withdraw, cancel, modify offers to investors and to reject any order in whole or in part. If the underwriters cannot sell all the

Notes at the initial public offering prices, they may change the public offering prices and the other selling terms.

We estimate that our total expenses of the offering, excluding underwriting commissions, will be approximately $ .

In order to facilitate the offering of the Notes, the underwriters may engage in transactions that stabilize, maintain or support the prices of such Notes, as the case may be, for a limited period after the issue date. Specifically, the underwriters may over-allot in connection with the offering, creating a short position in the Notes for their own account. In addition, to cover over-allotments or to stabilize the price of the Notes, the underwriters may bid for, and purchase, Notes in the open markets. Any of these activities may stabilize or maintain the market prices of the Notes above independent market levels. The underwriters are not required to engage in these activities, and may end any of these activities at any time.

The underwriters and their respective affiliates have, from time to time, performed, and may in the future perform various financial advisory, commercial banking and investment banking services for us, for which they received or will receive customary fees and expenses. These transactions and services are carried out in the ordinary course of business.

In addition, in the ordinary course of their business activities, the underwriters and their affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (including bank loans) for their own account and for the accounts of their customers. Such investments and securities activities may involve securities and/or instruments of ours or our affiliates. If any of the underwriters or their affiliates have a lending relationship with us, certain of those underwriters or their affiliates routinely hedge, and certain other of those underwriters or their affiliates may hedge, their credit exposure to us consistent with their customary risk management policies. Typically, these underwriters and their affiliates would hedge such exposure by entering into transactions which consist of either the purchase of credit default swaps or the creation of short positions in our securities, including potentially the Notes offered hereby. Any such credit default swaps or short positions could adversely affect future trading prices of the Notes offered hereby. The underwriters and their affiliates may also make investment recommendations and/or publish or express independent research views in respect of such securities or financial instruments and may hold, or recommend to clients that they acquire, long and/or short positions in such securities and instruments.

We expect that delivery of the Notes will be made to investors on or about 2019 (such settlement being referred to as T+8 ). Under Rule 15c6-1 of the Securities Exchange Act of 1934, trades in the secondary market generally are required to settle in two business days, unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade the securities prior to the second business day before the delivery of the securities will be required, by virtue of the fact that the securities initially will settle in T+8, to specify any alternate settlement cycle at the time of any such trade to prevent a failed settlement. Purchasers of the securities who wish to make such trades should consult their own advisors.

**Selling Restrictions**

***European Economic Area:***

The Notes are not intended to be offered, sold or otherwise made available to and should not be offered, sold or otherwise made available to any retail investor in the European Economic Area ( **EEA** ). For these purposes, a retail investor means a person who is one (or more) of: (i) a retail client as defined in point (11) of Article 4(1) of Directive 2014/65/EU (as amended, **MiFID II** ); or (ii) a customer within the meaning of Directive 2002/92/EC (as amended, the **Insurance Mediation Directive** ), where that customer would not qualify as a professional client as defined in point (10) of Article 4(1) of MiFID II; or (iii) not a qualified investor as defined in Directive 2003/71/EC (as amended, the **Prospectus Directive** ) . Consequently no key information document required by Regulation (EU) No 1286/2014 (as amended, the **PRIIPs Regulation** ) for offering or selling the Notes or otherwise making them available to retail investors in the EEA has been prepared and therefore offering or selling the Notes or otherwise making them available to any retail investor in the EEA may be unlawful under the PRIIPs Regulation. This prospectus supplement and the accompanying prospectus have been prepared on the basis that any offer of notes in any Member State of the EEA will be made pursuant to an exemption under the Prospectus Directive from the requirement to publish a prospectus for offers of Notes. This prospectus supplement and the accompanying prospectus are not a prospectus for the purposes of the Prospectus Directive.

***United Kingdom:***

Each of the underwriters has represented and agreed that, it has only communicated or caused to be communicated and will only communicate or cause to be communicated any invitation or inducement to engage in investment activity (within the meaning of section 21 of the Financial Services and Markets Act 2000 (the **FSMA** )) received by it in connection with the issue or sale of any Notes in circumstances in which section 21(1) of the FSMA does not apply to the Issuer or the Guarantors and that it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Notes in, from or otherwise involving the United Kingdom.

***France:***

Each of the underwriters and the Issuer has represented and agreed that:

Offer to the public in France: it has only made and will only make an offer of Notes to the public in France in the period beginning (i) when a prospectus in relation to those Notes has been approved by the *Autorité des marchés financiers* ( **AMF** ), on the date of the publication of such prospectus approved by the AMF, or (ii) when a prospectus has been approved by the competent authority of another Member State of the European Economic Area, on the date of notification of such approval to the AMF, all in accordance with Articles L.412-1 and L.621-8 of the French *Code monétaire et financier* and the provisions of the *Règlement général* of the AMF, and ending at the latest on the date which is 12 months after the date of approval of the Prospectus by the AMF; or

Private placement in France: it has not offered or sold and will not offer or sell, directly or indirectly, any Notes to the public in France, and it has not distributed or caused to be distributed and will not distribute or cause to be distributed to the public in France, the Prospectus, any Prospectus Supplement or any other offering material relating to the Notes, and that such offers, sales and distributions have been and shall only be made in France only to (a) providers of investment services relating to portfolio management for the account of third parties *(personnes fournissant le service d investissement de gestion de portefeuille pour le compte de tiers*), and/or (b) qualified investors (*investisseurs qualifiés*), all as defined in, and in accordance with, Articles L.411-1, L.411-2 and D.411-1 of the French *Code monétaire et financier*.

***Canada:***

The Notes may be sold only to purchasers purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Notes must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this Prospectus Supplement and Prospectus (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser s province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser s province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 Underwriting Conflicts (NI 33-105), the Underwriters are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with this offering.

***Hong Kong:***

Each underwriter has represented and agreed that (i) it has not offered or sold and will not offer or sell in Hong Kong, by means of any document, any Notes (except for Notes which are a structured product as defined in the Securities and Futures Ordinance (Cap. 571) of Hong Kong) other than (a) to professional investors as defined in the Securities and Futures Ordinance and any rules made under that Ordinance; or (b) in other circumstances which do not result in the document being a prospectus as defined in the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) of Hong Kong or which do not constitute an offer to the public within the meaning of that Ordinance, and (ii) it has not issued or had in its possession for the purposes of issue, and will not issue or have in its possession for the purposes of issue, whether in Hong Kong or elsewhere, any advertisement, invitation or document relating to the Notes, which is directed at, or the contents of which are likely to be accessed or read by, the public of Hong Kong (except if permitted to do so under the securities laws of Hong Kong) other than with respect to Notes which are or are intended to be disposed of only to persons outside Hong Kong or only to professional investors as defined in the Securities and Futures Ordinance and any rules made under that Ordinance.

***Japan:***

The Notes have not been and will not be registered under the Financial Instruments and Exchange Act of Japan (Act No. 25 of 1948, as amended; the **FIEA** ) and each underwriter has represented and agreed that it has not offered or sold

and will not offer or sell any Notes, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan (as defined under Item 5, Paragraph 1, Article 6 of the Foreign Exchange and Foreign Trade Act (Act No. 228 of 1949, as amended)), or to others for re-offering or resale, directly or indirectly, in Japan or to, or for the benefit of, a resident of Japan, except pursuant to an exemption from the registration requirements of, and otherwise in compliance with, the FIEA and any other applicable laws, regulations and ministerial guidelines of Japan.

***Singapore:***

This Prospectus Supplement and the accompanying Prospectus have not been registered as a Prospectus with the Monetary Authority of Singapore. Accordingly, this Prospectus Supplement, the accompanying Prospectus and any other document or material in connection with the offer or sale, or invitation for subscription or purchase, of the Notes may not be circulated or distributed, nor

may the Notes be offered or sold, or be made the subject of an invitation for subscription or purchase, whether directly or indirectly, to persons in Singapore other than (i) to an institutional investor under Section 274 of the Securities and Futures Act, Chapter 289 of Singapore (the **SFA** ), (ii) to a relevant person pursuant to Section 275(1), or any person pursuant to Section 275(1A), and in accordance with the conditions specified in Section 275, of the SFA or (iii) otherwise pursuant to, and in accordance with the conditions of, any other applicable provision of the SFA.

Where the Notes are subscribed or purchased under Section 275 of the SFA by a relevant person which is: (a) a corporation (which is not an accredited investor (as defined in Section 4A of the SFA)) the sole business of which is to hold investments and the entire share capital of which is owned by one or more individuals, each of whom is an accredited investor; or (b) a trust (where the trustee is not an accredited investor) whose sole purpose is to hold investments and each beneficiary of the trust is an individual who is an accredited investor, securities (as defined in Section 239(1) of the SFA) of that corporation or the beneficiaries rights and interest (howsoever described) in that trust shall not be transferred within 6 months after that corporation or that trust has acquired the Notes pursuant to an offer made under Section 275 of the SFA except: (1) to an institutional investor or to a relevant person defined in Section 275(2) of the SFA, or (in the case of a corporation) where the transfer arises from an offer referred to in Section 276(3)(i)(B) of the SFA or (in the case of a trust) where the transfer arises from an offer referred to in Section 276(4)(i)(B) of the SFA; (2) where no consideration is or will be given for the transfer; (3) where the transfer is by operation of law; or (4) as specified in Section 276(7) of the SFA; or (5) as specified in Regulation 32 of the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 of Singapore.

Solely for the purposes of its obligations pursuant to sections 309B(1)(a) and 309B(1)(c) of the SFA, the Issuer has determined, and hereby notifies all relevant persons (as defined in Section 309A of the SFA) that the Notes are prescribed capital markets products (as defined in the Securities and Futures (Capital Markets Products) Regulations 2018) and Excluded Investment Products (as defined in MAS Notice SFA 04-N12: Notice on the Sale of Investment Products and MAS Notice FAA-N16: Notice on Recommendations on Investment Products).

***Brazil:***

The Notes may not be offered or sold to the public in Brazil. Accordingly, this Prospectus Supplement and the accompanying Prospectus have not been nor will they be registered with the Brazilian Securities Commission (*Comissão de Valores Mobiliários*) nor have they been submitted to the foregoing agency for approval. Each underwriter has represented and agreed that it has not offered or sold and will not offer or sell the Notes publicly (as defined for purposes of the securities laws of Brazil) in Brazil, as the offering of the Notes pursuant to this Prospectus Supplement and Prospectus is not a public offering of securities in Brazil. Documents relating to the offer, as well as the information contained therein, may not be used in connection with any offer for subscription or sale of the Notes to the public in Brazil.

***Other jurisdictions outside the United States:***

Each underwriter has represented and agreed that with respect to any other jurisdiction outside the United States, it has not offered or sold and will not offer or sell any of the Notes in any jurisdiction, except under circumstances that resulted or will result in compliance with the applicable rules and regulations of such jurisdiction.

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# TAXATION

## Supplemental Discussion of United States Taxation

*See Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. in the accompanying Prospectus dated 19 March 2018 for a description of material United States federal income tax consequences of owning the Notes.*

The following discussion supplements, and, to the extent inconsistent, supersedes the discussion in the accompanying Prospectus.

You should consult your own tax advisor concerning the United States federal income tax consequences to you of acquiring, owning, and disposing of the Notes, as well as any tax consequences arising under the laws of any state, local, foreign, or other tax jurisdiction and the possible effects of changes in United States federal or other tax laws.

The Notes should be treated as fixed rate debt securities for United States federal income tax purposes. See Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. in the accompanying Prospectus for more information. Notwithstanding the fact that the 2059 Notes are due to mature more than 30 years from the date on which they are issued, they should be subject to the tax treatment described for fixed rate debt securities under Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. in the accompanying Prospectus.

As described under *Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. Withholdable Payments to Foreign Financial Entities and Other Foreign Entities* in the accompanying Prospectus, payments of gross proceeds from a sale or other disposition of debt securities could be subject to FATCA withholding if such disposition occurs on or after 1 January 2019. However, the U.S. Treasury Department recently released proposed regulations that, if finalized in their present form, would eliminate the federal withholding tax of 30% applicable to gross proceeds from sales or other dispositions of the Notes. In its preamble to such proposed regulations, the U.S. Treasury Department has stated that taxpayers may generally rely on the proposed regulation until final regulations are issued.

## Belgian Taxation

*The following is a general description of the principal Belgian tax consequences for investors receiving interest in respect of, or disposing of, the Notes and is of a general nature based on the issuer understanding of current law and practice.*

*This general description is based upon the law as in effect on the date of this Prospectus Supplement and is subject to change potentially with retroactive effect. Investors should appreciate that, as a result of changing law or practice, the tax consequences may be otherwise than as stated below. Investors should consult their professional advisers on the possible tax consequences of subscribing for, purchasing, holding or selling the Notes under the laws of their countries of citizenship, residence, ordinary residence or domicile.*

### *Withholding Tax and Income Tax*

For Belgian tax purposes, the following amounts are qualified and taxable as interest : (i) periodic interest income, (ii) amounts paid by the Issuer in excess of the issue price (whether or not on the maturity date), and (iii) in case of a realization of the Notes between two interest payment dates, the pro rata of accrued interest corresponding to the

detention period. For the purposes of the following paragraphs, any such gains and accrued interest are therefore referred to as interest.

For Belgian tax purposes, if interest is in a foreign currency, it is converted into euro on the date of payment or attribution.

For the purposes of the summary of the principal Belgian tax consequences for investors, a resident investor is:

- an individual subject to Belgian personal income tax, *i.e.* an individual having its domicile or seat of wealth in Belgium or assimilated individuals for purposes of Belgian tax law;

- a corporation (as defined by Belgian tax law) subject to Belgian corporate income tax, *i.e.* a company having its registered seat, principal establishment, administrative seat or effective place of management in Belgium; or

- a legal entity subject to the Belgian tax on legal entities, *i.e.* a legal entity other than a company subject to Belgian corporate income tax having its registered seat, principal establishment, administrative seat or effective place of management in Belgium.

A non-resident investor is any individual, company or legal entity that does not fall into any of the three previous classes.

*Tax rules applicable to individuals resident in Belgium*

Individuals who are Belgian residents for tax purposes, *i.e.* who are subject to the Belgian personal income tax (*Personenbelasting/Impôt des personnes physiques*) and who hold the Notes as a private investment, are in Belgium subject to the following tax treatment with respect to the Notes.

Other tax rules apply to Belgian resident individuals who do not hold the Notes as a private investment.

Payments of interest on the Notes made through a paying agent in Belgium will in principle be subject to a 30 per cent. withholding tax in Belgium (calculated on the interest received after deduction of any non-Belgian withholding taxes). The Belgian withholding tax constitutes the final income tax for Belgian resident individuals. This means that they do not have to declare the interest obtained on the Notes in their personal income tax return, *provided* Belgian withholding tax was levied on these interest payments.

However, if the interest is paid outside Belgium without the intervention of a Belgian paying agent, the interest received (after deduction of any non-Belgian withholding tax) must be declared in the personal income tax return and will be taxed at a flat rate of 30 per cent.

Capital gains realized on the sale of the Notes on the secondary market before maturity are generally not taxable for individuals, except if the purchaser is the Issuer. In the latter case, capital gains are taxable interest and subject to withholding tax if collected through a financial intermediary established in Belgium. The accrued interest part of a capital gain realized on a sale of the Notes which qualify as fixed income notes in the meaning of article 2, §1, 8° Belgian Income Tax Code is also taxable as interest. Capital losses realized on a sale of the Notes are not tax deductible.

*Belgian resident companies*

Corporations Noteholders who are Belgian residents for tax purposes, *i.e.* who are subject to Belgian Corporate Income Tax (*Vennootschapsbelasting/Impôt des sociétés*) are in Belgium subject to the following tax treatment with respect to the Notes.

Interest derived by Belgian corporate investors on the Notes and capital gains realized on the Notes will be subject to Belgian corporate income tax. The current normal corporate income tax rate in Belgium is 29.58 per cent. If the income has been subject to a foreign withholding tax, a foreign tax credit will be applied on the Belgian tax due. For interest income, the foreign tax credit is generally equal to a fraction where the numerator is equal to the foreign tax and the denominator is equal to 100 minus the rate of the foreign tax, up to a maximum of 15/85 of the net amount received (subject to some further limitations). Capital losses are in principle tax deductible.

Interest payments on the Notes made through a paying agent in Belgium to Belgian corporate investors will generally be subject to Belgian withholding tax, currently at a rate of 30 per cent. However, an exemption may apply *provided* that certain formalities are complied with. The exemption generally does not apply for income on zero coupon or capitalization bonds. The Belgian withholding tax that has been levied is creditable in accordance with the applicable legal provisions.

*Other Belgian legal entities*

Other legal entities Noteholders who are Belgian residents for tax purposes, *i.e.* who are subject to Belgian tax on legal entities (*Rechtspersonenbelasting/Impôt des personnes morales*) are in Belgium subject to the following tax treatment with respect to the Notes.

Payments of interest on the Notes made through a paying agent in Belgium will in principle be subject to a 30 per cent. withholding tax in Belgium and no further tax on legal entities will be due on the interest.

However, if the interest is paid outside Belgium without the intervention of a Belgian paying agent and without the deduction of Belgian withholding tax, the legal entity itself is responsible for the declaration and payment of the 30 per cent. withholding tax.

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Capital gains realized on the sale of the Notes on the secondary market before maturity are generally not taxable for individuals, except if the purchaser is the Issuer. In the latter case, capital gains are taxable interest and subject to withholding tax if collected through a financial intermediary established in Belgium. The accrued interest part of a capital gain realized on a sale of the Notes which qualify as fixed income notes in the meaning of article 2, §1, 8° Belgian Income Tax Code is also taxable as interest. Capital losses realized on a sale of the Notes are not tax deductible.

*Organizations for Financing Pensions*

Belgian pension fund entities that have the form of an OFP (*Organisme de financement de pensions/Organisme voor de financiering van pensioenen*) are subject to Belgian Corporate Income Tax (*Vennootschapsbelasting/Impôt des sociétés*). OFPs are in Belgium subject to the following tax treatment with respect to the Notes.

Interest derived by OFP Noteholders on the Notes and capital gains realized on the Notes will be exempt from Belgian Corporate Income Tax. Capital losses are in principle not tax deductible.

Subject to certain conditions, any Belgian withholding tax that has been levied can be credited against any corporate income tax sue and any excess amount is in principle refundable.

*Belgian non-residents*

Investors who are non-residents of Belgium for Belgian tax purposes and are not holding the Notes through a Belgian establishment and do not invest the Notes in the course of their Belgian professional activity will in principle not incur or become liable for any Belgian tax on income or capital gains (save as the case may be, in the form of withholding tax).

The interest income on the Notes paid through a professional intermediary in Belgium will, in principle, be subject to a 30 per cent. withholding tax, unless the Noteholder is resident in a country with which Belgium has concluded a double taxation agreement and delivers the requested affidavit. If the income is not collected through a financial institution or other intermediary established in Belgium, no Belgian withholding tax is due.

Non-resident investors that do not hold the Notes through a Belgian establishment can also obtain an exemption of Belgian withholding tax on interest from the Notes paid through a Belgian credit institution, a Belgian stock market company or a Belgian-recognized clearing or settlement institution, *provided* that they deliver an affidavit to such institution or company confirming (i) that the investors are non-residents, (ii) that the Notes are held in full ownership or in usufruct and (iii) that the Notes are not held for professional purposes in Belgium.

The non-residents who use the Notes to exercise a professional activity in Belgium through a permanent establishment are subject to the same tax rules as the Belgian resident companies (see above). Non-resident Noteholders who do not allocate the Notes to a professional activity in Belgium and who do not hold the Notes through a Belgian establishment are not subject to Belgian income tax, save, as the case may be, in the form of withholding tax.

***Tax on Stock Exchange Transactions***

A stock exchange tax (*Taxe sur les opérations de bourse / Taks op de beursverrichtingen*) will be levied on the purchase and sale in Belgium of the Notes on a secondary market through a professional intermediary. The rate applicable for secondary sales and purchases in Belgium through a professional intermediary is 0.12 per cent. with a maximum amount of Euro 1,300 per transaction and per party or, as the case may be, 0.35 per cent. with a maximum

amount of Euro 1,600 per transaction and per party. The tax is due separately from each party to any such transaction, i.e. the seller (transferor) and the purchaser (transferee), both collected by the professional intermediary. However, various types of investors (including credit institutions, insurance companies, pension funds and all non-residents of Belgium) are exempted from this tax.

The acquisition of Notes upon their issuance (primary market) is not subject to the tax on stock exchange transactions.

Transactions that are entered into or carried out by an intermediary that is not established in Belgium are considered to be entered into or carried out in Belgium if the order to execute the transaction is directly or indirectly given by either a natural person who has his/her habitual residence in Belgium or by a legal entity on behalf of its registered office or establishment in Belgium. In

such a scenario, foreign intermediaries have the possibility to appoint a Belgian tax representative that is responsible for collecting the stock exchange tax due and for paying it to the Belgian treasury on behalf of clients that fall within one of the aforementioned categories (provided that these clients do not qualify as exempt persons for stock exchange tax purposes see below). If no such permanent representative is appointed, the relevant parties themselves are responsible for the filing of a stock exchange tax return and for the timely payment of the amount of stock exchange tax due.

A tax on repurchase transactions (*Taxe sur les reports/ Taks op de reportverrichtingen*) at the rate of 0.085 per cent. will be due from each party to any such transaction entered into or settled in Belgium in which a stockbroker acts for either party (with a maximum amount of Euro 1,300 per transaction and per party or, as the case may be, with a maximum amount of Euro 1,600 per transaction and per party). Exemptions apply.

Neither the tax on stock exchange transactions nor the tax on repurchase transactions will be payable by exempt persons acting for their own account including investors who are not Belgian residents provided they deliver an affidavit to the financial intermediary in Belgium confirming their non-resident status and certain Belgian institutional investors as defined in Article 126/1, 2° of the Code of miscellaneous taxes and duties (*Code des droits et taxes divers/Wetboek diverse rechten en taksen*) for the tax on stock exchange transactions and Article 139, second paragraph, of the same code for the tax on repurchase transactions.

***Annual tax on securities accounts***

As of financial year 2018, certain individuals holding certain types of qualifying securities such as shares, bonds, shares or units of undertakings for collective investment (UCI) and warrants, for an aggregate amount of at least EUR 500,000 on one or more securities accounts, are charged an annual subscription tax of 0.15% on the full balance of their share in the securities account(s). The individuals subject to this tax are (i) Belgian tax resident individuals holding (a share in) one or more securities accounts with Belgian and/or foreign financial intermediar(y)/(ies) and (ii) non-resident individual investors holding (a share in) one or more securities account with (a) Belgian financial intermediar(y)/(ies).

The Notes will be qualifying securities for the purposes of this tax. Prospective individual investors should thus be aware that the value of the Notes that they hold may be taken into account in determining whether the aforementioned EUR 500,000 threshold is met or not and that, depending on their concrete situation, an investment in the Notes may trigger a 0.15% tax on the value thereof (and possibly also on the value of any other qualifying securities they may hold through one or more securities accounts).

Prospective investors are urged to consult their own tax advisors as to the tax consequences of the application of this new tax on their investment in the Notes.

## Luxembourg Taxation

*The following is of a general nature only and is based on the laws presently in force in Luxembourg, though it is not intended to be, nor should it be construed to be, legal or tax advice. Prospective investors in the Notes should therefore consult their own professional advisers as to the effects of state, local or foreign laws, including Luxembourg tax law, to which they may be subject.*

*Please be aware that the residence concept used under the respective headings below applies for Luxembourg income tax assessment purposes only. Any reference in the present section to a tax, duty, levy, impost or other charge or withholding of a similar nature, or to any other concepts, refers to Luxembourg tax law and/or concepts only. Also,*

*please note that a reference to Luxembourg income tax encompasses corporate income tax (impôt sur le revenu des collectivités), municipal business tax (impôt commercial communal), a solidarity surcharge (contribution au fonds pour l emploi) as well as personal income tax (impôt sur le revenu) generally. Investors may further be subject to net wealth tax (impôt sur la fortune) as well as other duties, levies or taxes. Corporate income tax, municipal business tax as well as the solidarity surcharge invariably apply to most corporate taxpayers resident in Luxembourg for tax purposes. Individual taxpayers are generally subject to personal income tax and the solidarity surcharge. Under certain circumstances, where an individual taxpayer acts in the course of the management of a professional or business undertaking, municipal business tax may apply as well.*

*A holder of Notes will not become resident, or be deemed to be resident, in Luxembourg by reason only of the holding of the Notes, or the execution, performance, delivery and/or enforcement of the Notes.*

***Withholding Tax***

*Taxation of Luxembourg non-residents*

Under Luxembourg tax law currently in force there is no Luxembourg withholding tax on payments of principal, premium or interest (including accrued but unpaid interest) made to non-resident holders of the Notes. There is also no Luxembourg withholding tax upon repayment of principal in case of reimbursement, redemption, repurchase or exchange of the Notes held by non-resident holders of the Notes.

On 10 November 2015, the European Council repealed Council Directive 2003/48/EC on the taxation of savings income in the form of interest payments (the **Savings Directive**) with effect from 1 January 2016. In this respect, the laws of 21 June 20015, as amended (herein after being defined as the **Laws**), implementing the Savings Directive in Luxembourg are no longer applicable. Consequently, since 1 January 2016, no withholding tax is levied under the Laws.

*Taxation of Luxembourg residents*

Under Luxembourg general tax laws currently in force and subject to the law of 23 December 2005, as amended (the **Relibi Law**), there is no withholding tax on payments of principal, premium or interest made to Luxembourg resident holders of Notes, nor on accrued but unpaid interest in respect of Notes, nor is any Luxembourg withholding tax payable upon redemption or repurchase of Notes held by Luxembourg resident holders of Notes.

Under the Relibi Law, interest payments or similar income made or ascribed by Luxembourg paying agents (defined in the same way as in the Laws) to or for the immediate benefit of Luxembourg individual residents are subject to a 20 per cent. withholding tax (the **20 per cent. Luxembourg Withholding Tax**). The 20 per cent. Luxembourg Withholding Tax will be in full discharge of income tax if the beneficial owner is an individual acting in the course of the management of his/her private wealth. Responsibility for the withholding of the tax will be assumed by the Luxembourg paying agent.

In addition, pursuant to the Relibi Law, Luxembourg resident individuals can opt to self-declare and pay a 20 per cent. tax (the **20 per cent. Tax**) on payment of interest or similar incomes made or ascribed by paying agents located in a Member State of the European Union other than Luxembourg or in a Member State of the European Economic Area.

The 20 per cent. Tax is final when Luxembourg resident individuals are acting in the context of the management of their private wealth.

***Income Taxation of the Holders of Notes***

*Taxation of Luxembourg non-residents*

A non-resident holder of Notes, not having a permanent establishment or permanent representative in Luxembourg to which/whom such Notes are attributable, is not subject to Luxembourg income tax on interest accrued or received, redemption premiums or issue discounts, under the Notes. A gain realized by such non-resident holder of Notes on the sale or disposal, in any form whatsoever, of the Notes is further not subject to Luxembourg income tax.

A non-resident corporate holder of Notes or an individual holder of Notes acting in the course of the management of a professional or business undertaking, who has a permanent establishment or permanent representative in Luxembourg to which or to whom such Notes are attributable, is subject to Luxembourg income tax on interest accrued or received,

redemption premiums or issue discounts, under the Notes and on any gains realized upon the sale or disposal, in any form whatsoever, of the Notes.

*Taxation of Luxembourg residents*

Holders of Notes who are residents of Luxembourg will not be liable for any Luxembourg income tax on repayments of principal except, under certain circumstances, if the repayment proceeds converted into euro exceed the historical acquisition value denominated in euros.

*Luxembourg resident individuals*

Luxembourg resident individuals, acting in the course of their private wealth, are subject to Luxembourg income tax on interest accrued or received, redemption premiums or issue discounts, under the Notes except if (i) the 20 per cent. Luxembourg Withholding Tax has been levied, or (ii) the individual holder of Notes has opted for the 20 per cent. Tax. The 20 per cent. Tax or the 20 per cent. Luxembourg Withholding Tax represents the final tax liability on interest received for the Luxembourg resident individuals receiving the interest payment in the course of the management of their private wealth and may be reduced in consideration of foreign withholding tax, based on double tax treaties concluded by Luxembourg. Individual Luxembourg resident holders of Notes receiving the interest as business income must include this interest in their taxable basis; if applicable, the 20 per cent. Tax or the 20 per cent. Luxembourg Withholding Tax levied will be credited against their final income tax liability.

Luxembourg resident individual holders of Notes are not subject to taxation on capital gains upon the disposal of the Notes, unless the disposal of the Notes precedes the acquisition of the Notes or the Notes are disposed of within six months of the date of acquisition of the Notes. However, upon the sale, redemption or exchange of the Notes, accrued but unpaid interest will be subject to the 20 per cent. Luxembourg Withholding Tax or to the 20 per cent. Tax if the Luxembourg resident individuals opt for the 20 per cent. Tax. Individual Luxembourg resident holders of Notes receiving the interest as business income must include the portion of the price corresponding to this interest in their taxable income; if applicable, the 20 per cent. Luxembourg Withholding Tax levied will be credited against their final income tax liability.

*Luxembourg resident companies*

Luxembourg resident joint stock companies (*sociétés de capitaux*) and other entities of a collective nature (*organismes à caractère collectif*) which are holders of Notes and which are subject to corporate taxes in Luxembourg without the benefit of a special tax regime in Luxembourg or foreign entities of the same type which have a permanent establishment or a permanent representative in Luxembourg with which the holding of the Notes is connected, must include in their taxable income any interest (including accrued but unpaid interest) and in case of sale, repurchase, redemption or exchange, the difference between the sale, repurchase, redemption or exchange price (received or accrued) converted into euros and the euro book value of the Notes sold, repurchased, redeemed or exchanged.

*Luxembourg resident companies benefiting from a special tax regime*

A corporate holder of Notes that is governed by the law of 11 May 2007 on family estate management companies, as amended, or by the law of 17 December 2010 on undertakings for collective investment, as amended, or by the law of 13 February 2007 on specialized investment funds, as amended, or by the law of 23 July 2016 on reserved alternative investment funds (provided it is not foreseen in the incorporation documents that (i) the exclusive object is the investment in risk capital and that (ii) article 48 of the aforementioned law of 23 July 2016 applies) is neither subject to Luxembourg income tax in respect of interest accrued or received, any redemption premium or issue discount, nor on gains realized on the sale or disposal, in any form whatsoever, of the Notes.

***Net Wealth Tax***

A corporate holder of Notes, whether it is resident of Luxembourg for tax purposes or, if not, it maintains a permanent establishment or a permanent representative in Luxembourg to which/whom such Notes are attributable, is subject to Luxembourg wealth tax assessed on the euro market value of such Notes, except if the holder of Notes is governed by (i) the law of 11 May 2007 on family estate management companies, as amended, or by (ii) the law of 17 December 2010 on undertakings for collective investment, as amended, or by (iii) the law of 13 February 2007 on specialized

investment funds, as amended, or by (iv) the law of 22 March 2004 on securitization companies, as amended, or by (v) the law of 15 June 2004 on venture capital vehicles, as amended, or by (vi) the law of 13 July 2005 on professional pension institutions, as amended, or by (vii) the law of 23 July 2016 on reserved alternative investment funds.

The Luxembourg Law of 18 December 2015 has introduced a minimum annual net wealth tax as from 1 January 2016. In this respect, as from 1 January 2017, a minimum net wealth ta of EUR 4,815 will be levied on any company whose financial assets, amounts owed by affiliated undertakings, transferable securities and cash at bank (*i.e.*, assets to be accounted for in Accounts 23, 41, 50 and 51 of the *Plan Comptable Normalisé*) represent more than 90% of its balance sheet and a minimum amount of EUR 350,000. If the company holds 90% or less of financial assets or if those financial assets do not exceed EUR 350,000, a minimum net wealth tax varying between EUR 535 and EUR 32,100 would apply, depending on the size of its balance sheet. The minimum annual net wealth tax applicable to any company (including any securitization company under the law of 22 March 2004, as amended, any venture capital vehicle under the law of 15 June 2004 and any professional pension company governed by the law of 13 July 2005, as

amended), except family estate management companies (under the law of 11 May 2007), undertakings for collective investment (under the law of 17 December 2010), specialized investment funds (law of 13 February 2007) and reserved alternative investment funds (law of 23 July 2016), provided it is not foreseen in the incorporation documents that (i) the exclusive object is the investment in risk capital and that (ii) article 48 of the aforementioned law of 23 July 2016 applies.

An individual holder of Notes, whether he/she is resident of Luxembourg or not, is not subject to Luxembourg wealth tax on such Notes.

***Other Taxes***

There is no Luxembourg registration tax, stamp duty or any other similar tax or duty payable in Luxembourg by holders of Notes as a consequence of the issuance of the Notes, nor will any of these taxes be payable as a consequence of a subsequent transfer, repurchase or redemption of the Notes unless the documents relating to the Notes are voluntarily registered in Luxembourg.

There is no Luxembourg VAT payable in respect of payments in consideration for the issuance of the Notes or in respect of the payment of interest or principal under the Notes or the transfer of the Notes.

Luxembourg VAT may, however, be payable in respect of fees charged for certain services rendered to the relevant Issuer, if for Luxembourg VAT purposes such services are rendered or are deemed to be rendered in Luxembourg and an exemption from Luxembourg VAT does not apply with respect to such services.

No Luxembourg inheritance taxes are levied on the transfer of the Notes upon death of a holder of Notes in cases where the deceased was not a resident of Luxembourg for inheritance tax purposes. No Luxembourg gift tax will be levied on the transfer of the Notes by way of gift unless the gift is registered in Luxembourg.

**EU Savings Directive 2003/48/EC**

On 10 November 2015, the European Council repealed the Savings Directive with effect from 1 January 2016. In December 2014, the European Council adopted Directive 2014/107/EU amending the provisions on the mandatory automatic exchange of information between tax administrations. Directive 2014/107/EU, the scope of which has been extended to include interest, dividends and other types of income, entered into force on 1 January 2016 and has been implemented in Luxembourg by the law of 18 December 2015.

Investors who are in any doubt as to their position should consult their professional advisors.

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## VALIDITY OF THE SECURITIES

The validity of the Notes and the Guarantees in connection with the offering of the Notes will be passed upon for the Issuer by Sullivan & Cromwell LLP, U.S. counsel to the Issuer, the Parent Guarantor, Anheuser-Busch InBev Finance Inc. and Anheuser-Busch Companies, LLC, and Clifford Chance LLP, Belgian counsel to the Parent Guarantor and Cobrew NV and Luxembourg counsel to Brandbrew S.A. and Brandbev S.à r.l. Certain legal matters will be passed upon for the Underwriters by Allen & Overy LLP, counsel to the Underwriters.

## EXPERTS

Our consolidated financial statements as of and for the years ended 31 December 2017 and 2016, and the retrospective adjustments to the 2015 consolidated financial statement disclosures, incorporated in this prospectus by reference from our Annual Report on Form 20-F for the year ended 31 December 2017, and the effectiveness of our internal control over financial reporting, have been audited by Deloitte Bedrijfsrevisoren BV o.v.v.e. CVBA, an independent registered public accounting firm, as stated in their reports, which are incorporated herein by reference (which reports (a) express an unqualified opinion on the 2017 and 2016 consolidated financial statements, (2) express an unqualified opinion on the retrospective adjustments to the 2015 consolidated financial statement disclosures to reflect the change in presentation of the AB InBev Group s segment information, and (3) express an unqualified opinion on the effectiveness of internal control over financial reporting). Such financial statements have been so incorporated in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

The consolidated financial statements of Anheuser-Busch InBev SA/NV for the year ended 31 December 2015, before the effects of the adjustments to retrospectively reflect the change in the composition of reportable segments, (not separately included or incorporated by reference in this Prospectus) and except as they relate to Ambev S.A., have been audited by PwC Bedrijfsrevisoren BCVBA, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting. The adjustments to those financial statements to retrospectively reflect the change in the composition of reportable segments have been audited by Deloitte Bedrijfsrevisoren BV o.v.v.e. CVBA. PwC Bedrijfsrevisoren BCVBA is a member of the Institut des Réviseurs d Entreprises/Instituut der Bedrijfsrevisoren.

The audited historical financial statements of SABMiller plc included on pages F-4 to F-78 of NEWBELCO SA/NV s Registration Statement on Form F-4 (No. 333-213328) have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

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**PROSPECTUS**

# *Anheuser-Busch InBev Finance Inc.*

# *Anheuser-Busch InBev Worldwide Inc.*

## Guaranteed Debt Securities

## Fully and unconditionally guaranteed by

# *Anheuser-Busch InBev SA/NV*

# *Anheuser-Busch InBev Finance Inc.*

# *Anheuser-Busch InBev Worldwide Inc.*

# *Brandbev S.à r.l.*

# *Brandbrew S.A.*

# *Cobrew NV*

# *Anheuser-Busch Companies, LLC*

This prospectus describes some of the general terms that may apply to these securities and the general manner in which they may be offered.

We will give you the specific terms of the securities, and the manner in which they are offered, in supplements to this prospectus. You should read this prospectus and the prospectus supplements carefully before you invest. We may offer and sell these securities to or through one or more underwriters, dealers and agents, or directly to purchasers, on a delayed or continuous basis. We will indicate the names of any underwriters in the applicable prospectus supplement.

Anheuser-Busch InBev Finance Inc. or Anheuser-Busch InBev Worldwide Inc. may use this prospectus to offer from time to time guaranteed debt securities.

This prospectus may not be used to sell securities unless it is accompanied by a prospectus supplement.

We have not applied to list the debt securities on any securities exchange. However, we may apply to list any particular issue of debt securities on a securities exchange. If we choose to do so, we would disclose the listing of such debt securities in the applicable prospectus supplement. We are under no obligation to list any issued debt securities and may in fact not list any.

***Investing in our securities involves certain risks. See*** ***Risk Factors*** ***beginning on page 2.***

**Neither the Securities and Exchange Commission nor any other regulatory body has approved or disapproved of these securities or passed upon the accuracy or adequacy of this prospectus. Any representation to the contrary is a criminal offense.**

The date of this prospectus is 19 March 2018.

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**ABOUT THIS PROSPECTUS**

In this prospectus, references to:

- we , us and our are, as the context requires, to Anheuser-Busch InBev SA/NV or Anheuser-Busch InBev SA/NV and the group of companies owned and/or controlled by Anheuser-Busch InBev SA/NV;
- AB InBev are, as the context requires, to Anheuser-Busch InBev SA/NV or Anheuser-Busch InBev SA/NV and the group of companies owned and/or controlled by Anheuser-Busch InBev SA/NV;
- ABIFI are to Anheuser-Busch InBev Finance Inc.;
- ABIWW are to Anheuser-Busch InBev Worldwide Inc.;
- Parent Guarantor are to Anheuser-Busch InBev SA/NV;
- Issuers are to Anheuser-Busch InBev Finance Inc. and Anheuser-Busch InBev Worldwide Inc. and either may be referred to as an Issuer ;
- Guarantors are to the Parent Guarantor and Subsidiary Guarantors;
- Subsidiary Guarantors are to one or more of Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, Anheuser-Busch InBev Worldwide Inc. (in respect of debt securities for which it is not the Issuer) and Anheuser-Busch InBev Finance Inc. (in respect of debt securities for which it is not the Issuer), which are providing additional guarantees of a particular series of debt securities, as indicated in the applicable prospectus supplement;
- SAB are, as the context requires, to ABI SAB Group Holding Limited (formerly SABMiller Limited and prior to that SABMiller plc) or to ABI SAB Group Holding Limited and the group of companies owned and/or controlled by ABI SAB Group Holding Limited; and
- AB InBev Group are to Anheuser-Busch InBev SA/NV and the group of companies owned and/or controlled by Anheuser-Busch InBev SA/NV.

Anheuser-Busch InBev Finance Inc. or Anheuser-Busch InBev Worldwide Inc. will be the issuer in an offering of debt securities. Anheuser-Busch InBev SA/NV will be the guarantor in an offering of debt securities of Anheuser-Busch InBev Finance Inc. or Anheuser-Busch InBev Worldwide Inc., which are referred to as guaranteed debt securities. The guaranteed debt securities may also be guaranteed by one or more of Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, Anheuser-Busch InBev Worldwide Inc. (in respect of debt securities for which it is not the Issuer) and Anheuser-Busch InBev Finance Inc. (in respect of debt securities for which it is not the Issuer) as indicated in the applicable prospectus supplement. We refer to the guaranteed debt securities issued by Anheuser-Busch InBev Finance Inc. or Anheuser-Busch InBev Worldwide Inc. collectively as the debt securities or as the securities.

This prospectus is part of a registration statement that we filed with the U.S. Securities and Exchange Commission (the **SEC** ), using a shelf registration process. Under this shelf process, the securities described by this prospectus may be sold in one or more offerings. Each time we offer securities under the registration statement, we will provide a prospectus supplement that will contain specific information about the terms of that offering. The prospectus supplement may also add, update or change information contained in this prospectus. Before you invest in any securities offered under this prospectus, you should read this prospectus and the applicable prospectus supplement together with the additional information described under the headings Incorporation of Certain Documents by Reference and Where You Can Find More Information .

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## RISK FACTORS

*Investing in the securities offered using this prospectus involves risk. We urge you to carefully review the risks described below, together with the risks described in the documents incorporated by reference into this prospectus and any risk factors included in the prospectus supplement, before you decide to buy our securities. If any of these risks actually occur, our business, financial condition and results of operations could suffer, and the trading price and liquidity of the securities offered using this prospectus could decline, in which case you may lose all or part of your investment.*

### Risks Relating to Our Business

You should read Risk Factors in our Annual Report on Form 20-F for the fiscal year ended 31 December 2017 (the **Annual Report** ), which is incorporated by reference in this prospectus, or similar sections in subsequent filings incorporated by reference in this prospectus, for information on risks relating to our business.

### Risks Relating to the Debt Securities

***Since Anheuser-Busch InBev Finance Inc. is a finance subsidiary and Anheuser-Busch InBev Worldwide Inc. and the Parent Guarantor are holding companies that conduct their operations through subsidiaries, your right to receive payments on the debt securities and the Guarantees is subordinated to the other liabilities of the subsidiaries of the Parent Guarantor which are not Subsidiary Guarantors.***

Anheuser-Busch InBev Finance Inc. is a finance subsidiary, and its principal source of income will consist of payments on intra-group receivables from the Parent Guarantor. Anheuser-Busch InBev Worldwide Inc. and the Parent Guarantor are organized as holding companies, and substantially all of their operations are carried on through their subsidiaries. The principal sources of income of Anheuser-Busch InBev Worldwide Inc. and the Parent Guarantor are the dividends and distributions they receive from their subsidiaries. On an unconsolidated basis, the Parent Guarantor had guaranteed a total of USD 115.9 billion of debt as of 31 December 2017.

The ability of Anheuser-Busch InBev Worldwide Inc. and the Parent Guarantor to meet their financial obligations is dependent upon the availability of cash flows from their domestic and foreign subsidiaries and affiliated companies through dividends, intercompany advances, management fees and other payments. The subsidiaries and affiliated companies of Anheuser-Busch InBev Worldwide Inc. and the Parent Guarantor are not required and may not be able to pay dividends to Anheuser-Busch InBev Worldwide Inc. or the Parent Guarantor. Only certain subsidiaries of the Parent Guarantor may be guarantors of the debt securities. To the extent specified in the applicable prospectus supplement for a particular series of debt securities, debt securities of that series will only benefit from the guarantees of the Subsidiary Guarantors. Claims of the creditors of the Parent Guarantor s subsidiaries who are not Subsidiary Guarantors have priority as to the assets of such subsidiaries over the claims of creditors of the Issuers or the Parent Guarantor. Consequently, holders will be structurally subordinated, on an Issuer s or the Parent Guarantor s insolvency, to the prior claims of the creditors of the Parent Guarantor s subsidiaries who are not Subsidiary Guarantors.

***The Guarantees to be provided by the Parent Guarantor and any of the Subsidiary Guarantors will be subject to certain limitations that may affect the validity or enforceability of the Guarantees.***

Enforcement of each Guarantee will be subject to certain generally available defenses. Local laws and defenses may vary, and may include those that relate to corporate benefit (*ultra vires*), fraudulent conveyance or transfer (*actio pauliana*), voidable preference, financial assistance, corporate purpose, subordination and capital maintenance or similar laws and concepts. They may also include regulations or defenses which affect the rights of creditors generally.

If a court were to find a Guarantee given by a Guarantor, or a portion thereof, void or unenforceable as a result of such local laws or defenses, or to the extent that agreed limitations on Guarantees apply (see Description of Debt Securities and Guarantees Guarantee Limitations ), holders of the debt securities would

cease to have any claim in respect of that Guarantor and would be creditors solely of the relevant Issuer and any remaining Guarantors and, if payment had already been made under the relevant Guarantee, the court could require that the recipient return the payment to the relevant Guarantor.

***Any Guarantee to be provided by Brandbrew S.A. or Brandbev S.à r.l. is subject to certain limitations pursuant to Luxembourg law.***

Pursuant to restrictions imposed by Luxembourg law, for the purposes of any Guarantees to be provided by Brandbrew S.A. or Brandbev S.à r.l. (each, a **Luxembourg Guarantor** ), the maximum aggregate liability of such Luxembourg Guarantor under its Guarantee (including any actual or contingent liabilities as a guarantor of the Other Guaranteed Facilities (as defined below) shall not exceed an amount equal to the aggregate of (without double counting): (A) the aggregate amount of all moneys received by such Luxembourg Guarantor and its subsidiaries as a borrower or issuer under the Other Guaranteed Facilities; (B) the aggregate amount of all outstanding intercompany loans made to such Luxembourg Guarantor and its Subsidiaries by other members of the AB InBev Group which have been directly or indirectly funded using the proceeds of borrowings under the debt securities to be issued under each of the ABIFI Indenture and the ABIWW Indenture (each such term as defined below) (together the **Indentures** ) and the Other Guaranteed Facilities; and (C) an amount equal to 100% of the greater of (I) the sum of (x) such Luxembourg Guarantor s own capital (*capitaux propres*) (as referred to in the Luxembourg law dated 19 December 2002 on the commercial register and annual accounts, as amended (the **Luxembourg Law of 2002** ), and as implemented by the Grand-Ducal regulation dated 18 December 2015 setting out the form and content of the presentation of the balance sheet and profit and loss account (the **Luxembourg Regulation** )) as reflected in such Luxembourg Guarantor s then most recent annual accounts approved by the competent organ of such Luxembourg Guarantor (as audited by its statutory auditor (*réviseur d entreprises agréé*), if required by law) at the date of an enforcement of such Luxembourg Guarantor s Guarantee and (y) any amounts owed by such Luxembourg Guarantor to any other member of the AB InBev Group which have not been funded, directly or indirectly, using the proceeds of borrowings under the Indentures or the Other Guaranteed Facilities (as defined below) and (II) the sum of (x) such Luxembourg Guarantor s own capital (*capitaux propres*) (as referred to by article 34 of the Luxembourg Law of 2002 and as implemented by the Luxembourg Regulation) as reflected in its most recent annual accounts available as of the date of the applicable Indenture and (y) any amounts owed by such Luxembourg Guarantor to any other member of the AB InBev Group which have not been funded, directly or indirectly, using the proceeds of borrowings under the Indentures or the Other Guaranteed Facilities.

In addition, the obligations and liabilities of such Luxembourg Guarantor under its Guarantee and under any of the Other Guaranteed Facilities shall not include:

(i) in the case of Brandbrew S.A., any obligation which, if incurred, would constitute a breach of the provisions on unlawful financial assistance as contained in article 430-19 (formerly article 49-6) of the Luxembourg Law on Commercial Companies dated 10 August 1915, as amended; and

(ii) in the case of Brandbev S.à r.l., the guarantee of any amount if and to the extent the granting of such guarantee for such amounts would constitute unlawful financial assistance in violation of article 1500-7 (formerly article 168) of the Luxembourg Law on Commercial Companies dated 10 August 1915, as amended.

For further details on such the limitations, see Description of Debt Securities and Guarantees Guarantee Limitations .

Brandbrew S.A. and Brandbev S.à r.l., the Subsidiary Guarantors whose Guarantees are subject to limitations, accounted in aggregate for less than 0.1% of the total consolidated EBITDA, as defined, of AB InBev for the year ended 31 December 2017 and approximately 0.1% of the total consolidated debt of AB InBev as of 31 December 2017.

***Any Guarantees to be provided by the Subsidiary Guarantors (but not the Parent Guarantor) will be released in certain circumstances.***

The Guarantees of a Subsidiary Guarantor will be terminated at substantially the same time that (i) the relevant Subsidiary Guarantor is released from its guarantee of both the 2010 Senior Facility Agreement (as defined in the Annual Report under the heading Item 5. Operating and Financial Review G. Liquidity and Capital Resources and as it may be amended from time to time) or is no longer a guarantor under such facility and (ii) the aggregate amount of indebtedness for borrowed money for which the relevant Subsidiary Guarantor is an obligor (as a guarantor or borrower) does not exceed 10% of the consolidated gross assets of the Parent Guarantor as reflected in the balance sheet included in its most recent publicly released interim or annual consolidated financial statements. In addition, the Guarantees of each Subsidiary Guarantor whose Guarantee is subject to the limitations described below under Description of Debt Securities and Guarantees Guarantee Limitations will be terminated in the event that under the rules, regulations or interpretations of the SEC the Parent Guarantor determines that it would be required to include its financial statements in any registration statement filed with the SEC with respect to any series of debt securities or guarantees issued under each indenture or in periodic reports filed with or furnished to the SEC (by reason of such limitations or otherwise). For more information see Description of Debt Securities and Guarantees Guarantees .

In relation to any of our future periodic or other filings with the SEC, the rules and regulations of the SEC require that the Guarantees be full and unconditional obligations of each of the Subsidiary Guarantors; otherwise, in connection with such filing, separate financial statements of the Subsidiary Guarantors would be required to be filed as well. As discussed below under Description of Debt Securities and Guarantees Guarantee Limitations , any Guarantee that is subject to limitations may be terminated or amended or modified in order to ensure compliance with the SEC s rules and regulations and to ensure that separate financial statements of such Subsidiary Guarantor need not be provided. It may not be possible to amend the limitations on the Guarantees in a manner that would meet the SEC s requirements for full and unconditional guarantees and be consistent with local law requirements for guarantees. For more information see Description of Debt Securities and Guarantees Guarantee .

If the Guarantees by the Subsidiary Guarantors are released, the Issuers and the Parent Guarantor are not required to replace them, and the debt securities will have the benefit of fewer or no Subsidiary guarantees for the remaining maturity of the debt securities.

***Since the debt securities are unsecured, your right to receive payments may be adversely affected.***

The debt securities that the Issuers are offering will be unsecured. The debt securities issued by an Issuer will not be subordinated to any of such Issuer s other debt obligations, and, therefore, they will rank equally with all its other unsecured and unsubordinated indebtedness. If an Issuer defaults on the debt securities or the Guarantors default on the Guarantees, or after bankruptcy, examinership, liquidation or reorganization, then, to the extent that such Issuer or the Guarantors have granted security over their assets, the assets that secure their debts will be used to satisfy the obligations under that secured debt before such Issuer or the Guarantors can make payment on the debt securities or the Guarantees. There may only be limited assets available to make payments on the debt securities or the Guarantees in the event of an acceleration of the debt securities. If there is not enough collateral to satisfy the obligations of the secured debt, then the remaining amounts on the secured debt would share equally with all unsubordinated unsecured indebtedness.

***Your rights as a holder may be inferior to the rights of holders of debt securities issued under a different series pursuant to each indenture.***

The debt securities are governed by indentures, which are described below under the heading Description of Debt Securities and Guarantees . The Issuers may issue as many distinct series of debt securities under each indenture (or other indentures entered into from time to time) as they wish. The Issuers may also issue series of

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notes under each indenture that provide holders of those notes with rights superior to the rights already granted or that may be granted in the future to holders of another series. You should read carefully the specific terms of any particular series of debt securities we may offer contained in the prospectus supplement relating to such debt securities.

***Should the Guarantors default on their Guarantees, your right to receive payments on the Guarantees may be adversely affected by the insolvency laws of the jurisdiction of organization of the defaulting Guarantors.***

The Parent Guarantor and Subsidiary Guarantors are organized under the laws of various jurisdictions, and it is likely that any insolvency proceedings applicable to a Guarantor would be governed by the law of its jurisdiction of organization. The insolvency laws of the various jurisdictions of organization of the Guarantors may vary as to treatment of unsecured creditors and may contain prohibitions on the Guarantors ability to pay any debts existing at the time of the insolvency.

***Since the Parent Guarantor and Cobrew NV are Belgian companies, Belgian insolvency laws may adversely affect a recovery by the holders of the debt securities of amounts payable under the debt securities.***

There are two types of insolvency procedures under Belgian law: (i) the judicial restructuring (réorganisation judiciaire/gerechtelijke reorganisatie) procedure and (ii) the bankruptcy (faillite/faillissement) procedure, each of which is described below.

A proceeding for a judicial restructuring may be commenced if the continuation of the debtor s business is, either immediately or in the future, at risk. The continuation of the debtor s business is, in any event, deemed to be at risk if, as a result of losses, the debtor s net assets have declined to less than 50 per cent. of its stated capital.

A request for a judicial restructuring is filed on the initiative of the debtor by a petition. The court can consider a preliminary suspension of payments during an initial period of six months, which can be extended by up to a maximum period of six months at the request of the company. In exceptional circumstances and in the interest of the creditors, there may be an additional extension of six months. In principle, during the initial suspension period, the debtor cannot be dissolved or declared bankrupt. However, the initial suspension period can be terminated if it becomes manifestly clear that the debtor will not be able to continue its business. Following early termination of the initial suspension period, the debtor can be dissolved or declared bankrupt. As a rule, creditors cannot enforce their rights against the debtor s assets during the period of preliminary suspension of payments, except in the following circumstances: (i) failure by the debtor to pay interest or charges falling due in the course of the preliminary suspension period, (ii) failure by the debtor to pay any new debts (e.g. debts which have arisen after the date of the preliminary suspension of payments), or (iii) enforcement by a creditor of security over receivables (other than cash) or financial instruments (or certain contractual set-off arrangements) pursuant to the Belgian Act of 15 December 2004 on financial collateral.

During the preliminary suspension period, the debtor must draw up a restructuring plan which must be approved by a majority of its creditors who were present at a meeting of creditors and whose aggregate claims represent over half of all outstanding claims of the debtor. The restructuring plan must have a maximum duration of five years. This plan will be approved by the court provided the plan does not violate the formalities required by the judicial restructuring legislation nor public policy. The plan will be binding on all creditors listed in the plan. Enforcement rights of creditors secured by certain types of in rem rights are not bound by the plan. Such creditors may, as a result, enforce their security from the beginning of the final suspension period. Under certain conditions, and subject to certain exceptions, enforcement by such creditors can be suspended for up to 24 months (as from the filing of the request for a judicial restructuring with the relevant court or, in respect of a proceeding for judicial restructuring opened on or after 1 May 2018, as from the date on which the court ratifies the restructuring plan). Under further conditions, this period of 24 months may be extended by a further 12 months.

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Any provision providing that an agreement would be terminated as the result of a debtor entering a judicial composition is ineffective, subject to the limited exceptions set forth in the Belgian Act of 15 December 2004 on financial collateral.

The above essentially describes the so called judicial restructuring by collective agreement of the creditors. The judicial restructuring legislation also provides for alternative judicial restructuring procedures, including (i) by amicable settlement between the debtor and two or more of its creditors and (ii) by court ordered transfer of part or all of the debtor s business.

A company which, on a sustained basis, has ceased to make payments and whose credit is impaired will be deemed to be in a state of bankruptcy. Within one month after the cessation of payments, the company must file for bankruptcy. If the company is late in filing for bankruptcy, its directors could be held liable for damages to creditors as a result thereof. Bankruptcy procedures may also be initiated on the request of unpaid creditors or on the initiative of the public prosecutor.

Once the court decides that the requirements for bankruptcy are met, the court will establish a date before which claims for all unpaid debts must be filed by creditors. A bankruptcy trustee will be appointed to assume the operation of the business and to organise a sale of the debtor s assets, the distribution of the proceeds thereof to creditors and the liquidation of the debtor.

Payments or other transactions (as listed below) made by a company during a certain period of time prior to that company being declared bankrupt (the suspect period ) (période suspecte/verdachte periode) can be voided for the benefit of the creditors. The court will determine the date of commencement and the duration of the suspect period. This period starts on the date of sustained cessation of payment of debts by the debtor. The court can only determine the date of sustained cessation of payment of debts if it has been requested to do so by a creditor proceeding for a bankruptcy judgment or if proceedings are initiated to that effect by the bankruptcy trustee or by any other interested party. This date cannot be earlier than six months before the date of the bankruptcy judgment, unless a decision to dissolve the company was made more than six months before the date of the bankruptcy judgment, in which case the date could be the date of such decision to dissolve the company. The ruling determining the date of commencement of the suspect period or the bankruptcy judgment itself can be opposed by third parties, such as other creditors, within 15 days following the publication of that ruling in the Belgian Official Gazette.

The transactions which can or must be voided under the bankruptcy rules for the benefit of the bankrupt estate include (i) any transaction entered into by a Belgian company during the suspect period if the value given to creditors significantly exceeded the value the company received in consideration, (ii) any transaction entered into by a company which has stopped making payments if the counter party to the transaction was aware of the suspension of payments, (iii) security interests granted during the suspect period if they intend to secure a debt which existed prior to the date on which the security interest was granted, (iv) any payments (in whatever form, i.e. money or in kind or by way of set off) made during the suspect period of any debt which was not yet due, as well as all payments made during the suspect period other than with money or monetary instruments (i.e. checks, promissory notes, etc.), and (v) any transaction or payment effected with fraudulent intent irrespective of its date.

Following a judgment commencing a bankruptcy proceeding, enforcement rights of individual creditors are suspended (subject to exceptions set forth in the Belgian Act of 15 December 2004 on financial collateral). Creditors secured by in rem rights which can be enforced on movable assets, such as share pledges, will regain their ability to enforce their rights under the security after the bankruptcy trustee has verified the creditors claims.

A new insolvency bill was adopted on 13 July 2017 which abolishes and replaces the existing laws governing the insolvency procedures described above, compiling all relevant provisions in a new Book XX of the Belgian Code of Economic Law (Wetboek van 28 februari 2013 van economisch recht/Code du 28 février 2013

de droit économique). The new insolvency rules included in Book XX will only apply to insolvency proceedings opened on or after 1 May 2018 and, in general terms, do not affect the principles described above.

The above applies to both the Parent Guarantor and to Cobrew NV.

***The debt securities lack a developed trading market, and such a market may never develop. The trading price for the debt securities may be adversely affected by credit market conditions.***

Unless specified in the applicable prospectus supplement, the Issuers do not intend to list the debt securities on any securities exchange. There can be no assurance that an active trading market will develop for the debt securities, nor any assurance regarding the ability of holders to sell their debt securities or the price at which such holders may be able to sell their debt securities, even if we were to list a particular issue of debt securities on a securities exchange. If a trading market were to develop, the debt securities could trade at prices that may be higher or lower than the initial offering price depending on many factors, including, among other things, prevailing interest rates, the relevant Issuer s or the Parent Guarantor s financial results, any decline in the relevant Issuer s or the Parent Guarantor s creditworthiness and the market for similar securities. The trading market for the debt securities will be affected by general credit market conditions, which in recent periods have been marked by significant volatility and price reductions, including for debt issued by investment-grade companies.

Any underwriters, broker-dealers or agents that participate in the distribution of the debt securities may make a market in the debt securities as permitted by applicable laws and regulations but will have no obligation to do so, and any such market-making activities may be discontinued at any time. Therefore, there can be no assurance as to the liquidity of any trading market for the debt securities or that an active public market for the debt securities will develop. See Plan of Distribution .

***As a foreign private issuer in the United States, we are exempt from a number of rules under the U.S. securities laws and are permitted to file less information with the SEC.***

As a foreign private issuer, we are exempt from certain rules under the U.S. Securities Exchange Act of 1934, as amended (the **Exchange Act** ), that impose certain disclosure obligations and procedural requirements for proxy solicitations under Section 14 of the Exchange Act. In addition, our officers, directors and principal shareholders are exempt from the reporting and short-swing profit recovery provisions under Section 16 of the Exchange Act. Moreover, we are not required to file periodic reports and financial statements with the SEC as frequently or as promptly as U.S. companies whose securities are registered under the Exchange Act. Accordingly, there may be less publicly available information concerning us than there is for U.S. public companies.

***If, in the future, either Issuer elects to convert to a Delaware limited liability company, such conversion may be treated by the U.S. Internal Revenue Service as a taxable exchange of the debt securities which could have adverse United States federal income tax consequences to U.S. persons who hold the debt securities.***

Each of the Issuers may, at its election in the future, convert from a Delaware corporation to a Delaware limited liability company, as described below in Description of Debt Securities and Guarantees Legal Status of the Issuers (such event, the **conversion** ). Such conversions could result in unfavorable United States federal income tax consequences for certain holders of the debt securities. We do not provide any indemnity to holders of debt securities in respect of this conversion, and, accordingly, would not provide any indemnity for such tax consequences. Please see Tax Considerations United States Taxation for more information.

**Risks Relating to Debt Securities Denominated or Payable in or Linked to a Non-U.S. Dollar Currency**

If you intend to invest in non-U.S. dollar debt securities e.g., debt securities whose principal and/or interest are payable in a currency other than U.S. dollars or that may be settled by delivery of or reference to a non-U.S. dollar currency or property denominated in or otherwise linked to a non-U.S. dollar currency you should consult your own financial and legal advisors as to the currency risks entailed by your investment.

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Securities of this kind may not be an appropriate investment for investors who are unsophisticated with respect to non-U.S. dollar currency transactions.

The information in this prospectus is directed primarily to investors who are U.S. residents. Investors who are not U.S. residents should consult their own financial and legal advisors about currency-related risks particular to their investment.

***An investment in non-U.S. dollar debt securities involves currency-related risks.***

An investment in non-U.S. dollar debt securities entails significant risks that are not associated with a similar investment in debt securities that are payable solely in U.S. dollars and where settlement value is not otherwise based on a non-U.S. dollar currency. These risks include the possibility of significant changes in rates of exchange between the U.S. dollar and the various non-U.S. dollar currencies or composite currencies and the possibility of the imposition or modification of foreign exchange controls or other conditions by either the United States or non-U.S. governments. These risks generally depend on factors over which we have no control, such as economic and political events and the supply of and demand for the relevant currencies in the global markets.

***Changes in currency exchange rates can be volatile and unpredictable***

Rates of exchange between the U.S. dollar and many other currencies have been highly volatile, and this volatility may continue and perhaps spread to other currencies in the future. Fluctuations in currency exchange rates could adversely affect an investment in debt securities denominated in, or whose value is otherwise linked to, a specified currency other than U.S. dollars. Depreciation of the specified currency against the U.S. dollar could result in a decrease in the U.S. dollar-equivalent value of payments on the debt securities, including the principal payable at maturity or settlement value payable upon exercise. That in turn could cause the market value of the debt securities to fall. Depreciation of the specified currency against the U.S. dollar could result in a loss to the investor on a U.S. dollar basis.

***Government policy can adversely affect currency exchange rates and an investment in non-U.S. dollar debt securities.***

Currency exchange rates can either float or be fixed by sovereign governments. From time to time, governments use a variety of techniques, such as intervention by a country s central bank or imposition of regulatory controls or taxes, to affect the exchange rate of their currencies. Governments may also issue a new currency to replace an existing currency or alter the exchange rate or exchange characteristics by devaluation or revaluation of a currency. Thus, a special risk in purchasing non-U.S. dollar debt securities is that their yields or payouts could be significantly and unpredictably affected by governmental actions. Even in the absence of governmental action directly affecting currency exchange rates, political or economic developments in the country issuing the specified currency for non-U.S. dollar debt securities or elsewhere could lead to significant and sudden changes in the exchange rate between the U.S. dollar and the specified currency. These changes could affect the value of the debt securities as participants in the global currency markets move to buy or sell the specified currency or U.S. dollars in reaction to these developments.

Governments have imposed from time to time and may in the future impose exchange controls or other conditions, including taxes, with respect to the exchange or transfer of a specified currency that could affect exchange rates as well as the availability of a specified currency for a debt security at its maturity or on any other payment date. In addition, the ability of a holder to move currency freely out of the country in which payment in the currency is received or to convert the currency at a freely determined market rate could be limited by governmental actions.

***Non-U.S. dollar debt securities may permit us to make payments in U.S. dollars or delay payment if we are unable to obtain the specified currency.***

Debt securities payable in a currency other than U.S. dollars may provide that, if the other currency is subject to convertibility, transferability, market disruption or other conditions affecting its availability at or about

the time when a payment on the debt securities comes due because of circumstances beyond our control, we will be entitled to make the payment in U.S. dollars or delay making the payment. These circumstances could include the imposition of exchange controls or our inability to obtain the other currency because of a disruption in the currency markets. If we made payment in U.S. dollars, the exchange rate we would use would be determined in the manner described under Description of Debt Securities and Guarantees . A determination of this kind may be based on limited information and would involve significant discretion on the part of our foreign exchange agent. As a result, the value of the payment in U.S. dollars an investor would receive on the payment date may be less than the value of the payment the investor would have received in the other currency if it had been available, or may be zero. In addition, a government may impose extraordinary taxes on transfers of a currency. If that happens, we will be entitled to deduct these taxes from any payment on debt securities payable in that currency.

***We will not adjust non-U.S. dollar debt securities to compensate for changes in currency exchange rates.***

Except as described above, we will not make any adjustment or change in the terms of non-U.S. dollar debt securities in the event of any change in exchange rates for the relevant currency, whether in the event of any devaluation, revaluation or imposition of exchange or other regulatory controls or taxes or in the event of other developments affecting that currency, the U.S. dollar or any other currency. Consequently, investors in non-U.S. dollar debt securities will bear the risk that their investment may be adversely affected by these types of events.

***In a lawsuit for payment on non-U.S. dollar debt securities, an investor may bear currency exchange risk.***

Our debt securities will be governed by New York law. Under Section 27 of the New York Judiciary Law, a state court in the State of New York rendering a judgment on a security denominated in a currency other than U.S. dollars would be required to render the judgment in the specified currency; however, the judgment would be converted into U.S. dollars at the exchange rate prevailing on the date of entry of the judgment. Consequently, in a lawsuit for payment on a debt security denominated in a currency other than U.S. dollars, investors would bear currency exchange risk until judgment is entered, which could be a long time.

In courts outside New York, investors may not be able to obtain judgment in a specified currency other than U.S. dollars. For example, a judgment for money in an action based on a non-U.S. dollar debt security in many other U.S. federal or state courts ordinarily would be enforced in the United States only in U.S. dollars. The date used to determine the rate of conversion of the currency in which any particular security is denominated into U.S. dollars will depend upon various factors, including which court renders the judgment.

***Information about exchange rates may not be indicative of future exchange rates.***

If we issue non-U.S. dollar securities, we may include in the applicable prospectus supplement a currency supplement that provides information about historical exchange rates for the relevant non-U.S. dollar currency or currencies. Any information about exchange rates that we may provide will be furnished as a matter of information only, and you should not regard the information as indicative of the range of, or trends in, fluctuations in currency exchange rates that may occur in the future. That rate will likely differ from the exchange rate used under the terms that apply to a particular security.

***Determinations made by the exchange rate agent.***

All determinations made by the exchange rate agent will be made in its sole discretion (except to the extent expressly provided in this prospectus or in the applicable prospectus supplement that any determination is subject to approval by us). In the absence of manifest error, its determinations will be conclusive for all purposes and will bind all holders and us. The exchange rate agent will not have any liability for its determinations.

**Additional risks, if any, specific to particular debt securities issued under this prospectus will be detailed in the applicable prospectus supplements.**

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## FORWARD-LOOKING STATEMENTS

There are statements in this document, such as statements that include the words or phrases *will likely result* , *are expected to* , *will continue* , *is anticipated* , *anticipate* , *estimate* , *project* , *may* , *might* , *could* , *believe* , *expect* , *plan* , *potential* , *we aim* , *our goal* , *our v* *intend* or similar expressions that are forward-looking statements. These statements are subject to certain risks and uncertainties. Actual results may differ materially from those suggested by these statements due to, among others, the risks or uncertainties listed below. See also Item 3. Key Information D. Risk Factors of our 2017 Annual Report for further discussion of risks and uncertainties that could impact our business.

These forward-looking statements are not guarantees of future performance. Rather, they are based on current views and assumptions and involve known and unknown risks, uncertainties and other factors, many of which are outside our control and are difficult to predict, that may cause actual results or developments to differ materially from any future results or developments expressed or implied by the forward-looking statements. Factors that could cause actual results to differ materially from those contemplated by the forward-looking statements include, among others:

- local, regional, national and international economic conditions, including the risks of a global recession or a recession in one or more of our key markets, and the impact they may have on us and our customers and our assessment of that impact;

- financial risks, such as interest rate risk, foreign exchange rate risk (in particular as against the U.S. dollar, our reporting currency), commodity risk, asset price risk, equity market risk, counterparty risk, sovereign risk, liquidity risk, inflation or deflation;

- continued geopolitical instability, which may result in, among other things, economic and political sanctions and currency exchange rate volatility, and which may have a substantial impact on the economies of one or more of our key markets;

- changes in government policies and currency controls;

- continued availability of financing and our ability to achieve our targeted coverage and debt levels and terms, including the risk of constraints on financing in the event of a credit rating downgrade;

- the monetary and interest rate policies of central banks, in particular the European Central Bank, the Board of Governors of the U.S. Federal Reserve System, the Bank of England, *Banco Central do Brasil*, *Banco Central de la República Argentina*, the Central Bank of China, the South African Reserve Bank, *Banco de la República* in Colombia and other central banks;

- changes in applicable laws, regulations and taxes in jurisdictions in which we operate, including the laws and regulations governing our operations and changes to tax benefit programs, as well as actions or decisions of courts and regulators;

- limitations on our ability to contain costs and expenses;

- our expectations with respect to expansion plans, premium growth, accretion to reported earnings, working capital improvements and investment income or cash flow projections;

- our ability to continue to introduce competitive new products and services on a timely, cost-effective basis;

the effects of competition and consolidation in the markets in which we operate, which may be influenced by regulation, deregulation or enforcement policies;

changes in consumer spending;

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- changes in pricing environments;
- volatility in the prices of raw materials, commodities and energy;
- difficulties in maintaining relationships with employees;
- regional or general changes in asset valuations;
- greater than expected costs (including taxes) and expenses;
- the risk of unexpected consequences resulting from acquisitions, joint ventures, strategic alliances, corporate reorganizations or divestiture plans, and our ability to successfully and cost-effectively implement these transactions and integrate the operations of businesses or other assets we have acquired;
- an inability to realize synergies from the combination with SAB;
- the outcome of pending and future litigation, investigations and governmental proceedings;
- natural and other disasters;
- any inability to economically hedge certain risks;
- inadequate impairment provisions and loss reserves;
- technological changes and threats to cybersecurity;
- other statements included in this annual report that are not historical; and
- our success in managing the risks involved in the foregoing.

Our statements regarding financial risks, including interest rate risk, foreign exchange rate risk, commodity risk, asset price risk, equity market risk, counterparty risk, sovereign risk, inflation and deflation, are subject to uncertainty. For example, certain market and financial risk disclosures are dependent on choices about key model characteristics and assumptions and are subject to various limitations. By their nature, certain of the market or financial risk disclosures are only estimates and, as a result, actual future gains and losses could differ materially from those that have been estimated.

We caution that the forward-looking statements in this document are further qualified by the risk factors disclosed in Item 3. Key Information D. Risk Factors in our 2017 Annual Report that could cause actual results to differ materially from those in the forward-looking statements. Subject to our obligations under Belgian and U.S. law in relation to disclosure and ongoing information, we undertake no obligation to update publicly or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

**INCORPORATION OF CERTAIN DOCUMENTS BY REFERENCE**

The SEC allows us to incorporate by reference the information we file with them, which means we can disclose important information to you by referring you to those documents. The most recent information that we file with the SEC automatically updates and supersedes earlier information.

We have filed with the SEC a registration statement on Form F-3 relating to the securities covered by this prospectus. This prospectus is a part of the registration statement and does not contain all the information in the registration statement. Whenever a reference is made in this prospectus to a contract or other document of the company, the reference is only a summary and you should refer to the exhibits that are a part of the registration statement for a copy of the contract or other document. You may review a copy of the registration statement at the SEC s public reference room in Washington, D.C., as well as through the SEC s internet site, as discussed below.

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The following documents filed with the Commission are incorporated in this registration statement by reference and made a part hereof:

1. Annual Report on Form 20-F for the year ended 31 December 2017 filed with the Commission on 19 March 2018 ( Annual Report ); and

2. the Form F-4 (File No. 333-213328) filed with the Commission on 26 August 2016 solely with respect to the audited consolidated financial statements of ABI SAB Group Holding Limited as of 31 March 2016 and 2015 and for the years ended 31 March 2016, 2015 and 2014, appearing on pages F-1 to F-78 of the Form F-4.

In addition, we will incorporate by reference into this prospectus all documents that we file with the SEC under Section 13(a), 13(c), 14 or 15(d) of the Exchange Act and, to the extent, if any, we designate therein, reports on Form 6-K we furnish to the SEC after the date of this prospectus and prior to the termination of any offering contemplated in this prospectus.

We will provide to you, upon your written or oral request, without charge, a copy of any or all of the documents referred to above which we have incorporated in this prospectus by reference. You should direct your requests to Anheuser-Busch InBev SA/NV, Brouwerijplein 1, 3000 Leuven, Belgium (telephone: +32 (0)1 627 6111).

**ANHEUSER-BUSCH INBEV SA/NV**

We are the world s largest brewer by volume and one of the world s top five consumer products companies by revenue. As a consumer-focused, insights-driven company, we produce, market, distribute and sell a diversified portfolio of well over 500 beer and other malt beverage brands. These include brands with significant international distribution, such as Budweiser, Corona (except in the United States), Stella Artois, Beck s, Leffe, Hoegaarden, Castle Lager (except in the United States), Castle Lite (except in the United States), and Redd s (except in the United States); and brands primarily distributed to local markets such as Bud Light and Michelob Ultra in the United States; Corona Light, Modelo Especial, Negra Modelo, Victoria and Pacifico in Mexico; Skol, Brahma and Antarctica in Brazil; Aguila and Poker in Colombia; Cristal and Pilsen Callao in Peru; Quilmes in Argentina; Jupiler in Belgium and the Netherlands; Franziskaner in Germany; Carling Black Label and Hansa Pilsener in South Africa; Hero in Nigeria; Safari and Kilimanjaro in Tanzania; Harbin and Sedrin in China; Cass in South Korea; and Victoria Bitter and Carlton Draught in Australia. We also produce and distribute soft drinks, particularly in Central and South America and Africa, and other near beer products, such as Lime-A-Rita and other Rita family products in the United States and Mexico; MixxTail in Argentina and other countries; and Skol Beats in Brazil. Our 2017 volumes (beer and non-beer) were 613 million hectoliters and our revenue amounted to USD 56.4 billion.

AB InBev is a publicly traded company, listed on Euronext Brussels, with secondary listings on the Bolsa Mexicana de Valores and the Johannesburg Stock Exchange. AB InBev American Depositary Shares representing rights to receive AB InBev ordinary shares are listed and trade on the New York Stock Exchange ( **NYSE** ) under the symbol BUD.

AB InBev was incorporated on 3 March 2016 for an unlimited duration under the laws of Belgium under the original name Newbelco SA/NV, and is the successor entity to Anheuser-Busch InBev SA/NV, which was incorporated on 2 August 1977 for an unlimited duration under the laws of Belgium under the original name BEMES. It has the legal form of a public limited liability company (*société anonyme/naamloze vennootschap*). Its registered office is located at Grand Place/Grote Markt 1, 1000 Brussels, Belgium, and it is registered with the Register of Legal Entities of Brussels under the number 0417.497.106. The AB InBev Group s global headquarters are located at Brouwerijplein 1, 3000 Leuven, Belgium (tel.: +32 16 27 61 11).

## ANHEUSER-BUSCH INBEV FINANCE INC.

Anheuser-Busch InBev Finance Inc. was incorporated on 17 December 2012 as a Delaware corporation. Anheuser-Busch InBev Finance Inc. complies with the laws and regulations of the State of Delaware regarding corporate governance. Anheuser-Busch InBev Finance Inc. s registered office is located at Corporation Trust Center, 1209 Orange Street, Wilmington, New Castle County, Delaware 19801, United States.

## ANHEUSER-BUSCH INBEV WORLDWIDE INC.

Anheuser-Busch InBev Worldwide Inc., was incorporated on 9 July 2008 under the name of InBev Worldwide S.à r.l as a private limited liability company (*société à responsabilité limitée*) under the Luxembourg act dated 10 August 1915 on commercial companies, as amended. On 19 November 2008, InBev Worldwide S.à r.l. was domesticated as a corporation in the State of Delaware in accordance with Section 388 of the Delaware General Corporation Law and, in connection with such domestication, changed its name to Anheuser-Busch InBev Worldwide Inc. Anheuser-Busch InBev Worldwide Inc. complies with the laws and regulations of the State of Delaware regarding corporate governance. Anheuser-Busch InBev Worldwide Inc. s registered office is located at 1209 Orange Street, Wilmington, Delaware 19801.

## THE GUARANTORS

Anheuser-Busch InBev SA/NV will guarantee the debt securities, on an unconditional, full and irrevocable basis. In addition, one or more of Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, Anheuser-Busch Companies, LLC, Anheuser-Busch InBev Worldwide Inc. and Anheuser-Busch InBev Finance Inc., which are direct or indirect subsidiaries of Anheuser-Busch InBev SA/NV, may, as specified in the applicable prospectus supplement, jointly and severally guarantee the debt securities of a particular series, on an unconditional, full and irrevocable basis, subject to certain limitations described in Description of Debt Securities and Guarantees . In addition, the Parent Company and such subsidiaries are obligors under our senior debt facilities agreements and certain other indebtedness of the AB InBev Group, as described in the Annual Report under the heading Item 5. Operating and Financial Review G. Liquidity and Capital Resources .

## USE OF PROCEEDS

Unless otherwise indicated in an accompanying prospectus supplement, we intend to use the net proceeds from any sales by us of the securities offered under this prospectus and an accompanying prospectus supplement to provide additional funds for general corporate purposes. We may set forth additional information on the use of net proceeds from the sale of securities we offer under this prospectus or in the prospectus supplemental relating to a specific offering.

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**RATIOS OF EARNINGS TO FIXED CHARGES**

The following table sets out our ratios of earnings to fixed charges for each of the five years ended 31 December 2017, 2016, 2015, 2014 and 2013 based on information derived from our consolidated financial statements, which are prepared in accordance with International Financial Reporting Standards ( **IFRS** ).

| | Year ended 31 December | | | | |
|---|---|---|---|---|---|
| | **2017** | **2016** | **2015** | **2014** | **2013** |
| Earnings: | | | | | |
| Profit from operations before taxes and share of results of associates | 10,646 | 4,318 | 12,451 | 13,792 | 18,240 |
| Add: Fixed charges (below) | 4,957 | 4,608 | 2,200 | 2,366 | 2,389 |
| Less: Interest capitalized (below) | 22 | 12 | 28 | 39 | 38 |
| Total earnings | 15 581 | **8,914** | **14,623** | **16,119** | **20,591** |
| Fixed charges: | | | | | |
| Interest expense and similar charges | 4,292 | 4,080 | 1,805 | 1,969 | 2,005 |
| Accretion expense | 541 | 468 | 289 | 266 | 261 |
| Interest capitalized | 22 | 12 | 28 | 39 | 38 |
| Estimated interest portion of rental expense | 102 | 48 | 78 | 92 | 85 |
| Total fixed charges | 4,957 | **4,608** | **2,200** | **2,366** | **2,389** |
| Ratio of earnings to fixed charges | **3.14** | **1.93** | **6.65** | **6.81** | **8.62** |

The ratio of earnings to fixed charges represents the number of times fixed charges are covered by earnings. For purposes of computing this ratio, earnings consist of profit from operations before taxes and share of results of associates and joint ventures, plus fixed charges, minus interest capitalized during the period. Fixed charges consist of interest and accretion expense, interest on finance lease obligations, interest capitalized, plus one-third of rent expense on operating leases, estimated by us as representative of the interest factor attributable to such rent expense.

We did not have any preferred stock outstanding and did not pay or accrue any preferred stock dividends during the periods presented above.

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## CAPITALIZATION AND INDEBTEDNESS

The following table shows our cash and cash equivalents and capitalization as of 31 December 2017 and on an as adjusted basis to give effect to (i) the issuance on 23 January 2018 by Anheuser Busch SA/NV of EUR 4,250 million aggregate principal amount of bonds (the January 2018 Issuance ), (ii) the early repayment in March 2018 of bonds maturing in January 2019 in the aggregate principal amount of $2,500 million, (iii) $5,800 million in non-current unsecured bond issuances becoming current interest-bearing liabilities and (iv) the net repayment of $131 million of commercial paper. This information reflects only the adjustments detailed in the foregoing sentence and should be read in conjunction with the consolidated financial statements and the accompanying notes of AB InBev incorporated by reference into this prospectus and the unaudited pro forma condensed combined financial information included in this prospectus.

| | **As of 31 December 2017** *(USD million, unaudited)* | **As adjusted** *(USD million, unaudited)* |
|---|---|---|
| Cash and cash equivalents, less bank overdrafts(1)(2)(4) | 10 355 | 12,930 |
| **Current interest-bearing liabilities** | | |
| Secured bank loans | 272 | 272 |
| Commercial papers(4) | 1,870 | 1,739 |
| Unsecured bank loans | 739 | 739 |
| Unsecured bond issues(3) | 4,510 | 10,310 |
| Unsecured other loans | 15 | 15 |
| Finance lease liabilities | 27 | 27 |
| **Non-current interest-bearing liabilities** | | |
| Secured bank loans | 230 | 230 |
| Unsecured bank loans | 153 | 153 |
| Unsecured bond issues(1)(2)(3) | 108,327 | 105,233 |
| Unsecured other loans | 53 | 53 |
| Finance lease liabilities | 186 | 186 |
| **Total interest-bearing liabilities** | **116,382** | **118,957** |
| Equity attributable to our equity holders | 72,585 | 72,585 |
| Non-controlling interests | 7,635 | 7,635 |
| **Total Capitalization:** | **196,602** | **199,177** |

Notes:

(1) After 31 December 2017, we used the net proceeds from January 2018 Issuance of $5,206 million for general corporate purposes. This resulted in an increase to our non-current unsecured bonds issues and our cash and cash equivalents, less bank overdrafts, of $5,206 million.

(2) After 31 December 2017, $2,500 million of non-current unsecured bond issues became current interest-bearing liabilities, resulting in our current unsecured bond issues increasing by $2,500 million and our non-current unsecured bond issues decreasing by $2,500 million. Subsequently, we early repaid in March 2018 bonds maturing in 2019. Such repayments decreased our current unsecured bond issues and our cash and cash equivalents, less bank overdrafts, by $2,500 million.

(3) After 31 December 2017, $5,800 million of our non-current unsecured bond issues became current interest-bearing liabilities, resulting in our current unsecured bond issues increasing by $5,800 million and our non-current unsecured bond issues decreasing by $5,800 million.

(4) After 31 December 2017, as a result of repayments/issuances, our commercial paper was decreased by a net amount of $131 million and our cash and cash equivalents, less bank overdrafts, decreased by $131 million, partially offset by issuances.

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## LEGAL OWNERSHIP

*Street Name and Other Indirect Holders.* Investors who hold debt securities in accounts at banks or brokers will generally not be recognized by us as legal holders of debt securities. This is called holding in street name .

Instead, we would recognize only the bank or broker, or the financial institution the bank or broker uses to hold its debt securities. These intermediary banks, brokers and other financial institutions pass along principal, interest and other payments on the debt securities, either because they agree to do so in their customer agreements or because they are legally required to do so. An investor who holds debt securities in street name should check with the investor s own intermediary institution to find out:

- how it handles debt securities payments and notices;
- whether it imposes fees or charges;
- how it would handle voting if it were ever required;
- whether and how the investor can instruct it to send the investor s debt securities registered in the investor s own name so the investor can be a direct holder as described below; and
- how it would pursue rights under the debt securities if there were a default or other event triggering the need for holders to act to protect their interests.

*Direct Holders.* Our obligations, as well as the obligations of the trustee and those of any third parties employed by us or the trustee, run only to persons who are registered as holders of debt securities. As noted above, we do not have obligations to an investor who holds in street name or other indirect means, either because the investor chooses to hold debt securities in that manner or because the debt securities are issued in the form of global securities as described below. For example, once we make payment to the registered holder, we have no further responsibility for the payment even if that holder is legally required to pass the payment along to the investor as a street name customer but does not do so.

*Global Securities.* A global security is a special type of indirectly held security, as described above under Street Name and Other Indirect Holders . If we issue debt securities in the form of global securities, the ultimate beneficial owners can only be indirect holders.

We require that the global security be registered in the name of a financial institution we select. In addition, we require that the debt securities included in the global security not be transferred to the name of any other direct holder unless the special circumstances described in the section Global Securities occur. The financial institution that acts as the sole direct holder of the global security is called the depositary. Any person wishing to own a security must do so indirectly by virtue of an account with a broker, bank or other financial institution that in turn has an account with the depositary. Unless the applicable prospectus supplement indicates otherwise, each series of debt securities will be issued only in the form of global securities.

### *Global Securities*

*Special Investor Considerations for Global Securities*

As an indirect holder, an investor s rights relating to a global security will be governed by the account rules of the investor s financial institution and of the depositary, as well as general laws relating to securities transfers. We do not recognize this type of investor as a holder of securities and instead deal only with the depositary that holds the global security.

Investors in securities that are issued only in the form of global securities should be aware that:

they cannot get securities registered in their own name;

they cannot receive physical certificates for their interests in securities;

they will be a street name holder and must look to their own bank or broker for payments on the securities and protection of their legal rights relating to the securities, as explained earlier under Street Name and Other Indirect Holders ;

they may not be able to sell interests in the securities to some insurance companies and other institutions that are required by law to own their securities in the form of physical certificates;

the depositary s policies will govern payments, transfers, exchange and other matters relating to their interest in the global security. We and the trustee have no responsibility for any aspect of the depositary s actions or for its records of ownership interests in the global security. We and the trustee also do not supervise the depositary in any way; and

the depositary will require that interests in a global security be purchased or sold within its system using same-day funds. By contrast, payment for purchases and sales in the market for corporate bonds and other securities is generally made in next-day funds. The difference could have some effect on how interests in global securities trade, but we do not know what that effect will be.

*Special Situations When a Global Security Will Be Terminated*

In a few special situations described below, the global security will terminate and interests in it will be exchanged for physical certificates representing securities. After that exchange, the choice of whether to hold the securities directly or in street name will be up to the investor. Investors must consult their own bank or brokers to find out how to have their interests in a global security transferred to their own name so that they will be direct holders. The rights of street name investors and direct holders in the securities have been previously described in the sections entitled Legal Ownership Street Name and Other Indirect Holders; Direct Holders .

The special situations for termination of a global security are:

when the depositary notifies us that it is unwilling, unable or no longer qualified to continue as depositary; and

when an Event of Default has occurred and has not been cured. Defaults are discussed below under Description of Debt Securities and Guarantees Events of Default .

The prospectus supplement may also list additional situations for terminating a global security that would apply only to the particular series of securities covered by the prospectus supplement. When a global security terminates, the depositary (and not us or the trustee) is responsible for deciding the names of the institutions that will be the initial direct holders.

***In the remainder of this description, holders means direct holders and not street name or other indirect holders of debt securities. Indirect holders should read the sub-section entitled Street Name and Other Indirect Holders .***

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## DESCRIPTION OF DEBT SECURITIES AND GUARANTEES

*The following is a summary of the general terms of the debt securities. It sets forth possible terms and provisions for each series of debt securities. Each time that we offer debt securities, we will prepare and file a prospectus supplement with the SEC, which you should read carefully. The prospectus supplement may contain additional terms and provisions of those securities. If there is any inconsistency between the terms and provisions presented here and those in the prospectus supplement, those in the prospectus supplement will apply and will replace those presented here.*

*Because this section is a summary, it does not describe every aspect of the debt securities in detail. As required by U.S. federal law for all bonds and notes of companies that are publicly offered, the debt securities are governed by documents called indentures. The form of indenture relating to securities to be issued by Anheuser-Busch InBev Finance Inc. (the* ***ABIFI Indenture*** *) is a form of contract between Anheuser-Busch InBev Finance Inc., as Issuer, Anheuser-Busch InBev SA/NV, as the Parent Guarantor, Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, Anheuser-Busch InBev Worldwide Inc., as Subsidiary Guarantors, and The Bank of New York Mellon Trust Company, N.A., as Trustee. The form of indenture relating to securities to be issued by Anheuser-Busch InBev Worldwide Inc. (the* ***ABIWW Indenture*** *) is a form of contract between Anheuser-Busch InBev Worldwide Inc., as Issuer, Anheuser-Busch InBev SA/NV, as the Parent Guarantor, Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV, Anheuser-Busch InBev Finance Inc., as Subsidiary Guarantors, and The Bank of New York Mellon Trust Company, N.A., as Trustee. This summary is subject to, and qualified by reference to, all of the definitions and provisions of each indenture, any supplement to an indenture and each series of debt securities. We may issue as many distinct series of debt securities under each indenture as we wish. We may also from time to time without the consent of the holders of the debt securities create and issue further debt securities having the same terms and conditions as debt securities of an already issued series so that the further issue is consolidated and forms a single series with that series. Certain terms, unless otherwise defined here, have the meaning given to them in the relevant indenture.*

### General

Anheuser-Busch InBev SA/NV will, and Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV and Anheuser-Busch InBev Worldwide Inc. may, act as guarantors of the debt securities issued under the ABIFI Indenture. Anheuser-Busch InBev SA/NV will, and Anheuser-Busch Companies, LLC, Brandbev S.à r.l., Brandbrew S.A., Cobrew NV and Anheuser-Busch InBev Finance Inc. may, act as guarantors of the debt securities issued under the ABIWW Indenture.

The guarantors of each series of debt securities will be specified in the applicable prospectus supplement and pricing agreement relating to the series. The guarantee is described under Guarantee below. Each indenture and its associated documents contain the full legal text of the matters described in this section. The indentures, the debt securities and the guarantees are governed by New York law. Copies of the indentures are filed with the SEC as an exhibit to our registration statement. See Incorporation of Certain Documents by Reference and Where You Can Find More Information for information on how to obtain a copy.

Neither indenture limits the amount of debt securities that we may issue. We may issue the debt securities in one or more series. We may issue the debt securities as original issue discount securities, which are debt securities that are offered and sold at a substantial discount to their stated principal amount. The debt securities may also be issued as indexed securities or securities denominated in foreign currencies or currency units, as described in more detail in the prospectus supplement relating to any such debt securities.

In addition, the specific financial, legal and other terms particular to a series of debt securities are described in the prospectus supplement and the pricing agreement relating to the series. Those terms may vary from the terms described here. Accordingly, this summary also is subject to and qualified by reference to the description of the terms of the series described in the prospectus supplement.

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The prospectus supplement will indicate for each series of debt securities:

- the issuer of the debt securities;
- the title of the debt securities;
- any guarantors of the debt securities (in addition to Anheuser-Busch InBev SA/NV);
- any limit on the aggregate principal amount of the series of debt securities;
- the person to whom any interest on a debt security of the series will be payable if other than the person in whose name the security is registered;
- the date or dates on which we will pay the principal of the series of debt securities;
- the rate or rates at which any debt securities of the series will bear interest, the date or dates from which any such interest will accrue, the interest payment dates on which such interest will be payable, and the regular record date for any such interest payable;
- the place or places where the principal of and any premium and interest on any debt securities of the series will be payable;
- the period or periods within which, the price or prices at which and the terms and conditions upon which any of the debt securities of the series may be redeemed, in whole or in part, at the option of the relevant issuer;
- any mandatory or optional sinking funds or analogous provisions or provisions for redemption at the option of the holder;
- the denominations in which the series of debt securities will be issuable if in other than denominations of $1,000;
- the manner in which the amount of principal of or any premium or interest on any debt securities will be determined if the such amount may be determined with reference to an index or other formula;
- the currency of payment of principal, premium, if any, and interest on the series of debt securities if other than the currency of the United States of America and the manner of determining the equivalent amount in the currency of the United States of America;
- if any payment on the debt securities of that series will be made, at our option or your option, in any currency other than in the currency in which the debt securities state that they will be payable, the terms and conditions regarding how that election shall be made;

if less than the entire principal amount is payable upon a declaration of acceleration of the maturity, that portion of the principal which is payable;

if the principal amount payable at the Stated Maturity of any debt securities is not determinable prior to such date, the amount which will be deemed to be the principal amount of such debt securities as of any such date;

the applicability of the provisions described below under Discharge and Defeasance ;

if the series of debt securities will be issuable in whole or part in the form of a global security as described later under Legal Ownership Global Securities , the form of any legends to be borne by such global security, the depositary or its nominee with respect to the series of debt securities, and any special circumstances under which the global security may be registered for transfer or exchange in the name of a person other than the depositary or its nominee;

any additions to or changes in the covenants and the events of default described later under Events of Default ; and

any other terms of the series of debt securities that are not inconsistent with the provisions of the relevant indenture.

Holders of debt securities have no voting rights except as explained below under Modifications and Amendment and Events of Default .

**Principal Amount, Stated Maturity and Maturity**

The principal amount of a series of debt securities means the principal amount payable at its stated maturity, unless that amount is not determinable, in which case the principal amount of a debt security is its face amount. Any debt securities owned by us or any of our affiliates are not deemed to be outstanding.

The term stated maturity with respect to any debt security means the day on which the principal amount of your debt securities is scheduled to become due. The principal may become due sooner, by reason of redemption or acceleration after a default or otherwise in accordance with the terms of your debt securities. The day on which the principal actually becomes due, whether at the stated maturity or earlier, is called the maturity of the principal.

We also use the terms stated maturity and maturity to refer to the days when other payments become due. For example, we may refer to a regular interest payment date when an installment of interest is scheduled to become due as the stated maturity of that installment. When we refer to the stated maturity or the maturity of a debt security without specifying a particular payment, we mean the stated maturity or maturity, as the case may be, of the principal.

**Currency of Debt Securities**

Amounts that become due and payable on your debt securities in cash will be payable in a currency, composite currency, basket of currencies or currency unit or units specified in the applicable prospectus supplement. We refer to this currency, composite currency, basket of currencies or currency unit or units as a specified currency . The specified currency for your debt securities will be U.S. dollars, unless the applicable prospectus supplement states otherwise. Some debt securities may have different specified currencies for principal and interest. You will have to pay for your debt securities by delivering the requisite amount of the specified currency for the principal to the trustee, unless other arrangements have been made between you and us. We will make payments on your debt securities in the specified currency, except as described below in Additional Mechanics Payment and Paying Agents . See Risk Factors Risks Relating to Debt Securities Denominated or Payable in or Linked to a Non-U.S. Dollar Currency above for more information about risks of investing in debt securities of this kind.

**Form of Debt Securities**

We will issue debt securities in global i.e., book-entry form only, unless we specify otherwise in the applicable prospectus supplement. Debt securities in book-entry form will be represented by a global security registered in the name of a depositary, which will be the holder of all the debt securities represented by the global security. Those who own beneficial interests in a global debt security will do so through participants in the depositary s securities clearance system, and the rights of these indirect owners will be governed solely by the applicable procedures of the depositary and its participants. We describe book-entry securities above under Legal Ownership .

In addition, we will generally issue each debt security in registered form, without coupons, unless we specify otherwise in the applicable prospectus supplement.

**Type of Security**

We may issue any of the three types of debt securities described below. A debt security may have elements of each of the three types of debt securities described below. For example, a debt security may bear interest at a fixed rate for some periods and at a variable rate in others. Similarly, a debt security may provide for a payment of principal at maturity linked to an index and also bear interest at a fixed or variable rate.

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**Fixed Rate Debt Securities**

A series of debt securities of this type will bear interest at a fixed rate described in the applicable prospectus supplement. This type includes zero coupon debt securities, which bear no interest and are instead issued at a price lower than the principal amount. The prospectus supplement relating to original issue discount securities will describe special considerations applicable to them.

Each series of fixed rate debt securities, except any zero coupon debt securities, will bear interest from their original issue date or from the most recent date to which interest on the debt securities have been paid or made available for payment. Interest will accrue on the principal of a series of fixed rate debt securities at the fixed yearly rate stated in the applicable prospectus supplement, until the principal is paid or made available for payment or the debt securities are converted or exchanged. Each payment of interest due on an interest payment date or the date of maturity will include interest accrued from and including the last date to which interest has been paid, or made available for payment, or from the issue date if none has been paid or made available for payment, to but excluding the interest payment date or the date of maturity. We will compute interest on a series of fixed rate debt securities on the basis of a 360-day year of twelve 30-day months, unless the applicable prospectus supplement provides that we will compute interest on a different basis. We will pay interest on each interest payment date and at maturity as described below under Additional Mechanics Payment and Paying Agents .

**Variable Rate Debt Securities**

A series of debt securities of this type will bear interest at rates that are determined by reference to an interest rate formula. In some cases, the rates may also be adjusted by adding or subtracting a spread or multiplying by a spread multiplier and may be subject to a minimum rate or a maximum rate. If your debt securities are variable rate debt securities, the formula and any adjustments that apply to the interest rate will be specified in the applicable prospectus supplement.

Each series of variable rate debt securities will bear interest from its original issue date or from the most recent date to which interest on the debt security has been paid or made available for payment. Interest will accrue on the principal of a series of variable rate debt securities at the yearly rate determined according to the interest rate formula stated in the applicable prospectus supplement, until the principal is paid or made available for payment. We will pay interest on each interest payment date and at maturity as described below under Additional Mechanics Payment and Paying Agents .

*Calculation of Interest*. Calculations relating to a series of variable rate debt securities will be made by the calculation agent, an institution that we appoint as our agent for this purpose. The prospectus supplement for a particular series of variable rate debt securities will name the institution that we have appointed to act as the calculation agent for that particular series as of its original issue date. We may appoint a different institution to serve as calculation agent from time to time after the original issue date of the debt security without your consent and without notifying you of the change. Absent manifest error, all determinations of the calculation agent will be final and binding on you and us, without any liability on the part of the calculation agent.

For a series of variable rate debt securities, the calculation agent will determine, on the corresponding interest calculation or determination date, as described in the applicable prospectus supplement, the interest rate that takes effect on each interest reset date. In addition, the calculation agent will calculate the amount of interest that has accrued during each interest period i.e., the period from and including the original issue date, or the last date to which interest has been paid or made available for payment, to but excluding the payment date. For each interest period, the calculation agent will calculate the amount of accrued interest by multiplying the face or other specified amount of the variable rate debt security by an accrued interest factor for the interest period. This factor will equal the sum of the interest factors calculated for each day during the interest period. The interest factor for each day will be expressed as a decimal and will be calculated by dividing the interest rate, also expressed as a decimal, applicable to that day by 360 or by the actual number of days in the year, as specified in the applicable prospectus supplement.

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Upon the request of the holder of any variable rate debt security, the calculation agent will provide for that debt security the interest rate then in effect and, if determined, the interest rate that will become effective on the next interest reset date. The calculation agent s determination of any interest rate, and its calculation of the amount of interest for any interest period, will be final and binding in the absence of manifest error.

All percentages resulting from any calculation relating to a series of variable rate debt securities will be rounded upward or downward, as appropriate, to the next higher or lower one hundred-thousandth of a percentage point, e.g., 9.876541 percent (or .09876541) being rounded down to 9.87654 percent (or .0987654) and 9.876545 percent (or .09876545) being rounded up to 9.87655 percent (or .0987655). All amounts used in or resulting from any calculation relating to a series of variable rate debt securities will be rounded upward or downward, as appropriate, to the nearest cent, in the case of U.S. dollars, or to the nearest corresponding hundredth of a unit, in the case of a currency other than U.S. dollars, with one-half cent or one-half of a corresponding hundredth of a unit or more being rounded upward.

In determining the base rate that applies to a particular series of variable rate debt securities during a particular interest period, the calculation agent may obtain rate quotes from various banks or dealers active in the relevant market, as described in the applicable prospectus supplement. Those reference banks and dealers may include the calculation agent itself and its affiliates, as well as any underwriter, dealer or agent participating in the distribution of the relevant variable rate debt securities and its affiliates.

**Indexed Debt Securities**

A series of debt securities of this type provides that the principal amount payable at its maturity, and/or the amount of interest payable on an interest payment date, will be determined by reference to:

- securities of one or more issuers;
- one or more currencies;
- one or more commodities;
- any other financial, economic or other measure or instrument, including the occurrence or non-occurrence of any event or circumstance; and/or
- one or more indices or baskets of the items described above.

If you are a holder of indexed debt securities, you may receive an amount at maturity (including upon acceleration following an event of default) that is greater than or less than the face amount of your debt securities depending upon the formula used to determine the amount payable and the value of the applicable index at maturity. The value of the applicable index will fluctuate over time.

A series of indexed debt securities may provide either for cash settlement or for physical settlement by delivery of the underlying property or another property of the type listed above. A series of indexed debt securities may also provide that the form of settlement may be determined at our option or at the holder s option.

If you purchase an indexed debt security, the applicable prospectus supplement will include information about the relevant index, about how amounts that are to become payable will be determined by reference to the price or value of that index and about the terms on which the security may be settled physically or in cash. The prospectus supplement will also identify the calculation agent that will calculate the amounts payable with respect to the indexed debt security and may exercise significant discretion in doing so. See Risk Factors Risks Relating to Indexed Debt Securities for more information about risks of investing in debt securities of this type.

**Original Issue Discount Debt Securities**

A fixed rate debt security, a variable rate debt security or an indexed debt security may be an original issue discount debt security. A series of debt securities of this type is issued at a price lower than its principal amount and provides that, upon redemption or acceleration of its maturity, an amount less than its principal amount will be payable. An original issue discount debt security may be a zero coupon debt security. A debt security issued at a discount to its principal may, for U.S. federal income tax purposes, be considered an original issue discount debt security, regardless of the amount payable upon redemption or acceleration of maturity. See Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. United States Holders Original Issue Discount and Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Finance Inc. United States Holders Original Issue Discount for a brief description of the U.S. federal income tax consequences of owning an original issue discount debt security.

**Guarantee**

Each debt security will benefit from an unconditional, full and irrevocable guarantee by the Parent Guarantor. One or more of the following Subsidiary Guarantors, which are subsidiaries of the Parent Guarantor, may, along with the Parent Guarantor, jointly and severally guarantee the debt securities on a full, unconditional and irrevocable basis:

Anheuser-Busch Companies, LLC

Anheuser-Busch InBev Worldwide Inc.

Anheuser-Busch InBev Finance Inc.

Brandbev S.à r.l.

Brandbrew S.A.

Cobrew NV

The Subsidiary Guarantors, if any, for any particular series of debt securities will be specified in the applicable prospectus supplement. The Issuer of a particular series of securities will not act as a Subsidiary Guarantor for that series.

Each guarantee to be provided is referred to as a **Guarantee** and collectively, the **Guarantees**; the subsidiaries of the Parent Guarantor providing Guarantees are referred to as the **Subsidiary Guarantors** and the Parent Guarantor and Subsidiary Guarantors collectively are referred to as the **Guarantors**.

All such Guarantees are set forth in each indenture, or a supplement thereto, and may take the form of a guarantee to be endorsed on a particular series of securities or a global guarantee that applies to multiple series of securities under an indenture. The Guarantees provided by several of the Guarantors will be subject to certain limitations set forth below under Guarantee Limitations.

Under the Guarantees, the Guarantors will guarantee to each Holder the due and punctual payment of any principal, accrued and unpaid interest (and all Additional Amounts, as defined below, if any) due under the debt securities in accordance with each indenture. Each Guarantor will also pay Additional Amounts (if any) in respect of payments under its Guarantee. The Guarantees will be the full, direct, unconditional, unsecured and unsubordinated general obligations of the Guarantors. The Guarantees will rank *pari passu* among themselves, without any preference of one over the other by reason of priority of date of issue or otherwise, and at least equally with all other unsecured and unsubordinated general obligations of the Guarantors from time to time outstanding.

Any Subsidiary Guarantor will automatically and unconditionally be released from all obligations under its Subsidiary Guarantee and such Subsidiary Guarantee shall thereupon terminate and be discharged of no further force or effect, in the event that at substantially the same time its Guarantee of the debt securities is terminated, (i) (for so long as any commitments remain outstanding under the 2010 Senior Facility Agreement) the relevant Subsidiary Guarantor is or has been released from its guarantee of 2010 Senior Facility Agreement (as defined in the Annual Report under the heading Item 5. Operating and Financial Review G. Liquidity and Capital Resources and as it may be amended from time to time) or is no longer a guarantor under the 2010 Senior Facility Agreement, and (ii) the aggregate amount of indebtedness for borrowed money for which the relevant Guarantor is an obligor (as a guarantor or borrower) does not exceed 10% of the consolidated gross assets of the Parent Guarantor as reflected in the balance sheet included in its most recent publicly released interim or annual consolidated financial statements. For purposes of this paragraph, the amount of a Guarantor s indebtedness for borrowed money shall not include (A) the debt securities issued pursuant to the indentures dated 12 January 2009, 16 October 2009 and 16 December 2016, and the indentures supplemental thereto, in each case between Anheuser-Busch InBev Worldwide Inc., as Issuer, the Parent Guarantor, the Subsidiary Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as trustee, (B) the debt securities issued pursuant to the indentures dated 17 January 2013, 25 January 2016 and 15 May 2017, and the indentures supplemental thereto, in each case between Anheuser-Busch InBev Finance Inc., as Issuer, the Parent Guarantor, the Subsidiary Guarantors named therein and The Bank of New York Mellon Trust Company, N.A., as trustee, (C) any other debt the terms of which permit the termination of the Guarantor s guarantee of such debt under similar circumstances, as long as such Guarantor s obligations in respect of such other debt are terminated at substantially the same time as its guarantee of the debt securities, and (D) any debt that is being refinanced at substantially the same time that the Guarantee of the debt securities is being released; *provided that* any obligations of the Guarantor in respect of the debt that is incurred in the refinancing shall be included in the calculation of the Guarantor s indebtedness for borrowed money.

In addition, Brandbrew S.A. and/or Brandbev S.à r.l., whose guarantees are subject to certain limitations described below, shall be entitled to terminate its Guarantee, and the trustee under each indenture shall execute a release and termination agreement effecting such termination, with respect to any or all series of the notes issued under each indenture, in the event that Brandbrew S.A. or Brandbev S.à r.l determines that under the rules, regulations or interpretations of the SEC it would be required to include its financial statements in any registration statement filed with the SEC with respect to any series of notes or guarantees issued under each indenture or in periodic reports filed with or furnished to the SEC (by reason of such limitations or otherwise). Furthermore, Brandbrew S.A. and/or Brandbev S.à r.l. will be entitled to amend or modify by execution of indentures supplemental to each indenture the terms of its Guarantee or the limitations applicable to its Guarantee, as set forth below, in any respect reasonably deemed necessary by Brandbrew S.A. or Brandbev S.à r.l to meet the requirements of Rule 3-10 under Regulation S-X under the Securities Act (or any successor or similar regulation or exemption) in order for financial statements of such Subsidiary Guarantor not to be required to be included in any registration statement or in periodic reports filed with or furnished to the SEC.

**Supplemental Information on Subsidiary Guarantors**

Brandbrew S.A. and Brandbev S.à r.l., the Subsidiary Guarantors whose Guarantees are subject to limitations, as described below under Guarantee Limitations , accounted in aggregate for less than 0.1% of the total consolidated EBITDA, as defined, of AB InBev for the year ended 31 December 2017 and approximately 0.1% of the total consolidated debt of AB InBev as of 31 December 2017.

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**Guarantee Limitations**

Pursuant to restrictions imposed by Luxembourg law, notwithstanding anything to the contrary in the Guarantees to be provided by Brandbrew S.A. or Brandbev S.à r.l., (each, a **Luxembourg Guarantor** ), for the purposes of any such Guarantees, the maximum aggregate liability of such Luxembourg Guarantor under its Guarantee (including any actual or contingent liabilities as a guarantor under the Other Guaranteed Facilities (as defined below)) shall not exceed an amount equal to the aggregate of (without double counting):

(1) the aggregate amount of all moneys received by such Luxembourg Guarantor and its Subsidiaries as a borrower or issuer under the Other Guaranteed Facilities;

(2) the aggregate amount of all outstanding intercompany loans made to such Luxembourg Guarantor and its Subsidiaries by other members of the AB InBev Group which have been directly or indirectly funded using the proceeds of borrowings under the Debt Securities and the Other Guaranteed Facilities; and

(3) an amount equal to 100% of the greater of:

(a) the sum of (x) such Luxembourg Guarantor s own capital (*capitaux propres*) (as referred to in article 34 of the Luxembourg Law of 2002, and as implemented by the Luxembourg Regulation) as reflected in such Luxembourg Guarantor s then most recent annual accounts approved by the competent organ of such Luxembourg Guarantor (as audited by its statutory auditor (*réviseur d entreprises agréé*), if required by law) at the date an enforcement is made under such Luxembourg Guarantor s Guarantee and (y) any amounts owed by such Luxembourg Guarantor to any other member of the AB InBev Group which have not been funded, directly or indirectly, using the proceeds of borrowings under the Indentures or the Other Guaranteed Facilities (as defined below); and

(b) the sum of (x) such Luxembourg Guarantor s own capital (*capitaux propres*) (as referred to in article 34 of the Luxembourg Law of 2002, and as implemented by the Luxembourg Regulation) as reflected in its most recent annual accounts available as of the date of the applicable Indenture and (y) any amounts owed by such Luxembourg Guarantor to any other member of the AB InBev Group which have not been funded, directly or indirectly, using the proceeds of borrowings under the Indentures or the Other Guaranteed Facilities (as defined below).

For the avoidance of doubt, the limitation on the Guarantee provided by such Luxembourg Guarantor shall not apply to any Guarantee by it of any obligations owed by its Subsidiaries under the Other Guaranteed Facilities.

In addition, the obligations and liabilities of such Luxembourg Guarantor under its Guarantee and under any of the Other Guaranteed Facilities shall not include any obligation which, if incurred, would constitute a breach of the provisions on unlawful financial assistance as contained in articles 49-6 or 168, as applicable, of the Luxembourg Law on Commercial Companies dated 10 August 1915, as amended.

**Other Guaranteed Facilities means:**

(1) any debt securities issued by Anheuser-Busch Companies, LLC under any of the following indentures:

(a) the Indenture, dated August 1, 1995, between Anheuser-Busch Companies, LLC (formerly known as Anheuser-Busch Companies, Inc.) and The Bank of New York Mellon Trust Company, N.A. (as successor to Chemical Bank), as trustee;

(b)

the Indenture, dated July 1, 2001, between Anheuser-Busch Companies, LLC (formerly known as Anheuser-Busch Companies, Inc.) and The Bank of New York Mellon Trust Company, N.A. (as successor to The Chase Manhattan Bank), as trustee; and

(c) the Indenture, dated October 1, 2007, between Anheuser-Busch Companies, LLC (formerly known as Anheuser-Busch Companies, Inc.) and The Bank of New York Mellon Trust Company, N.A. (formerly known as The Bank of New York Trust Company, N.A.), as trustee;

(2) the 2010 Senior Facilities Agreement;

(3) any debt securities issued or guaranteed by Brandbrew S.A., Brandbev S.à r.l. or the Parent Guarantor under the 15,000,000,000 Euro Medium Term Note Programme originally entered into on 16 January 2009, as the same may be amended from time to time;

(4) any debt securities issued or guaranteed by Brandbrew, Brandbev or the Parent Guarantor under the 40,000,000,000 Euro Medium Term Note Programme originally entered into on 6 December 2016;

(5) any debt securities issued or guaranteed by Brandbrew S.A., Brandbev S.à r.l. or the Parent Guarantor under the 40,000,000,000 Euro Medium Term Note Programme originally entered into on 20 December 2017, as the same may be amended from time to time;

(6) any debt securities issued by Anheuser-Busch InBev Worldwide and guaranteed by Brandbrew S.A. or Brandbev S.à r.l. under the indentures dated 12 January 2009, 16 October 2009, 16 December 2016 and the indentures supplemental thereto, in each case between Anheuser-Busch InBev Worldwide Inc., as Issuer, the Parent Guarantor, certain of the Subsidiary Guarantors and the Trustee;

(7) any debt securities guaranteed by Brandbrew S.A. or Brandbev S.à r.l. under the U.S. Commercial Paper Program of short-term notes due up to a maximum of 364 days from the date of issue issued by Anheuser-Busch InBev Worldwide Inc. pursuant to dealer agreements, an issuing and paying agency agreement, the master note, guarantees and private placement memoranda, each dated on or around June 6, 2011, as amended and restated on or around 20 August 2014;

(8) any debt securities guaranteed by Brandbrew S.A. or Brandbev S.à r.l. under the the indentures dated 17 January 2013, 25 January 2016 and 15 May 2017, and the indentures supplemental thereto, in each case between Anheuser-Busch InBev Finance Inc., as Issuer, the Parent Guarantor, certain of the Subsidiary Guarantors and the Trustee; and

(9) any refinancing (in whole or part) of any of the above items for the same or a lower amount.

**Redemption**

*Optional Redemption.* The relevant prospectus supplement will specify whether we may redeem the debt securities of any series, in whole or in part, at our option, in any other circumstances. The prospectus supplement will also specify the notice we will be required to give, what prices and any premium we will pay, and the dates on which we may redeem the debt securities. Any notice of redemption of debt securities will state:

the date fixed for redemption;

the redemption price, or if not ascertainable, the manner of calculation thereof;

the amount of debt securities to be redeemed if we are only redeeming a part of the series;

that on the date fixed for redemption the redemption price will become due and payable on each debt security to be redeemed and, if applicable, that any interest will cease to accrue on or after the redemption date;

- the place or places at which each holder may obtain payment of the redemption price;

- the CUSIP number or numbers, if any, with respect to the debt securities; and

- that the redemption is for a sinking fund, if such is the case.

In the case of a partial redemption, the trustee shall select the debt securities that we will redeem in any manner it deems fair and appropriate or in the case of global securities in accordance with the applicable procedures of the clearing systems.

If we exercise an option to redeem any debt securities, we will give to the holder written notice of the principal amount of the debt securities to be redeemed, not less than 10 days nor more than 60 days before the applicable redemption date.

A notice of redemption may, at our discretion, be subject to one or more conditions precedent, including, but not limited to, completion of an equity offering, a financing, or other corporate transaction. In addition, if such redemption or notice is subject to satisfaction of one or more conditions precedent, such notice shall state that, in our discretion, the redemption date may be postponed until up to 60 days following the notice of redemption, and such notice may be rescinded in the event that any or all such conditions shall not have been satisfied by the redemption date (including as it may be postponed). We will provide written notice to the trustee prior to the close of business two business days prior to the applicable redemption date if any such redemption has been rescinded or delayed, and upon receipt the trustee will provide such notice to each Holder.

**Additional Mechanics**

*Form, Exchange and Transfer*

You may have your debt securities broken into more debt securities of smaller denominations or combined into fewer debt securities of larger denominations, as long as the total principal amount is not changed. This is called an exchange.

Subject to certain restrictions outlined in each indenture, you may exchange or transfer registered debt securities at the office of the trustee. The trustee acts as our agent for registering debt securities in the names of holders and transferring registered debt securities. We may change this appointment to another entity or perform the service ourselves. The entity performing the role of maintaining the list of registered holders is called the security registrar. It will also register transfers of the registered debt securities.

You will not be required to pay a service charge for registering a transfer or exchange of debt securities, but you may be required to pay for any tax or other governmental charge associated with the registration of the exchange or transfer. The transfer or exchange of a registered debt security will only be made if the security registrar is satisfied with your proof of ownership.

If we have designated additional transfer agents, they will be named in the prospectus supplement. We may cancel the designation of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts.

If the debt securities are redeemable and we redeem less than all of the debt securities of a particular series, we may block the transfer or exchange of debt securities during a specified period of time in order to freeze the list of holders to prepare the mailing. The period begins 15 days before the day we mail the notice of redemption and ends on the day of that mailing. We may also refuse to register transfers or exchanges of debt securities selected for redemption. However, we will continue to permit transfers and exchanges of the unredeemed portion of any security being partially redeemed.

*Payment and Paying Agents*

We will pay interest to you if you are a direct holder listed in the trustee s records at the close of business on a particular day in advance of each due date for interest, even if you no longer own the security on the interest due date. That particular day, usually about two weeks in advance of the interest due date, is called the regular record date and is stated in the applicable prospectus supplement.

Holders buying and selling debt securities must work out between them how to compensate for the fact that we will pay all the interest for an interest period to the one who is the registered holder on the regular record date. The most common manner is to adjust the sales price of the debt securities to prorate interest fairly between buyer and seller.

We will pay interest, principal and any other money due on the registered debt securities at the corporate trust office of the trustee in New York City. You must make arrangements to have your payments picked up at or wired from that office. We may also choose to pay interest by mailing checks. Interest on global securities will be paid to the holder thereof by wire transfer of same day funds.

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***Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments.***

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee s corporate trust office. These offices are called paying agents. We may also choose to act as our own paying agent. We must notify the trustee of changes in the paying agent for any particular series of debt securities.

*Payments Due in Other Currencies*

We will make payments on a global debt security in the applicable specified currency in accordance with the applicable policies as in effect from time to time of the depositary, which will be DTC, Euroclear or Clearstream, Luxembourg. Unless we specify otherwise in the applicable prospectus supplement, The Depository Trust Company, New York, New York, known as DTC, will be the depositary for all debt securities in global form.

Unless otherwise indicated in the applicable prospectus supplement, holders are not entitled to receive payments in U.S. dollars of an amount due in another currency.

If the applicable prospectus supplement specifies that holders may request that we make payments in U.S. dollars of an amount due in another currency, the exchange rate agent described below will calculate the U.S. dollar amount the holder receives in the exchange rate agent s discretion. A holder that requests payment in U.S. dollars will bear all associated currency exchange costs, which will be deducted from the payment.

If we are obligated to make any payment in a specified currency other than U.S. dollars, and the specified currency or any successor currency is not available to us due to circumstances beyond our control such as the imposition of exchange controls or a disruption in the currency markets we will be entitled to satisfy our obligation to make the payment in that specified currency by making the payment in U.S. dollars, on the basis of the exchange rate determined by the exchange rate agent described below, in its discretion.

The foregoing will apply to any debt security and to any payment, including a payment at maturity. Any payment made under the circumstances and in a manner described above will not result in a default under any debt security or the applicable indenture.

If we issue a debt security in a specified currency other than U.S. dollars, we will appoint a financial institution to act as the exchange rate agent and will name the institution initially appointed when the debt security is originally issued in the applicable prospectus supplement. We may change the exchange rate agent from time to time after the original issue date of the debt security without your consent and without notifying you of the change.

All determinations made by the exchange rate agent will be in its sole discretion unless we state in the applicable prospectus supplement that any determination requires our approval. In the absence of manifest error, those determinations will be conclusive for all purposes and binding on you and us, without any liability on the part of the exchange rate agent.

*Notices*

We and the trustee will send notices only to direct holders, using their addresses as listed in the trustee s records. Notices regarding the debt securities will be valid if given in writing and mailed, first-class postage prepaid, to each holder affected by the relevant event, at such holder s address as it appears in the Security Register, not later than the latest date (if any), and not earlier than the earliest date (if any), prescribed for the giving of such notice.

Regardless of who acts as paying agent, all money that we pay to a paying agent that remains unclaimed at the end of two years after the amount is due to direct holders will be repaid to us, as the case may be. After that two-year period, you may look only to the relevant Issuer for payment and not to the trustee, any other paying agent or anyone else.

**The Trustee**

The Bank of New York Mellon Trust Company, N.A. will be the trustee under each indenture. The trustee has two principal functions:

first, it can enforce a holder s rights against us if we default on debt securities issued under the relevant indenture. There are some limitations on the extent to which the trustee acts on a holder s behalf, described under Events of Default ; and

second, the trustee performs administrative duties for us, such as sending the holder s interest payments, transferring debt securities to a new buyer and sending notices to holders.

We and some of our subsidiaries maintain deposit accounts and conduct other banking transactions with the trustee and affiliates of the trustee in the ordinary course of our respective businesses. The address of The Bank of New York Mellon Trust Company, N.A. is 911 Washington Avenue, 3rd Floor, St. Louis, Missouri 63101.

If an event of default occurs, or an event occurs that would be an event of default if the requirements for giving us default notice or our default having to exist for a specific period of time were disregarded, the trustee may therefore be considered to have a conflicting interest with respect to the debt securities or the applicable indenture for purposes of the Trust Indenture Act of 1939. In that case, the trustee may be required to resign as trustee under the applicable indenture and we would be required to appoint a successor trustee.

*Regarding the Trustee, Paying Agent, Transfer Agent and Registrar*

For a description of the duties and the immunities and rights of any trustee, paying agent, transfer agent or registrar under each indenture, reference is made to such indenture, and the obligations of any Trustee, paying agent, transfer agent and registrar to the Holder are subject to such immunities and rights.

**Legal Status of the Issuers**

Each of the Issuers may at any time after the date of this prospectus, in its sole discretion, convert from a Delaware corporation to a Delaware limited liability company pursuant to Section 266 of the Delaware General Corporation Law or any other applicable law that provides that the limited liability company resulting from such conversion shall be deemed to be the same entity as the corporation. Each Issuer may so convert without being required to give any notice to Holders or advance notice to the Trustee. It is possible that such a conversion could be treated as a taxable exchange for United States federal income tax purposes. In that case, we would not provide any indemnity for the tax consequences arising from such a conversion. For more information on the U.S. federal income tax consequences of such a conversion, please see Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc. United States Holders Substitution of an Issuer and Discharge of Indenture and Tax Considerations United States Taxation Debt Securities Issued by Anheuser-Busch InBev Finance Inc. United States Holders Substitution of an Issuer and Discharge of Indenture .

**Modifications and Amendment**

Each Issuer, the Guarantors and the Trustee may execute agreements adding any provisions to or changing in any manner or eliminating any of the provisions of the applicable indenture or of any supplemental agreement or modifying in any manner the rights of the Holders under the debt securities or the Guarantees only with the

consent of the Holders of not less than a majority in aggregate principal amount of the debt securities then outstanding under such indenture (irrespective of series) that would be affected by the proposed modification or amendment; *provided that* no such agreement shall (a) change the maturity of the principal of, or any installment of interest on, any debt security, or reduce the principal amount or the interest thereof, or extend the time of payment of any installment of interest thereon, or change the currency of payment of principal of, or interest on, any debt security, or change the Issuer s or a Guarantor s obligation to pay Additional Amounts, impair or affect the right of any Holder to institute suit for the enforcement of any such payment on or after the due date thereof (or in the case of redemption on or after the redemption date) or change in any manner adverse to the interests of the Holders the terms and provisions of the Guarantees in respect of the due and punctual payment of principal amount of the debt securities then outstanding plus accrued and unpaid interest (and all Additional Amounts, if any) without the consent of the Holder of each debt securities so affected; or (b) reduce the aforesaid percentage of the consent of the Holders of which is required for any such agreement, without the consent of the Holders of the affected series of the debt securities then outstanding. To the extent that any changes directly affect fewer than all the series of the debt securities, only the consent of the Holders of debt securities of the relevant series (in the respective percentages set forth above) will be required.

Each Issuer, the Guarantors and the Trustee may, without the consent of the Holders, from time to time execute agreements or amendments or enter into an indenture or indentures supplemental thereto (including in respect of one series of debt securities only) for one or more of the following purposes:

to convey, transfer, assign, mortgage or pledge any property or assets to the Trustee or another person as security for the debt securities;

to evidence the succession of another person to the applicable Issuer or any Guarantors, or successive successions, and the assumption by the successor person of the covenants of that Issuer or any of the Guarantors, pursuant to an indenture and the debt securities;

to evidence and provide for the acceptance of appointment of a successor or successors to the Trustee in any of its capacities and to add to or change any of the provisions of an indenture to facilitate the administration of the trusts created thereunder by more than one trustee;

to add to the covenants of the applicable Issuer or the Guarantors, for the benefit of the holders of all or any series of the debt securities issued under the applicable indenture, or to surrender any rights or powers conferred on such Issuer or the Guarantors in such indenture;

to add any additional events of default for the benefit of the Holders of all or any series of debt securities (and if such additional events of default are to be for the benefit of less than all series of Holders, stating that such additional events of default are expressly being included solely for the benefit of such series);

to add to, change or eliminate any of the provisions of an indenture in respect of one or more series of debt securities; *provided that* any such addition, change or elimination (A) shall neither (i) apply to any debt security of any series created prior to the execution of such supplemental indenture and entitled to the benefit of such provision nor (ii) modify the rights of the Holder of any such debt security with respect to such provision or (B) shall become effective only when there is no such debt security outstanding;

to modify the restrictions on and procedures for resale and other transfers of the debt securities pursuant to law, regulation or practice relating to the resale or transfer of restricted securities generally;

to provide for the issues of securities in exchange for one or more series of outstanding debt securities;

to provide for the issuance and terms of any particular series of securities, the rights and obligations of the Guarantors and the holders of the securities of such series, the form or forms of the securities of such series and such other matters in connection therewith as the Issuers and the Guarantors shall consider appropriate, including, without limitation, provisions for (a) additional or different covenants,

restrictions or conditions applicable to such series, (b) additional or different events of default in respect of such series, (c) a longer or shorter period of grace and/or notice in respect of any provision applicable to such series than is otherwise provided, (d) immediate enforcement of any event of default in respect of such series or (e) limitations upon the remedies available in respect of any events of default in respect of such series or upon the rights of the holders of securities of such series to waive any such event of default;

to cure any ambiguity or to correct or supplement any provision contained in an indenture, any series of debt securities or the Guarantees, or in any supplemental agreement, which may be defective or inconsistent with any other provision contained therein or in any supplemental agreement, (b) to eliminate any conflict between the terms hereof and the Trust Indenture Act of 1939 or (c) to make such other provision in regard to matters or questions arising under an indenture or under any supplemental agreement as the Issuers may deem necessary or desirable and which will not adversely affect the interests of the Holders to which such provision relates in any material respect;

to reopen the debt securities of any series and create and issue additional debt securities having identical terms and conditions as the debt securities of such series (or in all respects except for the issue date, issue price, first interest accrual date and first interest payment date) so that the additional notes are consolidated and form a single series with the outstanding debt securities;

to add any Subsidiary of the Parent Guarantor as a Guarantor with respect to any series of notes, subject to applicable regulatory or contractual limitations relating to such subsidiary s Guarantee;

to provide for the release and termination of any Subsidiary Guarantor s Guarantee in the circumstances described under Guarantee above;

to provide for any amendment, modification or alteration of any Subsidiary Guarantor s Guarantee and the limitations applicable thereto in the circumstances described under Guarantee above; or

to make any other change that does not materially adversely affect the interests of the holders of the series of notes affected thereby.

***Street name and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we seek to change an indenture or the debt securities or request a waiver.***

**Certain Covenants**

***Limitation on Liens***

So long as any of the debt securities remains outstanding, the Parent Guarantor will not, nor will it permit any Restricted Subsidiary to, create, assume, guarantee or suffer to exist any mortgage, pledge, security interest or lien (an **Encumbrance** ) on any of its Principal Plants or on any capital stock of any Restricted Subsidiary without effectively providing that the debt securities (together with, if the Parent Guarantor shall so determine, any other indebtedness of the Parent Guarantor then existing or thereafter created ranking equally with the debt securities and any other indebtedness of such Restricted Subsidiary then existing or thereafter created) shall be secured by the security for such secured indebtedness equally and ratably therewith; *provided*, *however*, the above limitation does not apply to:

(a) purchase money liens, so long as such liens attach only to the assets so acquired and improvements thereon;

(b) Encumbrances existing at the time of acquisition of property (including through merger or consolidation) or securing indebtedness the proceeds of which are used to pay or reimburse the Parent Guarantor or a Restricted Subsidiary for the cost of such property

(provided such indebtedness is incurred within 180 days after such acquisition);

(c) Encumbrances on property of a Restricted Subsidiary existing at the time it becomes a Restricted Subsidiary;

(d) Encumbrances to secure the cost of development or construction of property, or improvements thereon; *provided that* the recourse of the creditors in respect of such indebtedness is limited to such property and improvements;

(e) Encumbrances in connection with the acquisition or construction of Principal Plants or additions thereto financed by tax-exempt securities;

(f) Encumbrances securing indebtedness owing to the Parent Guarantor or a Restricted Subsidiary by a Restricted Subsidiary;

(g) Encumbrances existing at the date of the applicable indenture;

(h) Encumbrances required in connection with state or local governmental programs which provide financial or tax benefits; *provided that* the obligations secured are in lieu of or reduce an obligation that would have been secured by an Encumbrance permitted under each indenture;

(i) any Encumbrance arising by operation of law and not securing amounts more than ninety (90) days overdue or otherwise being contested in good faith;

(j) judgment Encumbrances not giving rise to an event of default;

(k) any Encumbrance incurred or deposits made in the ordinary course of business, including, but not limited to, (i) any mechanics , materialmen s, carriers , workmen s, vendors or other like Encumbrances, (ii) any Encumbrances securing amounts in connection with workers compensation, unemployment insurance and other types of social security, and (iii) any easements, rights-of-way, restrictions and other similar charges;

(l) any Encumbrance upon specific items of inventory or other goods and proceeds of the Parent Guarantor or any Restricted Subsidiary securing the Parent Guarantor s or any such Restricted Subsidiary s obligations in respect of bankers acceptances issued or created for the account of such person to facilitate the purchase, shipment or storage of such inventory or other goods;

(m) any Encumbrance incurred or deposits made securing the performance of tenders, bids, leases, statutory obligations, surety and appeal bonds, government contracts, performance and return-of-money bonds and other obligations of like nature incurred in the ordinary course of business;

(n) any Encumbrance on any Principal Plant of the Parent Guarantor or any Restricted Subsidiary in favor of the Federal Government of the United States or the government of any State thereof, or the government of the United Kingdom, or any state in the European Union, or any instrumentality of any of them, securing the obligations of the Parent Guarantor or any Restricted Subsidiary pursuant to any contract or payments owed to such entity pursuant to applicable laws, rules, regulations or statutes;

(o) any Encumbrance securing taxes or assessments or other applicable governmental charges or levies;

(p) extensions, renewals or replacements of the Encumbrances referred to in clauses (a) through (o); *provided that* the amount of indebtedness secured by such extension, renewal or replacement shall not exceed the principal amount of indebtedness being

extended, renewed or replaced, together with the amount of any premiums, fees, costs and expenses associated with such extension, renewal or replacement, nor shall the pledge, mortgage or lien be extended to any additional Principal Plant unless otherwise permitted under this covenant;

(q) as permitted under the provisions described in the following two paragraphs herein; and

(r) sale-leaseback transactions.

Notwithstanding the provisions described in the immediately preceding paragraph, the Parent Guarantor or any Restricted Subsidiary may, without ratably securing the debt securities, create, assume, guarantee or suffer to exist any indebtedness which would otherwise be subject to such restrictions, and renew, extend or replace such indebtedness; *provided that* the aggregate amount of such indebtedness, when added to the fair market value of property transferred in certain sale and leaseback transactions (computed without duplication of amount) does not at the time exceed 15% of Net Tangible Assets.

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If the Parent Guarantor or any Restricted Subsidiary merges or consolidates with, or purchases all or substantially all of the assets of, another corporation, or the Parent Guarantor sells all or substantially all of its assets to another corporation, and if such other corporation has outstanding obligations secured by an Encumbrance which, by reason of an after-acquired property clause or similar provision, would extend to any Principal Plant owned by the Parent Guarantor or such Restricted Subsidiary immediately prior thereto, the Parent Guarantor or such Restricted Subsidiary, as the case may be, will in such event be deemed to have created an Encumbrance, within the prohibition of the covenant described above, unless (a) such merger or consolidation involving a Restricted Subsidiary constitutes a disposition by the Parent Guarantor of its interest in the Restricted Subsidiary or (b) (i) at or prior to the effective date of such merger, consolidation, sale or purchase, such Encumbrance shall be released of record or otherwise satisfied to the extent it would extend to such Principal Plant, (ii) prior thereto, the Parent Guarantor or such Restricted Subsidiary shall have created, as security for the debt securities (and, if the Parent Guarantor shall so determine, as security for any other indebtedness of the Parent Guarantor then existing or thereafter created ranking equally with the debt securities and any other indebtedness of such Restricted Subsidiary then existing or thereafter created), a valid Encumbrance which will rank equally and ratably with the Encumbrances of such other corporation on such Principal Plant of the Parent Guarantor or such Restricted Subsidiary, as the case may be, or (iii) such Encumbrance is otherwise permitted or complies with the covenant described above.

In each instance referred to in the preceding paragraphs where the Parent Guarantor is obligated to provide security for the debt securities (except, for certain issues of indebtedness, in the case of transactions relating to stock of a Restricted Subsidiary), the Parent Guarantor would be required to provide comparable security for other outstanding indebtedness under that indenture and other agreements relating thereto.

**Ranking**

The debt securities are not secured by any of our property or assets. Accordingly, your ownership of debt securities means you are one of our unsecured creditors. The debt securities are not subordinated to any of our other debt obligations and therefore they rank equally with all our other unsecured and unsubordinated indebtedness.

**Events of Default**

The occurrence and continuance of one or more of the following events will constitute an Event of Default under each indenture and the debt securities:

(a) Payment Default (i) The applicable Issuer or a Guarantor fails to pay interest within 30 days from the relevant due date, or (ii) the applicable Issuer or a Guarantor fails to pay the principal (or premium, if any) due on the debt securities at maturity; *provided that* to the extent any such failure to pay principal or premium is caused by a technical or administrative error, delay in processing payments or events beyond the control of the Issuer or Guarantors, no Event of Default shall occur for three days following such failure to pay; *provided*, further, that, in the case of a redemption payment, no Event of Default shall occur for 30 days following a failure to make such payment;

(b) Breach of Other Material Obligations The applicable Issuer or a Guarantor defaults in the performance or observance of any of its other material obligations under or in respect of the debt securities or an indenture and such default remains unremedied for 90 days after a written notice has been given to such Issuer and the Parent Guarantor by the Trustee or to such Issuer, the Parent Guarantor and the Trustee by the Holders of at least 25% in principal amount of the outstanding debt securities affected thereby, specifying such default or breach and requiring it to be remedied and stating that such notice is a Notice of Default under the debt securities;

(c) Bankruptcy or Insolvency A court of competent jurisdiction commences bankruptcy or other insolvency proceedings against the applicable Issuer, the Parent Guarantor or a Guarantor that is a Significant

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Subsidiary under the applicable laws of their respective jurisdictions of incorporation, or the applicable Issuer, the Parent Guarantor or a Guarantor that is a Significant Subsidiary applies for or institutes such proceedings or offers or makes an assignment for the benefit of its creditors generally, or a third party institutes bankruptcy or insolvency proceedings against the applicable Issuer, the Parent Guarantor or a Guarantor that is a Significant Subsidiary and such proceedings are not discharged or stayed within 90 days;

(d) Impossibility due to Government Action Any governmental order, decree or enactment shall be made in or by Belgium or the jurisdiction of incorporation of a Guarantor that is a Significant Subsidiary whereby the applicable Issuer, the Parent Guarantor, or such Guarantor that is a Significant Subsidiary is prevented from observing and performing in full its obligations as set forth in the terms and conditions of the debt securities and the Guarantees, respectively, and this situation is not cured within 90 days; or

(e) Invalidity of the Guarantees The Guarantees provided by the Parent Guarantor or a Guarantor that is a Significant Subsidiary cease to be valid and legally binding for any reason whatsoever or the Parent Guarantor or a Guarantor that is a Significant Subsidiary seeks to deny or disaffirm its obligations under the Guarantee.

If an Event of Default occurs and is continuing with respect to the debt securities of any series, then in each and every case, unless the principal of all of the debt securities of such series shall already have become due and payable (in which case no action is required for the acceleration of the debt securities of such series), the Holders of not less than 25% in aggregate principal amount of debt securities of such series then outstanding, by written notice to the applicable Issuer, the Parent Guarantor and the Trustee as provided in the applicable indenture, may declare the entire principal of all the debt securities of such series, and the interest accrued thereon, to be due and payable immediately; *provided*, *however*, that if an Event of Default specified in paragraph (c) above with respect to any series of the debt securities at the time outstanding occurs, the principal amount of that series shall automatically, and without any declaration or other action on the part of the Trustee or any Holder, become immediately due and payable. Under certain circumstances, the Holders of a majority in aggregate principal amount of a series of debt securities then outstanding may, by written notice to the applicable Issuer and the Trustee as provided in the applicable indenture, waive all defaults and rescind and annul such declaration and its consequences, but no such waiver or rescission and annulment shall extend to or shall affect any subsequent default or shall impair any right consequent thereon.

Except in cases of default, where the trustee has some special duties, the trustee is not required to take any action under an indenture at the request of any holders unless the holders offer the trustee reasonable protection from costs, expenses and liability. This protection is called an indemnity. If reasonable indemnity is provided, the holders of a majority in principal amount of the outstanding debt securities of any series may direct the time, method and place of conducting any proceeding seeking any remedy available to the trustee. These majority holders may also direct the trustee in performing any other action under an indenture, so long as such direction would not involve the Trustee in personal liability.

Before you bypass the trustee and bring your own lawsuit or other formal legal action or take other steps to enforce your rights or protect your interests relating to the debt securities, the following must occur:

- The trustee must be given written notice that an event of default has occurred and remains uncured.

- The holders of not less than 25% in principal amount of all outstanding debt securities of the relevant series must make a written request that the trustee institute proceedings because of the default, and must offer indemnity and/or security satisfactory to the trustee against the costs, expenses and liabilities of taking such request.

- The trustee must have not taken action for 60 days after receipt of the above notice, request and offer of indemnity.

- No direction inconsistent with such written request has been given to the trustee during such 60-day period by the holders of the majority in principal amount of the outstanding securities of that series.

However, you are entitled at any time to bring a lawsuit for the payment of money due on your security on or after its due date.
We will furnish to the Trustee every year a written statement of certain of our officers and directors, certifying that, to their knowledge, we are in compliance with each indenture and the debt securities, or else specifying any default.

***Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and to make or cancel a declaration of acceleration.***

**Substitution of an Issuer or Guarantor; Consolidation, Merger and Sale of Assets**

In all cases subject to any provisions contained in the applicable prospectus supplement describing the Holders option to require repayment upon a change in control, (i) any Issuer or Guarantor, without the consent of the Holders of any of the debt securities, may consolidate with or merge into, or sell, transfer, lease or convey all or substantially all of their respective assets to, any corporation or (ii) an Issuer may at any time substitute for itself either a Guarantor or any Affiliate (as defined below) of a Guarantor as principal debtor under the debt securities (a **Substitute Issuer** ); *provided that*:

(a) the Substitute Issuer or any other successor company shall expressly assume such Issuer s or Guarantor s respective obligations under the debt securities or the Guarantees, as the case may be, and each indenture, as applicable, except that if the Parent Guarantor is merged into any corporation organized under the laws of the Kingdom of Belgium via a merger by absorption in accordance with the Belgian Companies Code, that successor company shall, by virtue of the operation of Belgian law and without any further action by the Parent Guarantor or its successor, assume the obligations of the Parent Guarantor under the Guarantees and each indenture and no express assumption will be required;

(b) any other successor company is organized under the laws of a member country of the Organization for Economic Co-Operation and Development;

(c) such Issuer is not in default of any payments due under the debt securities and immediately before and after giving effect to such consolidation, merger, sale, transfer, lease, conveyance or substitution, no Event of Default shall be continuing;

(d) in the case of a Substitute Issuer:

(i) the obligations of the Substitute Issuer arising under or in connection with the debt securities and each indenture, as applicable, are fully, irrevocably and unconditionally guaranteed by the Guarantors (other than the Substitute Issuer, if applicable) on the same terms as existed immediately prior to such substitution under the Guarantees given by such Guarantors;

(ii) the Parent Guarantor, the applicable Issuer and the Substitute Issuer jointly and severally indemnify each Holder for any income tax or other tax (if any) recognized by such Holder solely as a result of the substitution of the Substitute Issuer (and not as a result of any transfer by such Holder); *provided*, *however*, that such indemnification shall not apply to any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the U.S. Internal Revenue Code of 1986, as amended (the **Code** ), any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement entered into in connection with the implementation of such Sections of the Code, and shall not require the payment of additional amounts on account of any such withholding or deduction;

(iii) each stock exchange on which the debt securities are listed, if any, shall have confirmed that, following the proposed substitution of the Substitute Issuer, such debt securities will continue to be listed on such stock exchange; and

(iv) each rating agency that rates the debt securities, if any, shall have confirmed that, following the proposed substitution of the Substitute Issuer, such debt securities will continue to have the same or better rating as immediately prior to such substitution; and

(e) written notice of such transaction shall be promptly provided to the Holders.

For purposes of the foregoing, **Affiliate** shall mean, with respect to any specified person, any other person directly or indirectly controlling or controlled by or under direct or indirect common control with such specified person.

Upon the effectiveness of any substitution, all of the foregoing provisions will apply *mutatis mutandis*, and references elsewhere herein to the Issuer or a Guarantor will, where the context so requires, be deemed to be or include references, to any successor company.

**Discharge and Defeasance**

***Discharge of Indentures***

Each indenture provides that the applicable Issuer and the Guarantors will be discharged from any and all obligations in respect of such indenture (except for certain obligations to register the transfer of or exchange debt securities, replace stolen, lost or mutilated debt securities, make payments of principal and interest and maintain paying agencies) if:

- the applicable Issuer or the Guarantors have paid or caused to be paid in full the principal of and interest on all debt securities outstanding thereunder;

- the applicable Issuer or the Guarantors shall have delivered to the Trustee for cancellation all debt securities outstanding theretofore authenticated; or

- all debt securities not theretofore delivered to the Trustee for cancellation (i) have become due and payable, (ii) will become due and payable in accordance with their terms within one year or (iii) are to be, or have been, called for redemption as described under Redemption Optional Redemption within one year under arrangements satisfactory to the Trustee for the giving of notice of redemption, and, in any such case, the applicable Issuer or Guarantors shall have irrevocably deposited with the Trustee as trust funds in irrevocable trust, specifically pledged as security for, and dedicated solely to, the benefit of the Holders of such debt securities, (a) cash in U.S. dollars in an amount, or (b) U.S. Government Obligations (as defined below) which through the payment of interest thereon and principal thereof in accordance with their terms will provide not later than the due date of any payment, cash in U.S. dollars in an amount, or (c) any combination of (a) and (b), sufficient to pay all the principal of, and interest (and Additional Amounts, if any) on, all such debt securities not theretofore delivered to the Trustee for cancellation on the dates such payments are due in accordance with the terms of the debt securities and all other amounts payable under the applicable indenture by the applicable Issuer.

**U.S. Government Obligations** means securities which are (i) direct obligations of the U.S. government or (ii) obligations of a person controlled or supervised by and acting as an agency or instrumentality of the U.S. government, the payment of which is unconditionally guaranteed by the U.S. government, which, in either case, are full faith and credit obligations of the U.S. government payable in U.S. dollars and are not callable or redeemable at the option of the issuer thereof.

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***Covenant Defeasance***

Each indenture also provides that the applicable Issuer and the Guarantors need not comply with certain covenants of such indenture (including those described under Certain Covenants Limitation on Liens ), and the Guarantors shall be released from their obligations under the Guarantees, if:

- the applicable Issuer or the Guarantors irrevocably deposit with the Trustee as trust funds in irrevocable trust, specifically pledged as security for, and dedicated solely to, the benefit of the holders of such debt securities, (i) cash in U.S. dollars in an amount, or (ii) U.S. government obligations which through the payment of interest thereon and principal thereof in accordance with their terms will provide not later than one day before the due date of any payment cash in U.S. dollars in an amount, or (iii) any combination of (i) and (ii), sufficient to pay all the principal of, and interest on, the debt securities then outstanding on the dates such payments are due in accordance with the terms of the debt securities;

- certain events of default, or events which with notice or lapse of time or both would become such an event of default, shall not have occurred and be continuing on the date of such deposit;

- the applicable Issuer, or the Guarantors, as the case may be, deliver to the Trustee an opinion of tax counsel of recognized standing with respect to U.S. federal income tax matters to the effect that the beneficial owners of the debt securities will not recognize income, gain or loss for U.S. federal income tax purposes as a result of the exercise of such Covenant Defeasance and will be subject to U.S. federal income tax on the same amounts, in the same manner and at the same times as would be the case if such Covenant Defeasance had not occurred;

- the applicable Issuer, or the Guarantors, as the case may be, deliver to the Trustee an opinion of tax counsel of recognized standing in its jurisdiction of incorporation to the effect that such deposit and related Covenant Defeasance will not cause the Holders, other than Holders who are or who are deemed to be residents of such jurisdiction of incorporation or use or hold or are deemed to use or hold their debt securities in carrying on a business in such jurisdiction of incorporation, to recognize income, gain or loss for income tax purposes in such jurisdiction of incorporation, and to the effect that payments out of the trust fund will be free and exempt from any and all withholding and other income taxes of whatever nature of such jurisdiction of incorporation or political subdivision thereof or therein having power to tax, except in the case of debt securities beneficially owned (i) by a person who is or is deemed to be a resident of such jurisdiction of incorporation or (ii) by a person who uses or holds or is deemed to use or hold such debt securities in carrying on a business in such jurisdiction of incorporation; and

- the applicable Issuer, or the Guarantors, as the case may be, deliver to the Trustee an officers certificate and an opinion of legal counsel of recognized standing, each stating that all conditions precedent provided for relating to such Covenant Defeasance have been complied with.

The effecting of these arrangements is also known as Covenant Defeasance .

**Additional Amounts**

To the extent that any Guarantor is required to make payments in respect of the debt securities, such Guarantor will make all payments in respect of the debt securities without withholding or deduction for or on account of any present or future taxes or duties of whatever nature imposed or levied by way of withholding or deduction at source by or on behalf of any jurisdiction in which such Guarantor is incorporated, organized or otherwise tax resident or any political subdivision or any authority thereof or therein having power to tax (the **Relevant Taxing Jurisdiction** ) unless such withholding or deduction is required by law. In such event, such Guarantor will pay to the Holders such additional amounts (the **Additional Amounts** ) as shall be necessary in order that the net amounts received by the Holders, after such withholding or deduction, shall equal the

respective amounts of principal and interest which would otherwise have been receivable in the absence of such withholding or deduction; except that no such Additional Amounts shall be payable on account of any taxes or duties which:

(a) are payable by any person acting as custodian bank or collecting agent on behalf of a Holder, or otherwise in any manner which does not constitute a deduction or withholding by the Guarantor from payment of principal or interest made by it;

(b) are payable by reason of the Holder or beneficial owner having, or having had, some personal or business connection with such Relevant Taxing Jurisdiction and not merely by reason of the fact that payments in respect of the debt securities or the Guarantees are, or for purposes of taxation are deemed to be, derived from sources in, or are secured in the Relevant Taxing Jurisdiction;

(c) are imposed or withheld by reason of the failure of the Holder or beneficial owner to provide certification, information, documents or other evidence concerning the nationality, residence or identity of the Holder and beneficial owner or to make any valid or timely declaration or similar claim or satisfy any other reporting requirements relating to such matters, whether required or imposed by statute, treaty, regulation or administrative practice, as a precondition to exemption from, or a reduction in the rate of withholding or deduction of, such taxes;

(d) consist of any estate, inheritance, gift, sales, excise, transfer, personal property or similar taxes;

(e) are imposed on or with respect to any payment by the applicable Guarantors to the registered Holder if such Holder is a fiduciary or partnership or any person other than the sole beneficial owner of such payment to the extent that taxes would not have been imposed on such payment had such registered Holder been the sole beneficial owner of such debt security;

(f) are payable by reason of a change in law or practice that becomes effective more than 30 days after the relevant payment of principal or interest becomes due, or is duly provided for and written notice thereof is provided to the Holders, whichever occurs later;

(g) are payable because any debt security was presented to a particular paying agent for payment if the debt security could have been presented to another paying agent without any such withholding or deduction; or

(h) are payable for any combination of (a) through (g) above.

References to principal or interest in respect of the debt securities shall be deemed to include any Additional Amounts, which may be payable as set forth in each indenture.

In addition, any amounts to be paid by an Issuer or any Guarantor on the debt securities will be paid net of any deduction or withholding imposed or required pursuant to Sections 1471 through 1474 of the Code, any current or future regulations or official interpretations thereof, any agreement entered into pursuant to Section 1471(b) of the Code, or any fiscal or regulatory legislation, rules or practices adopted pursuant to any intergovernmental agreement entered into in connection with the implementation of such Sections of the Code ( **FATCA Withholding** ). Neither any Guarantor nor any Issuer will be required to pay Additional Amounts on account of any FATCA Withholding.

The preceding covenant regarding Additional Amounts will not apply to any Guarantor at any time when such Guarantor is incorporated in a jurisdiction in the United States; *provided*, *however*, that such covenant will apply to an Issuer at any time when it is incorporated in a jurisdiction outside of the United States. The prospectus supplement relating to the debt securities may describe additional circumstances in which the Guarantors would not be required to pay additional amounts.

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**Indemnification of Judgment Currency**

To the fullest extent permitted by applicable law, the applicable Issuer and each of the Guarantors will indemnify each Holder against any loss incurred by such Holder as a result of any judgment or order being given or made for any amount due under any debt security or Guarantee and such judgment or order being expressed and paid in a currency (the **Judgment Currency** ), which is other than U.S. dollars and as a result of any variation between (i) the rate of exchange at which the U.S. dollar is converted into the Judgment Currency for the purposes of such judgment or order and (ii) the spot rate of exchange in The City of New York at which the Holder on the date of payment of such judgment is able to purchase U.S. dollars with the amount of the Judgment Currency actually received by such Holder. This indemnification will constitute a separate and independent obligation of each Issuer or each of the Guarantors, as the case may be, and will continue in full force and effect notwithstanding any such judgment or order as aforesaid. The term spot rate of exchange includes any premiums and costs of exchange payable in connection with the purchase of, or conversion into, U.S. dollars.

**Governing Law; Submission to Jurisdiction**

The indentures, the debt securities and the Guarantees will be governed by and construed in accordance with the laws of the State of New York.

Each Issuer and the Guarantors have irrevocably submitted to the non-exclusive jurisdiction of the courts of any U.S. state or federal court in the Borough of Manhattan in The City of New York, New York with respect to any legal suit, action or proceeding arising out of or based upon the applicable indenture, debt securities or Guarantees.

**Definitions**

**Net Tangible Assets** means the total assets of the Parent Guarantor and its Restricted Subsidiaries (including, with respect to the Parent Guarantor, its net investment in subsidiaries that are not Restricted Subsidiaries) after deducting therefrom (a) all current liabilities (excluding any thereof constituting debt by reason of being renewable or extendable) and (b) all goodwill, trade names, trademarks, patents, unamortized debt discount and expense, organization and developmental expenses and other like segregated intangibles, all as computed by the Parent Guarantor in accordance with generally accepted accounting principles applied by the Parent Guarantor as of a date within 90 days of the date as of which the determination is being made; *provided*, that any items constituting deferred income taxes, deferred investment tax credit or other similar items shall not be taken into account as a liability or as a deduction from or adjustment to total assets.

**Principal Plant** means (a) any brewery, or any manufacturing, processing or packaging plant, now owned or hereafter acquired by the Parent Guarantor or any Subsidiary, but shall not include (i) any brewery or manufacturing, processing or packaging plant which the Parent Guarantor shall by board resolution have determined is not of material importance to the total business conducted by the Parent Guarantor and its Subsidiaries, (ii) any plant which the Parent Guarantor shall by board resolution have determined is used primarily for transportation, marketing or warehousing (any such determination to be effective as of the date specified in the applicable board resolution) or (iii) at the option of the Parent Guarantor, any plant that (A) does not constitute part of the brewing operations of the Parent Guarantor and its Subsidiaries and (B) has a net book value, as reflected on the balance sheet contained in the Parent Guarantor s financial statements of not more than $100,000,000, and (b) any other facility owned by the Parent Guarantor or any of its Subsidiaries that the Parent Guarantor shall, by board resolution, designate as a Principal Plant. Following any determination, designation or election referred to herein that a brewery or plant shall not be included as a Principal Plant, the Parent Guarantor may, at its option, by board resolution, elect that such facility subsequently be included as a Principal Plant.

**Restricted Subsidiary** means (a) any Subsidiary which owns or operates a Principal Plant, (b) any other subsidiary which the Parent Guarantor, by board resolution, shall elect to be treated as a Restricted Subsidiary,

until such time as the Parent Guarantor may, by further board resolution, elect that such Subsidiary shall no longer be a Restricted Subsidiary, successive such elections being permitted without restriction, and (c) the Issuers and the Subsidiary Guarantors; *provided that* each of Companhia de Bebidas das Américas AmBev and Grupo Modelo S.A.B. de C.V. shall not be Restricted Subsidiaries until and unless the Parent Guarantor owns, directly or indirectly, 100% of the equity interests in such company. Any such election will be effective as of the date specified in the applicable board resolution.

**Significant Subsidiary** means any Subsidiary (i) the consolidated revenue of which represents 10% or more of the consolidated revenue of the Parent Guarantor, (ii) the consolidated earnings before interest, taxes, depreciation and amortization ( **EBITDA** ) of which represents 10% or more of the consolidated EBITDA of the Parent Guarantor or (iii) the consolidated gross assets of which represent 10% or more of the consolidated gross assets of the Parent Guarantor, in each case as reflected in the most recent annual audited financial statements of the Parent Guarantor; *provided that* (A) in the case of a Subsidiary acquired by the Parent Guarantor during or after the financial year shown in the most recent annual audited financial statements of the Parent Guarantor, such calculation shall be made on the basis of the contribution of the Subsidiary considered on a pro-forma basis as if it had been acquired at the beginning of the relevant period, with the pro-forma calculation (including any adjustments) being made by the Parent Guarantor acting in good faith and (B) EBITDA shall be calculated by the Parent Guarantor in substantially the same manner as it is calculated for the amounts shown in Item 5. Operating and Financial Review E. Results of Operations in the Annual Report incorporated in this prospectus.

**Subsidiary** means any corporation of which more than 50% of the issued and outstanding stock entitled to vote for the election of directors (otherwise than by reason of default in dividends) is at the time owned directly or indirectly by the Parent Guarantor or a Subsidiary or Subsidiaries or by the Parent Guarantor and a Subsidiary or Subsidiaries.

**Consent to Service**

Each indenture provides that we irrevocably designate AB InBev Services LLC, 250 Park Avenue, 2nd Floor, New York, New York 10177 as our authorized agent for service of process in any proceeding arising out of or relating to such indenture or the applicable debt securities or Guarantees brought in any federal or state court in New York City and we irrevocably submit to the jurisdiction of these courts.

## CLEARANCE AND SETTLEMENT

The securities we issue may be held through one or more international and domestic clearing systems. The principal clearing systems we will use are the book-entry systems operated by The Depository Trust Company ( **DTC** ), in the United States, Clearstream Banking, *société anonyme* ( **Clearstream, Luxembourg** ), in Luxembourg and Euroclear Bank S.A./N.V. ( **Euroclear** ), in Brussels, Belgium. These systems have established electronic securities and payment transfer, processing, depositary and custodial links among themselves and others, either directly or through custodians and depositaries. These links allow securities to be issued, held and transferred among the clearing systems without the physical transfer of certificates.

Special procedures to facilitate clearance and settlement have been established among these clearing systems to trade securities across borders in the secondary market. Where payments for securities we issue in global form will be made in U.S. dollars, these procedures can be used for cross-market transfers and the securities will be cleared and settled on a delivery against payment basis.

Global securities will be registered in the name of a nominee for, and accepted for settlement and clearance by, one or more of Euroclear, Clearstream, Luxembourg, DTC and any other clearing system identified in the applicable prospectus supplement.

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Cross-market transfers of securities that are not in global form may be cleared and settled in accordance with other procedures that may be established among the clearing systems for these securities.

Euroclear and Clearstream, Luxembourg hold interests on behalf of their participants through customers securities accounts in the names of Euroclear and Clearstream, Luxembourg on the books of their respective depositories, which, in the case of securities for which a global security in registered form is deposited with the DTC, in turn hold such interests in customers securities accounts in the depositories names on the books of the DTC.

The policies of DTC, Clearstream, Luxembourg and Euroclear will govern payments, transfers, exchange and other matters relating to the investor s interest in securities held by them. This is also true for any other clearance system that may be named in a prospectus supplement.

We have no responsibility for any aspect of the actions of DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We have no responsibility for any aspect of the records kept by DTC, Clearstream, Luxembourg or Euroclear or any of their direct or indirect participants. We also do not supervise these systems in any way. This is also true for any other clearing system indicated in a prospectus supplement.

DTC, Clearstream, Luxembourg, Euroclear and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. Investors should be aware that DTC, Clearstream, Luxembourg, Euroclear and their participants are not obligated to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Clearstream, Luxembourg and Euroclear as they are currently in effect. Those systems could change their rules and procedures at any time.

**The Clearing Systems**

*DTC*

DTC has advised us as follows:

DTC is:

(1) a limited purpose trust company organized under the laws of the State of New York;

(2) a banking organization within the meaning of New York Banking Law;

(3) a member of the Federal Reserve System;

(4) a clearing corporation within the meaning of the New York Uniform Commercial Code; and

(5) a clearing agency registered pursuant to the provisions of Section 17A of the Exchange Act.

DTC was created to hold securities for its participants and to facilitate the clearance and settlement of securities transactions between participants through electronic book-entry changes to accounts of its participants. This eliminates the need for physical movement of securities.

Participants in DTC include securities brokers and dealers, banks, trust companies and clearing corporations and may include certain other organizations. DTC is partially owned by some of these participants or their representatives.

Indirect access to the DTC system is also available to banks, brokers and dealers and trust companies that have custodial relationships with participants.

The rules applicable to DTC and DTC participants are on file with the SEC.

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*Clearstream, Luxembourg*

Clearstream, Luxembourg has advised us as follows:

Clearstream, Luxembourg is a duly licensed bank organized as a *société anonyme* incorporated under the laws of Luxembourg and is subject to regulation by the Luxembourg Commission for the Supervision of the Financial Sector (Commission de Surveillance du Secteur Financier).

Clearstream, Luxembourg holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through electronic book-entry transfers between the accounts of its customers. This eliminates the need for physical movement of securities.

Clearstream, Luxembourg provides other services to its customers, including safekeeping, administration, clearance and settlement of internationally traded securities and lending and borrowing of securities. It interfaces with the domestic markets in over 30 countries through established depositary and custodial relationships.

Clearstream, Luxembourg s customers include worldwide securities brokers and dealers, banks, trust companies and clearing corporations and may include professional financial intermediaries. Its U.S. customers are limited to securities brokers and dealers and banks.

Indirect access to the Clearstream, Luxembourg system is also available to others that clear through Clearstream, Luxembourg customers or that have custodial relationships with its customers, such as banks, brokers, dealers and trust companies.

*Euroclear*

Euroclear has advised us as follows:

Euroclear is incorporated under the laws of Belgium as a bank and is subject to regulation by the National Bank of Belgium (*Banque Nationale de Belgique / Nationale Bank van België*).

Euroclear holds securities for its customers and facilitates the clearance and settlement of securities transactions among them. It does so through simultaneous electronic book-entry delivery against payment, thereby eliminating the need for physical movement of certificates.

Euroclear provides other services to its customers, including credit, custody, lending and borrowing of securities and tri-party collateral management. It interfaces with the domestic markets of several countries.

Euroclear customers include banks, including central banks, securities brokers and dealers, trust companies and clearing corporations and may include certain other professional financial intermediaries.

Indirect access to the Euroclear system is also available to others that clear through Euroclear customers or that have custodial relationships with Euroclear customers.

All securities in Euroclear are held on a fungible basis. This means that specific certificates are not matched to specific securities clearance accounts.

*Other Clearing Systems*

We may choose any other clearing system for a particular series of debt securities. The clearance and settlement procedures for the clearing system we choose will be described in the applicable prospectus supplement.

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**Primary Distribution**

The distribution of the debt securities will be cleared through one or more of the clearing systems that we have described above or any other clearing system that is specified in the applicable prospectus supplement. Payment for debt securities will be made on a delivery versus payment or free delivery basis. These payment procedures will be more fully described in the applicable prospectus supplement.

Clearance and settlement procedures may vary from one series of debt securities to another according to the currency that is chosen for the specific series of securities. Customary clearance and settlement procedures are described below.

We will submit applications to the relevant system or systems for the debt securities to be accepted for clearance. The clearance numbers that are applicable to each clearance system will be specified in the applicable prospectus supplement.

**Clearance and Settlement Procedures DTC**

DTC participants that hold debt securities through DTC on behalf of investors will follow the settlement practices applicable to United States corporate debt obligations in DTC s Same-Day Funds Settlement System, or such other procedures as are applicable for other securities.

Debt securities will be credited to the securities custody accounts of these DTC participants against payment in same-day funds, for payments in U.S. dollars, on the settlement date. For payments in a currency other than U.S. dollars, debt securities will be credited free of payment on the settlement date.

**Clearance and Settlement Procedures Euroclear and Clearstream, Luxembourg**

We understand that investors that hold their debt securities through Euroclear or Clearstream, Luxembourg accounts will follow the settlement procedures that are applicable to conventional Eurobonds in registered form for debt securities, or such other procedures as are applicable for other securities.

Debt securities will be credited to the securities custody accounts of Euroclear and Clearstream, Luxembourg participants on the business day following the settlement date, for value on the settlement date. They will be credited either free of payment or against payment for value on the settlement date.

**Secondary Market Trading**

*Trading Between DTC Participants*

Secondary market trading between DTC participants will occur in the ordinary way in accordance with DTC s rules. Secondary market trading will be settled using procedures applicable to United States corporate debt obligations in DTC s Same-Day Funds Settlement System for debt securities, or such other procedures as are applicable for other securities.

If payment is made in U.S. dollars, settlement will be in same-day funds. If payment is made in a currency other than U.S. dollars, settlement will be free of payment. If payment is made other than in U.S. dollars, separate payment arrangements outside of the DTC system must be made between the DTC participants involved.

*Trading Between Euroclear and/or Clearstream, Luxembourg Participants*

We understand that secondary market trading between Euroclear and/or Clearstream, Luxembourg participants will occur in the ordinary way following the applicable rules and operating procedures of Euroclear and Clearstream, Luxembourg. Secondary market trading will be settled using procedures applicable to conventional Eurobonds in registered form for debt securities, or such other procedures as are applicable for other securities.

*Trading Between a DTC Seller and a Euroclear or Clearstream, Luxembourg Purchaser*

A purchaser of debt securities that are held in the account of a DTC participant must send instructions to Euroclear or Clearstream, Luxembourg at least one business day prior to settlement. The instructions will provide for the transfer of the debt securities from the selling DTC participant s account to the account of the purchasing Euroclear or Clearstream, Luxembourg participant. Euroclear or Clearstream, Luxembourg, as the case may be, will then instruct the common depositary for Euroclear and Clearstream, Luxembourg to receive the debt securities either against payment or free of payment.

The interests in the debt securities will be credited to the respective clearing system. The clearing system will then credit the account of the participant, following its usual procedures. Credit for the debt securities will appear on the next day, European time. Cash debit will be back-valued to, and the interest on the debt securities will accrue from, the value date, which would be the preceding day, when settlement occurs in New York. If the trade fails and settlement is not completed on the intended date, the Euroclear or Clearstream, Luxembourg cash debit will be valued as of the actual settlement date instead.

Euroclear participants or Clearstream, Luxembourg participants will need the funds necessary to process same-day funds settlement. The most direct means of doing this is to pre-position funds for settlement, either from cash or from existing lines of credit, as for any settlement occurring within Euroclear or Clearstream, Luxembourg. Under this approach, participants may take on credit exposure to Euroclear or Clearstream, Luxembourg until the debt securities are credited to their accounts one business day later.

As an alternative, if Euroclear or Clearstream, Luxembourg has extended a line of credit to them, participants can choose not to pre-position funds and will instead allow that credit line to be drawn upon to finance settlement. Under this procedure, Euroclear participants or Clearstream, Luxembourg participants purchasing debt securities would incur overdraft charges for one business day (assuming they cleared the overdraft as soon as the debt securities were credited to their accounts). However, any interest on the debt securities would accrue from the value date. Therefore, in many cases, the investment income on debt securities that is earned during that one-business day period may substantially reduce or offset the amount of the overdraft charges. This result will, however, depend on each participant s particular cost of funds.

Because the settlement will take place during New York business hours, DTC participants will use their usual procedures to deliver debt securities to the depositary on behalf of Euroclear participants or Clearstream, Luxembourg participants. The sale proceeds will be available to the DTC seller on the settlement date. For the DTC participants, then, a cross-market transaction will settle no differently than a trade between two DTC participants.

**Special Timing Considerations**

Investors should be aware that they will only be able to make and receive deliveries, payments and other communications involving the debt securities through Clearstream, Luxembourg and Euroclear on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Clearstream, Luxembourg and Euroclear on the same business day as in the United States. U.S. investors who wish to transfer their interests in the debt securities, or to receive or make a payment or delivery of the debt securities, on a particular day, may find that the transactions will not be performed until the next business day in Luxembourg or Brussels, depending on whether Clearstream, Luxembourg or Euroclear is used.

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## TAX CONSIDERATIONS

### United States Taxation

This section describes the material United States federal income tax consequences of owning the debt securities we are offering. It applies to you only if you acquire debt securities in the offering and you hold your debt securities as capital assets for tax purposes. This section is the opinion of Sullivan & Cromwell LLP, U.S. counsel to the Issuers. This section does not apply to you if you are a member of a class of holders subject to special rules, such as:

- a dealer in securities or currencies,
- a trader in securities that elects to use a mark-to-market method of accounting for your securities holdings,
- a bank,
- a life insurance company,
- a tax-exempt organization,
- a person that owns debt securities that are a hedge or that are hedged against interest rate or currency risks,
- a person that owns debt securities as part of a straddle or conversion transaction for tax purposes,
- a person that purchases or sells debt securities as part of a wash sale for tax purposes, or
- a United States holder (as defined below) whose functional currency for tax purposes is not the U.S. dollar.

This section deals only with debt securities that are issued in registered form and that are due to mature 30 years or less from the date on which they are issued. The United States federal income tax consequences of owning debt securities that are in bearer form or that are due to mature more than 30 years from their date of issue will be discussed in an applicable prospectus supplement. This section is based on the Code, its legislative history, existing and proposed regulations under the Code, published rulings and court decisions, all as currently in effect. These laws are subject to change, possibly on a retroactive basis.

If a partnership holds the debt securities, the United States federal income tax treatment of a partner will generally depend on the status of the partner and the tax treatment of the partnership. A partner in a partnership holding the debt securities should consult its tax advisor with regard to the United States federal income tax treatment of an investment in the debt securities.

*Please consult your own tax advisor concerning the consequences of owning these debt securities in your particular circumstances under the Code and the laws of any other taxing jurisdiction.*

**Debt Securities Issued by Anheuser-Busch InBev Worldwide Inc.**

**United States Holders**

This subsection describes the tax consequences to a United States holder. You are a United States holder if you are a beneficial owner of a debt security and you are:

- a citizen or resident of the United States,
- a domestic corporation,

an estate whose income is subject to United States federal income tax regardless of its source, or

a trust if a United States court can exercise primary supervision over the trust s administration and one or more United States persons are authorized to control all substantial decisions of the trust.

If you are not a United States holder, this subsection does not apply to you and you should refer to United States Alien Holders below.

Under recently enacted legislation, United States holders that use an accrual method of accounting for tax purposes generally will be required to include certain amounts in income no later than the time such amounts are reflected on certain financial statements. The application of this rule thus may require the accrual of income earlier than would be the case under the general tax rules described below, although the precise application of this rule is unclear at this time. This rule generally will be effective for tax years beginning after December 31, 2017 or, for debt securities issued with original issue discount, for tax years beginning after December 31, 2018. United States holders that use an accrual method of accounting should consult with their tax advisors regarding the potential applicability of this legislation to their particular situation.

**Payments of Interest**

Except as described below in the case of interest on a discount debt security that is not qualified stated interest, each as defined below under Original Issue Discount General , you will be taxed on any interest on your debt security (including any additional amounts paid with respect to withholding tax, as described above), whether payable in U.S. dollars or a foreign currency, including a composite currency or basket of currencies other than U.S. dollars, as ordinary income at the time you receive the interest or when it accrues, depending on your method of accounting for tax purposes.

Cash Basis Taxpayers. If you are a taxpayer that uses the cash receipts and disbursements method of accounting for tax purposes and you receive an interest payment that is denominated in, or determined by reference to, a foreign currency, you must recognize income equal to the U.S. dollar value of the interest payment, based on the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars.

Accrual Basis Taxpayers. If you are a taxpayer that uses an accrual method of accounting for tax purposes, you may determine the amount of income that you recognize with respect to an interest payment denominated in, or determined by reference to, a foreign currency by using one of two methods. Under the first method, you will determine the amount of income accrued based on the average exchange rate in effect during the interest accrual period or, with respect to an accrual period that spans two taxable years, that part of the period within the taxable year.

If you elect the second method, you would determine the amount of income accrued on the basis of the exchange rate in effect on the last day of the accrual period, or, in the case of an accrual period that spans two taxable years, the exchange rate in effect on the last day of the part of the period within the taxable year. Additionally, under this second method, if you receive a payment of interest within five business days of the last day of your accrual period or taxable year, you may instead translate the interest accrued into U.S. dollars at the exchange rate in effect on the day that you actually receive the interest payment. If you elect the second method, it will apply to all debt instruments that you hold at the beginning of the first taxable year to which the election applies and to all debt instruments that you subsequently acquire. You may not revoke this election without the consent of the Internal Revenue Service.

When you actually receive an interest payment, including a payment attributable to accrued but unpaid interest upon the sale or retirement of your debt security, denominated in, or determined by reference to, a foreign currency for which you accrued an amount of income, you will recognize ordinary income or loss measured by the difference, if any, between the exchange rate that you used to accrue interest income and the exchange rate in effect on the date of receipt, regardless of whether you actually convert the payment into U.S. dollars.

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**Original Issue Discount**

General. If you own a debt security, other than a short-term debt security with a term of one year or less, it will be treated as a discount debt security issued at an original issue discount if the amount by which the debt security s stated redemption price at maturity exceeds its issue price is more than a de minimis amount. Generally, a debt security s issue price will be the first price at which a substantial amount of debt securities included in the issue of which the debt security is a part is sold to persons other than bond houses, brokers, or similar persons or organizations acting in the capacity of underwriters, placement agents, or wholesalers. A debt security s stated redemption price at maturity is the total of all payments provided by the debt security that are not payments of qualified stated interest. Generally, an interest payment on a debt security is qualified stated interest if it is one of a series of stated interest payments on a debt security that are unconditionally payable at least annually at a single fixed rate, with certain exceptions for lower rates paid during some periods, applied to the outstanding principal amount of the debt security. There are special rules for variable rate debt securities that are discussed under Variable Rate Debt securities .

In general, your debt security is not a discount debt security if the amount by which its stated redemption price at maturity exceeds its issue price is less than the de minimis amount of $^1/_4$ of 1 percent of its stated redemption price at maturity multiplied by the number of complete years to its maturity. Your debt security will have de minimis original issue discount if the amount of the excess is less than the de minimis amount. If your debt security has de minimis original issue discount, you must include the de minimis amount in income as stated principal payments are made on the debt security, unless you make the election described below under Election to Treat All Interest as Original Issue Discount . You can determine the includible amount with respect to each such payment by multiplying the total amount of your debt security s de minimis original issue discount by a fraction equal to:

- the amount of the principal payment made

divided by:

- the stated principal amount of the debt security.

Generally, if your discount debt security matures more than one year from its date of issue, you must include original issue discount, or **OID** , in income before you receive cash attributable to that income. The amount of OID that you must include in income is calculated using a constant-yield method, and generally you will include increasingly greater amounts of OID in income over the life of your debt security. More specifically, you can calculate the amount of OID that you must include in income by adding the daily portions of OID with respect to your discount debt security for each day during the taxable year or portion of the taxable year that you hold your discount debt security. You can determine the daily portion by allocating to each day in any accrual period a pro rata portion of the OID allocable to that accrual period. You may select an accrual period of any length with respect to your discount debt security and you may vary the length of each accrual period over the term of your discount debt security. However, no accrual period may be longer than one year and each scheduled payment of interest or principal on the discount debt security must occur on either the first or final day of an accrual period.

You can determine the amount of OID allocable to an accrual period by:

- multiplying your discount debt security s adjusted issue price at the beginning of the accrual period by your debt security s yield to maturity, and then

- subtracting from this figure the sum of the payments of qualified stated interest on your debt security allocable to the accrual period.

You must determine the discount debt security s yield to maturity on the basis of compounding at the close of each accrual period and adjusting for the length of each accrual period. Further, you determine your discount debt security s adjusted issue price at the beginning of any accrual period by:

- adding your discount debt security s issue price and any accrued OID for each prior accrual period, and then

subtracting any payments previously made on your discount debt security that were not qualified stated interest payments.

If an interval between payments of qualified stated interest on your discount debt security contains more than one accrual period, then, when you determine the amount of OID allocable to an accrual period, you must allocate the amount of qualified stated interest payable at the end of the interval, including any qualified stated interest that is payable on the first day of the accrual period immediately following the interval, pro rata to each accrual period in the interval based on their relative lengths. In addition, you must increase the adjusted issue price at the beginning of each accrual period in the interval by the amount of any qualified stated interest that has accrued prior to the first day of the accrual period but that is not payable until the end of the interval. You may compute the amount of OID allocable to an initial short accrual period by using any reasonable method if all other accrual periods, other than a final short accrual period, are of equal length.

The amount of OID allocable to the final accrual period is equal to the difference between:

the amount payable at the maturity of your debt security, other than any payment of qualified stated interest, and

your debt security s adjusted issue price as of the beginning of the final accrual period.

Acquisition Premium. If you purchase your debt security for an amount that is less than or equal to the sum of all amounts, other than qualified stated interest, payable on your debt security after the purchase date but is greater than the amount of your debt security s adjusted issue price, as determined above under General , the excess is acquisition premium. If you do not make the election described below under Election to Treat All Interest as Original Issue Discount , then you must reduce the daily portions of OID by a fraction equal to:

the excess of your adjusted basis in the debt security immediately after purchase over the adjusted issue price of the debt security

divided by:

the excess of the sum of all amounts payable, other than qualified stated interest, on the debt security after the purchase date over the debt security s adjusted issue price.

Pre-Issuance Accrued Interest. An election may be made to decrease the issue price of your debt security by the amount of pre-issuance accrued interest if:

a portion of the initial purchase price of your debt security is attributable to pre-issuance accrued interest,

the first stated interest payment on your debt security is to be made within one year of your debt security s issue date, and

the payment will equal or exceed the amount of pre-issuance accrued interest.

If this election is made, a portion of the first stated interest payment will be treated as a return of the excluded pre-issuance accrued interest and not as an amount payable on your debt security.

Debt Securities Subject to Contingencies Including Optional Redemption. Your debt security is subject to a contingency if it provides for an alternative payment schedule or schedules applicable upon the occurrence of a contingency or contingencies, other than a remote or incidental contingency, whether such contingency relates to payments of interest or of principal. In such a case, you must determine the yield and maturity of your debt security by assuming that the payments will be made according to the payment schedule most likely to occur if:

the timing and amounts of the payments that comprise each payment schedule are known as of the issue date and

one of such schedules is significantly more likely than not to occur.

If there is no single payment schedule that is significantly more likely than not to occur, other than because of a mandatory sinking fund, you must include income on your debt security in accordance with the general rules that govern contingent payment obligations. These rules will be discussed in the applicable prospectus supplement.

Notwithstanding the general rules for determining yield and maturity, if your debt security is subject to contingencies, and either you or we have an unconditional option or options that, if exercised, would require payments to be made on the debt security under an alternative payment schedule or schedules, then:

- in the case of an option or options that we may exercise, we will be deemed to exercise or not exercise an option or combination of options in the manner that minimizes the yield on your debt security and

- in the case of an option or options that you may exercise, you will be deemed to exercise or not exercise an option or combination of options in the manner that maximizes the yield on your debt security.

If both you and we hold options described in the preceding sentence, those rules will apply to each option in the order in which they may be exercised. You may determine the yield on your debt security for the purposes of those calculations by using any date on which your debt security may be redeemed or repurchased as the maturity date and the amount payable on the date that you chose in accordance with the terms of your debt security as the principal amount payable at maturity.

If a contingency, including the exercise of an option, actually occurs or does not occur contrary to an assumption made according to the above rules then, except to the extent that a portion of your debt security is repaid as a result of this change in circumstances and solely to determine the amount and accrual of OID, you must redetermine the yield and maturity of your debt security by treating your debt security as having been retired and reissued on the date of the change in circumstances for an amount equal to your debt security s adjusted issue price on that date.

Election to Treat All Interest as Original Issue Discount. You may elect to include in gross income all interest that accrues on your debt security using the constant-yield method described above under General , with the modifications described below. For purposes of this election, interest will include stated interest, OID, de minimis original issue discount, market discount, de minimis market discount and unstated interest, as adjusted by any amortizable bond premium, described below under Debt Securities Purchased at a Premium , or acquisition premium.

If you make this election for your debt security, then, when you apply the constant-yield method:

- the issue price of your debt security will equal your cost,

- the issue date of your debt security will be the date you acquired it, and

- no payments on your debt security will be treated as payments of qualified stated interest.

Generally, this election will apply only to the debt security for which you make it; however, if the debt security has amortizable bond premium, you will be deemed to have made an election to apply amortizable bond premium against interest for all debt instruments with amortizable bond premium, other than debt instruments the interest on which is excludible from gross income, that you hold as of the beginning of the taxable year to which the election applies or any taxable year thereafter. Additionally, if you make this election for a market discount debt security, you will be treated as having made the election discussed below under Market Discount to include market discount in income currently over the life of all debt instruments having market discount that you

acquire on or after the first day of the first taxable year to which the election applies. You may not revoke any election to apply the constant-yield method to all interest on a debt security or the deemed elections with respect to amortizable bond premium or market discount debt securities without the consent of the Internal Revenue Service (the **IRS** ).

Variable Rate Debt Securities. Your debt security will be a variable rate debt security if:

your debt security s issue price does not exceed the total non-contingent principal payments by more than the lesser of:

1. .015 multiplied by the product of the total non-contingent principal payments and the number of complete years to maturity from the issue date, or

2. 15 percent of the total non-contingent principal payments;

your debt security provides for stated interest, compounded or paid at least annually, only at:

1. one or more qualified floating rates,

2. a single fixed rate and one or more qualified floating rates,

3. a single objective rate, or

4. a single fixed rate and a single objective rate that is a qualified inverse floating rate; and

the value of any variable rate on any date during the term of your debt security is set no earlier than three months prior to the first day on which that value is in effect and no later than one year following that first day.

Your debt security will have a variable rate that is a qualified floating rate if:

variations in the value of the rate can reasonably be expected to measure contemporaneous variations in the cost of newly borrowed funds in the currency in which your debt security is denominated; or

the rate is equal to such a rate either:

1. multiplied by a fixed multiple that is greater than 0.65 but not more than 1.35 or

2. multiplied by a fixed multiple greater than 0.65 but not more than 1.35, and then increased or decreased by a fixed rate.

If your debt security provides for two or more qualified floating rates that are within 0.25 percentage points of each other on the issue date or can reasonably be expected to have approximately the same values throughout the term of the debt security, the qualified floating rates together

constitute a single qualified floating rate.

Your debt security will not have a qualified floating rate, however, if the rate is subject to certain restrictions (including caps, floors, governors, or other similar restrictions) unless such restrictions are caps, floors or governors that are fixed throughout the term of the debt security or such restrictions are not reasonably expected to significantly affect the yield on the debt security.

Your debt security will have a variable rate that is a single objective rate if:

- the rate is not a qualified floating rate, and
- the rate is determined using a single, fixed formula that is based on objective financial or economic information that is not within the control of or unique to the circumstances of ABIWW or a related party.

Your debt security will not have a variable rate that is an objective rate, however, if it is reasonably expected that the average value of the rate during the first half of your debt security s term will be either significantly less than or significantly greater than the average value of the rate during the final half of your debt security s term.

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An objective rate as described above is a qualified inverse floating rate if:

- the rate is equal to a fixed rate minus a qualified floating rate and
- the variations in the rate can reasonably be expected to inversely reflect contemporaneous variations in the cost of newly borrowed funds.

Your debt security will also have a single qualified floating rate or an objective rate if interest on your debt security is stated at a fixed rate for an initial period of one year or less followed by either a qualified floating rate or an objective rate for a subsequent period, and either:

- the fixed rate and the qualified floating rate or objective rate have values on the issue date of the debt security that do not differ by more than 0.25 percentage points or
- the value of the qualified floating rate or objective rate is intended to approximate the fixed rate.

In general, if your variable rate debt security provides for stated interest at a single qualified floating rate or objective rate, or one of those rates after a single fixed rate for an initial period, all stated interest on your debt security is qualified stated interest. In this case, the amount of OID, if any, is determined by using, in the case of a qualified floating rate or qualified inverse floating rate, the value as of the issue date of the qualified floating rate or qualified inverse floating rate, or, for any other objective rate, a fixed rate that reflects the yield reasonably expected for your debt security.

If your variable rate debt security does not provide for stated interest at a single qualified floating rate or a single objective rate, and also does not provide for interest payable at a fixed rate other than a single fixed rate for an initial period, you generally must determine the interest and OID accruals on your debt security by:

| | | | | | | |
|---|---|---|---|---|---|---|
| **Expenses** | | | | | | |
| Benefits, claims and settlement expenses | | **1,110.0** | | **1,108.7** | | **1.3** |
| Operating expenses | | **724.1** | | **725.2** | | **(1.1)** |
| | | | | | | |
| Income before income taxes | | **235.0** | | **235.7** | | **(0.7)** |
| Income taxes | | **50.9** | | **51.1** | | **(0.2)** |
| Net income | **$** | **184.1** | **$** | **184.6** | **$** | **(0.5)** |
| | | | | | | |
| Net income available to common stockholders | **$** | **173.1** | **$** | **173.6** | **$** | **(0.5)** |
| | | | | | | |
| **Earnings per common share** | | | | | | |
| Basic earnings per common share | **$** | **0.58** | **$** | **0.58** | **$** | |
| Diluted earnings per common share | **$** | **0.58** | **$** | **0.58** | **$** | |

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**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**June 30, 2012**

**(Unaudited)**

**Consolidated Statements of Operations**

| | For the six months ended June 30, 2012 | | |
|---|---|---|---|
| | New reinsurance accounting method | Former reinsurance accounting method | Effect of Reinsurance Accounting Change |
| | (in millions, except per share data) | | |
| **Revenue** | | | |
| Fees and other revenues | $ 1,234.1 | $ 1,243.1 | $ (9.0) |
| | | | |
| **Expenses** | | | |
| Benefits, claims and settlement expenses | 2,322.5 | 2,308.5 | 14.0 |
| Operating expenses | 1,280.1 | 1,302.1 | (22.0) |
| | | | |
| Income before income taxes | 512.1 | 513.1 | (1.0) |
| Income taxes | 109.1 | 109.4 | (0.3) |
| Net income | $ 403.0 | $ 403.7 | $ (0.7) |
| | | | |
| Net income available to common stockholders | $ 374.6 | $ 375.3 | $ (0.7) |
| | | | |
| **Earnings per common share** | | | |
| Basic earnings per common share | $ 1.25 | $ 1.25 | $ |
| Diluted earnings per common share | $ 1.24 | $ 1.24 | $ |

Certain of the current and prior period line items in the consolidated statements of cash flows and consolidated statements of stockholders equity were affected by the DPAC Guidance and the Reinsurance Accounting Change. All of the line item changes in the consolidated statements of cash flows were included in the operating activities section and the changes in the consolidated statements of stockholders equity have largely been addressed through the preceding disclosures.

Our accounting policy for DPAC follows, which has been updated from our Form 10-K for the year ended December 31, 2011, to reflect this change.

**Deferred Policy Acquisition Costs**

Incremental direct costs of contract acquisition as well as certain costs directly related to acquisition activities (underwriting, policy issuance and processing, medical and inspection and sales force contract selling) for the successful 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.

DPAC for universal life-type insurance contracts, participating life insurance policies and certain investment contracts are being amortized over the lives of the policies and contracts in relation to the emergence of EGPs or, in certain circumstances, estimated gross revenues. This amortization is adjusted in the current period when EGPs or estimated gross revenues are revised. For individual variable life insurance, individual variable annuities and group annuities that 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 assumption used for the amortization of DPAC. The DPAC of nonparticipating term life insurance and individual disability policies are being amortized over the premium-paying period of the related policies using assumptions consistent with those used in computing policyholder liabilities.

DPAC 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. If loss recognition is necessary, DPAC would be 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.

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## Recent Accounting Pronouncements

In December 2011, the FASB issued authoritative guidance related to balance sheet offsetting. The new guidance requires disclosures about assets and liabilities that are offset or have the potential to be offset. These disclosures are intended to address differences in the asset and liability offsetting requirements under U.S. GAAP and International Financial Reporting Standards. This new guidance will be effective for us for interim and annual reporting periods beginning January 1, 2013, with retrospective application required and is not expected to have a material impact on our consolidated financial statements.

Also in December 2011, the FASB issued authoritative guidance that requires a reporting entity to follow the real estate sales guidance when the reporting entity ceases to have a controlling financial interest in a subsidiary that is in-substance real estate as a result of a default on the subsidiary s nonrecourse debt. This guidance will be effective for us on January 1, 2013, and is not expected to have a material impact on our consolidated financial statements.

In September 2011, the FASB issued authoritative guidance that amends how goodwill is tested for impairment. The amendments provide an option to perform a qualitative assessment to determine whether it is necessary to perform the annual two-step quantitative goodwill impairment test. This guidance will be effective for our 2012 goodwill impairment test and is not expected to have a material impact on our consolidated financial statements.

In June 2011, the FASB issued authoritative guidance that changes the presentation of comprehensive income in the financial statements. The new guidance eliminates the presentation options contained in current guidance and instead requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements that show the components of net income and other comprehensive income ( OCI ), including adjustments for items that are reclassified from OCI to net income. The guidance does not change the items that must be reported in OCI or when an item of OCI must be reclassified to net income. In December 2011, the FASB issued a final standard to defer the new requirement to present classification adjustments out of OCI to net income on the face of the financial statements. All other requirements contained in the original statement on comprehensive income are still effective. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. The required disclosures are included in our consolidated financial statements. See Note 8, Stockholders Equity, for further details.

In May 2011, the FASB issued authoritative guidance that clarifies and changes fair value measurement and disclosure requirements. This guidance expands existing disclosure requirements for fair value measurements and makes other amendments but does not require additional fair value measurements. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. See Note 9, Fair Value Measurements, for further details.

In April 2011, the FASB issued authoritative guidance that modifies the criteria for determining when repurchase agreements would be accounted for as secured borrowings as opposed to sales. The guidance was effective for us on January 1, 2012, for new transfers and modifications to existing transactions and did not have a material impact on our consolidated financial statements.

Also in April 2011, the FASB issued authoritative guidance which clarifies when creditors should classify a loan modification as a troubled debt restructuring ( TDR ). A TDR occurs when a creditor grants a concession to a debtor experiencing financial difficulties. Loans denoted as a TDR are considered impaired and are specifically reserved for when calculating the allowance for credit losses. This guidance also ends the indefinite deferral issued in January 2011 surrounding new disclosures on loans classified as a TDR required as part of the credit quality disclosures guidance issued in July 2010. This guidance was effective for us on July 1, 2011, and was applied retrospectively to restructurings occurring on or after January 1, 2011. This guidance did not have a material impact on our consolidated financial statements. See Note 3, Investments, for further detail.

In July 2010, the FASB issued authoritative guidance that requires new and expanded disclosures related to the credit quality of financing receivables and the allowance for credit losses. Reporting entities are required to provide qualitative and quantitative disclosures on the allowance for credit losses, credit quality, impaired loans, modifications and nonaccrual and past due financing receivables. The disclosures are required to be presented on a disaggregated basis by portfolio segment and class of financing receivable. Disclosures required by the guidance that relate to the end of a reporting period were effective for us in our December 31, 2010, consolidated financial statements. Disclosures required by the guidance that relate to an activity that occurs during a reporting period were effective for us on January 1, 2011, and did not have a material impact on our consolidated financial statements. See Note 3, Investments, for further details.

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

In January 2010, the FASB issued authoritative guidance that requires new disclosures related to fair value measurements and clarifies existing disclosure requirements about the level of disaggregation, inputs and valuation techniques. Specifically, reporting entities now must disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In addition, in the reconciliation for Level 3 fair value measurements, a reporting entity should present separately information about purchases, sales, issuances and settlements. The guidance clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities for disclosure of fair value measurement, considering the level of disaggregated information required by other applicable U.S. GAAP guidance and should also provide disclosures about the valuation techniques and inputs used to measure fair value for each class of assets and liabilities. This guidance was effective for us on January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair value measurements, which were effective for us on January 1, 2011. This guidance did not have a material impact on our consolidated financial statements. See Note 9, Fair Value Measurements, for further details.

**Separate Accounts**

At June 30, 2012 and December 31, 2011, the separate accounts include a separate account valued at $146.6 million and $146.5 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

**2. Variable Interest Entities**

We have relationships with and may have a variable interest in various types of special purpose entities. Following is a discussion of our interest in entities that meet the definition of a VIE. When we are the primary beneficiary, we are required to consolidate the entity in our financial statements. The primary beneficiary of a VIE is defined as the enterprise with (1) the power to direct the activities of a VIE that most significantly impact the entity s economic performance and (2) the obligation to absorb losses of the entity or the right to receive benefits from

the entity that could potentially be significant to the VIE. On an ongoing basis, we assess whether we are the primary beneficiary of VIEs we have relationships with.

**Consolidated Variable Interest Entities**

***Grantor Trusts***

We contributed undated subordinated floating rate notes to three grantor trusts. The trusts separated the cash flows by issuing an interest-only certificate and a residual certificate related to each note contributed. Each interest-only certificate entitles the holder to interest on the stated note for a specified term, while the residual certificate entitles the holder to interest payments subsequent to the term of the interest-only certificate and to all principal payments. We retained the interest-only certificates and the residual certificates were subsequently sold to third parties. We have determined these grantor trusts are VIEs due to insufficient equity to sustain them. We determined we are the primary beneficiary as a result of our contribution of securities into the trusts and our continuing interest in the trusts.

***Collateralized Private Investment Vehicles***

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

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primarily include derivatives and the notes due at maturity or termination of the trusts. We determined we are the primary beneficiary for certain of these entities because we act as the investment manager of the underlying portfolio and we have an ownership interest.

***Commercial Mortgage-Backed Securities***

We sold commercial mortgage loans to a real estate mortgage investment conduit trust. The trust issued various commercial mortgage-backed securities ( CMBS ) certificates using the cash flows of the underlying commercial mortgages it purchased. This is considered a VIE due to insufficient equity to sustain itself. We have determined we are the primary beneficiary as we retained the special servicing role for the assets within the trust as well as the ownership of the bond class that controls the unilateral kick out rights of the special servicer.

***Hedge Funds***

We are a general partner with insignificant equity ownership in various hedge funds. These entities were deemed VIEs due to the equity owners not having decision-making ability. We determined we were the primary beneficiary of these entities due to our control through our management relationships, related party ownership and our fee structure in certain of these funds.

In the second quarter of 2012, the hedge funds were no longer consolidated. We determined we were no longer the primary beneficiary due to the increase in external ownership in the funds. As a result of deconsolidation, total assets decreased $587.2 million and liabilities and noncontrolling interest decreased $586.1 million.

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

| | Grantor trusts | Collateralized private investment vehicles | CMBS<br>(in millions) | Hedge funds (2) | Total |
|---|---|---|---|---|---|
| **June 30, 2012** | | | | | |

| | | | | | |
|---|---|---|---|---|---|
| Fixed maturities, available-for-sale | **$ 184.8** | **$ 7.6** | **$** | **$** | **$ 192.4** |
| Fixed maturities, trading | | **132.4** | | | **132.4** |
| Other investments | | | **83.6** | | **83.6** |
| Accrued investment income | **0.6** | | **0.5** | | **1.1** |
| Total assets | **$ 185.4** | **$ 140.0** | **$ 84.1** | **$** | **$ 409.5** |
| Deferred income taxes | **$ 1.9** | **$** | **$** | **$** | **$ 1.9** |
| Other liabilities (1) | **133.9** | **135.9** | **50.9** | | **320.7** |
| Total liabilities | **$ 135.8** | **$ 135.9** | **$ 50.9** | **$** | **$ 322.6** |
| **December 31, 2011** | | | | | |
| Fixed maturities, available-for-sale | $ 199.2 | $ 15.0 | $ | $ | $ 214.2 |
| Fixed maturities, trading | | 132.4 | | | 132.4 |
| Equity securities, trading | | | | 207.6 | 207.6 |
| Other investments | | | 97.5 | 0.3 | 97.8 |
| Cash and cash equivalents | | | | 317.7 | 317.7 |
| Accrued investment income | 1.2 | 0.1 | 0.6 | | 1.9 |
| Premiums due and other receivables | | | | 39.1 | 39.1 |
| Total assets | $ 200.4 | $ 147.5 | $ 98.1 | $ 564.7 | $ 1,010.7 |
| Deferred income taxes | $ 2.2 | $ | $ | $ | $ 2.2 |
| Other liabilities (1) | 136.9 | 143.8 | 64.5 | 220.0 | 565.2 |
| Total liabilities | $ 139.1 | $ 143.8 | $ 64.5 | $ 220.0 | $ 567.4 |

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

(2) The consolidated statements of financial position included a $343.6 million noncontrolling interest for hedge funds as of December 31, 2011.

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We did not provide financial or other support to investees designated as VIEs for the six months ended June 30, 2012 and 2011.

**Unconsolidated Variable Interest Entities**

***Invested Securities***

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

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

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

We have invested in various VIE trusts as a debt holder. All of these entities are classified as VIEs due to insufficient equity to sustain them. We have determined we are not the primary beneficiary primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

We have invested in partnerships, some of which are classified as VIEs. The partnership returns are in the form of income tax credits and investment income. These entities are classified as VIEs as the general partner does not have an equity investment at risk in the entity. We have determined we are not the primary beneficiary because we are not the general partner, who makes all the significant decisions for the entity.

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

| | Asset carrying value | Maximum exposure to loss (1) |
|---|---|---|
| | (in millions) | |
| **June 30, 2012** | | |
| Fixed maturities, available-for-sale: | | |
| Corporate | **$ 526.8** | **$ 396.3** |
| Residential mortgage-backed pass-through securities | **3,298.2** | **3,095.7** |
| Commercial mortgage-backed securities | **3,744.9** | **4,128.1** |
| Collateralized debt obligations | **366.1** | **438.4** |
| Other debt obligations | **3,480.2** | **3,525.5** |
| Fixed maturities, trading: | | |
| Residential mortgage-backed pass-through securities | **103.3** | **103.3** |
| Commercial mortgage-backed securities | **3.5** | **3.5** |
| Collateralized debt obligations | **50.6** | **50.6** |
| Other debt obligations | **16.9** | **16.9** |
| Other investments: | | |
| Other limited partnership interests | **126.3** | **126.3** |
| | | |
| **December 31, 2011** | | |
| Fixed maturities, available-for-sale: | | |
| Corporate | $ 544.0 | $ 392.6 |
| Residential mortgage-backed pass-through securities | 3,343.0 | 3,155.8 |
| Commercial mortgage-backed securities | 3,413.7 | 3,894.3 |
| Collateralized debt obligations | 338.8 | 399.7 |
| Other debt obligations | 3,570.2 | 3,606.9 |
| Fixed maturities, trading: | | |
| Residential mortgage-backed pass-through securities | 105.6 | 105.6 |
| Commercial mortgage-backed securities | 12.0 | 12.0 |
| Collateralized debt obligations | 51.4 | 51.4 |
| Other debt obligations | 64.9 | 64.9 |
| Other investments: | | |
| Other limited partnership interests | 122.1 | 122.1 |

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

***Sponsored Investment Funds***

We are the investment manager for certain money market mutual funds that are deemed to be VIEs. We are not the primary beneficiary of these VIEs since our involvement is limited primarily to being a service provider, and our variable interest does not absorb the majority of the variability of the entities net assets. As of June 30, 2012 and December 31, 2011, these VIEs held $1.5 billion and $1.7 billion in total assets, respectively. We have no contractual obligation to contribute to the funds.

We provide asset management and other services to certain investment structures that are considered VIEs as we generally earn performance-based management fees. We are not the primary beneficiary of these entities as we do not have the obligation to absorb losses of the entities that could be potentially significant to the VIE or the right to receive benefits from these entities that could be potentially significant.

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## 3. Investments

### Fixed Maturities and Equity Securities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock and nonredeemable preferred stock. We classify fixed maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 9, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders equity, net of adjustments related to DPAC, sales inducements, unearned revenue reserves, policyholder liabilities, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). We also have a minimal amount of assets within trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. Mark-to-market adjustments related to these trading securities are reflected in net investment income.

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

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

| | Amortized cost | Gross unrealized gains | Gross unrealized losses (in millions) | Other-than-temporary impairments in AOCI (1) | Fair value |
|---|---|---|---|---|---|
| **June 30, 2012** | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| U.S. government and agencies | $ 790.9 | $ 34.1 | $ 0.9 | $ | $ 824.1 |
| Non-U.S. government and agencies | 918.0 | 242.1 | 0.9 | | 1,159.2 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| States and political subdivisions | | **2,638.4** | | **232.4** | | **1.4** | | | | **2,869.4** |
| Corporate | | **31,992.8** | | **2,601.6** | | **523.5** | | **19.4** | | **34,051.5** |
| Residential mortgage-backed pass-through securities | | **3,095.7** | | **202.7** | | **0.2** | | | | **3,298.2** |
| Commercial mortgage-backed securities | | **4,128.1** | | **161.1** | | **351.6** | | **192.7** | | **3,744.9** |
| Collateralized debt obligations | | **438.4** | | **2.9** | | **67.2** | | **8.0** | | **366.1** |
| Other debt obligations | | **3,525.5** | | **60.4** | | **19.1** | | **86.6** | | **3,480.2** |
| Total fixed maturities, available-for-sale | **$** | **47,527.8** | **$** | **3,537.3** | **$** | **964.8** | **$** | **306.7** | **$** | **49,793.6** |
| Total equity securities, available-for-sale | **$** | **140.3** | **$** | **12.2** | **$** | **13.5** | | | **$** | **139.0** |
| **December 31, 2011** | | | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | | | |
| U.S. government and agencies | $ | 772.3 | $ | 32.8 | $ | | $ | | $ | 805.1 |
| Non-U.S. government and agencies | | 917.6 | | 180.5 | | 1.4 | | | | 1,096.7 |
| States and political subdivisions | | 2,670.0 | | 218.2 | | 5.5 | | | | 2,882.7 |
| Corporate | | 31,954.2 | | 2,321.3 | | 699.5 | | 19.5 | | 33,556.5 |
| Residential mortgage-backed pass-through securities | | 3,155.8 | | 187.9 | | 0.7 | | | | 3,343.0 |
| Commercial mortgage-backed securities | | 3,894.3 | | 117.0 | | 429.4 | | 168.2 | | 3,413.7 |
| Collateralized debt obligations | | 399.7 | | 1.9 | | 55.8 | | 7.0 | | 338.8 |
| Other debt obligations | | 3,606.9 | | 100.3 | | 47.0 | | 90.0 | | 3,570.2 |
| Total fixed maturities, available-for-sale | $ | 47,370.8 | $ | 3,159.9 | $ | 1,239.3 | $ | 284.7 | $ | 49,006.7 |
| Total equity securities, available-for-sale | $ | 75.2 | $ | 8.4 | $ | 6.5 | | | $ | 77.1 |

(1) Excludes $29.0 million and $28.9 million as of June 30, 2012 and December 31, 2011, respectively, of net unrealized gains on impaired fixed maturities, available-for-sale related to changes in fair value subsequent to the impairment date.

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The amortized cost and fair value of fixed maturities available-for-sale at June 30, 2012, by expected maturity, were as follows:

| | Amortized cost | Fair value |
|---|---|---|
| | (in millions) | |
| Due in one year or less | $ 3,605.4 | $ 3,657.7 |
| Due after one year through five years | 12,713.2 | 13,231.7 |
| Due after five years through ten years | 9,131.5 | 10,058.0 |
| Due after ten years | 10,890.0 | 11,956.8 |
| Subtotal | 36,340.1 | 38,904.2 |
| Mortgage-backed and other asset-backed securities | 11,187.7 | 10,889.4 |
| Total | $ 47,527.8 | $ 49,793.6 |

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

**Net Realized Capital Gains and Losses**

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

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (in millions) | | | |
| Fixed maturities, available-for-sale: | | | | |
| Gross gains | $ 4.4 | $ 5.7 | $ 19.7 | $ 18.2 |
| Gross losses | (50.8) | (37.9) | (86.9) | (61.2) |
| | 17.1 | (9.7) | 22.0 | (48.1) |

| | | | | |
|---|---|---|---|---|
| Other-than-temporary impairment losses reclassified to (from) OCI | | | | |
| Hedging, net | **23.4** | 59.7 | **6.7** | 29.5 |
| Fixed maturities, trading | **(2.0)** | 3.3 | **1.0** | (1.3) |
| Equity securities, available-for-sale: | | | | |
| Gross gains | | | **0.1** | 2.2 |
| Gross losses | | (4.5) | | (4.5) |
| Equity securities, trading | **(3.5)** | 26.5 | **30.7** | 56.6 |
| Mortgage loans | **(10.2)** | (12.1) | **(21.3)** | (22.0) |
| Derivatives | **2.8** | (64.6) | **30.4** | (55.7) |
| Other | **19.0** | 71.3 | **(8.9)** | 66.0 |
| Net realized capital gains (losses) | **$ 0.2** | $ 37.7 | **$ (6.5)** | $ (20.3) |

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were $0.3 billion and $0.2 billion for the three months ended June 30, 2012 and 2011, and $0.7 billion and $0.7 billion for the six months ended June 30, 2012 and 2011, respectively.

**Other-Than-Temporary Impairments**

We have a process in place to identify fixed maturity and equity securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers credit ratings, business climate,

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management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Each reporting period, all securities are reviewed to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest-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; (4) for structured securities, the adequacy of the expected cash flows; (5) for fixed maturities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and (6) for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized.

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

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

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| | | (in millions) | | |
| Fixed maturities, available-for-sale | **$ (49.1)** | $ (36.4) | **$ (82.8)** | $ (52.6) |
| Equity securities, available-for-sale | | (4.5) | | (2.3) |
| Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities | **(49.1)** | (40.9) | **(82.8)** | (54.9) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) OCI (1) | **17.1** | (9.7) | **22.0** | (48.1) |
| | **$ (32.0)** | $ (50.6) | **$ (60.8)** | $ (103.0) |

| Net impairment losses on available-for-sale securities |
|---|

(1) Represents the net impact of (a) gains resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI and (b) losses resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold.

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

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

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (in millions) | | | |
| Beginning balance | **$ (404.7)** | $ (312.1) | **$ (434.9)** | $ (325.7) |
| Credit losses for which an other-than-temporary impairment was not previously recognized | **(9.5)** | (12.8) | **(16.9)** | (15.0) |
| Credit losses for which an other-than-temporary impairment was previously recognized | **(19.1)** | (34.2) | **(39.9)** | (68.7) |
| Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold | **56.5** | 0.5 | **113.9** | 51.7 |
| Net reduction (increase) for positive changes in cash flows expected to be collected and amortization (1) | **1.3** | (1.1) | **2.3** | (2.0) |
| Ending balance | **$ (375.5)** | $ (359.7) | **$ (375.5)** | $ (359.7) |

(1) Amounts are recognized in net investment income.

**Gross Unrealized Losses for Fixed Maturities and Equity Securities**

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

| | June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Greater than or equal to twelve months | | Total | |
| | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses |

| | | | | | | (in millions) | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Fixed maturities, available-for-sale: | | | | | | | | | | | | |
| U.S. government and agencies | $ | **39.3** | $ | **0.9** | $ | | $ | | $ | **39.3** | $ | **0.9** |
| Non-U.S. governments | | **61.3** | | **0.9** | | **0.4** | | | | **61.7** | | **0.9** |
| States and political subdivisions | | **73.6** | | **0.2** | | **34.9** | | **1.2** | | **108.5** | | **1.4** |
| Corporate | | **1,740.8** | | **47.9** | | **2,659.4** | | **495.0** | | **4,400.2** | | **542.9** |
| Residential mortgage-backed pass-through securities | | **53.8** | | **0.1** | | **2.4** | | **0.1** | | **56.2** | | **0.2** |
| Commercial mortgage-backed securities | | **248.8** | | **9.5** | | **899.1** | | **534.8** | | **1,147.9** | | **544.3** |
| Collateralized debt obligations | | **135.8** | | **4.4** | | **139.9** | | **70.8** | | **275.7** | | **75.2** |
| Other debt obligations | | **185.6** | | **2.4** | | **560.6** | | **103.3** | | **746.2** | | **105.7** |
| Total fixed maturities, available-for-sale | $ | **2,539.0** | $ | **66.3** | $ | **4,296.7** | $ | **1,205.2** | $ | **6,835.7** | $ | **1,271.5** |
| Total equity securities, available-for-sale | $ | **20.7** | $ | **3.8** | $ | **46.7** | $ | **9.7** | $ | **67.4** | $ | **13.5** |

Of the total amounts, Principal Life s consolidated portfolio represented $6,404.9 million in available-for-sale fixed maturities with gross unrealized losses of $1,213.5 million. Of those fixed maturity assets in Principal Life s consolidated portfolio with a gross unrealized loss position, 72% were investment grade (rated AAA through BBB-) with an average price of 84 (carrying value/amortized cost) at June 30, 2012. Gross unrealized losses in our fixed maturities portfolio decreased during the six months ended June 30, 2012, due to a tightening of credit spreads, primarily in the corporate and commercial mortgage-backed securities sectors.

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For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 268 securities with a carrying value of $2,226.0 million and unrealized losses of $55.2 million reflecting an average price of 98 at June 30, 2012. Of this portfolio, 84% was investment grade (rated AAA through BBB-) at June 30, 2012, with associated unrealized losses of $45.9 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 609 securities with a carrying value of $4,178.9 million and unrealized losses of $1,158.3 million. The average rating of this portfolio was BBB- with an average price of 78 at June 30, 2012. Of the $1,158.3 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $534.8 million in unrealized losses with an average price of 63 and an average credit rating of BBB-. The remaining unrealized losses consist primarily of $448.1 million within the corporate sector at June 30, 2012. The average price of the corporate sector was 85 and the average credit rating was BBB. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at June 30, 2012.

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Less than twelve months | | Greater than or equal to twelve months | | Total | |
| | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses |
| | (in millions) | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Non-U.S. governments | $ 68.5 | $ 1.4 | $ 0.3 | $ | $ 68.8 | $ 1.4 |
| States and political subdivisions | 5.7 | 0.1 | 51.7 | 5.4 | 57.4 | 5.5 |
| Corporate | 3,445.6 | 140.9 | 2,403.9 | 578.1 | 5,849.5 | 719.0 |
| Residential mortgage-backed pass-through securities | 77.8 | 0.5 | 3.7 | 0.2 | 81.5 | 0.7 |
| Commercial mortgage-backed securities | 608.4 | 57.3 | 858.9 | 540.3 | 1,467.3 | 597.6 |
| Collateralized debt obligations | 107.2 | 2.5 | 204.4 | 60.3 | 311.6 | 62.8 |
| Other debt obligations | 708.1 | 13.0 | 508.1 | 124.0 | 1,216.2 | 137.0 |
| Total fixed maturities, available-for-sale | $ 5,021.3 | $ 215.7 | $ 4,031.0 | $ 1,308.3 | $ 9,052.3 | $ 1,524.0 |
| Total equity securities, available-for-sale | $ 14.3 | $ 3.2 | $ 15.6 | $ 3.3 | $ 29.9 | $ 6.5 |

Of the total amounts, Principal Life s consolidated portfolio represented $8,540.7 million in available-for-sale fixed maturities with gross unrealized losses of $1,470.3 million. Of those fixed maturity assets in Principal Life s consolidated portfolio with a gross unrealized loss position, 76% were investment grade (rated AAA through BBB-) with an average price of 85 (carrying value/amortized cost) at December 31, 2011. Gross unrealized losses in our fixed maturities portfolio increased slightly during the year ended December 31, 2011, due to a widening of credit spreads primarily in the corporate and commercial mortgage-backed securities sectors.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 477 securities with a carrying value of $4,573.6 million and unrealized losses of $198.7 million reflecting an average price of 96 at December 31, 2011. Of this portfolio, 86% was investment grade (rated AAA through BBB-) at December 31, 2011, with associated unrealized losses of $128.5 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 628 securities with a carrying value of $3,967.1 million and unrealized losses of $1,271.6 million. The average rating of this portfolio was BBB with an average price of 76 at December 31, 2011. Of the $1,271.6 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $540.3 million in unrealized losses with an average price of 61 and an

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average credit rating of BBB-. The remaining unrealized losses consist primarily of $541.4 million within the corporate sector at December 31, 2011. The average price of the corporate sector was 81 and the average credit rating was BBB. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at December 31, 2011.

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

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

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | (in millions) | |
| Net unrealized gains on fixed maturities, available-for-sale (1) | **$ 2,566.6** | $ 1,920.6 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale | **(306.7)** | (284.7) |
| Net unrealized gains (losses) on equity securities, available-for-sale | **(1.3)** | 1.9 |
| Adjustments for assumed changes in amortization patterns | **(420.3)** | (376.1) |
| Adjustments for assumed changes in policyholder liabilities | **(645.3)** | (442.7) |
| Net unrealized gains on derivative instruments | **153.4** | 113.2 |
| Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments | **173.6** | 150.3 |
| Provision for deferred income taxes | **(495.0)** | (354.1) |
| Net unrealized gains on available-for-sale securities and derivative instruments | **$ 1,025.0** | $ 728.4 |

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

**Mortgage Loans**

Mortgage loans consist of commercial and residential mortgage loans. We evaluate risks inherent in our commercial mortgage loans in two classes: (1) brick and mortar property loans, where we analyze the property s rent payments as support for the loan, and (2) credit tenant loans ( CTL ), where we rely on the credit analysis of the tenant for the repayment of the loan. We evaluate risks inherent in our residential mortgage loan portfolio in two classes: (1) home equity mortgages and (2) first lien mortgages. The carrying amount of our mortgage loan portfolio was as follows:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | (in millions) | | | |
| Commercial mortgage loans | **$** | **9,874.0** | $ | 9,461.4 |
| Residential mortgage loans | | **1,370.8** | | 1,367.9 |
| Total amortized cost | | **11,244.8** | | 10,829.3 |
| Valuation allowance | | **(86.2)** | | (102.1) |
| Total carrying value | **$** | **11,158.6** | $ | 10,727.2 |

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. We purchased $50.9 million and $14.7 million of residential mortgage loans during the three months ended June 30, 2012 and 2011, and $62.3 million and $30.0 million during the six months ended June 30, 2012 and 2011, respectively. We sold $6.3 million and $3.6 million of residential mortgage loans during the three months ended June 30, 2012 and 2011, and $12.1 million and $8.3 million during the six months ended June 30, 2012 and 2011, respectively. We sold $4.0 million of commercial mortgage loans during both the three and six months ended June 30, 2012.

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Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on fully or near fully leased properties. Our commercial mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Amortized cost | Percent of total | Amortized cost | Percent of total |
| | (in millions) | | | |
| **Geographic distribution** | | | | |
| New England | **$ 475.8** | **4.8%** | $ 454.0 | 4.8% |
| Middle Atlantic | **2,093.7** | **21.2** | 1,744.4 | 18.4 |
| East North Central | **663.3** | **6.7** | 774.8 | 8.2 |
| West North Central | **384.9** | **3.9** | 407.8 | 4.3 |
| South Atlantic | **2,163.3** | **21.9** | 2,099.8 | 22.2 |
| East South Central | **230.7** | **2.3** | 231.8 | 2.4 |
| West South Central | **774.7** | **7.8** | 648.6 | 6.9 |
| Mountain | **758.2** | **7.7** | 643.2 | 6.8 |
| Pacific | **2,318.7** | **23.6** | 2,446.4 | 25.9 |
| International | **10.7** | **0.1** | 10.6 | 0.1 |
| Total | **$ 9,874.0** | **100.0%** | $ 9,461.4 | 100.0% |
| | | | | |
| **Property type distribution** | | | | |
| Office | **$ 2,838.6** | **28.6%** | $ 2,753.8 | 29.1% |
| Retail | **2,839.5** | **28.8** | 2,580.2 | 27.3 |
| Industrial | **1,872.1** | **19.0** | 2,070.7 | 21.9 |
| Apartments | **1,476.2** | **15.0** | 1,242.9 | 13.1 |
| Hotel | **514.1** | **5.2** | 467.7 | 4.9 |
| Mixed use/other | **333.5** | **3.4** | 346.1 | 3.7 |
| Total | **$ 9,874.0** | **100.0%** | $ 9,461.4 | 100.0% |

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of $552.7 million and $611.0 million and first lien mortgages with an amortized cost of $818.1 million and $756.9 million as of June 30, 2012 and December 31, 2011, respectively. Most of our residential home equity mortgages are concentrated in the United States and are generally second lien mortgages comprised of closed-end loans and lines of credit. The majority of our first lien loans are concentrated in the Chilean market.

**Mortgage Loan Credit Monitoring**

***Commercial Credit Risk Profile Based on Internal Rating***

We actively monitor and manage our commercial mortgage loan portfolio. All commercial mortgage loans are analyzed regularly and substantially all are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. The model stresses expected cash flows at various levels and at different points in time depending on the durability of the income stream, which includes our assessment of factors such as location (macro and micro markets), tenant quality and lease expirations. Our internal rating analysis presents expected losses in terms of a Standard & Poor s ( S&P ) bond equivalent rating. As the credit risk for commercial mortgage loans increases, we adjust our internal ratings downward with loans in the category B+ and below having the highest risk for credit loss. Internal ratings on commercial mortgage loans are updated at least annually and potentially more often for certain loans with material changes in collateral value or occupancy and for loans on an internal watch list .

Commercial mortgage loans that require more frequent and detailed attention than other loans in our portfolio are identified and placed on an internal watch list . Among the criteria that would indicate a potential problem are imbalances in ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

The amortized cost of our commercial mortgage loan portfolio by credit risk, as determined by our internal rating system expressed in terms of an S&P bond equivalent rating, was as follows:

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| | June 30, 2012 | | |
|---|---|---|---|
| | Brick and mortar | CTL | Total |
| | | (in millions) | |
| A- and above | $ **6,539.0** | $ **329.2** | $ **6,868.2** |
| BBB+ thru BBB- | **1,998.9** | **212.6** | **2,211.5** |
| BB+ thru BB- | **366.6** | **15.0** | **381.6** |
| B+ and below | **407.8** | **4.9** | **412.7** |
| Total | $ **9,312.3** | $ **561.7** | $ **9,874.0** |

| | December 31, 2011 | | |
|---|---|---|---|
| | Brick and mortar | CTL | Total |
| | | (in millions) | |
| A- and above | $ 5,682.5 | $ 308.6 | $ 5,991.1 |
| BBB+ thru BBB- | 2,112.3 | 238.8 | 2,351.1 |
| BB+ thru BB- | 403.7 | 16.4 | 420.1 |
| B+ and below | 693.3 | 5.8 | 699.1 |
| Total | $ 8,891.8 | $ 569.6 | $ 9,461.4 |

***Residential Credit Risk Profile Based on Performance Status***

Our residential mortgage loan portfolio is monitored based on performance of the loans. Monitoring on a residential mortgage loan increases when the loan is delinquent or earlier if there is an indication of impairment. We define non-performing residential mortgage loans as loans 90 days or greater delinquent or on non-accrual status.

The amortized cost of our performing and non-performing residential mortgage loans were as follows:

| | June 30, 2012 | | |
|---|---|---|---|
| | Home equity | First liens | Total |
| | | (in millions) | |
| Performing | $ **524.6** | $ **795.2** | $ **1,319.8** |
| Nonperforming | **28.1** | **22.9** | **51.0** |
| Total | $ **552.7** | $ **818.1** | $ **1,370.8** |

| | December 31, 2011 | | |
|---|---|---|---|
| | Home equity | First liens | Total |

| | | (in millions) | |
|---|---|---|---|
| Performing | $ 597.8 | $ 733.7 | $ 1,331.5 |
| Nonperforming | 13.2 | 23.2 | 36.4 |
| Total | $ 611.0 | $ 756.9 | $ 1,367.9 |

**Non-Accrual Mortgage Loans**

Commercial and residential mortgage loans are placed on non-accrual status if we have concern regarding the collectability of future payments or if a loan has matured without being paid off or extended. Factors considered may include conversations with the borrower, loss of major tenant, bankruptcy of borrower or major tenant, decreased property cash flow for commercial mortgage loans or number of days past due and other circumstances for residential mortgage loans. Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income. Accrual of interest resumes after factors resulting in doubts about collectability have improved. Residential first lien mortgages in the Chilean market are carried on accrual for a longer period of delinquency than domestic loans, as assessment of collectability is based on the nature of the loans and collection practices in that market.

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The amortized cost of mortgage loans on non-accrual status were as follows:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | (in millions) | |
| Commercial: | | |
| Brick and mortar (1) | $ 81.1 | $ 46.8 |
| Residential: | | |
| Home equity (2) | 28.1 | 13.2 |
| First liens | 14.6 | 15.7 |
| Total | $ 123.8 | $ 75.7 |

(1) The increase from December 31, 2011, was primarily due to certain loans that matured but were not paid off or extended near the end of the period ended June 30, 2012, for which resolution is pending and anticipated in the next quarter through either payoff, extension or foreclosure.

(2) The increase from December 31, 2011, was primarily due to a change in our assessment of a non-accrual loan to include the payment status of the related first lien loan. Non-accrual loans are already included in the mortgage loan valuation allowance analysis.

The aging of our mortgage loans, based on amortized cost, were as follows:

| | June 30, 2012 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 days past due | 60-89 days past due | 90 days or more past due | Total past due | Current | Total loans | Recorded investment 90 days or more and accruing |
| | | | | (in millions) | | | |
| Commercial-brick and mortar | $ | $ | $ 4.1 | $ 4.1 | $ 9,308.2 | $ 9,312.3 | $ |
| Commercial-CTL | | | | | 561.7 | 561.7 | |
| Residential-home equity | 4.8 | 0.7 | 4.6 | 10.1 | 542.6 | 552.7 | |
| Residential-first liens | 19.8 | 4.7 | 21.5 | 46.0 | 772.1 | 818.1 | 8.3 |
| Total | $ 24.6 | $ 5.4 | $ 30.2 | $ 60.2 | $ 11,184.6 | $ 11,244.8 | $ 8.3 |

| | December 31, 2011 | | | | | | |
|---|---|---|---|---|---|---|---|
| | 30-59 days past due | 60-89 days past due | 90 days or more past | Total past due | Current | Total loans | Recorded investment |

| | | due | | | | | 90 days or more and accruing |
|---|---|---|---|---|---|---|---|
| | | | | (in millions) | | | |
| Commercial-brick and mortar | $ 61.4 | $ 4.4 | $ 22.5 | $ 88.3 | $ 8,803.5 | $ 8,891.8 | $ |
| Commercial-CTL | | | | | 569.6 | 569.6 | |
| Residential-home equity | 7.8 | 2.6 | 6.2 | 16.6 | 594.4 | 611.0 | |
| Residential-first liens | 15.8 | 6.0 | 22.2 | 44.0 | 712.9 | 756.9 | 7.5 |
| Total | $ 85.0 | $ 13.0 | $ 50.9 | $ 148.9 | $ 10,680.4 | $ 10,829.3 | $ 7.5 |

**Mortgage Loan Valuation Allowance**

We establish a valuation allowance to provide for the risk of credit losses inherent in our portfolio. The valuation allowance includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. 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 equal to the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. 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. Subsequent changes in the estimated value are reflected in the valuation allowance. Amounts on loans deemed to be uncollectible are charged off and removed from the valuation

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allowance. The change in the valuation allowance provision is included in net realized capital gains (losses) on our consolidated statements of operations.

The valuation allowance is maintained at a level believed adequate by management to absorb estimated probable credit losses. Management s periodic evaluation and assessment of the valuation allowance adequacy is based on known and inherent risks in the portfolio, adverse situations that may affect a borrower s ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, portfolio delinquency information, underwriting standards, peer group information, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component is subjective, as it requires the estimation of timing and amount of future cash flows expected to be received on impaired loans.

We review our commercial mortgage loan portfolio and analyze the need for a valuation allowance for any loan that is delinquent for 60 days or more, in process of foreclosure, restructured, on the internal watch list or that currently has a valuation allowance. In addition to establishing allowance levels for specifically identified impaired commercial mortgage loans, management determines an allowance for all other loans in the portfolio for which historical experience and current economic conditions indicate certain losses exist. These loans are segregated by major product type and/or risk level with an estimated loss ratio applied against each product type and/or risk level. The loss ratio is generally based upon historic loss experience for each loan type as adjusted for certain environmental factors management believes to be relevant.

For our residential mortgage loan portfolio, we separate the loans into several homogeneous pools, each of which consist of loans of a similar nature including but not limited to loans similar in collateral, term and structure and loan purpose or type. We evaluate loan pools based on aggregated risk ratings, estimated specific loss potential in the different classes of credits, and historical loss experience by pool type. We adjust these quantitative factors for qualitative factors of present conditions. Qualitative factors include items such as economic and business conditions, changes in the portfolio, value of underlying collateral, and concentrations. Residential mortgage loan pools exclude loans that have been restructured or impaired, as those loans are evaluated individually.

A rollforward of our valuation allowance and ending balances of the allowance and loan balance by basis of impairment method was as follows:

| | For the three months ended June 30, 2012 | | |
|---|---|---|---|
| | Commercial | Residential<br>(in millions) | Total |
| Beginning balance | $ 52.4 | $ 36.9 | $ 89.3 |
| Provision | 3.4 | 6.6 | 10.0 |
| Charge-offs | (6.5) | (7.3) | (13.8) |
| Recoveries | | 0.8 | 0.8 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Effect of exchange rates | | | | (0.1) | | (0.1) |
| Ending balance | $ | 49.3 | $ | 36.9 | $ | 86.2 |

| | For the six months ended June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Commercial | | Residential (in millions) | | Total | |
| Beginning balance | $ | 64.8 | $ | 37.3 | $ | 102.1 |
| Provision | | 10.4 | | 13.2 | | 23.6 |
| Charge-offs | | (25.9) | | (15.6) | | (41.5) |
| Recoveries | | | | 2.0 | | 2.0 |
| Ending balance | $ | 49.3 | $ | 36.9 | $ | 86.2 |
| Allowance ending balance by basis of impairment method: | | | | | | |
| Individually evaluated for impairment | $ | 5.7 | $ | 4.6 | $ | 10.3 |
| Collectively evaluated for impairment | | 43.6 | | 32.3 | | 75.9 |
| Allowance ending balance | $ | 49.3 | $ | 36.9 | $ | 86.2 |
| Loan balance by basis of impairment method: | | | | | | |
| Individually evaluated for impairment | $ | 37.9 | $ | 31.6 | $ | 69.5 |
| Collectively evaluated for impairment | | 9,836.1 | | 1,339.2 | | 11,175.3 |
| Loan ending balance | $ | 9,874.0 | $ | 1,370.8 | $ | 11,244.8 |

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| | For the three months ended June 30, 2011 | | |
|---|---|---|---|
| | Commercial | Residential (in millions) | Total |
| Beginning balance | $ 85.1 | $ 39.6 | $ 124.7 |
| Provision | 6.2 | 7.6 | 13.8 |
| Charge-offs | (15.8) | (9.2) | (25.0) |
| Recoveries | 0.1 | 0.6 | 0.7 |
| Effect of exchange rates | | 0.1 | 0.1 |
| Ending balance | $ 75.6 | $ 38.7 | $ 114.3 |

| | For the six months ended June 30, 2011 | | |
|---|---|---|---|
| | Commercial | Residential (in millions) | Total |
| Beginning balance | $ 80.6 | $ 40.5 | $ 121.1 |
| Provision | 13.1 | 13.9 | 27.0 |
| Charge-offs | (18.2) | (17.2) | (35.4) |
| Recoveries | 0.1 | 1.5 | 1.6 |
| Ending balance | $ 75.6 | $ 38.7 | $ 114.3 |
| Allowance ending balance by basis of impairment method: | | | |
| Individually evaluated for impairment | $ 6.4 | $ 4.3 | $ 10.7 |
| Collectively evaluated for impairment | 69.2 | 34.4 | 103.6 |
| Allowance ending balance | $ 75.6 | $ 38.7 | $ 114.3 |
| Loan balance by basis of impairment method: | | | |
| Individually evaluated for impairment | $ 28.0 | $ 23.6 | $ 51.6 |
| Collectively evaluated for impairment | 9,402.7 | 1,468.5 | 10,871.2 |
| Loan ending balance | $ 9,430.7 | $ 1,492.1 | $ 10,922.8 |

**Impaired Mortgage Loans**

Impaired mortgage loans are loans with a related specific valuation allowance, loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary or a loan modification has been classified as a TDR. Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. Our recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

**June 30, 2012**
**Unpaid**

| | Recorded investment | principal balance (in millions) | Related allowance |
|---|---|---|---|
| With no related allowance recorded: | | | |
| Commercial-brick and mortar | $ 43.4 | $ 46.1 | $ |
| Residential-first liens | 5.6 | 5.5 | |
| With an allowance recorded: | | | |
| Commercial-brick and mortar | 22.2 | 24.2 | 5.7 |
| Residential-home equity | 17.6 | 17.3 | 3.3 |
| Residential-first liens | 8.4 | 8.4 | 1.3 |
| Total: | | | |
| Commercial | $ 65.6 | $ 70.3 | $ 5.7 |
| Residential | $ 31.6 | $ 31.2 | $ 4.6 |

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| | December 31, 2011 | | |
|---|---|---|---|
| | Recorded investment | Unpaid principal balance | Related allowance |
| | (in millions) | | |
| With no related allowance recorded: | | | |
| Commercial-brick and mortar | $ | $ 0.3 | $ |
| Residential-first liens | 4.4 | 4.2 | |
| With an allowance recorded: | | | |
| Commercial-brick and mortar | 114.0 | 114.0 | 16.3 |
| Residential-home equity | 14.5 | 14.2 | 1.9 |
| Residential-first liens | 8.5 | 8.5 | 1.3 |
| Total: | | | |
| Commercial | $ 114.0 | $ 114.3 | $ 16.3 |
| Residential | $ 27.4 | $ 26.9 | $ 3.2 |

| | For the three months ended June 30, 2012 | | For the six months ended June 30, 2012 | |
|---|---|---|---|---|
| | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| | (in millions) | | (in millions) | |
| With no related allowance recorded: | | | | |
| Commercial-brick and mortar | **$ 69.4** | **$ 0.8** | **$ 21.7** | **$ 1.9** |
| Residential-first liens | **5.9** | | **5.0** | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | **31.3** | **0.1** | **68.1** | **0.1** |
| Residential-home equity | **17.0** | **0.2** | **16.0** | **0.5** |
| Residential-first liens | **8.5** | **0.1** | **8.5** | **0.1** |
| Total: | | | | |
| Commercial | **$ 100.7** | **$ 0.9** | **$ 89.8** | **$ 2.0** |
| Residential | **$ 31.4** | **$ 0.3** | **$ 29.5** | **$ 0.6** |

| | For the three months ended June 30, 2011 | | For the six months ended June 30, 2011 | |
|---|---|---|---|---|
| | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| | (in millions) | | (in millions) | |
| With no related allowance recorded: | | | | |
| Commercial-brick and mortar | $ 36.6 | $ 0.2 | $ 35.8 | $ 0.5 |
| Residential-first liens | 4.0 | | 4.7 | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | 34.0 | 0.4 | 28.9 | 0.6 |
| Residential-home equity | 12.4 | 0.2 | 12.3 | 0.3 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Residential-first liens | | 10.9 | | | | 10.3 | | 0.1 |
| Total: | | | | | | | | |
| Commercial | $ | 70.6 | $ | 0.6 | $ | 64.7 | $ | 1.1 |
| Residential | $ | 27.3 | $ | 0.2 | $ | 27.3 | $ | 0.4 |

**Mortgage Loan Modifications**

Our commercial and residential mortgage loan portfolios include loans that have been modified. We assess loan modifications on a case-by-case basis to evaluate whether a TDR has occurred. The commercial mortgage loan TDRs were modified to delay or reduce principal payments and to increase, reduce or delay interest payments. For these TDR assessments, we have determined the loan rates are now considered below market based on current circumstances. The commercial mortgage loan modifications resulted in

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delayed cash receipts and a decrease in interest income. The residential mortgage loan TDRs include modifications of interest-only payment periods, delays in principal balloon payments, and interest rate reductions. Residential mortgage loan modifications resulted in delayed or decreased cash receipts and a decrease in interest income.

The following table includes information about outstanding loans that were modified and met the criteria of a TDR during the periods indicated. In addition, the table includes information for loans that were modified and met the criteria of a TDR within the past twelve months that were in payment default during the periods indicated:

| | For the three months ended June 30, 2012 | | | |
|---|---|---|---|---|
| | TDRs | | TDRs in payment default | |
| | Number of Contracts | Recorded investment (in millions) | Number of Contracts | Recorded investment (in millions) |
| Commercial-brick and mortar | 2 | $ 41.4 | | $ |
| Residential-home equity | 54 | 2.2 | 1 | |
| Total | 56 | $ 43.6 | 1 | $ |

| | For the six months ended June 30, 2012 | | | |
|---|---|---|---|---|
| | TDRs | | TDRs in payment default | |
| | Number of Contracts | Recorded investment (in millions) | Number of Contracts | Recorded investment (in millions) |
| Commercial-brick and mortar | 3 | $ 45.8 | | $ |
| Residential-home equity | 103 | 4.5 | 3 | |
| Total | 106 | $ 50.3 | 3 | $ |

Commercial mortgage loans that have been designated as a TDR have been previously reserved in the mortgage loan valuation allowance to the estimated fair value of the underlying collateral reduced by the cost to sell.

Residential mortgage loans that have been designated as a TDR are specifically reserved for in the mortgage loan valuation allowance if losses result from the modification. Residential mortgage loans that have defaulted are reduced to the expected collectible amount.

**Securities Posted as Collateral**

We posted $1,461.7 million in fixed maturities, available-for-sale securities at June 30, 2012, to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements and our obligation under funding agreements with the Federal Home Loan Bank of Des Moines ( FHLB Des Moines ). In addition, we posted $1,741.4 million in commercial mortgage loans as of June 30, 2012, to satisfy collateral requirements associated with our obligation under funding agreements with the FHLB Des Moines. Since we did not relinquish ownership rights on these instruments, they are reported as fixed maturities, available-for-sale and mortgage loans, respectively, on our consolidated statements of financial position.

**4. Derivative Financial Instruments**

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

**Types of Derivative Instruments**

***Interest Rate Contracts***

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. Sources of interest rate risk include the difference between the maturity and interest rate changes of assets with the liabilities they support, timing differences between the pricing of liabilities and the purchase or procurement of assets and changing cash flow profiles from original projections due

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to prepayment options embedded within asset and liability contracts. We use various derivatives to manage our exposure to fluctuations in interest rates.

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

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

A swaption is an option to enter into an interest rate swap at a future date. We purchase swaptions to offset or modify existing exposures. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

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

***Foreign Exchange Contracts***

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

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

Currency forwards are contracts in which we agree with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell. We have also used currency forwards to hedge the currency risk associated with net investments in foreign operations. We did not use any currency forwards during 2012 or 2011 to hedge our net investment in foreign operations.

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***Equity Contracts***

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

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

***Credit Contracts***

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in our investment portfolio. Credit derivatives are used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name s credit spread at the time the agreement is executed. In cases where we sell protection, at the same time we enter into these synthetic transactions, we buy a quality cash bond to match against the credit default swap. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Total return swaps are contracts in which we agree with other parties to exchange, at specified intervals, an amount determined by the difference between the previous price and the current price of a reference asset based upon an agreed upon notional principal amount plus an additional amount determined by the financing spread. We currently use total return swaps referencing equity indices to hedge our portfolio from potential credit losses related to systemic events.

***Other Contracts***

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

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

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

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

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

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**Exposure**

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

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

We posted $435.2 million and $502.4 million in cash and securities under collateral arrangements as of June 30, 2012 and December 31, 2011, respectively, to satisfy collateral requirements associated with our derivative credit support agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the rating on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of June 30, 2012 and December 31, 2011, was $1,401.6 million and $1,484.0 million, respectively. With respect to these derivatives, we posted collateral of $435.2 million and $502.4 million as of June 30, 2012 and December 31, 2011, respectively, in the normal course of business, which reflects netting under derivative credit support annex agreements. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2012, we would be required to post an additional $73.7 million of collateral to our counterparties.

As of June 30, 2012 and December 31, 2011, we had received $282.5 million and $237.0 million, respectively, of cash collateral associated with our derivative credit support annex agreements, for which we recorded a corresponding liability reflecting our obligation to return the collateral.

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

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| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | (in millions) | |
| **Notional amounts of derivative instruments** | | |
| ***Interest rate contracts:*** | | |
| Interest rate swaps | **$ 18,674.8** | $ 19,498.3 |
| Interest rate collars | **500.0** | 500.0 |
| Swaptions | **325.0** | 68.5 |
| Futures | **66.5** | 522.0 |
| ***Foreign exchange contracts:*** | | |
| Foreign currency swaps | **3,624.3** | 3,919.8 |
| Currency forwards | **193.6** | 147.3 |
| ***Equity contracts:*** | | |
| Options | **1,726.0** | 1,608.4 |
| Futures | **337.7** | 270.3 |
| ***Credit contracts:*** | | |
| Credit default swaps | **1,370.5** | 1,530.3 |
| Total return swaps | **100.0** | 15.0 |
| ***Other contracts:*** | | |
| Embedded derivative financial instruments | **5,676.3** | 4,921.7 |
| Total notional amounts at end of period | **$ 32,594.7** | $ 33,001.6 |
| | | |
| **Credit exposure of derivative instruments** | | |
| ***Interest rate contracts:*** | | |
| Interest rate swaps | **$ 780.3** | $ 752.2 |
| Interest rate collars | **44.2** | 38.5 |
| Swaptions | **1.3** | |
| ***Foreign exchange contracts:*** | | |
| Foreign currency swaps | **238.6** | 318.6 |
| Currency forwards | **5.3** | 1.5 |
| ***Equity contracts:*** | | |
| Options | **112.0** | 120.3 |
| ***Credit contracts:*** | | |
| Credit default swaps | **8.5** | 14.0 |
| Total gross credit exposure | **1,190.2** | 1,245.1 |
| Less: collateral received | **287.4** | 237.0 |
| Net credit exposure | **$ 902.8** | $ 1,008.1 |

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

| | Derivative assets (1) | | Derivative liabilities (2) | |
|---|---|---|---|---|
| | June 30, 2012 | December 31, 2011 | June 30, 2012 | December 31, 2011 |
| | (in millions) | | | |
| **Derivatives designated as hedging instruments** | | | | |
| Interest rate contracts | **$ 12.0** | $ 0.2 | **$ 486.3** | $ 500.9 |
| Foreign exchange contracts | **205.0** | 267.2 | **154.2** | 158.4 |
| Total derivatives designated as hedging instruments | **$ 217.0** | $ 267.4 | **$ 640.5** | $ 659.3 |
| | | | | |
| **Derivatives not designated as hedging instruments** | | | | |
| Interest rate contracts | **$ 757.5** | $ 730.9 | **$ 605.4** | $ 651.5 |
| Foreign exchange contracts | **41.3** | 38.5 | **38.8** | 42.7 |
| Equity contracts | **112.0** | 120.3 | **3.4** | 0.8 |
| Credit contracts | **8.5** | 14.0 | **141.4** | 169.7 |
| Other contracts | | | **317.4** | 336.0 |
| Total derivatives not designated as hedging instruments | **919.3** | 903.7 | **1,106.4** | 1,200.7 |
| | | | | |
| Total derivative instruments | **$ 1,136.3** | $ 1,171.1 | **$ 1,746.9** | $ 1,860.0 |

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

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statement of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of $179.4 million and $195.8 million as of June 30, 2012 and December 31, 2011, respectively, are reported with contractholder funds on the consolidated statements of financial position.

**Credit Derivatives Sold**

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

statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by $10.0 million as of June 30, 2012 and $20.0 million as of December 31, 2011. These purchased credit derivative transactions had a net asset (liability) fair value of $0.6 million as of June 30, 2012 and zero as of December 31, 2011. In certain circumstances, our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

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

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

| | June 30, 2012 | | | |
|---|---|---|---|---|
| | Notional amount | Fair value | Maximum future payments | Weighted average expected life (in years) |
| | | (in millions) | | |
| **Single name credit default swaps** | | | | |
| Corporate debt | | | | |
| AA | $ 80.0 | $ (0.5) | $ 80.0 | 3.3 |
| A | 567.0 | 0.6 | 567.0 | 2.3 |
| BBB | 135.0 | (2.0) | 135.0 | 2.6 |
| Structured finance | | | | |
| C | 5.0 | (4.4) | 5.0 | 9.6 |
| Near default | 7.7 | (6.9) | 7.7 | 7.3 |
| Total single name credit default swaps | 794.7 | (13.2) | 794.7 | 2.6 |
| **Basket and index credit default swaps** | | | | |
| Corporate debt | | | | |
| Near default | 140.0 | (102.3) | 140.0 | 4.5 |
| Government/municipalities | | | | |
| AA | 30.0 | (8.8) | 30.0 | 5.2 |
| Structured finance | | | | |
| BBB | 25.0 | (10.1) | 25.0 | 5.0 |
| Total basket and index credit default swaps | 195.0 | (121.2) | 195.0 | 4.7 |
| Total credit default swap protection sold | $ 989.7 | $ (134.4) | $ 989.7 | 3.0 |

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**(Unaudited)**

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Notional amount | Fair value | Maximum future payments | Weighted average expected life (in years) |
| | (in millions) | | | |
| **Single name credit default swaps** | | | | |
| Corporate debt | | | | |
| AA | $ 85.0 | $ (1.0) | $ 85.0 | 4.0 |
| A | 483.0 | (1.4) | 483.0 | 2.5 |
| BBB | 110.0 | (0.3) | 110.0 | 1.7 |
| CCC | 10.0 | (0.1) | 10.0 | 0.2 |
| Structured finance | | | | |
| C | 10.0 | (8.9) | 10.0 | 10.1 |
| Near default | 12.9 | (12.8) | 12.9 | 1.2 |
| Total single name credit default swaps | 710.9 | (24.5) | 710.9 | 2.6 |
| | | | | |
| **Basket and index credit default swaps** | | | | |
| Corporate debt | | | | |
| CCC | 132.4 | (104.7) | 132.4 | 5.2 |
| CC | 15.0 | (14.8) | 15.0 | 1.0 |
| Government/municipalities | | | | |
| A | 40.0 | (10.5) | 40.0 | 4.4 |
| Structured finance | | | | |
| BBB | 25.0 | (11.0) | 25.0 | 5.5 |
| Total basket and index credit default swaps | 212.4 | (141.0) | 212.4 | 4.8 |
| Total credit default swap protection sold | $ 923.3 | $ (165.5) | $ 923.3 | 3.1 |

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

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| | June 30, 2012 | | |
|---|---|---|---|
| | Amortized cost | Carrying value (in millions) | Weighted average expected life (in years) |
| **Corporate debt** | | | |
| BBB | $ 15.5 | $ 15.5 | 4.5 |
| B | 25.0 | 23.3 | 1.0 |
| CC | 3.8 | 0.8 | 3.6 |
| Total corporate debt | 44.3 | 39.6 | 2.4 |
| **Structured finance** | | | |
| AA | 6.3 | 6.3 | 6.8 |
| BBB | 24.8 | 22.5 | 4.3 |
| BB | 18.2 | 16.4 | 2.6 |
| B | 8.4 | 8.4 | 5.2 |
| CCC | 7.4 | 7.8 | 6.9 |
| CC | 0.4 | 0.4 | 7.5 |
| C | | | 2.0 |
| Total structured finance | 65.5 | 61.8 | 4.5 |
| Total fixed maturities with credit derivatives | $ 109.8 | $ 101.4 | 3.7 |

| | December 31, 2011 | | |
|---|---|---|---|
| | Amortized cost | Carrying value (in millions) | Weighted average expected life (in years) |
| **Corporate debt** | | | |
| BB | $ 14.7 | $ 14.7 | 5.0 |
| CCC | 25.0 | 20.8 | 1.5 |
| CC | 3.7 | 0.7 | 4.0 |
| Total corporate debt | 43.4 | 36.2 | 2.9 |
| **Structured finance** | | | |
| AA | 9.3 | 9.3 | 6.4 |
| BBB | 27.4 | 24.5 | 4.5 |
| BB | 15.0 | 13.9 | 2.5 |
| B | 11.2 | 11.2 | 5.4 |
| CCC | 3.5 | 3.6 | 4.8 |
| CC | 0.7 | 0.7 | 5.3 |
| C | 0.2 | 0.1 | 8.2 |
| Near default | 0.2 | 0.2 | 4.7 |
| Total structured finance | 67.5 | 63.5 | 4.5 |

| | | | | | |
|---|---|---|---|---|---|
| Total fixed maturities with credit derivatives | $ | 110.9 | $ | 99.7 | 3.9 |

**Fair Value Hedges**

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

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

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We have sold callable investment-type insurance contracts and used cancellable interest rate swaps to hedge the changes in fair value of the callable feature.

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

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

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

| Derivatives in fair value hedging relationships | Amount of gain (loss) recognized in net income on derivatives for the three months ended June 30, (1) 2012 | 2011 | Hedged items in fair value hedging relationships | Amount of gain (loss) recognized in net income on related hedged item for the three months ended June 30, (1) 2012 | 2011 |
|---|---|---|---|---|---|
| | (in millions) | | | (in millions) | |
| Interest rate contracts | **$ (25.1)** | $ (51.0) | Fixed maturities, available-for-sale | **$ 24.3** | $ 49.9 |
| Interest rate contracts | | (1.2) | Investment-type insurance contracts | | 1.0 |
| Foreign exchange contracts | **2.4** | (1.6) | Fixed maturities, available-for-sale | **(2.4)** | 1.6 |
| Foreign exchange contracts | **(23.2)** | 7.1 | Investment-type insurance contracts | **22.1** | (5.9) |
| Total | **$ (45.9)** | $ (46.7) | Total | **$ 44.0** | $ 46.6 |

| Derivatives in fair value hedging relationships | Amount of gain (loss) recognized in net income on derivatives for the six months ended June 30, (1) 2012 | 2011 | Hedging items in fair value hedging relationships | Amount of gain (loss) recognized in net income on related hedged item for the six months ended June 30, (1) 2012 | 2011 |
|---|---|---|---|---|---|
| | (in millions) | | | (in millions) | |
| Interest rate contracts | **$ 6.6** | $ (11.3) | Fixed maturities, available-for-sale | **$ (3.9)** | $ 11.9 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Interest rate contracts | | | | (2.2) | Investment-type insurance contracts | | | 2.4 |
| Foreign exchange contracts | | **1.6** | | (3.3) | Fixed maturities, available-for-sale | | **(1.1)** | 3.6 |
| Foreign exchange contracts | | **(7.0)** | | 14.4 | Investment-type insurance contracts | | **7.3** | (14.1) |
| Total | **$** | **1.2** | $ | (2.4) | Total | **$** | **2.3** | $ 3.8 |

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

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

| Hedged Item | Amount of gain (loss) for the three months ended June 30, 2012 | 2011 | Amount of gain (loss) for the six months ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| | | (in millions) | | |
| Fixed maturities, available-for-sale (1) | **$ (33.6)** | $ (40.3) | **$ (69.1)** | $ (80.1) |
| Investment-type insurance contracts (2) | **9.1** | 11.1 | **17.9** | 22.6 |

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

**Cash Flow Hedges**

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

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

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

The maximum length of time that we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 8.0 years. At June 30, 2012, we had $134.4 million of net gains reported in AOCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from OCI into net income. No amounts were reclassified from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring during the three and six months ended June 30, 2012 and 2011.

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

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**(Unaudited)**

| Derivatives in cash flow hedging relationships | Related hedged item | Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three months ended June 30, 2012 | 2011 | Location of gain (loss) reclassified from AOCI into net income (effective portion) | Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the three months ended June 30, 2012 | 2011 |
|---|---|---|---|---|---|---|
| | | (in millions) | | | (in millions) | |
| Interest rate contracts | Fixed maturities, available-for-sale | **$ 28.0** | $ 5.9 | Net investment income | **$ 2.2** | $ 1.8 |
| Interest rate contracts | Investment-type insurance contracts | **(1.1)** | (0.7) | Benefits, claims and settlement expenses | | (0.3) |
| Interest rate contracts | Debt | | | Operating expense | **(1.5)** | (1.3) |
| Foreign exchange contracts | Fixed maturities, available-for-sale | **47.9** | (24.6) | Net realized capital losses | **(1.7)** | (6.3) |
| Foreign exchange contracts | Investment-type insurance contracts | **1.1** | 2.6 | Benefits, claims and settlement expenses | | (0.2) |
| Total | | **$ 75.9** | $ (16.8) | Total | **$ (1.0)** | $ (6.3) |

| Derivatives in cash flow hedging relationships | Related hedged item | Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the six months ended June 30, 2012 | 2011 | Location of gain (loss) reclassified from AOCI into net income (effective portion) | Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the six months ended June 30, 2012 | 2011 |
|---|---|---|---|---|---|---|
| | | (in millions) | | | (in millions) | |
| Interest rate contracts | Fixed maturities, available-for-sale | **$ 25.9** | $ 2.6 | Net investment income | **$ 4.1** | $ 3.6 |
| Interest rate contracts | Investment-type insurance contracts | **0.6** | 2.3 | Benefits, claims and settlement expenses | | (0.5) |
| Interest rate contracts | Debt | | | Operating expense | **(2.9)** | (2.6) |
| Foreign exchange contracts | Fixed maturities, available-for-sale | **28.4** | (67.4) | Net realized capital losses | **(11.9)** | (14.0) |
| Foreign exchange contracts | Investment-type insurance contracts | **(2.8)** | (16.9) | Benefits, claims and settlement expenses | | (1.7) |
| Total | | **$ 52.1** | $ (79.4) | Total | **$ (10.7)** | $ (15.2) |

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

| Hedged Item | Amount of gain (loss) for the three months ended June 30, 2012 | 2011 | Amount of gain (loss) for the six months ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| | | (in millions) | | |
| Fixed maturities, available-for-sale (1) | **$ 1.9** | $ 2.4 | **$ 3.9** | $ 5.4 |

| | | | | |
|---|---|---|---|---|
| Investment-type insurance contracts (2) | **(3.1)** | (3.7) | **(6.4)** | (6.3) |

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

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was $0.2 million and $0.1 million for the three months ended June 30, 2012 and 2011, respectively. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was $0.3 million and $0.2 million for the six months ended June 30, 2012 and 2011, respectively.

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We expect to reclassify net losses of $(1.7) million from AOCI into net income in the next 12 months, which includes both net deferred losses on discontinued hedges and on periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

**Derivatives Not Designated as Hedging Instruments**

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

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

| Derivatives not designated as hedging instruments | Amount of gain (loss) recognized in net income on derivatives for the three months ended June 30, 2012 | 2011 | Amount of gain (loss) recognized in net income on derivatives for the six months ended June 30, 2012 | 2011 |
|---|---|---|---|---|
| | (in millions) | | | |
| Interest rate contracts | **$ 61.0** | $ 11.7 | **$ 26.2** | $ 16.0 |
| Foreign exchange contracts | **(14.0)** | (30.0) | **13.6** | (11.0) |
| Equity contracts | **41.6** | 9.9 | **(22.3)** | (12.7) |
| Credit contracts | **(9.1)** | 5.4 | **9.5** | 3.0 |
| Other contracts | **(46.0)** | (51.0) | **22.2** | (56.0) |
| Total | **$ 33.5** | $ (54.0) | **$ 49.2** | $ (60.7) |

**5. Income Taxes**

The effective income tax rate for the three and six months ended June 30, 2012, was lower than the U.S. corporate income tax rate of 35% ( U.S. statutory rate ) primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the interest exclusion from taxable income.

The effective income tax rate for the three and six months ended June 30, 2011, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the inclusion of income attributable to noncontrolling interest in income before income taxes with no corresponding change in income taxes reported by us as the controlling interest.

We are a U.S. shareholder in various foreign entities classified as controlled foreign corporations ( CFCs ) for U.S. tax purposes. U.S. shareholders of CFCs are generally required to take into account as gross income in the U.S. certain passive income earned by the CFCs ( Subpart F income ) even if the income is not currently distributed. A temporary exception (the active financing exception ) was applicable for tax years beginning before January 1, 2012, to avoid the current recognition of Subpart F income derived in the active conduct of a banking, financing, insurance or similar business. The U.S. Congress and the President have yet to enact extenders legislation for 2012 as of June 30, 2012. Therefore, current tax expense has increased by an immaterial amount associated with the U.S. recognition of Subpart F income from our foreign operations. We will reverse any tax expense subject to the active financing exception during the quarter of enactment should extenders legislation be enacted during 2012, assuming the legislation is retroactive to January 1, 2012.

The Internal Revenue Service ( IRS ) has completed examination of our consolidated federal income tax returns for years prior to 2004. We are contesting certain issues and have filed suit in the Court of Federal Claims, requesting refunds for the years 1995-2003. We do not expect the litigation to be resolved within the next twelve months. The IRS also completed its examinations of tax years 2004 through 2005 and 2006 through 2008 resulting in receipt of notices of deficiency, which were paid in 2011. We filed claims for refund for 2004 and 2005 relating to disputed adjustments during the second quarter of 2012. The IRS commenced audit of our federal income tax return for 2009 and 2010 in 2011 and during the first quarter of 2012, respectively. We do not expect the

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results of these audits or developments in other tax areas for all open tax years to significantly change the possible increase in the amount of unrecognized tax benefits, but the outcome of tax reviews is uncertain and unforeseen results can occur.

The U.S. District Court for the Southern District of Iowa issued a decision in the case of Pritired 1, LLC ( Pritired ), and Principal Life Insurance Co. v. United States on September 30, 2011. The court ruled that the securities Pritired held should be characterized as debt, not equity, and thus Principal Life was not entitled to foreign tax credits for the years 2002 and 2003. Pritired and Principal Life are seeking clarification from the court but have not yet decided whether to appeal this ruling.

## 6. Employee and Agent Benefits

### Components of Net Periodic Benefit Cost

| | Pension benefits For the three months ended June 30, | | Other postretirement benefits For the three months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (in millions) | | | |
| Service cost | **$ 11.8** | $ 10.9 | **$ 0.4** | $ 0.3 |
| Interest cost | **27.2** | 27.2 | **2.0** | 2.2 |
| Expected return on plan assets | **(28.7)** | (29.3) | **(8.4)** | (8.8) |
| Amortization of prior service benefit | **(2.2)** | (2.5) | **(7.2)** | (7.4) |
| Recognized net actuarial loss | **22.7** | 13.3 | **0.2** | 0.1 |
| Amounts recognized due to special events | | (0.4) | | (1.7) |
| Net periodic benefit cost (income) | **$ 30.8** | $ 19.2 | **$ (13.0)** | $ (15.3) |

| | Pension benefits For the six months ended June 30, | | Other postretirement benefits For the six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (in millions) | | | |
| Service cost | **$ 23.5** | $ 21.8 | **$ 0.7** | $ 0.6 |
| Interest cost | **54.5** | 54.0 | **4.1** | 4.4 |

| | | | | |
|---|---|---|---|---|
| Expected return on plan assets | **(57.3)** | (57.5) | **(16.8)** | (17.3) |
| Amortization of prior service benefit | **(4.6)** | (5.0) | **(14.3)** | (14.8) |
| Recognized net actuarial loss | **45.4** | 29.0 | **0.4** | 0.2 |
| Amounts recognized due to special events | | (0.7) | | (2.9) |
| Net periodic benefit cost (income) | **$ 61.5** | $ 41.6 | **$ (25.9)** | $ (29.8) |

**Contributions**

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act ( ERISA ) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2012 will be zero so we will not be required to fund our qualified pension plan during 2012. However, it is possible that we may fund the qualified and nonqualified pension plans in 2012 for a combined total of $60.0 million to $110.0 million. During the three and six months ended June 30, 2012, we contributed $23.0 million and $46.0 million to these plans, respectively.

**7. Contingencies, Guarantees and Indemnifications**

**Litigation and Regulatory Contingencies**

We are regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services, life, health and disability insurance. Some of the lawsuits may be class actions, or purport to be, and some may include claims for unspecified or substantial punitive and treble damages.

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We may discuss such litigation in one of three ways. We accrue a charge to income and disclose legal matters for which the chance of loss is probable and for which the amount of loss can be reasonably estimated. We may disclose contingencies for which the chance of loss is reasonably possible, and provide an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. Finally, we may voluntarily disclose loss contingencies for which the chance of loss is remote in order to provide information concerning matters that potentially expose us to possible losses.

In addition, regulatory bodies such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor, the Federal Reserve Board and other regulatory agencies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers. We receive requests from regulators and other governmental authorities relating to industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life. Principal Life s motion to transfer venue was granted and the case is now pending in the Southern District of Iowa. The complaint alleged, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleged that these acts constitute prohibited transactions under ERISA. Plaintiff sought to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. On August 27, 2008, the plaintiff s motion for class certification was denied. On June 13, 2011, the court entered a consent judgment resolving the claims of the plaintiff. On July 12, 2011, plaintiff filed a notice of appeal related to the issue of the denial of class certification. Principal Life continues to aggressively defend the lawsuit.

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

On December 2, 2009 and December 4, 2009, two plaintiffs, Cruise and Mullaney, each filed putative class action lawsuits in the United States District Court for the Southern District of New York against us; Principal Life; Principal Global Investors, LLC; and Principal Real Estate Investors, LLC (the Cruise/Mullaney Defendants ). The lawsuits alleged the Cruise/Mullaney Defendants failed to manage the Principal U.S. Property Separate Account ( PUSPSA ) in the best interests of investors, improperly imposed a withdrawal freeze on September 26, 2008, and instituted a withdrawal queue to honor withdrawal requests as sufficient liquidity became available. Plaintiffs allege these actions constitute a breach of fiduciary duties under ERISA. Plaintiffs seek to certify a class including all qualified ERISA plans and the participants of those plans

that invested in PUSPSA between September 26, 2008, and the present that have suffered losses caused by the queue. The two lawsuits, as well as two subsequently filed complaints asserting similar claims, have been consolidated and are now known as In re Principal U.S. Property Account Litigation. On April 22, 2010, an order was entered granting the motion made by the Cruise/Mullaney Defendants for change of venue to the United States District Court for the Southern District of Iowa. Plaintiffs filed an Amended Consolidated Complaint adding five new plaintiffs on November 22, 2010, and the Cruise/Mullaney Defendants moved to dismiss the amended complaint. The court denied the Cruise/Mullaney Defendants motion to dismiss on May 17, 2011. The Cruise/Mullaney Defendants are aggressively defending the lawsuit.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any such matter will have a material adverse effect on our business or financial position. As of June 30, 2012, there were no estimated losses accrued related to the legal matters discussed above because we believe the loss from these matters is not probable and cannot be reasonably estimated.

We believe all of the litigation contingencies discussed above involve a chance of loss that is either remote or reasonably possible. All of these matters involve unspecified claim amounts, in which the respective plaintiffs seek an indeterminate amount of damages. To the extent such matters present a reasonably possible chance of loss, we are not able to estimate the possible loss or range of loss associated therewith.

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The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts that we could not estimate at June 30, 2012.

**Guarantees and Indemnifications**

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary. These agreements generally expire through 2019. The maximum exposure under these agreements as of June 30, 2012, was approximately $135.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. While the likelihood is remote, such outcomes could materially affect net income in a particular quarter or annual period.

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

**8. Stockholders Equity**

**Common Stock**

On June 29, 2012, we paid a quarterly dividend of $53.7 million, equal to $0.18 per share, to stockholders of record as of June 11, 2012. On March 30, 2012, we paid a quarterly dividend of $54.3 million, equal to $0.18 per share, to stockholders of record as of March 12, 2012.

**Reconciliation of Outstanding Shares**

| | Series A preferred stock | Series B preferred stock (in millions) | Common stock |
|---|---|---|---|
| Outstanding shares at January 1, 2011 | 3.0 | 10.0 | 320.4 |
| Shares issued | | | 1.2 |
| Treasury stock acquired | | | (7.9) |
| Outstanding shares at June 30, 2011 | 3.0 | 10.0 | 313.7 |
| | | | |
| Outstanding shares at January 1, 2012 | **3.0** | **10.0** | **301.1** |
| Shares issued | | | **2.3** |
| Treasury stock acquired | | | **(7.8)** |
| Outstanding shares at June 30, 2012 | **3.0** | **10.0** | **295.6** |

In May 2011, our Board of Directors reinstated the November 2007 share repurchase program. In July 2011, we completed this program. In August 2011, our Board of Directors authorized a share repurchase program of up to $200.0 million of our outstanding common stock. We completed this program in September 2011. In November 2011, our Board of Directors authorized a share repurchase program of up to $100.0 million of our outstanding common stock. We completed this program in December 2011. In February 2012, our Board of Directors authorized a share repurchase program of up to $100.0 million of our outstanding common stock. We completed this program in May 2012. In May 2012, our Board of Directors authorized a share repurchase program of up to $200.0 million of our outstanding common stock.

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Our Board of Directors has authorized various repurchase programs under which we are allowed to purchase shares of our outstanding common stock. Shares repurchased under these programs are accounted for as treasury stock, carried at cost and reflected as a reduction to stockholders equity.

**Other Comprehensive Income**

| | For the three months ended June 30, 2012 | | | For the six months ended June 30, 2012 | | |
|---|---|---|---|---|---|---|
| | Pre-Tax | Tax | After-Tax | Pre-Tax | Tax | After-Tax |
| | | | (in millions) | | | |
| Net unrealized gains on available-for-sale securities during the period | $ 292.9 | $ (83.2) | $ 209.7 | $ 626.0 | $ (195.4) | $ 430.6 |
| Reclassification adjustment for losses included in net income | 29.6 | (10.1) | 19.5 | 40.1 | (14.0) | 26.1 |
| Adjustments for assumed changes in amortization patterns | (24.1) | 8.4 | (15.7) | (79.6) | 27.8 | (51.8) |
| Adjustments for assumed changes in policyholder liabilities | (150.6) | 37.8 | (112.8) | (202.6) | 59.7 | (142.9) |
| Net unrealized gains on available-for-sale securities | 147.8 | (47.1) | 100.7 | 383.9 | (121.9) | 262.0 |
| | | | | | | |
| Noncredit component of impairment losses on fixed maturities, available-for-sale during the period | (17.1) | 6.1 | (11.0) | (22.0) | 7.7 | (14.3) |
| Adjustments for assumed changes in amortization patterns | 1.7 | (0.6) | 1.1 | 5.5 | (2.0) | 3.5 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale (1) | (15.4) | 5.5 | (9.9) | (16.5) | 5.7 | (10.8) |
| | | | | | | |
| Net unrealized gains on derivative instruments during the period | 73.3 | (25.6) | 47.7 | 29.5 | (10.3) | 19.2 |
| Reclassification adjustment for losses included in net income | 1.0 | (0.5) | 0.5 | 10.7 | (3.9) | 6.8 |
| Adjustments for assumed changes in amortization patterns | 1.1 | (0.4) | 0.7 | 29.9 | (10.5) | 19.4 |
| Net unrealized gains on derivative instruments | 75.4 | (26.5) | 48.9 | 70.1 | (24.7) | 45.4 |
| | | | | | | |
| Foreign currency translation adjustment | (99.4) | 12.7 | (86.7) | (38.0) | 16.6 | (21.4) |

| | | | | | | |
|---|---|---|---|---|---|---|
| Unrecognized postretirement benefit obligation during the period | | | | | | |
| Amortization of prior service cost and actuarial loss included in net periodic benefit cost | **13.5** | **(4.7)** | **8.8** | **26.9** | **(9.4)** | **17.5** |
| Net unrecognized postretirement benefit obligation | **13.5** | **(4.7)** | **8.8** | **26.9** | **(9.4)** | **17.5** |
| | | | | | | |
| Other comprehensive income | **$ 121.9** | **$ (60.1)** | **$ 61.8** | **$ 426.4** | **$ (133.7)** | **$ 292.7** |

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| | For the three months ended June 30, 2011 | | | For the six months ended June 30, 2011 | | |
|---|---|---|---|---|---|---|
| | Pre-Tax | Tax | After-Tax | Pre-Tax | Tax | After-Tax |
| | (in millions) | | | | | |
| Net unrealized gains on available-for-sale securities during the period | $ 265.8 | $ (103.5) | $ 162.3 | $ 546.9 | $ (204.2) | $ 342.7 |
| Reclassification adjustment for losses included in net income | 27.3 | (8.2) | 19.1 | 27.1 | (8.1) | 19.0 |
| Adjustments for assumed changes in amortization patterns | (73.1) | 25.6 | (47.5) | (120.2) | 42.1 | (78.1) |
| Adjustments for assumed changes in policyholder liabilities | 12.8 | | 12.8 | 38.5 | | 38.5 |
| Net unrealized gains on available-for-sale securities | 232.8 | (86.1) | 146.7 | 492.3 | (170.2) | 322.1 |
| | | | | | | |
| Noncredit component of impairment losses on fixed maturities, available-for-sale during the period | 9.7 | (1.6) | 8.1 | 48.1 | (17.6) | 30.5 |
| Adjustments for assumed changes in amortization patterns | 1.3 | (0.4) | 0.9 | (6.5) | 2.3 | (4.2) |
| Noncredit component of impairment losses on fixed maturities, available-for-sale (1) | 11.0 | (2.0) | 9.0 | 41.6 | (15.3) | 26.3 |
| | | | | | | |
| Net unrealized losses on derivative instruments during the period | (15.6) | 5.4 | (10.2) | (33.0) | 11.5 | (21.5) |
| Reclassification adjustment for losses included in net income | 6.2 | (2.2) | 4.0 | 15.0 | (5.3) | 9.7 |
| Adjustments for assumed changes in amortization patterns | (3.1) | 1.1 | (2.0) | (1.2) | 0.4 | (0.8) |
| Net unrealized losses on derivative instruments | (12.5) | 4.3 | (8.2) | (19.2) | 6.6 | (12.6) |
| | | | | | | |
| Foreign currency translation adjustment | 65.5 | (15.8) | 49.7 | 92.5 | (21.0) | 71.5 |
| | | | | | | |
| Unrecognized postretirement benefit obligation during the period (2) | (35.2) | 12.4 | (22.8) | 36.1 | (12.6) | 23.5 |
| Amortization of prior service cost and actuarial loss included in net periodic benefit cost | 1.4 | (0.5) | 0.9 | 5.8 | (2.0) | 3.8 |
| Net unrecognized postretirement benefit obligation | (33.8) | 11.9 | (21.9) | 41.9 | (14.6) | 27.3 |
| | | | | | | |
| Other comprehensive income | $ 263.0 | $ (87.7) | $ 175.3 | $ 649.1 | $ (214.5) | $ 434.6 |

(1) Represents the net impact of (1) unrealized gains resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold and (2) unrealized losses resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI.

(2) Includes the impact of the quarterly remeasurement of plan assets and liabilities in 2011 resulting from curtailment accounting associated with our exited group medical insurance business.

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**Accumulated Other Comprehensive Income**

| | Net unrealized gains on available-for-sale securities | Noncredit component of impairment losses on fixed maturities available-for-sale | Net unrealized gains (losses) on derivative instruments | Foreign currency translation adjustment | Unrecognized postretirement benefit obligation | Accumulated other comprehensive income |
|---|---|---|---|---|---|---|
| | | | (in millions) | | | |
| **Balances at January 1, 2011** | $ 652.1 | $ (198.2) | $ 11.3 | $ 29.7 | $ (188.2) | $ 306.7 |
| Other comprehensive income | 322.1 | 26.3 | (12.6) | 71.5 | 27.3 | 434.6 |
| **Balances at June 30, 2011** | $ 974.2 | $ (171.9) | $ (1.3) | $ 101.2 | $ (160.9) | $ 741.3 |
| **Balances at January 1, 2012** | **$ 860.7** | **$ (167.2)** | **$ 34.9** | **$ (109.3)** | **$ (361.1)** | **$ 258.0** |
| Other comprehensive income | **262.0** | **(10.8)** | **45.4** | **(21.6)** | **17.5** | **292.5** |
| **Balances at June 30, 2012** | **$ 1,122.7** | **$ (178.0)** | **$ 80.3** | **$ (130.9)** | **$ (343.6)** | **$ 550.5** |

**Noncontrolling Interest**

Interest held by unaffiliated parties in consolidated entities are reflected in noncontrolling interest, which represents the noncontrolling partners share of the underlying net assets of our consolidated subsidiaries. Noncontrolling interest that is not redeemable is reported in the equity section of the consolidated statements of financial position.

The noncontrolling interest holders in certain of our subsidiaries maintain an equity interest that is redeemable at the option of the holder, which may be exercised on varying dates beginning in 2014. Since redemption of the noncontrolling interest is outside of our control, this interest is presented on the consolidated statements of financial position line item titled Redeemable noncontrolling interest. If the interest were to be redeemed, we would be required to purchase such interest at a redemption value based on a formula that management intended to reasonably approximate fair value based on a fixed multiple of earnings over a measurement period. As such, the redeemable noncontrolling interest is measured at redemption value at each reporting period. Any adjustments to the carrying amount of the redeemable noncontrolling interest for changes in redemption value prior to exercise of the redemption option are determined after the attribution of net income or loss of the subsidiary and are recorded in retained earnings.

Following is a reconciliation of the changes in the redeemable noncontrolling interest for the six months ended June 30, 2012 (in millions):

| | | |
|---|---|---|
| **Balance at January 1, 2012** | **$** | **22.2** |
| Net income attributable to redeemable noncontrolling interest | | **0.7** |
| Redeemable noncontrolling interest assumed related to acquisition | | **37.7** |
| Distributions to redeemable noncontrolling interest | | **(0.4)** |
| Foreign currency translation adjustment | | **0.3** |
| **Balance at June 30, 2012** | **$** | **60.5** |

## 9. Fair Value Measurements

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

### Valuation Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels.

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

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

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

**Determination of Fair Value**

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

Fair value estimates are made based on available market information and judgments about the financial instrument at a specific point in time. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during 2012.

***Fixed Maturities***

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

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

If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to the asset class, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available and where at least one significant unobservable input is utilized, which are reflected in Level 3 and can include fixed maturities across all asset classes. As of June 30, 2012, less than 1% of our fixed maturities were valued using internal pricing models, which were classified as Level 3 assets accordingly.

The primary inputs, by asset class, for valuations of the majority of our Level 2 investments from third party pricing vendors or our internal pricing valuation approach are described below.

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***U.S. Government and Agencies/Non-U.S. Governments***. Inputs include recently executed market transactions, interest rate yield curves, maturity dates, market price quotations and credit spreads relating to similar instruments.

***State and Political Subdivisions***. Inputs include Municipal Securities Rulemaking Board reported trades, U.S. Treasury and other benchmark curves, material event notices, new issue data and obligor credit ratings.

***Corporate***. Inputs include recently executed transactions, market price quotations, benchmark yields, issuer spreads and observations of equity and credit default swap curves related to the issuer. For private placement corporate securities valued through the matrix valuation approach inputs include the current U.S. Treasury curve and risk spreads based on sector, rating and average life of the issuance.

***RMBS, CMBS, Collateralized Debt Obligations and Other Debt Obligations***. Inputs include cash flows, priority of the tranche in the capital structure, expected time to maturity for the specific tranche, reinvestment period remaining and performance of the underlying collateral including prepayments, defaults, deferrals, loss severity of defaulted collateral and, for RMBS, prepayment speed assumptions. Other inputs include market indices and recently executed market transactions.

***Equity Securities***

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

***Derivatives***

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

volatilities. Certain over-the-counter derivatives utilize unobservable market data, primarily independent broker quotes that are nonbinding quotes based on models that do not reflect the result of market transactions, which are reflected in Level 3.

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

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

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

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

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***Credit Contracts.*** We use either the ISDA Credit Default Swap Standard discounted cash flow model that utilizes observable default probabilities and recovery rates as inputs or broker prices to determine the fair value of credit default swaps. These are reflected in Level 3. In addition, we have a limited number of total return swaps that are valued based on the observable quoted price of underlying equity indices. These are reflected in Level 2.

***Other Investments***

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

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

***Cash and Cash Equivalents***

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

***Separate Account Assets***

Separate account assets include equity securities, debt securities and derivative instruments, for which fair values are determined as previously described, and are reflected in Level 1, Level 2 and Level 3. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of the loans. The market clearing spreads vary based on mortgage type, weighted average life, rating and liquidity. These are reflected in Level 3. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. In addition, each property is appraised annually by an independent appraiser. The real estate within the separate accounts is reflected in

Level 3.

***Investment-Type Insurance Contracts***

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

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

***Other Liabilities***

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities that are valued based on prices obtained from third party pricing vendors as utilized and described in our discussion of how fair value is determined for fixed maturities, which are reflected in Level 2.

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

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

Assets and liabilities measured at fair value on a recurring basis are summarized below.

| | As of June 30, 2012 | | | |
|---|---|---|---|---|
| | Assets/ (liabilities) measured at fair value | | Fair value hierarchy level | |
| | | Level 1 | Level 2 | Level 3 |
| | (in millions) | | | |
| **Assets** | | | | |
| Fixed maturities, available-for-sale: | | | | |
| U.S. government and agencies | $ 824.1 | $ 103.1 | $ 721.0 | $ |
| Non-U.S. governments | 1,159.2 | | 1,119.6 | 39.6 |
| States and political subdivisions | 2,869.4 | | 2,869.4 | |
| Corporate | 34,051.5 | 92.3 | 33,759.6 | 199.6 |
| Residential mortgage-backed securities | 3,298.2 | | 3,298.2 | |
| Commercial mortgage-backed securities | 3,744.9 | | 3,744.9 | |
| Collateralized debt obligations | 366.1 | | 288.5 | 77.6 |
| Other debt obligations | 3,480.2 | | 3,475.1 | 5.1 |
| Total fixed maturities, available-for-sale | 49,793.6 | 195.4 | 49,276.3 | 321.9 |
| Fixed maturities, trading | 776.5 | 127.5 | 463.3 | 185.7 |
| Equity securities, available-for-sale | 139.0 | 61.2 | 60.7 | 17.1 |
| Equity securities, trading | 224.3 | 97.3 | 127.0 | |
| Derivative assets (1) | 1,136.3 | | 1,077.5 | 58.8 |
| Other investments (2) | 218.8 | 21.1 | 114.1 | 83.6 |
| Cash equivalents (3) | 854.7 | 7.3 | 847.4 | |
| Sub-total excluding separate account assets | 53,143.2 | 509.8 | 51,966.3 | 667.1 |
| | | | | |
| Separate account assets | 75,950.5 | 49,922.3 | 21,587.7 | 4,440.5 |
| **Total assets** | $ 129,093.7 | $ 50,432.1 | $ 73,554.0 | $ 5,107.6 |
| | | | | |
| **Liabilities** | | | | |
| Investments-type insurance contracts (4) | $ (179.4) | $ | $ | $ (179.4) |

| | | | | |
|---|---|---|---|---|
| Derivative liabilities (1) | **(1,433.6)** | | **(1,286.5)** | **(147.1)** |
| Other liabilities (4) | **(218.0)** | | **(184.4)** | **(33.6)** |
| **Total liabilities** | **$ (1,831.0)** | **$** | **$ (1,470.9)** | **$ (360.1)** |
| | | | | |
| **Net assets (liabilities)** | **$ 127,262.7** | **$ 50,432.1** | **$ 72,083.1** | **$ 4,747.5** |

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| | As of December 31, 2011 | | | |
|---|---|---|---|---|
| | Assets/ (liabilities) measured at fair value | Fair value hierarchy level | | |
| | | Level 1 | Level 2 | Level 3 |
| | (in millions) | | | |
| **Assets** | | | | |
| Fixed maturities, available-for-sale: | | | | |
| U.S. government and agencies | $ 805.1 | $ 57.5 | $ 747.6 | $ |
| Non-U.S. governments | 1,096.7 | | 1,073.8 | 22.9 |
| States and political subdivisions | 2,882.7 | | 2,882.7 | |
| Corporate | 33,556.5 | 87.5 | 33,172.0 | 297.0 |
| Residential mortgage-backed securities | 3,343.0 | | 3,343.0 | |
| Commercial mortgage-backed securities | 3,413.7 | | 3,413.7 | |
| Collateralized debt obligations | 338.8 | | 236.3 | 102.5 |
| Other debt obligations | 3,570.2 | | 3,542.9 | 27.3 |
| Total fixed maturities, available-for-sale | 49,006.7 | 145.0 | 48,412.0 | 449.7 |
| Fixed maturities, trading | 971.7 | 199.6 | 551.3 | 220.8 |
| Equity securities, available-for-sale | 77.1 | 56.5 | 2.6 | 18.0 |
| Equity securities, trading | 404.8 | 291.6 | 113.2 | |
| Derivative assets (1) | 1,171.1 | | 1,110.9 | 60.2 |
| Other investments (2) | 213.3 | 17.6 | 98.2 | 97.5 |
| Cash equivalents (3) | 1,659.8 | 677.3 | 982.5 | |
| Sub-total excluding separate account assets | 53,504.5 | 1,387.6 | 51,270.7 | 846.2 |
| | | | | |
| Separate account assets | 71,364.4 | 49,477.1 | 17,689.1 | 4,198.2 |
| **Total assets** | $ 124,868.9 | $ 50,864.7 | $ 68,959.8 | $ 5,044.4 |
| | | | | |
| **Liabilities** | | | | |
| Investments-type insurance contracts (4) | $ (195.8) | $ | $ | $ (195.8) |
| Derivative liabilities (1) | (1,527.3) | | (1,350.2) | (177.1) |
| Other liabilities (4) | (225.3) | | (201.1) | (24.2) |
| **Total liabilities** | $ (1,948.4) | $ | $ (1,551.3) | $ (397.1) |
| | | | | |
| **Net assets (liabilities)** | $ 122,920.5 | $ 50,864.7 | $ 67,408.5 | $ 4,647.3 |

(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities. Refer to Note 4, Derivative Financial Instruments, for further information on fair value by class of derivative instruments. Our derivatives are primarily Level 2, with the exception of certain credit default swaps and other swaps that are Level 3.

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

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

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

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**Changes in Level 3 Fair Value Measurements**

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) are summarized as follows:

| | For the three months ended June 30, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Total realized/unrealized gains (losses) | | | | | | |
| | Beginning asset/ (liability) balance as of March 31, 2012 | Included in net income (1) | Included in other comprehensive income | Net purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | Ending asset/ (liability) balance as of June 30, 2012 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
| | (in millions) | | | | | | | |
| **Assets** | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | $ 36.8 | $ | $ 0.3 | $ 2.5 | $ | $ | $ 39.6 | $ |
| Corporate | 202.7 | (2.8) | 7.0 | (14.9) | 22.6 | (15.0) | 199.6 | (0.1) |
| Collateralized debt obligations | 79.0 | (0.1) | (6.1) | 4.8 | | | 77.6 | (0.1) |
| Other debt obligations | 6.1 | (1.5) | 0.6 | (0.1) | | | 5.1 | (1.6) |
| Total fixed maturities, available-for-sale | 324.6 | (4.4) | 1.8 | (7.7) | 22.6 | (15.0) | 321.9 | (1.8) |
| Fixed maturities, trading | 206.2 | (1.1) | (4.0) | (24.9) | 9.5 | | 185.7 | (1.1) |
| Equity securities, available-for-sale | 17.5 | | (0.4) | | | | 17.1 | |
| Derivative assets | 47.3 | 10.8 | | 0.7 | | | 58.8 | 11.8 |
| Other investments | 89.8 | 0.2 | | (6.4) | | | 83.6 | 0.2 |
| Separate account assets (2) | 4,280.3 | 126.3 | 0.2 | 32.5 | 1.3 | (0.1) | 4,440.5 | 126.9 |
| **Liabilities** | | | | | | | | |
| Investments-type insurance contracts | (129.0) | (46.4) | | (4.0) | | | (179.4) | (47.6) |
| Derivative liabilities | (142.3) | (12.6) | (1.1) | 8.9 | | | (147.1) | (13.4) |
| Other liabilities (3) | (40.7) | 7.1 | | | | | (33.6) | 7.2 |

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| | For the three months ended June 30, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Beginning asset/ (liability) balance as of March 31, 2011 | Total realized/unrealized gains (losses) | | Net purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | Ending asset/ (liability) balance as of June 30, 2011 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
| | | Included in net income (1) | Included in other comprehensive income | | | | | |
| | (in millions) | | | | | | | |
| **Assets** | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | $ 24.5 | $ | $ 0.2 | $ (1.4) | $ | $ | $ 23.3 | $ |
| Corporate | 545.2 | (1.0) | (4.6) | (23.4) | 18.4 | | 534.6 | (1.1) |
| Commercial mortgage-backed securities | 19.0 | | (0.3) | (0.3) | | (7.1) | 11.3 | |
| Collateralized debt obligations | 111.1 | (0.8) | 0.6 | | | | 110.9 | (0.7) |
| Other debt obligations | 88.5 | | 0.4 | (28.9) | 8.2 | (31.1) | 37.1 | |
| Total fixed maturities, available-for-sale | 788.3 | (1.8) | (3.7) | (54.0) | 26.6 | (38.2) | 717.2 | (1.8) |
| Fixed maturities, trading | 269.6 | (0.3) | | (28.4) | | (19.4) | 221.5 | (0.4) |
| Equity securities, available-for-sale | 48.2 | (4.5) | 4.7 | | | | 48.4 | (4.5) |
| Derivative assets | 39.4 | 5.7 | (0.1) | (11.3) | | | 33.7 | 5.7 |
| Other investments | 122.2 | | | (14.8) | | | 107.4 | |
| Separate account assets (2) | 3,799.5 | 161.9 | 0.2 | (52.3) | | (4.9) | 3,904.4 | 161.9 |
| **Liabilities** | | | | | | | | |
| Investment-type insurance contracts | (4.2) | (51.9) | | 6.9 | | | (49.2) | (53.5) |
| Derivative liabilities | (185.0) | 5.5 | 0.4 | 0.3 | | | (178.8) | 6.3 |
| Other liabilities (3) | (158.9) | (6.1) | (9.3) | (4.5) | | | (178.8) | (6.1) |

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| | For the six months ended June 30, 2012 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | Total realized/unrealized gains (losses) | | | | | | |
| | Beginning asset/ (liability) balance as of December 31, 2011 | Included in net income (1) | Included in other comprehensive income | Purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | Ending asset/ (liability) balance as of June 30, 2012 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
| | (in millions) | | | | | | | |
| **Assets** | | | | | | | | |
| Fixed maturities, available-for-sale | | | | | | | | |
| Non-U.S. governments | $ 22.9 | $ | $ | $ 2.2 | $ 14.5 | $ | $ 39.6 | $ |
| Corporate | 297.0 | (5.4) | 9.0 | (31.5) | 26.0 | (95.5) | 199.6 | (2.7) |
| Collateralized debt obligations | 102.5 | (0.2) | (3.0) | 5.3 | | (27.0) | 77.6 | (0.2) |
| Other debt obligations | 27.3 | (2.2) | (0.7) | (25.3) | 6.0 | | 5.1 | (2.2) |
| Total fixed maturities, available-for-sale | 449.7 | (7.8) | 5.3 | (49.3) | 46.5 | (122.5) | 321.9 | (5.1) |
| Fixed maturities, trading | 220.8 | (2.8) | 1.3 | (43.1) | 9.5 | | 185.7 | (3.6) |
| Equity securities, available-for-sale | 18.0 | | (0.9) | | | | 17.1 | |
| Derivative assets | 60.2 | (3.8) | | 2.4 | | | 58.8 | (2.8) |
| Other investments | 97.5 | (0.7) | | (13.2) | | | 83.6 | (0.7) |
| Separate account assets (2) | 4,198.2 | 212.4 | 0.3 | 29.8 | 1.6 | (1.8) | 4,440.5 | 203.6 |
| | | | | | | | | |
| Liabilities | | | | | | | | |
| Investments-type insurance contracts | (195.8) | 22.4 | | (6.0) | | | (179.4) | 21.2 |
| Derivative liabilities | (177.1) | 12.8 | 0.2 | 17.0 | | | (147.1) | 13.7 |
| Other liabilities (3) | (24.2) | (9.4) | | | | | (33.6) | (9.4) |

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| | For the six months ended June 30, 2011 | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | Beginning asset/ (liability) balance as of December 31, 2010 | Total realized/unrealized gains (losses) Included in net income (1) | Included in other comprehensive income | Purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | Ending asset/ (liability) balance as of June 30, 2011 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
| | (in millions) | | | | | | | |
| **Assets** | | | | | | | | |
| Fixed maturities, available-for-sale | | | | | | | | |
| Non-U.S. governments | $ 24.5 | $ | $ 0.2 | $ (1.4) | $ | $ | $ 23.3 | $ |
| Corporate | 552.1 | (8.9) | 0.1 | (34.6) | 45.9 | (20.0) | 534.6 | (2.3) |
| Commercial mortgage-backed securities | 16.2 | | 2.3 | (0.1) | | (7.1) | 11.3 | |
| Collateralized debt obligations | 109.3 | (11.1) | 15.3 | (1.3) | | (1.3) | 110.9 | (0.7) |
| Other debt obligations | 88.8 | | 0.9 | (30.1) | 8.6 | (31.1) | 37.1 | |
| Total fixed maturities, available-for-sale | 790.9 | (20.0) | 18.8 | (67.5) | 54.5 | (59.5) | 717.2 | (3.0) |
| Fixed maturities, trading | 269.1 | (4.4) | | (23.8) | | (19.4) | 221.5 | (3.6) |
| Equity securities, available-for-sale | 43.2 | (4.5) | 9.7 | | | | 48.4 | (4.5) |
| Derivative assets | 33.3 | 12.0 | (0.2) | (11.4) | | | 33.7 | 10.7 |
| Other investments | 128.3 | (2.1) | | (18.8) | | | 107.4 | (2.1) |
| Separate account assets (2) | 3,771.5 | 235.6 | (0.1) | (69.6) | 3.1 | (36.1) | 3,904.4 | 231.1 |
| Liabilities | | | | | | | | |
| Investments-type insurance contracts | (6.6) | (56.4) | | 13.8 | | | (49.2) | (56.2) |
| Derivative liabilities | (181.5) | 6.9 | 2.4 | (6.6) | | | (178.8) | 8.8 |
| Other liabilities (3) | (156.8) | (1.7) | (9.1) | (11.2) | | | (178.8) | (1.7) |

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

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

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

(4) Gross purchases, sales, issuances and settlements were:

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| | For the three months ended June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | $ **2.8** | $ | $ | $ **(0.3)** | $ **2.5** |
| Corporate | **5.8** | **(20.0)** | | **(0.7)** | **(14.9)** |
| Collateralized debt obligations | **5.1** | | | **(0.3)** | **4.8** |
| Other debt obligations | | | | **(0.1)** | **(0.1)** |
| Total fixed maturities, available-for-sale | **13.7** | **(20.0)** | | **(1.4)** | **(7.7)** |
| Fixed maturities, trading | | | | **(24.9)** | **(24.9)** |
| Derivative assets | **0.7** | | | | **0.7** |
| Other investments | | | | **(6.4)** | **(6.4)** |
| Separate account assets | **41.0** | **(28.7)** | **(11.4)** | **31.6** | **32.5** |
| **Liabilities** | | | | | |
| Investment-type insurance contracts | | | **(4.8)** | **0.8** | **(4.0)** |
| Derivative liabilities | **(1.0)** | **9.9** | | | **8.9** |

| | For the three months ended June 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | $ 2.5 | $ (3.9) | $ | $ | $ (1.4) |
| Corporate | 0.8 | | | (24.2) | (23.4) |
| Commercial mortgage-backed securities | | | | (0.3) | (0.3) |
| Other debt obligations | | | | (28.9) | (28.9) |
| Total fixed maturities, available-for-sale | 3.3 | (3.9) | | (53.4) | (54.0) |
| Fixed maturities, trading | | (0.4) | | (28.0) | (28.4) |
| Derivative assets | 0.8 | (12.1) | | | (11.3) |
| Other investments | | | | (14.8) | (14.8) |
| Separate account assets | 38.2 | (79.9) | 2.3 | (12.9) | (52.3) |
| **Liabilities** | | | | | |
| Investment-type insurance contracts | | | 5.7 | 1.2 | 6.9 |
| Derivative liabilities | (0.5) | 0.8 | | | 0.3 |
| Other liabilities | | | | (4.5) | (4.5) |

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**(Unaudited)**

| | For the six months ended June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | | | | | |
| Non-U.S. government | $ **6.7** | $ **(3.9)** | $ | $ **(0.6)** | $ **2.2** |
| Corporate | **18.1** | **(46.6)** | | **(3.0)** | **(31.5)** |
| Collateralized debt obligations | **5.1** | | | **0.2** | **5.3** |
| Other debt obligations | | | | **(25.3)** | **(25.3)** |
| Total fixed maturities, available-for-sale | **29.9** | **(50.5)** | | **(28.7)** | **(49.3)** |
| Fixed maturities, trading | | **(0.9)** | | **(42.2)** | **(43.1)** |
| Derivative assets | **3.2** | **(0.8)** | | | **2.4** |
| Other investments | | | | **(13.2)** | **(13.2)** |
| Separate account assets | **168.5** | **(119.0)** | **(146.3)** | **126.6** | **29.8** |
| **Liabilities** | | | | | |
| Investment-type insurance contracts | | | **(8.1)** | **2.1** | **(6.0)** |
| Derivative liabilities | **(1.7)** | **18.7** | | | **17.0** |

| | For the six months ended June 30, 2011 | | | | |
|---|---|---|---|---|---|
| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | | | | | |
| Non-U.S. government | $ 2.5 | $ (3.9) | $ | $ | $ (1.4) |
| Corporate | 8.4 | (16.5) | | (26.5) | (34.6) |
| Commercial mortgage-backed securities | | | | (0.1) | (0.1) |
| Collateralized debt obligations | 0.3 | (0.4) | | (1.2) | (1.3) |
| Other debt obligations | | | | (30.1) | (30.1) |
| Total fixed maturities, available-for-sale | 11.2 | (20.8) | | (57.9) | (67.5) |
| Fixed maturities, trading | 10.0 | (5.7) | | (28.1) | (23.8) |
| Derivative assets | 0.8 | (12.2) | | | (11.4) |
| Other investments | | | | (18.8) | (18.8) |
| Separate account assets | 73.4 | (124.6) | 2.3 | (20.7) | (69.6) |
| **Liabilities** | | | | | |
| Investment-type insurance contracts | | | 12.0 | 1.8 | 13.8 |
| Derivative liabilities | (9.9) | 3.3 | | | (6.6) |
| Other liabilities | (2.1) | | | (9.1) | (11.2) |

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**Transfers**

Transfers of assets and liabilities measured at fair value on a recurring basis between fair value hierarchy levels are summarized below.

| | For the three months ended June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Transfers out of Level 1 into Level 2 | Transfers out of Level 1 into Level 3 | Transfers out of Level 2 into Level 1 | Transfers out of Level 2 into Level 3 | Transfers out of Level 3 into Level 1 | Transfers out of Level 3 into Level 2 |
| | (in millions) | | | | | |
| **Assets** | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Corporate | $ | $ | $ | $ 22.6 | $ | $ 15.0 |
| Total fixed maturities, available-for-sale | | | | 22.6 | | 15.0 |
| Fixed maturities, trading | | | | 9.5 | | |
| Separate account assets | 3,222.8 | | | 1.3 | | 0.1 |

| | For the six months ended June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Transfers out of Level 1 into Level 2 | Transfers out of Level 1 into Level 3 | Transfers out of Level 2 into Level 1 | Transfers out of Level 2 into Level 3 | Transfers out of Level 3 into Level 1 | Transfers out of Level 3 into Level 2 |
| | (in millions) | | | | | |
| **Assets** | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Non-U.S. governments | $ | $ | $ | $ 14.5 | $ | $ |
| Corporate | | | | 26.0 | | 95.5 |
| Collateralized debt obligations | | | | | | 27.0 |
| Other debt obligations | | | | 6.0 | | |
| Total fixed maturities, available-for-sale | | | | 46.5 | | 122.5 |
| Fixed maturities, trading | | | | 9.5 | | |
| Separate account assets | 3,222.8 | 0.3 | | 1.3 | | 1.8 |

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

During the three and six months ended June 30, 2011, $3,549.7 million and $3,552.0 million, respectively, of separate account assets transferred out of Level 1 into Level 2. Separate account assets transferred between Level 1 and Level 2 during the six months ended June 30, 2012 and

during the three and six months ended June 30, 2011, primarily related to foreign equity securities. When these securities are valued at the local close price of the exchange where the assets traded, they are reflected in Level 1. When events materially affecting the value occur between the close of the local exchange and the New York Stock Exchange, we use adjusted prices determined by a third party pricing vendor to update the foreign market closing prices and the fair value is reflected in Level 2.

Assets transferred into Level 3 during the six months ended June 30, 2012 and 2011, primarily included those assets for which we are now unable to obtain pricing from a recognized third party pricing vendor as well as assets that were previously priced using a matrix valuation approach that may no longer be relevant when applied to asset-specific situations.

Assets transferred out of Level 3 during the six months ended June 30, 2012 and 2011, included those for which we are now able to obtain pricing from a recognized third party pricing vendor or from internal models using substantially all market observable information.

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**Quantitative Information about Level 3 Fair Value Measurements**

The following table provides quantitative information about the significant unobservable inputs used for recurring fair value measurements categorized within Level 3, excluding assets and liabilities for which significant quantitative unobservable inputs are not developed internally, which primarily consists of those valued using broker quotes. Refer to Assets and liabilities measured at fair value on a recurring basis for a complete valuation hierarchy summary.

| | | | | | | |
|---|---|---|---|---|---|---|
| **Assets** | | | | | | |
| Non-U.S. governments | **$** | **13.8** | Discounted cash flow | Discount rate (1) | 1.6% | 1.6% |
| | | | | Illiquidity premium | 50 basis points ( bps ) | 50bps |
| Collateralized debt obligations | | **36.2** | Discounted cash flow | Discount rate (1) | 1.8%-21.8% | 14.6% |
| | | | | Illiquidity premium | 400bps-1,000bps | 786bps |
| Fixed maturities, trading | | **37.8** | Discounted cash flow | Discount rate (1) | 2.1%-69.4% | 8.5% |
| | | | | Illiquidity premium | 0bps-1,400bps | 360bps |
| | | | | Earnings before interest, taxes, depreciation and amortization multiple | 0x-6.5x | 0.5x |

| | | | | |
|---|---|---|---|---|
| | | Potential loss severity | 0%-66% | 11.1% |
| **132.4** | See note (2) | | | |

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| | As of June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | **Assets / (liabilities) measured at fair value (in millions)** | **Valuation technique(s)** | **Unobservable input description** | **Input/range of inputs** | **Weighted average** |
| Other investments | **89.8** | Discounted cash flow | Discount rate (1) | 4.3% | 4.3% |
| | | | Illiquidity premium | 334bps | 334bps |
| Separate account assets | **4,123.9** | Discounted cash flow - mortgage loans | Discount rate (1) | 1.0%-12.6% | 4.2% |
| | | | Illiquidity premium | 0bps-50bps | |
| | | | Credit spread rate | 70bps-1,245bps | 352bps |
| | | Discounted cash flow - real estate | Discount rate (1) | 6.5%-10.5% | 8.2% |
| | | | Terminal capitalization rate | 5.5%-9.5% | 7.3% |
| | | | Average market rent growth rate | 2.3%-5.7% | 3.4% |
| **Liabilities** | | | | | |
| Investment-type insurance contracts | **(179.4)** | Discounted cash flow | Long duration interest rate | 2.4%-2.5% (3) | See note (3) |
| | | | Long-term equity market volatility | 16.1%-44.5% | |
| | | | Non-performance risk | 0.9%-2.9% | |
| | | | Utilization rate | See note (4) | See note (4) |
| | | | Lapse rate | 0.5%-16.0% | |
| | | | Mortality rate | See note (5) | See note (5) |
| Derivative liabilities | **(94.7)** | See note (2) | | | |
| Other liabilities | **(33.6)** | See note (2) | | | |

(1) Represents market comparable interest rate or an index adjusted rate used as the base rate in the discounted cash flow analysis prior to any credit spread, illiquidity or other adjustments, where applicable.

(2) Relates to a consolidated collateralized private investment vehicle that is a VIE. Fixed maturity, trading represents the underlying collateral of the investment structure and consists of high-grade fixed maturity investments, which are over-collateralized based on outstanding notes priced at par. The derivative liability represents credit default swaps that are valued using a correlation model to the credit default swap ( CDS ) Index ( CDX ) and inputs to the valuation are based on observable market data such as the end of period swap curve, CDS constituents of the index and spread levels of the index, as well as CDX tranche spreads. The other liabilities represent obligations to third party note holders due at maturity or termination of the trust. The value of the obligations reflect the third parties interest in the investment structure.

(3) Represents the range of rate curves used in the valuation analysis that we have determined market participants would use when pricing the instrument. Derived from interpolation between observable 20 and 30-year swap rates.

**Principal Financial Group, Inc.**

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**(Unaudited)**

(4) This input factor is the number of contractholders taking withdrawals as well as the amount and timing of the withdrawals and a range does not provide a meaningful presentation.

(5) This input is based on an appropriate industry mortality table and a range does not provide a meaningful presentation.

Market comparable discount rates are used as the base rate in the discounted cash flows used to determine the fair value of certain assets. Increases or decreases in the credit spreads on the comparable assets could cause the fair value of asset to significantly decrease or increase, respectively. Additionally, we may adjust the base discount rate or the modeled price by applying an illiquidity premium given the highly structured nature of certain assets. Increases or decreases in this illiquidity premium could cause significant decreases or increases, respectively, in the fair value of the asset.

Embedded derivatives can be either assets or liabilities within the investment-type insurance contracts line item, depending on certain inputs at the reporting date. Increases to an asset or decreases to a liability are described as increases to fair value. Increases or decreases in market volatilities could cause significant decreases or increases, respectively, in the fair value of embedded derivatives in investment-type insurance contracts. Long duration interest rates are used as the mean return when projecting the growth in the value of associated account value and impact the discount rate used in the discounted future cash flows valuation. The amount of claims will increase if account value is not sufficient to cover guaranteed withdrawals. Increases or decreases in risk free rates could cause the fair value of the embedded derivative to significantly increase or decrease, respectively. Increases or decreases in our own credit risks, which impact the rates used to discount future cash flows, could significantly increase or decrease, respectively, the fair value of the embedded derivative. All of these changes in fair value would impact net income.

Decreases or increases in the mortality rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. Decreases or increases in the overall lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The lapse rate assumption varies dynamically based on the relationship of the guarantee and associated account value. A stronger or weaker dynamic lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The utilization rate assumption includes how many contractholders will take withdrawals, when they will take them and how much of their benefit they will take. Increases or decreases in the assumption of the number of contractholders taking withdrawals could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take withdrawals earlier or later could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take more or less of their benefit could cause the fair value of the embedded derivative to decrease or increase, respectively.

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

Certain assets are measured at fair value on a nonrecurring basis. During the six months ended June 30, 2012, certain mortgage loans had been marked to fair value of $172.7 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of $3.4 million and $11.2 million for the three and six months ended June 30, 2012, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs. The fair value of the underlying collateral is determined based on a discounted cash flow valuation either from an external broker opinion of value or an internal model. Significant inputs used in the discounted cash flow calculation include: a discount rate, terminal capitalization rate and average market rent growth. The ranges of inputs used in the fair value measurements for the mortgage loans marked to fair value during the six months ended June 30, 2012, were:

Discount rate = 8.0% - 20.0%

Terminal capitalization rate = 6.3% - 10.5%

Average market rent growth = 3.0% - 8.0%

During the six months ended June 30, 2012, certain mortgage servicing rights had been marked to fair value of $5.9 million. The net impact of impairments and subsequent improvements in estimated fair value of previously impaired mortgage servicing rights resulted in a net loss of $0.1 million and zero for the three and six months ended June 30, 2012, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans. The discount rate used in calculating the present value of the future servicing cash flows was 3.1% for the six months ended June 30, 2012.

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During the six months ended June 30, 2011, certain mortgage loans had been marked to fair value of $97.4 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of $14.8 million and $14.0 million for the three months and six ended June 30, 2011, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During the six months ended June 30, 2011, certain mortgage servicing rights had been written down to fair value of $1.0 million. The net impact of impairments and improvements in estimated fair value of previously impaired mortgage servicing rights resulted in a net loss of $0.1 million and zero for the three months and six ended June 30, 2011, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans.

**Fair Value Option**

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

The fair value and aggregate contractual principal amounts of commercial mortgage loans for which the fair value option has been elected were $83.6 million and $82.8 million as of June 30, 2012, and $97.5 million and $96.1 million as of December 31, 2011, respectively. The change in fair value of the loans resulted in a $0.2 million and $0.0 million pre-tax gain (loss) for the three months ended June 30, 2012 and 2011, respectively, and a ($0.7) million and ($2.1) million pre-tax gain (loss) for the six months ended June 30, 2012 and 2011, respectively, none of which related to instrument-specific credit risk. None of these loans were more than 90 days past due or in nonaccrual status. Interest income on these commercial mortgage loans is included in net investment income on the consolidated statements of operations and is recorded based on the effective interest rates as determined at the closing of the loan. Interest income recorded on these commercial mortgage loans was $1.7 million and $2.1 million for the three months ended June 30, 2012 and 2011, respectively, and $3.5 million and $4.6 million for the six months ended June 30, 2012 and 2011, respectively.

The fair value and aggregate unpaid principal amounts of obligations for which the fair value option has been elected were $84.1 million and $215.2 million as of June 30, 2012, and $88.4 million and $169.8 million as of December 31, 2011, respectively. For the three months ended June 30, 2012 and 2011, the change in fair value of the obligations resulted in a pre-tax gain (loss) of $7.5 million and ($6.1) million, which includes a pre-tax gain (loss) of $7.2 million and ($6.1) million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. For the six months ended June 30, 2012 and 2011, the change in fair value of the obligations resulted in a pre-tax gain (loss) of ($8.5) million and $0.2 million, which includes a pre-tax gain (loss) of ($9.4) million and ($1.7) million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. Interest expense recorded on these obligations is included in operating expenses on the consolidated statements of operations and was $1.3 million and $1.7 million for the three months ended June 30, 2012 and 2011, respectively, and $2.7 million and $3.6 million for the six months ended June 30, 2012 and 2011, respectively.

**Financial Instruments Not Reported at Fair Value**

The carrying value and estimated fair value of financial instruments not recorded at fair value on a recurring basis but required to be disclosed at fair value were as follows:

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| | June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | | | Fair value hierarchy level | | |
| | Carrying amount | Fair value | Level 1 | Level 2 | Level 3 |
| | (in millions) | | | | |
| **Assets (liabilities)** | | | | | |
| Mortgage loans | **$ 11,158.6** | **$ 11,706.9** | **$** | **$** | **$ 11,706.9** |
| Policy loans | **867.8** | **1,079.0** | | | **1,079.0** |
| Other investments | **244.5** | **245.3** | | **158.8** | **86.5** |
| Cash and cash equivalents | **791.9** | **791.9** | **791.9** | | |
| Investments-type insurance contracts | **(31,215.0)** | **(30,977.2)** | | **(6,727.7)** | **(24,249.5)** |
| Short-term debt | **(262.9)** | **(262.9)** | | **(262.9)** | |
| Long-term debt | **(1,576.9)** | **(1,819.3)** | | **(1,789.7)** | **(29.6)** |
| Separate account liabilities | **(68,014.8)** | **(67,070.3)** | | | **(67,070.3)** |
| Bank deposits | **(2,132.1)** | **(2,137.9)** | **(1,324.1)** | **(813.8)** | |
| Cash collateral payable | **(279.1)** | **(279.1)** | **(279.1)** | | |

| | December 31, 2011 | |
|---|---|---|
| | Carrying amount | Fair value |
| | (in millions) | |
| **Assets (liabilities)** | | |
| Mortgage loans | $ 10,727.2 | $ 11,223.4 |
| Policy loans | 885.1 | 1,114.2 |
| Other investments | 165.6 | 165.6 |
| Cash and cash equivalents | 1,174.1 | 1,174.1 |
| Investments-type insurance contracts | (32,408.5) | (32,234.0) |
| Short-term debt | (105.2) | (105.2) |
| Long-term debt | (1,564.8) | (1,750.7) |
| Separate account liabilities | (64,016.2) | (62,906.9) |
| Bank deposits | (2,142.8) | (2,150.2) |
| Cash collateral payable | (234.0) | (234.0) |

***Mortgage Loans***

Fair values of commercial and residential mortgage loans are primarily determined by discounting the expected cash flows at current treasury rates plus an applicable risk spread, which reflects credit quality and maturity of the loans. The risk spread is based on market clearing levels for loans with comparable credit quality, maturities and risk. The fair value of mortgage loans may also be based on the fair value of the underlying real estate collateral less cost to sell, which is estimated using appraised values. These are reflected in Level 3.

***Policy Loans***

Fair values of policy loans are estimated by discounting expected cash flows using a risk-free rate based on the U.S. Treasury curve. The expected cash flows reflect an estimate of timing of the repayment of the loans. These are reflected in Level 3.

***Other Investments***

The fair value of commercial loans and certain consumer loans included in other investments is calculated by discounting scheduled cash flows through the estimated maturity date using market interest rates that reflect the credit and interest rate risk inherent in the loans. The estimate of term to maturity is based on historical experience, adjusted as required, for current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate. These are reflected in Level 3. The carrying value of the remaining investments reported in this line item approximate their fair value and are of a short-term nature. These are reflected in Level 2.

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**Principal Financial Group, Inc.**

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**(Unaudited)**

***Cash and Cash Equivalents***

The carrying amounts of cash and cash equivalents that are not reported at fair value on a recurring basis approximate their fair value, which are reflected in Level 1 given the nature of cash.

***Investment-Type Insurance Contracts***

The fair values of our reserves and liabilities for investment-type insurance contracts are determined via a third party pricing vendor or using discounted cash flow analyses when we are unable to find a price from third party pricing vendors. Third party pricing on various outstanding medium-term notes and funding agreements is based on observable inputs such as benchmark yields and spreads based on reported trades for our medium-term notes and funding agreement issuances. These are reflected in Level 2. The discounted cash flow analyses for the remaining contracts is based on current interest rates, including non-performance risk, being offered for similar contracts with maturities consistent with those remaining for the investment-type contracts being valued. These are reflected in Level 3. Investment-type insurance contracts include insurance, annuity and other policy contracts that do not involve significant mortality or morbidity risk and are only a portion of the policyholder liabilities appearing in the consolidated statements of financial position. Insurance contracts include insurance, annuity and other policy contracts that do involve significant mortality or morbidity risk. The fair values for our insurance contracts, other than investment-type contracts, are not required to be disclosed.

***Short-Term Debt***

The carrying amount of short-term debt approximates its fair value because of the relatively short time between origination of the debt instrument and its maturity, which is reflected in Level 2.

***Long-Term Debt***

Long-term debt primarily includes senior note issuances for which the fair values are determined using inputs that are observable in the market or that can be derived from or corroborated with observable market data. These are reflected in Level 2. Additionally, our long-term debt includes non-recourse mortgages and notes payable that are primarily financings for real estate developments for which the fair values are

estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. These are reflected in Level 3.

***Separate Account Liabilities***

Fair values of separate account liabilities, excluding insurance-related elements, are estimated based on market assumptions around what a potential acquirer would pay for the associated block of business, including both the separate account assets and liabilities. As the applicable separate account assets are already reflected at fair value, any adjustment to the fair value of the block is an assumed adjustment to the separate account liabilities. To compute fair value, the separate account liabilities are originally set to equal separate account assets because these are pass-through contracts. The separate account liabilities are reduced by the amount of future fees expected to be collected that are intended to offset upfront acquisition costs already incurred that a potential acquirer would not have to pay. The estimated future fees are adjusted by an adverse deviation discount and the amount is then discounted at a risk-free rate as measured by the yield on U.S. Treasury securities at maturities aligned with the estimated timing of fee collection. These are reflected in Level 3.

***Bank Deposits***

The fair value of deposits of our Principal Bank subsidiary with no stated maturity, such as demand deposits, savings, and interest-bearing demand accounts, is equal to the amount payable on demand (i.e., their carrying amounts). These are reflected in Level 1. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount is estimated using the rates currently offered for deposits of similar remaining maturities. These are reflected in Level 2.

***Cash Collateral Payable***

The carrying amount of the payable associated with our obligation to return the cash collateral received under derivative credit support annex (collateral) agreements approximates its fair value, which is reflected in Level 1.

**Principal Financial Group, Inc.**

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**(Unaudited)**

**10. Segment Information**

We provide financial products and services through the following segments: Retirement and Investor Services, Principal Global Investors, Principal International and U.S. Insurance Solutions. In addition, there is a Corporate segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

The Retirement and Investor Services segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals.

The Principal Global Investors segment provides asset management services to our asset accumulation business, our insurance operations, the Corporate segment and third-party clients.

The Principal International segment has operations in Brazil, Chile, China, Hong Kong Special Administrative Region, India, Mexico and Southeast Asia. We focus on countries with large middle classes, favorable demographics and growing long-term savings, ideally with defined contribution markets. We entered these countries through acquisitions, start-up operations and joint ventures.

The U.S. Insurance Solutions segment provides individual life insurance and specialty benefits, which consists of group dental and vision insurance, individual and group disability insurance, group life insurance, wellness services and non-medical fee-for-service claims administration, throughout the United States.

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

Management uses segment operating earnings in goal setting, as a basis for determining employee compensation and in evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income for net realized capital gains (losses), as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating

trends. Net realized capital gains (losses), as adjusted, are net of income taxes, related changes in the amortization pattern of DPAC and sales inducements, recognition of deferred front-end fee revenues for sales charges on retirement and life insurance products and services, amortization of hedge accounting book value adjustments for certain discontinued hedges, net realized capital gains and losses distributed, noncontrolling interest capital gains and losses and certain market value adjustments to fee revenues. Net realized capital gains (losses), as adjusted, exclude periodic settlements and accruals on derivative instruments not designated as hedging instruments and exclude certain market value adjustments of embedded derivatives and realized capital gains (losses) associated with our exited group medical insurance business. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on derivatives not designated as hedging instruments), including their impact on recognition of front-end fee revenues, certain market value adjustments to fee revenues and amortization of hedge accounting book value adjustments for certain discontinued hedges, and revenue from our exited group medical insurance business. Segment operating revenues include operating revenues from real estate properties that qualify for discontinued operations. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

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

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**(Unaudited)**

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

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | (in millions) | |
| **Assets:** | | |
| Retirement and Investor Services | **$ 111,536.2** | $ 108,998.0 |
| Principal Global Investors | **1,218.4** | 1,833.3 |
| Principal International | **17,229.1** | 15,612.1 |
| U.S. Insurance Solutions | **18,082.5** | 17,389.1 |
| Corporate | **3,984.5** | 3,529.2 |
| Total consolidated assets | **$ 152,050.7** | $ 147,361.7 |

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | 2012 | 2011 | 2012 | 2011 |
| | (in millions) | | | |
| **Operating revenues by segment:** | | | | |
| Retirement and Investor Services | **$ 1,081.2** | $ 1,044.2 | **$ 2,136.3** | $ 2,062.1 |
| Principal Global Investors | **141.1** | 136.3 | **279.2** | 261.6 |
| Principal International | **210.6** | 227.2 | **473.1** | 433.3 |
| U.S. Insurance Solutions | **751.5** | 730.7 | **1,448.5** | 1,462.7 |
| Corporate | **(48.1)** | (39.9) | **(93.4)** | (73.7) |
| Total segment operating revenues | **2,136.3** | 2,098.5 | **4,243.7** | 4,146.0 |
| Net realized capital gains (losses), net of related revenue adjustments | **(21.7)** | 12.2 | **(52.1)** | (68.3) |
| Exited group medical insurance business | **4.0** | 180.8 | **22.9** | 435.7 |
| Assumption change within our Individual Life business | | 4.9 | | 4.9 |
| Total revenues per consolidated statements of operations | **$ 2,118.6** | $ 2,296.4 | **$ 4,214.5** | $ 4,518.3 |
| **Operating earnings (loss) by segment, net of related income taxes:** | | | | |
| Retirement and Investor Services | **$ 141.7** | $ 154.7 | **$ 285.3** | $ 308.8 |
| Principal Global Investors | **18.2** | 20.8 | **34.4** | 37.4 |
| Principal International | **36.9** | 36.3 | **78.7** | 64.1 |
| U.S. Insurance Solutions | **50.2** | 49.0 | **100.4** | 102.4 |
| Corporate | **(30.7)** | (31.8) | **(69.5)** | (63.9) |
| Total segment operating earnings, net of related income taxes | **216.3** | 229.0 | **429.3** | 448.8 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Net realized capital gains (losses), as adjusted (1) | | **(39.2)** | | 23.5 | | **(49.2)** | | (31.4) |
| Other after-tax adjustments (2) | | **(4.0)** | | (35.2) | | **(5.5)** | | (18.1) |
| Net income available to common stockholders per consolidated statements of operations | **$** | **173.1** | $ | 217.3 | **$** | **374.6** | $ | 399.3 |

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**(Unaudited)**

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

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in millions) | | | |
| **Net realized capital gains (losses):** | | | | |
| Net realized capital gains (losses) | **$ 0.2** | $ 37.7 | **$ (6.5)** | $ (20.3) |
| Certain derivative and hedging-related adjustments | **(22.4)** | (25.5) | **(45.7)** | (47.8) |
| Certain market value adjustments to fee revenues | | (0.1) | | (0.1) |
| Recognition of front-end fee revenue | **0.5** | 0.1 | **0.1** | (0.1) |
| Net realized capital gains (losses), net of related revenue adjustments | **(21.7)** | 12.2 | **(52.1)** | (68.3) |
| Amortization of deferred policy acquisition and sales inducement costs | **(28.7)** | (14.3) | **4.2** | 6.3 |
| Capital (gains) losses distributed | **5.6** | (3.0) | **(1.9)** | (11.7) |
| Certain market value adjustments of embedded derivatives | **0.5** | 60.0 | **(1.4)** | 63.8 |
| Net realized capital (gains) losses associated with exited group medical insurance business | **0.1** | (0.1) | **0.2** | (0.2) |
| Noncontrolling interest capital gains | **(0.1)** | (19.3) | **(8.2)** | (36.8) |
| Income tax effect | **5.1** | (12.0) | **10.0** | 15.5 |
| Net realized capital gains (losses), as adjusted | **$ (39.2)** | $ 23.5 | **$ (49.2)** | $ (31.4) |

(2) For the three months ended June 30, 2012, other after-tax adjustments included the negative effect resulting from losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended June 30, 2011, other after-tax adjustments included (1) the negative effect of (a) an assumption change in our Individual Life business ($34.5 million) and (b) a contribution made to The Principal Financial Group Foundation, Inc. ($19.5 million) and (2) the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP ($18.8 million).

For the six months ended June 30, 2012, other after-tax adjustments included the negative effect resulting from losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP.

For the six months ended June 30, 2011, other after-tax adjustments included (1) the negative effect of (a) an assumption change in our Individual Life business ($34.5 million) and b) a contribution made to The Principal Financial Group Foundation, Inc. ($19.5 million) and (2) the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP ($35.9 million).

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**June 30, 2012**

**(Unaudited)**

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in millions) | | | |
| Retirement and Investor Services: | | | | |
| Full service accumulation | **$ 334.4** | $ 342.3 | **$ 667.1** | $ 685.7 |
| Principal Funds | **149.1** | 144.2 | **296.2** | 285.8 |
| Individual annuities | **289.6** | 288.2 | **561.9** | 562.4 |
| Bank and trust services | **25.3** | 24.6 | **49.8** | 48.4 |
| Eliminations | **(29.0)** | (28.5) | **(58.2)** | (57.4) |
| Total Accumulation | **769.4** | 770.8 | **1,516.8** | 1,524.9 |
| Investment only | **108.3** | 127.8 | **223.6** | 263.4 |
| Full service payout | **203.5** | 145.6 | **395.9** | 273.8 |
| Total Guaranteed | **311.8** | 273.4 | **619.5** | 537.2 |
| Total Retirement and Investor Services | **1,081.2** | 1,044.2 | **2,136.3** | 2,062.1 |
| Principal Global Investors (1) | **141.1** | 136.3 | **279.2** | 261.6 |
| Principal International | **210.6** | 227.2 | **473.1** | 433.3 |
| U.S. Insurance Solutions: | | | | |
| Individual life insurance | **358.7** | 353.5 | **672.2** | 711.8 |
| Specialty benefits insurance | **392.8** | 377.2 | **776.3** | 750.9 |
| Total U.S. Insurance Solutions | **751.5** | 730.7 | **1,448.5** | 1,462.7 |
| Corporate | **(48.1)** | (39.9) | **(93.4)** | (73.7) |
| Total operating revenues | **$ 2,136.3** | $ 2,098.5 | **$ 4,243.7** | $ 4,146.0 |
| Total operating revenues | **$ 2,136.3** | $ 2,098.5 | **$ 4,243.7** | $ 4,146.0 |
| Net realized capital gains (losses), net of related revenue adjustments | **(21.7)** | 12.2 | **(52.1)** | (68.3) |
| Exited group medical insurance business | **4.0** | 180.8 | **22.9** | 435.7 |
| Assumption change within our Individual Life business | | 4.9 | | 4.9 |
| Total revenues per consolidated statements of operations | **$ 2,118.6** | $ 2,296.4 | **$ 4,214.5** | $ 4,518.3 |

(1) Reflects inter-segment revenues of $53.3 million and $55.8 million for the three months ended June 30, 2012 and 2011, respectively, and $105.9 million and $107.5 million for the six months ended June 30, 2012 and 2011, respectively.

**11. Stock-Based Compensation Plans**

As of June 30, 2012, we have the Amended and Restated 2010 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan, the Directors Stock Plan and the Long-Term Performance Plan ( Stock-Based Compensation Plans ). As of May 17, 2005, no new grants will be made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan. Under

the terms of the Amended and Restated 2010 Stock Incentive Plan, grants may be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units or other stock-based awards. The 2005 Directors Stock Plan provides for the grant of nonqualified stock options, restricted stock, restricted stock units or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock or performance units.

As of June 30, 2012, the maximum number of new shares of common stock that were available for grant under the Amended and Restated 2010 Stock Incentive Plan and the 2005 Directors Stock Plan was 8.8 million.

For awards with graded vesting, we use an accelerated expense attribution method. The compensation cost that was charged against income for stock-based awards granted under the Stock-Based Compensation Plans was as follows:

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**June 30, 2012**

**(Unaudited)**

| | For the six months ended June 30, 2012 | 2011 |
|---|---|---|
| | (in millions) | |
| Compensation cost | $ **27.2** | $ 23.4 |
| Related income tax benefit | **9.0** | 8.0 |
| Capitalized as part of an asset | **1.2** | 1.1 |

**Nonqualified Stock Options**

Nonqualified stock options were granted to certain employees under the Amended and Restated 2010 Stock Incentive Plan. Total options granted were 0.8 million for the six months ended June 30, 2012. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 2.6 percent, a weighted-average expected volatility of 70.0 percent, a weighted-average risk-free interest rate of 1.1 percent and a weighted-average expected term of 6 years. The weighted-average estimated fair value of stock options granted during the six months ended June 30, 2012, was $13.95 per share.

As of June 30, 2012, there were $8.4 million of total unrecognized compensation costs related to nonvested stock options. The costs are expected to be recognized over a weighted-average service period of approximately 1.6 years.

**Performance Share Awards**

Performance share awards were granted to certain employees under the Amended and Restated 2010 Stock Incentive Plan. Total performance share awards granted were 0.4 million for the six months ended June 30, 2012. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance objective to be determined at the end of the performance period. The actual number of shares to be awarded at the end of each performance period will range between 0% and 150% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was $27.46 per common share.

As of June 30, 2012, there were $10.0 million of total unrecognized compensation costs related to nonvested performance share awards granted. The costs are expected to be recognized over a weighted-average service period of approximately 1.6 years.

**Restricted Stock Units**

Restricted stock units were issued to certain employees and agents pursuant to the Amended and Restated 2010 Stock Incentive Plan and non-employee directors pursuant to the 2005 Directors Stock Plan. Total restricted stock units granted were 1.1 million for the six months ended June 30, 2012. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was $27.33 per common share.

As of June 30, 2012, there were $46.8 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted. The costs are expected to be recognized over a weighted-average period of approximately 2.0 years.

**Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan, employees purchased 0.5 million shares for the six months ended June 30, 2012. The weighted average fair value of the discount on the stock purchased was $4.76 per share.

As of June 30, 2012, a total of 6.4 million of new shares are available to be made issuable by us for this plan.

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**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**June 30, 2012**

**(Unaudited)**

## 12. Earnings Per Common Share

The computations of the basic and diluted per share amounts were as follows:

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in millions, except per share data) | | | |
| Net income | **$ 184.1** | $ 249.2 | **$ 403.0** | $ 458.0 |
| Subtract: | | | | |
| Net income attributable to noncontrolling interest | **2.7** | 23.6 | **11.9** | 42.2 |
| Preferred stock dividends | **8.3** | 8.3 | **16.5** | 16.5 |
| Net income available to common stockholders | **$ 173.1** | $ 217.3 | **$ 374.6** | $ 399.3 |
| Weighted-average shares outstanding: | | | | |
| Basic | **299.4** | 320.0 | **300.6** | 320.7 |
| Dilutive effects: | | | | |
| Stock options | **0.9** | 1.3 | **1.0** | 1.4 |
| Restricted stock units | **1.3** | 1.5 | **1.4** | 1.5 |
| Performance share awards | **0.3** | 0.4 | **0.3** | 0.4 |
| Diluted | **301.9** | 323.2 | **303.3** | 324.0 |
| Net income per common share: | | | | |
| Basic | **$ 0.58** | $ 0.68 | **$ 1.25** | $ 1.24 |
| Diluted | **$ 0.58** | $ 0.67 | **$ 1.24** | $ 1.23 |

The calculation of diluted earnings per share for the three and six months ended June 30, 2012 and 2011, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

## 13. Condensed Consolidating Financial Information

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

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) Principal Life, (iii) Principal Financial Services, Inc. ( PFS ) and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of June 30, 2012 and December 31, 2011, and for the six months ended June 30, 2012 and 2011.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG s interest in PFS, (ii) Principal Life s interest in all direct subsidiaries of Principal Life and (iii) PFS s interest in Principal Life even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent s investment and earnings. All intercompany balances and transactions, including elimination of the parent s investment in subsidiaries, between PFG, Principal Life and PFS and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

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**Principal Financial Group, Inc.**
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**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | $ | $ 43,864.7 | $ 6,284.7 | $ (355.8) | $ 49,793.6 |
| Fixed maturities, trading | 152.2 | 298.2 | 326.1 | | 776.5 |
| Equity securities, available-for-sale | | 135.3 | 3.7 | | 139.0 |
| Equity securities, trading | | 0.3 | 224.0 | | 224.3 |
| Mortgage loans | | 9,698.4 | 1,855.0 | (394.8) | 11,158.6 |
| Real estate | | 9.0 | 1,166.0 | (0.9) | 1,174.1 |
| Policy loans | | 839.7 | 28.1 | | 867.8 |
| Investment in unconsolidated entities | 10,216.3 | 2,914.5 | 4,982.3 | (17,291.2) | 821.9 |
| Other investments | 5.8 | 2,775.2 | 1,034.5 | (1,540.6) | 2,274.9 |
| Cash and cash equivalents | 374.4 | 472.8 | 826.1 | (26.7) | 1,646.6 |
| Accrued investment income | 0.2 | 522.2 | 67.4 | (0.3) | 589.5 |
| Premiums due and other receivables | | 921.9 | 1,003.8 | (828.7) | 1,097.0 |
| Deferred policy acquisition costs | | 2,408.8 | 255.0 | | 2,663.8 |
| Property and equipment | | 406.2 | 63.5 | | 469.7 |
| Goodwill | | 54.3 | 487.7 | | 542.0 |
| Other intangibles | | 28.6 | 906.3 | | 934.9 |
| Separate account assets | | 65,126.0 | 10,824.5 | | 75,950.5 |
| Other assets | 13.7 | 460.2 | 1,068.1 | (616.0) | 926.0 |
| Total assets | $ 10,762.6 | $ 130,936.3 | $ 31,406.8 | $ (21,055.0) | $ 152,050.7 |
| **Liabilities** | | | | | |
| Contractholder funds | $ | $ 36,239.0 | $ 761.3 | $ (272.8) | $ 36,727.5 |
| Future policy benefits and claims | | 16,653.6 | 4,280.3 | (142.5) | 20,791.4 |
| Other policyholder funds | | 630.6 | 33.1 | (0.3) | 663.4 |
| Short-term debt | | 222.0 | 40.9 | | 262.9 |
| Long-term debt | 1,351.7 | 99.4 | 528.2 | (402.4) | 1,576.9 |
| Income taxes currently payable | (20.3) | (411.1) | 26.7 | 407.1 | 2.4 |
| Deferred income taxes | (16.8) | 368.9 | 234.3 | (17.7) | 568.7 |
| Separate account liabilities | | 65,126.0 | 10,824.5 | | 75,950.5 |
| Other liabilities | 25.3 | 4,518.4 | 4,384.0 | (2,916.1) | 6,011.6 |
| Total liabilities | 1,339.9 | 123,446.8 | 21,113.3 | (3,344.7) | 142,555.3 |

| | | | | | |
|---|---|---|---|---|---|
| Redeemable noncontrolling interest | | | **60.5** | | **60.5** |
| **Stockholders equity** | | | | | |
| Series A preferred stock | | | | | |
| Series B preferred stock | **0.1** | | | | **0.1** |
| Common stock | **4.5** | **2.5** | | **(2.5)** | **4.5** |
| Additional paid-in capital | **9,685.4** | **5,729.0** | **7,892.8** | **(13,621.8)** | **9,685.4** |
| Retained earnings | **4,667.1** | **1,154.9** | **1,735.5** | **(2,890.4)** | **4,667.1** |
| Accumulated other comprehensive income | **550.5** | **603.1** | **588.0** | **(1,191.1)** | **550.5** |
| Treasury stock, at cost | **(5,484.9)** | | | | **(5,484.9)** |
| Total stockholders equity attributable to PFG | **9,422.7** | **7,489.5** | **10,216.3** | **(17,705.8)** | **9,422.7** |
| Noncontrolling interest | | | **16.7** | **(4.5)** | **12.2** |
| Total stockholders equity | **9,422.7** | **7,489.5** | **10,233.0** | **(17,710.3)** | **9,434.9** |
| Total liabilities and stockholders equity | **$ 10,762.6** | **$ 130,936.3** | **$ 31,406.8** | **$ (21,055.0)** | **$ 152,050.7** |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | $ | $ 43,285.3 | $ 6,082.4 | $ (361.0) | $ 49,006.7 |
| Fixed maturities, trading | 268.7 | 374.8 | 328.2 | | 971.7 |
| Equity securities, available-for-sale | | 73.4 | 3.7 | | 77.1 |
| Equity securities, trading | | 0.3 | 404.5 | | 404.8 |
| Mortgage loans | | 9,271.5 | 1,831.8 | (376.1) | 10,727.2 |
| Real estate | | 9.2 | 1,084.9 | (1.2) | 1,092.9 |
| Policy loans | | 859.3 | 25.8 | | 885.1 |
| Investment in unconsolidated entities | 9,828.0 | 3,115.7 | 4,718.4 | (16,834.8) | 827.3 |
| Other investments | 7.0 | 2,559.0 | 925.3 | (1,332.8) | 2,158.5 |
| Cash and cash equivalents | 226.7 | 1,344.5 | 1,277.6 | (14.9) | 2,833.9 |
| Accrued investment income | 1.8 | 551.1 | 66.6 | (4.3) | 615.2 |
| Premiums due and other receivables | | 969.1 | 827.7 | (600.3) | 1,196.5 |
| Deferred policy acquisition costs | | 2,197.4 | 230.6 | | 2,428.0 |
| Property and equipment | | 395.9 | 61.3 | | 457.2 |
| Goodwill | | 54.3 | 428.0 | | 482.3 |
| Other intangibles | | 29.2 | 861.4 | | 890.6 |
| Separate account assets | | 61,615.1 | 9,749.3 | | 71,364.4 |
| Other assets | 14.8 | 668.9 | 994.7 | (736.1) | 942.3 |
| Total assets | $ 10,347.0 | $ 127,374.0 | $ 29,902.2 | $ (20,261.5) | $ 147,361.7 |
| **Liabilities** | | | | | |
| Contractholder funds | $ | $ 37,356.8 | $ 586.7 | $ (267.1) | $ 37,676.4 |
| Future policy benefits and claims | | 16,373.3 | 3,937.9 | (100.8) | 20,210.4 |
| Other policyholder funds | | 519.7 | 29.0 | (0.1) | 548.6 |
| Short-term debt | | | 105.2 | | 105.2 |
| Long-term debt | 1,351.7 | 99.4 | 504.8 | (391.1) | 1,564.8 |
| Income taxes currently payable | (18.6) | (218.4) | 34.3 | 205.8 | 3.1 |
| Deferred income taxes | (22.5) | 90.6 | 155.2 | (14.6) | 208.7 |
| Separate account liabilities | | 61,615.1 | 9,749.3 | | 71,364.4 |
| Other liabilities | 18.5 | 4,293.3 | 4,591.5 | (2,617.1) | 6,286.2 |
| Total liabilities | 1,329.1 | 120,129.8 | 19,693.9 | (3,185.0) | 137,967.8 |
| | | | | | |
| Redeemable noncontrolling interest | | | 22.2 | | 22.2 |

| | | | | | |
|---|---|---|---|---|---|
| **Stockholders equity** | | | | | |
| Series A preferred stock | | | | | |
| Series B preferred stock | 0.1 | | | | 0.1 |
| Common stock | 4.5 | 2.5 | | (2.5) | 4.5 |
| Additional paid-in capital | 9,634.7 | 5,718.1 | 7,870.2 | (13,588.3) | 9,634.7 |
| Retained earnings | 4,402.3 | 1,195.0 | 1,660.3 | (2,855.3) | 4,402.3 |
| Accumulated other comprehensive income | 258.0 | 328.6 | 297.5 | (626.1) | 258.0 |
| Treasury stock, at cost | (5,281.7) | | | | (5,281.7) |
| Total stockholders equity attributable to PFG | 9,017.9 | 7,244.2 | 9,828.0 | (17,072.2) | 9,017.9 |
| Noncontrolling interest | | | 358.1 | (4.3) | 353.8 |
| Total stockholders equity | 9,017.9 | 7,244.2 | 10,186.1 | (17,076.5) | 9,371.7 |
| Total liabilities and stockholders equity | $ 10,347.0 | $ 127,374.0 | $ 29,902.2 | $ (20,261.5) | $ 147,361.7 |

**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the six months ended June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Premiums and other considerations | $ | $ 1,185.9 | $ 175.2 | $ | $ 1,361.1 |
| Fees and other revenues | 0.2 | 718.7 | 665.0 | (149.8) | 1,234.1 |
| Net investment income | 1.2 | 1,257.6 | 361.7 | 5.3 | 1,625.8 |
| Net realized capital gains, excluding impairment losses on available-for-sale securities | | 18.3 | 52.9 | (16.9) | 54.3 |
| Total other-than-temporary impairment losses on available-for-sale securities | | (72.0) | (10.7) | (0.1) | (82.8) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income | | 16.2 | 5.8 | | 22.0 |
| Net impairment losses on available-for-sale securities | | (55.8) | (4.9) | (0.1) | (60.8) |
| Net realized capital gains (losses) | | (37.5) | 48.0 | (17.0) | (6.5) |
| Total revenues | 1.4 | 3,124.7 | 1,249.9 | (161.5) | 4,214.5 |
| **Expenses** | | | | | |
| Benefits, claims and settlement expenses | | 2,013.8 | 315.0 | (6.3) | 2,322.5 |
| Dividends to policyholders | | 99.8 | | | 99.8 |
| Operating expenses | 60.1 | 749.0 | 601.6 | (130.6) | 1,280.1 |
| Total expenses | 60.1 | 2,862.6 | 916.6 | (136.9) | 3,702.4 |
| Income (loss) before income taxes | (58.7) | 262.1 | 333.3 | (24.6) | 512.1 |
| Income taxes (benefits) | (22.8) | 60.5 | 71.7 | (0.3) | 109.1 |
| Equity in the net income of subsidiaries | 427.0 | 119.5 | 177.4 | (723.9) | |
| Net income | 391.1 | 321.1 | 439.0 | (748.2) | 403.0 |
| Net income attributable to noncontrolling interest | | | 12.0 | (0.1) | 11.9 |
| Net income attributable to PFG | 391.1 | 321.1 | 427.0 | (748.1) | 391.1 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Net income available to common stockholders | $ 374.6 | $ 321.1 | $ 427.0 | $ (748.1) | $ 374.6 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net income | $ | **391.1** | $ | **321.1** | $ | **439.0** | $ | **(748.2)** | $ | **403.0** |
| Other comprehensive income | | **249.6** | | **275.0** | | **25.7** | | **(257.6)** | | **292.7** |
| Comprehensive income | $ | **640.7** | $ | **596.1** | $ | **464.7** | $ | **(1,005.8)** | $ | **695.7** |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the six months ended June 30, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Premiums and other considerations | $ | $ 1,401.2 | $ 147.8 | $ | $ 1,549.0 |
| Fees and other revenues | 0.1 | 794.4 | 614.5 | (152.8) | 1,256.2 |
| Net investment income | 11.7 | 1,287.0 | 387.3 | 47.4 | 1,733.4 |
| Net realized capital gains, excluding impairment losses on available-for-sale securities | | 40.1 | 43.9 | (1.3) | 82.7 |
| Total other-than-temporary impairment losses on available-for-sale securities | | (39.2) | (15.7) | | (54.9) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income | | (56.9) | 8.8 | | (48.1) |
| Net impairment losses on available-for-sale securities | | (96.1) | (6.9) | | (103.0) |
| Net realized capital gains (losses) | | (56.0) | 37.0 | (1.3) | (20.3) |
| Total revenues | 11.8 | 3,426.6 | 1,186.6 | (106.7) | 4,518.3 |
| **Expenses** | | | | | |
| Benefits, claims and settlement expenses | | 2,092.2 | 297.4 | (6.8) | 2,382.8 |
| Dividends to policyholders | | 106.5 | | | 106.5 |
| Operating expenses | 58.7 | 965.7 | 563.2 | (130.3) | 1,457.3 |
| Total expenses | 58.7 | 3,164.4 | 860.6 | (137.1) | 3,946.6 |
| | | | | | |
| Income (loss) before income taxes | (46.9) | 262.2 | 326.0 | 30.4 | 571.7 |
| Income taxes (benefits) | (17.9) | 64.5 | 67.2 | (0.1) | 113.7 |
| Equity in the net income of subsidiaries | 444.8 | 155.1 | 228.2 | (828.1) | |
| Net income | 415.8 | 352.8 | 487.0 | (797.6) | 458.0 |
| Net income attributable to noncontrolling interest | | | 42.2 | | 42.2 |
| Net income attributable to PFG | 415.8 | 352.8 | 444.8 | (797.6) | 415.8 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Net income available to common stockholders | $ 399.3 | $ 352.8 | $ 444.8 | $ (797.6) | $ 399.3 |
| | | | | | |
| Net income | $ 415.8 | $ 352.8 | $ 487.0 | $ (797.6) | $ 458.0 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Other comprehensive income | | 451.2 | | 368.3 | | 104.6 | | (489.5) | | 434.6 |
| Comprehensive income | $ | 867.0 | $ | 721.1 | $ | 591.6 | $ | (1,287.1) | $ | 892.6 |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the six months ended June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Operating activities** | | | | | |
| Net cash provided by (used in) operating activities | $ 90.6 | $ 1,625.6 | $ (365.0) | $ 150.8 | $ 1,502.0 |
| **Investing activities** | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | (3,422.9) | (505.5) | 16.6 | (3,911.8) |
| Sales | | 668.9 | 33.6 | (7.4) | 695.1 |
| Maturities | | 2,602.1 | 500.2 | | 3,102.3 |
| Mortgage loans acquired or originated | | (1,196.5) | (114.4) | | (1,310.9) |
| Mortgage loans sold or repaid | | 789.6 | 174.5 | (148.1) | 816.0 |
| Real estate acquired | | | (39.8) | | (39.8) |
| Net purchases of property and equipment | | (16.5) | (8.2) | | (24.7) |
| Purchases of interests in subsidiaries, net of cash acquired | | | (62.5) | | (62.5) |
| Dividends and returns of capital received from unconsolidated entities | 364.8 | 160.5 | 364.7 | (890.0) | |
| Net change in other investments | | (23.9) | (54.4) | (12.2) | (90.5) |
| Net cash provided by (used in) investing activities | 364.8 | (438.7) | 288.2 | (1,041.1) | (826.8) |
| **Financing activities** | | | | | |
| Issuance of common stock | 11.7 | | | | 11.7 |
| Acquisition of treasury stock | (203.2) | | | | (203.2) |
| Proceeds from financing element derivatives | | 20.8 | | | 20.8 |
| Payments for financing element derivatives | | (26.4) | | | (26.4) |
| Excess tax benefits from share-based payment arrangements | | 5.2 | 5.5 | | 10.7 |
| Dividends to common stockholders | (108.0) | | | | (108.0) |
| Dividends to preferred stockholders | (8.2) | | | | (8.2) |
| Issuance of long-term debt | | | 9.1 | | 9.1 |
| Principal repayments of long-term debt | | | 10.0 | (11.5) | (1.5) |
| Net proceeds from (repayments of) short-term borrowings | | 222.0 | (66.5) | | 155.5 |
| Dividends and capital paid to parent | | (364.7) | (525.3) | 890.0 | |

| | | | | | |
|---|---|---|---|---|---|
| Investment contract deposits | | **2,682.5** | **204.2** | | **2,886.7** |
| Investment contract withdrawals | | **(4,594.3)** | **(1.1)** | | **(4,595.4)** |
| Net decrease in banking operation deposits | | | **(10.6)** | | **(10.6)** |
| Other | | **(3.7)** | | | **(3.7)** |
| Net cash used in financing activities | **(307.7)** | **(2,058.6)** | **(374.7)** | **878.5** | **(1,862.5)** |
| Net increase (decrease) in cash and cash equivalents | **147.7** | **(871.7)** | **(451.5)** | **(11.8)** | **(1,187.3)** |
| Cash and cash equivalents at beginning of period | **226.7** | **1,344.5** | **1,277.6** | **(14.9)** | **2,833.9** |
| Cash and cash equivalents at end of period | **$ 374.4** | **$ 472.8** | **$ 826.1** | **$ (26.7)** | **$ 1,646.6** |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the six months ended June 30, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Operating activities** | | | | | |
| Net cash provided by (used in) operating activities | $ (48.8) | $ 1,692.8 | $ 299.0 | $ (157.5) | $ 1,785.5 |
| **Investing activities** | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | (4.4) | (3,002.4) | (400.7) | | (3,407.5) |
| Sales | 200.0 | 482.0 | 98.4 | (20.7) | 759.7 |
| Maturities | 4.4 | 2,779.9 | 349.0 | | 3,133.3 |
| Mortgage loans acquired or originated | | (551.6) | (75.2) | 27.1 | (599.7) |
| Mortgage loans sold or repaid | | 829.6 | 157.8 | (58.6) | 928.8 |
| Real estate acquired | | | (18.1) | | (18.1) |
| Net purchases of property and equipment | | (14.1) | (4.4) | | (18.5) |
| Dividends and returns of capital received from unconsolidated entities | 506.3 | 309.6 | 506.3 | (1,322.2) | |
| Net change in other investments | | (33.6) | 40.8 | 8.7 | 15.9 |
| Net cash provided by investing activities | 706.3 | 799.4 | 653.9 | (1,365.7) | 793.9 |
| **Financing activities** | | | | | |
| Issuance of common stock | 10.8 | | | | 10.8 |
| Acquisition of treasury stock | (236.2) | | | | (236.2) |
| Proceeds from financing element derivatives | | 42.5 | | | 42.5 |
| Payments for financing element derivatives | | (25.8) | | | (25.8) |
| Excess tax benefits from share-based payment arrangements | | 0.7 | 1.2 | | 1.9 |
| Dividends to preferred stockholders | (16.5) | | | | (16.5) |
| Issuance of long-term debt | | | 2.0 | | 2.0 |
| Principal repayments of long-term debt | | | (38.2) | 35.1 | (3.1) |
| Dividends and capital paid to parent | | (506.3) | (815.9) | 1,322.2 | |
| Investment contract deposits | | 2,147.4 | 196.9 | | 2,344.3 |
| Investment contract withdrawals | | (4,371.1) | (0.2) | | (4,371.3) |
| Net decrease in banking operation deposits | | | (33.8) | | (33.8) |
| Other | | (2.0) | | | (2.0) |

| | | | | | |
|---|---|---|---|---|---|
| Net cash used in financing activities | (241.9) | (2,714.6) | (688.0) | 1,357.3 | (2,287.2) |
| Net increase (decrease) in cash and cash equivalents | 415.6 | (222.4) | 264.9 | (165.9) | 292.2 |
| Cash and cash equivalents at beginning of period | 370.9 | 699.8 | 719.9 | 86.8 | 1,877.4 |
| Cash and cash equivalents at end of period | $ 786.5 | $ 477.4 | $ 984.8 | $ (79.1) | $ 2,169.6 |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

On May 24, 2011, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2008, as it was scheduled to expire in June 2011. Under our current shelf registration, we have the ability to issue unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration statement.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) PFS, (iii) Principal Life and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of June 30, 2012 and December 31, 2011, and for the six months ended June 30, 2012 and 2011.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG s interest in PFS and (ii) PFS s interest in Principal Life and all other subsidiaries, where applicable, even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent s investment and earnings. All intercompany balances and transactions, including elimination of the parent s investment in subsidiaries, between PFG, PFS and Principal Life and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | $ | $ | $ 49,793.6 | $ | $ 49,793.6 |
| Fixed maturities, trading | 152.2 | | 624.3 | | 776.5 |
| Equity securities, available-for-sale | | | 139.0 | | 139.0 |
| Equity securities, trading | | | 224.3 | | 224.3 |
| Mortgage loans | | | 11,158.6 | | 11,158.6 |
| Real estate | | | 1,174.1 | | 1,174.1 |
| Policy loans | | | 867.8 | | 867.8 |
| Investment in unconsolidated entities | 10,216.3 | 10,164.8 | 821.9 | (20,381.1) | 821.9 |
| Other investments | 5.8 | 23.2 | 2,245.9 | | 2,274.9 |
| Cash and cash equivalents | 374.4 | 618.4 | 1,599.2 | (945.4) | 1,646.6 |
| Accrued investment income | 0.2 | | 589.3 | | 589.5 |
| Premiums due and other receivables | | | 1,095.7 | 1.3 | 1,097.0 |
| Deferred policy acquisition costs | | | 2,663.8 | | 2,663.8 |
| Property and equipment | | | 469.7 | | 469.7 |
| Goodwill | | | 542.0 | | 542.0 |
| Other intangibles | | | 934.9 | | 934.9 |
| Separate account assets | | | 75,950.5 | | 75,950.5 |
| Other assets | 13.7 | 11.5 | 912.2 | (11.4) | 926.0 |
| Total assets | $ 10,762.6 | $ 10,817.9 | $ 151,806.8 | $ (21,336.6) | $ 152,050.7 |
| **Liabilities** | | | | | |
| Contractholder funds | $ | $ | $ 36,727.5 | $ | $ 36,727.5 |
| Future policy benefits and claims | | | 20,791.4 | | 20,791.4 |
| Other policyholder funds | | | 663.4 | | 663.4 |
| Short-term debt | | | 574.3 | (311.4) | 262.9 |
| Long-term debt | 1,351.7 | | 225.2 | | 1,576.9 |
| Income taxes currently payable | (20.3) | 0.3 | 11.9 | 10.5 | 2.4 |
| Deferred income taxes | (16.8) | (35.1) | 640.2 | (19.6) | 568.7 |
| Separate account liabilities | | | 75,950.5 | | 75,950.5 |
| Other liabilities | 25.3 | 636.4 | 5,984.9 | (635.0) | 6,011.6 |
| Total liabilities | 1,339.9 | 601.6 | 141,569.3 | (955.5) | 142,555.3 |
| | | | | | |
| | | | 60.5 | | 60.5 |

| | | | | | |
|---|---|---|---|---|---|
| Redeemable noncontrolling interest | | | | | |
| **Stockholders equity** | | | | | |
| Series A preferred stock | | | | | |
| Series B preferred stock | **0.1** | | | | **0.1** |
| Common stock | **4.5** | | **17.8** | **(17.8)** | **4.5** |
| Additional paid-in capital | **9,685.4** | **7,892.8** | **7,621.0** | **(15,513.8)** | **9,685.4** |
| Retained earnings | **4,667.1** | **1,735.5** | **1,952.0** | **(3,687.5)** | **4,667.1** |
| Accumulated other comprehensive income | **550.5** | **588.0** | **576.0** | **(1,164.0)** | **550.5** |
| Treasury stock, at cost | **(5,484.9)** | | **(2.0)** | **2.0** | **(5,484.9)** |
| Total stockholders equity attributable to PFG | **9,422.7** | **10,216.3** | **10,164.8** | **(20,381.1)** | **9,422.7** |
| Noncontrolling interest | | | **12.2** | | **12.2** |
| Total stockholders equity | **9,422.7** | **10,216.3** | **10,177.0** | **(20,381.1)** | **9,434.9** |
| Total liabilities and stockholders equity | **$ 10,762.6** | **$ 10,817.9** | **$ 151,806.8** | **$ (21,336.6)** | **$ 152,050.7** |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Assets** | | | | | |
| Fixed maturities, available-for-sale | $ | $ | $ 49,006.7 | $ | $ 49,006.7 |
| Fixed maturities, trading | 268.7 | | 703.0 | | 971.7 |
| Equity securities, available-for-sale | | | 77.1 | | 77.1 |
| Equity securities, trading | | | 404.8 | | 404.8 |
| Mortgage loans | | | 10,727.2 | | 10,727.2 |
| Real estate | | | 1,092.9 | | 1,092.9 |
| Policy loans | | | 885.1 | | 885.1 |
| Investment in unconsolidated entities | 9,828.0 | 9,762.9 | 827.2 | (19,590.8) | 827.3 |
| Other investments | 7.0 | 3.0 | 2,148.5 | | 2,158.5 |
| Cash and cash equivalents | 226.7 | 702.4 | 2,787.9 | (883.1) | 2,833.9 |
| Accrued investment income | 1.8 | | 613.4 | | 615.2 |
| Premiums due and other receivables | | | 1,195.2 | 1.3 | 1,196.5 |
| Deferred policy acquisition costs | | | 2,428.0 | | 2,428.0 |
| Property and equipment | | | 457.2 | | 457.2 |
| Goodwill | | | 482.3 | | 482.3 |
| Other intangibles | | | 890.6 | | 890.6 |
| Separate account assets | | | 71,364.4 | | 71,364.4 |
| Other assets | 14.8 | 10.4 | 926.1 | (9.0) | 942.3 |
| Total assets | $ 10,347.0 | $ 10,478.7 | $ 147,017.6 | $ (20,481.6) | $ 147,361.7 |
| **Liabilities** | | | | | |
| Contractholder funds | $ | $ | $ 37,676.4 | $ | $ 37,676.4 |
| Future policy benefits and claims | | | 20,210.4 | | 20,210.4 |
| Other policyholder funds | | | 548.6 | | 548.6 |
| Short-term debt | | 50.0 | 318.9 | (263.7) | 105.2 |
| Long-term debt | 1,351.7 | | 213.1 | | 1,564.8 |
| Income taxes currently payable | (18.6) | (0.9) | 12.0 | 10.6 | 3.1 |
| Deferred income taxes | (22.5) | (22.9) | 270.8 | (16.7) | 208.7 |
| Separate account liabilities | | | 71,364.4 | | 71,364.4 |
| Other liabilities | 18.5 | 624.5 | 6,264.1 | (620.9) | 6,286.2 |
| Total liabilities | 1,329.1 | 650.7 | 136,878.7 | (890.7) | 137,967.8 |

| | | | | | |
|---|---|---|---|---|---|
| Redeemable noncontrolling interest | | | 22.2 | | 22.2 |
| | | | | | |
| **Stockholders equity** | | | | | |
| Series A preferred stock | | | | | |
| Series B preferred stock | 0.1 | | | | 0.1 |
| Common stock | 4.5 | | 17.8 | (17.8) | 4.5 |
| Additional paid-in capital | 9,634.7 | 7,870.2 | 7,543.4 | (15,413.6) | 9,634.7 |
| Retained earnings | 4,402.3 | 1,660.3 | 1,907.5 | (3,567.8) | 4,402.3 |
| Accumulated other comprehensive income | 258.0 | 297.5 | 296.2 | (593.7) | 258.0 |
| Treasury stock, at cost | (5,281.7) | | (2.0) | 2.0 | (5,281.7) |
| Total stockholders equity attributable to PFG | 9,017.9 | 9,828.0 | 9,762.9 | (19,590.9) | 9,017.9 |
| Noncontrolling interest | | | 353.8 | | 353.8 |
| Total stockholders equity | 9,017.9 | 9,828.0 | 10,116.7 | (19,590.9) | 9,371.7 |
| Total liabilities and stockholders equity | $ 10,347.0 | $ 10,478.7 | $ 147,017.6 | $ (20,481.6) | $ 147,361.7 |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the six months ended June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Premiums and other considerations | $ | $ | $ 1,361.1 | $ | $ 1,361.1 |
| Fees and other revenues | 0.2 | | 1,234.4 | (0.5) | 1,234.1 |
| Net investment income | 1.2 | | 1,624.3 | 0.3 | 1,625.8 |
| Net realized capital gains, excluding impairment losses on available-for-sale securities | | 0.2 | 54.1 | | 54.3 |
| Total other-than-temporary impairment losses on available-for-sale securities | | | (82.8) | | (82.8) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income | | | 22.0 | | 22.0 |
| Net impairment losses on available-for-sale securities | | | (60.8) | | (60.8) |
| Net realized capital gains (losses) | | 0.2 | (6.7) | | (6.5) |
| Total revenues | 1.4 | 0.2 | 4,213.1 | (0.2) | 4,214.5 |
| **Expenses** | | | | | |
| Benefits, claims and settlement expenses | | | 2,322.5 | | 2,322.5 |
| Dividends to policyholders | | | 99.8 | | 99.8 |
| Operating expenses | 60.1 | 3.7 | 1,216.5 | (0.2) | 1,280.1 |
| Total expenses | 60.1 | 3.7 | 3,638.8 | (0.2) | 3,702.4 |
| | | | | | |
| Income (loss) before income taxes | (58.7) | (3.5) | 574.3 | | 512.1 |
| Income taxes (benefits) | (22.8) | (3.8) | 135.7 | | 109.1 |
| Equity in the net income of subsidiaries | 427.0 | 426.7 | | (853.7) | |
| Net income | 391.1 | 427.0 | 438.6 | (853.7) | 403.0 |
| Net income attributable to noncontrolling interest | | | 11.9 | | 11.9 |
| Net income attributable to PFG | 391.1 | 427.0 | 426.7 | (853.7) | 391.1 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Net income available to common stockholders | $ 374.6 | $ 427.0 | $ 426.7 | $ (853.7) | $ 374.6 |

| | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| Net income | $ | **391.1** | $ | **427.0** | $ | **438.6** | $ | **(853.7)** | $ | **403.0** |
| Other comprehensive income | | **249.6** | | **290.8** | | **279.9** | | **(527.6)** | | **292.7** |
| Comprehensive income | $ | **640.7** | $ | **717.8** | $ | **718.5** | $ | **(1,381.3)** | $ | **695.7** |

**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the six months ended June 30, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Revenues** | | | | | |
| Premiums and other considerations | $ | $ | $ 1,549.0 | $ | $ 1,549.0 |
| Fees and other revenues | 0.1 | | 1,258.6 | (2.5) | 1,256.2 |
| Net investment income (loss) | 11.7 | (2.3) | 1,721.5 | 2.5 | 1,733.4 |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | | (0.1) | 82.8 | | 82.7 |
| Total other-than-temporary impairment losses on available-for-sale securities | | | (54.9) | | (54.9) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | | | (48.1) | | (48.1) |
| Net impairment losses on available-for-sale securities | | | (103.0) | | (103.0) |
| Net realized capital losses | | (0.1) | (20.2) | | (20.3) |
| Total revenues | 11.8 | (2.4) | 4,508.9 | | 4,518.3 |
| **Expenses** | | | | | |
| Benefits, claims and settlement expenses | | | 2,382.8 | | 2,382.8 |
| Dividends to policyholders | | | 106.5 | | 106.5 |
| Operating expenses | 58.7 | 0.4 | 1,398.2 | | 1,457.3 |
| Total expenses | 58.7 | 0.4 | 3,887.5 | | 3,946.6 |
| | | | | | |
| Income (loss) before income taxes | (46.9) | (2.8) | 621.4 | | 571.7 |
| Income taxes (benefits) | (17.9) | (5.3) | 136.9 | | 113.7 |
| Equity in the net income of subsidiaries | 444.8 | 442.3 | | (887.1) | |
| Net income | 415.8 | 444.8 | 484.5 | (887.1) | 458.0 |
| Net income attributable to noncontrolling interest | | | 42.2 | | 42.2 |
| Net income attributable to PFG | 415.8 | 444.8 | 442.3 | (887.1) | 415.8 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Net income available to common stockholders | $ 399.3 | $ 444.8 | $ 442.3 | $ (887.1) | $ 399.3 |
| | | | | | |
| Net income | $ 415.8 | $ 444.8 | $ 484.5 | $ (887.1) | $ 458.0 |

| | | | | | |
|---|---|---|---|---|---|
| Other comprehensive income | 451.2 | 433.0 | 444.6 | (894.2) | 434.6 |
| Comprehensive income | $ 867.0 | $ 877.8 | $ 929.1 | $ (1,781.3) | $ 892.6 |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the six months ended June 30, 2012**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| | | | (in millions) | | |
| **Operating activities** | | | | | |
| Net cash provided by operating activities | $ 90.6 | $ 9.8 | $ 1,416.2 | $ (14.6) | $ 1,502.0 |
| **Investing activities** | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | | (3,911.8) | | (3,911.8) |
| Sales | | | 695.1 | | 695.1 |
| Maturities | | | 3,102.3 | | 3,102.3 |
| Mortgage loans acquired or originated | | | (1,310.9) | | (1,310.9) |
| Mortgage loans sold or repaid | | | 816.0 | | 816.0 |
| Real estate acquired | | | (39.8) | | (39.8) |
| Net purchases of property and equipment | | | (24.7) | | (24.7) |
| Purchases of interests in subsidiaries, net of cash acquired | | | (62.5) | | (62.5) |
| Dividends and returns of capital received from unconsolidated entities | 364.8 | 341.0 | | (705.8) | |
| Net change in other investments | | (20.0) | (70.5) | | (90.5) |
| Net cash provided by (used in) investing activities | 364.8 | 321.0 | (806.8) | (705.8) | (826.8) |
| **Financing activities** | | | | | |
| Issuance of common stock | 11.7 | | | | 11.7 |
| Acquisition of treasury stock | (203.2) | | | | (203.2) |
| Proceeds from financing element derivatives | | | 20.8 | | 20.8 |
| Payments for financing element derivatives | | | (26.4) | | (26.4) |
| Excess tax benefits from share-based payment arrangements | | | 10.7 | | 10.7 |
| Dividends to common stockholders | (108.0) | | | | (108.0) |
| Dividends to preferred stockholders | (8.2) | | | | (8.2) |
| Issuance of long-term debt | | | 9.1 | | 9.1 |
| Principal repayments of long-term debt | | | (1.5) | | (1.5) |
| | | (50.0) | 253.2 | (47.7) | 155.5 |

| | | | | | |
|---|---|---|---|---|---|
| Net proceeds from (repayments of) short-term borrowings | | | | | |
| Dividends and capital paid to parent | | **(364.8)** | **(341.0)** | **705.8** | |
| Investment contract deposits | | | **2,886.7** | | **2,886.7** |
| Investment contract withdrawals | | | **(4,595.4)** | | **(4,595.4)** |
| Net decrease in banking operation deposits | | | **(10.6)** | | **(10.6)** |
| Other | | | **(3.7)** | | **(3.7)** |
| Net cash used in financing activities | **(307.7)** | **(414.8)** | **(1,798.1)** | **658.1** | **(1,862.5)** |
| Net increase (decrease) in cash and cash equivalents | **147.7** | **(84.0)** | **(1,188.7)** | **(62.3)** | **(1,187.3)** |
| Cash and cash equivalents at beginning of period | **226.7** | **702.4** | **2,787.9** | **(883.1)** | **2,833.9** |
| Cash and cash equivalents at end of period | $ **374.4** | $ **618.4** | $ **1,599.2** | $ **(945.4)** | $ **1,646.6** |

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**Principal Financial Group, Inc.**
**Notes to Consolidated Financial Statements**
**June 30, 2012**
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the six months ended June 30, 2011**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|---|---|---|---|---|
| **Operating activities** | | | | | |
| Net cash provided by (used in) operating activities | $ (48.8) | $ 202.9 | $ 1,837.6 | $ (206.2) | $ 1,785.5 |
| **Investing activities** | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | (4.4) | | (3,403.1) | | (3,407.5) |
| Sales | 200.0 | | 559.7 | | 759.7 |
| Maturities | 4.4 | | 3,128.9 | | 3,133.3 |
| Mortgage loans acquired or originated | | | (599.7) | | (599.7) |
| Mortgage loans sold or repaid | | | 928.8 | | 928.8 |
| Real estate acquired | | | (18.1) | | (18.1) |
| Net purchases of property and equipment | | | (18.5) | | (18.5) |
| Dividends and returns of capital received from unconsolidated entities | 506.3 | 528.1 | | (1,034.4) | |
| Net change in other investments | | 2.4 | 13.5 | | 15.9 |
| Net cash provided by investing activities | 706.3 | 530.5 | 591.5 | (1,034.4) | 793.9 |
| **Financing activities** | | | | | |
| Issuance of common stock | 10.8 | | | | 10.8 |
| Acquisition of treasury stock | (236.2) | | | | (236.2) |
| Proceeds from financing element derivatives | | | 42.5 | | 42.5 |
| Payments for financing element derivatives | | | (25.8) | | (25.8) |
| Excess tax benefits from share-based payment arrangements | | | 1.9 | | 1.9 |
| Dividends to preferred stockholders | (16.5) | | | | (16.5) |
| Issuance of long-term debt | | | 2.0 | | 2.0 |
| Principal repayments of long-term debt | | | (3.1) | | (3.1) |
| Net proceeds from short-term borrowings | | | 9.3 | (9.3) | |
| Dividends and capital paid to parent | | (506.3) | (528.1) | 1,034.4 | |
| Investment contract deposits | | | 2,344.3 | | 2,344.3 |
| Investment contract withdrawals | | | (4,371.3) | | (4,371.3) |
| Net decrease in banking operation deposits | | | (33.8) | | (33.8) |

| | | | | | |
|---|---|---|---|---|---|
| Other | | | (2.0) | | (2.0) |
| Net cash used in financing activities | (241.9) | (506.3) | (2,564.1) | 1,025.1 | (2,287.2) |
| Net increase (decrease) in cash and cash equivalents | 415.6 | 227.1 | (135.0) | (215.5) | 292.2 |
| Cash and cash equivalents at beginning of period | 370.9 | 519.7 | 1,821.7 | (834.9) | 1,877.4 |
| Cash and cash equivalents at end of period | $ 786.5 | $ 746.8 | $ 1,686.7 | $ (1,050.4) | $ 2,169.6 |

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**June 30, 2012**

**(Unaudited)**

**14. Subsequent Event**

In July 2012, Catalyst Health Solutions, Inc. merged with a wholly-owned subsidiary of SXC Health Solutions Corp. As a shareholder of Catalyst Health Solutions, Inc., we realized an after-tax gain of approximately $126.0 million. The gain will be reported as a net realized capital gain in the third quarter of 2012.

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

The following analysis discusses our financial condition as of June 30, 2012, compared with December 31, 2011, and our consolidated results of operations for the three and six months ended June 30, 2012 and 2011, prepared in conformity with U.S. GAAP. The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2011, filed with the SEC and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

**Forward-Looking Information**

Our narrative analysis below contains forward-looking statements intended to enhance the reader s ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as anticipate, believe, plan, estimate, expect, inten 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 including, but not limited to, the following: (1) adverse capital and credit market conditions may significantly affect our ability to meet liquidity needs, as well as our access to capital and cost of capital; (2) continued difficult conditions in the global capital markets and the economy generally may materially and adversely affect our business and results of operations; (3) continued volatility or further declines in the equity markets could reduce our assets under management ( AUM ) and may result in investors withdrawing from the markets or decreasing their rates of investment, all of which could reduce our revenues and net income; (4) changes in interest rates or credit spreads may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period-to-period; (5) our investment portfolio is subject to several risks that 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; (6) our valuation of fixed maturities and equity securities may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our results of operations or financial condition; (7) the determination of the amount of allowances and impairments taken on our investments requires estimations and assumptions which are subject to differing interpretations and could materially impact our results of operations or financial position; (8) gross unrealized losses may be realized or result in future impairments, resulting in a reduction in our net income; (9) 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; (10) 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; (11) our efforts to reduce the impact of interest rate changes on our profitability and retained earnings may not be effective; (12) if we are unable to attract and retain sales representatives and develop new distribution sources, sales of our products and services may be reduced; (13) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (14) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (15) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends or distributions Iowa insurance laws impose on Principal Life; (16) the pattern of amortizing our DPAC and other actuarial balances on our universal life-type insurance contracts, participating life insurance policies and certain investment contracts may change, impacting both the level of the asset and the timing of our net income; (17) we may need to fund deficiencies in our Closed Block assets that support participating ordinary life insurance policies that had a dividend scale in force at the time of Principal Life s 1998 conversion into a stock life insurance company; (18) a pandemic, terrorist attack or other catastrophic event could adversely affect our net income; (19) our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and profitability; (20) we face risks arising from acquisitions of businesses; (21) changes in laws, regulations or accounting standards may reduce our profitability; (22) we may be unable to mitigate the impact of Regulation XXX and Actuarial Guideline 38, potentially resulting in a negative impact to our capital position and/or a reduction in sales of term and universal life

insurance products; (23) a computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our profitability; (24) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (25) from time to time we may become subject to tax audits, tax litigation or similar proceedings, and as a result we may owe additional taxes, interest and penalties in amounts that may be material; (26) fluctuations in foreign currency exchange rates could reduce our profitability; (27) applicable laws and our certificate of incorporation and by-laws may discourage takeovers and business combinations that some stockholders might consider in their best interests and (28) our financial results may be adversely impacted by global climate changes.

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## Overview

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

- Retirement and Investor Services, 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, nonqualified 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.

- Principal Global Investors, which consists of our asset management operations, manages assets for sophisticated investors around the world, using a multi-boutique strategy that enables the segment to provide an expanded range of diverse investment capabilities including equity, fixed income and real estate investments. Principal Global Investors also has experience in currency management, asset allocation, stable value management and other structured investment strategies.

- Principal International, which offers retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products through operations in Brazil, Chile, China, Hong Kong SAR, India, Mexico and Southeast Asia.

- U.S. Insurance Solutions, which provides individual life 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 specialty benefit products include group dental and vision insurance, individual and group disability insurance, group life insurance, wellness services and non-medical fee-for-service claims administration.

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

## Critical Accounting Policies and Estimates

### *Deferred Policy Acquisition Costs and Other Actuarial Balances*

Incremental direct costs of contract acquisition as well as certain costs directly related to acquisition activities (underwriting, policy issuance and processing, medical and inspection and sales force contract selling) for the successful 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 net income 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 EGPs. In addition to DPAC, the following

actuarial balances are also amortized in relation to EGPs.

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

- 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 EGPs.

- Reinsurance asset or liability For universal-life type products that are reinsured, a reinsurance asset or liability is established to spread the expected net reinsurance costs or profits in proportion to the EGPs 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 or a block of insurance business. PVFP for universal life-type insurance contracts, participating life insurance policies and certain investment contracts is amortized over the expected life of the contracts acquired, in proportion to EGPs.

We also have additional benefit reserves 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.

We define EGPs to include assumptions relating to mortality, morbidity, lapses, investment yield and expenses as well as the change in our liability for certain guarantees and the difference between actual and expected reinsurance premiums and recoveries,

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depending on the nature of the contract. We develop an estimate of EGPs at issue and each valuation date. 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 net income. In addition, we are required to revise our assumptions regarding future experience if actual experience or other evidence suggests that earlier estimates should be revised. 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 life insurance, individual variable annuities and group annuities that have separate account U.S. equity investment options, we utilize a mean reversion methodology (reversion to the mean assumption), a common industry practice, to determine the future domestic equity market growth rate assumption used for the calculation of EGPs. If actual annualized U.S. equity market performance varies from our 8% long-term assumption, we assume different performance levels in the short-term such that the mean return is equal to the long-term assumption over the mean reversion period. However, our mean reversion process generally limits assumed returns to a range of 4-12% during the mean reversion period. The 12% cap was reached during the third quarter of 2008, and the mean reversion rate has remained at the 12% cap since then. Therefore, until the mean reversion rate falls below the 12% cap, we will not adjust the equity return assumption by the amount needed to result in a mean return equal to the long-term assumption.

In limited circumstances, DPAC and certain of the actuarial balances noted above are amortized in proportion to estimated gross revenues rather than EGPs. Estimated gross revenues include similar assumptions as EGPs and the changes of future estimates and reflection of actual experience is done in the same manner as EGPs discussed above.

***Amortization Based on Premium-Paying Period.*** DPAC of non-participating term life insurance and individual disability 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. As of March 31, 2012, these policies accounted for 13% of our total DPAC balance.

***Internal Replacements.*** We review policies 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 related 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 existing DPAC and related 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.*** 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 as of March 31, 2012. The net balance of DPAC and related actuarial balances, excluding balances affected by changes in other comprehensive income, was a $2,508.2 million asset.

| | | Estimated impact to net income (1) (in millions) |
|---|---|---|
| Reducing the future equity return assumption by 1% | **$** | **(5)** |
| Reducing the long-term general account net investment returns assumption by 0.5% (2) | | **(45)** |
| A one-time, 10% drop in equity market values | | **(13)** |

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(1) Reflects the net impact of changes to the DPAC asset, sales inducement asset, unearned revenue liability, reinsurance sset or liability, PVFP and additional benefit reserves. Includes the impact on net income of changes in DPAC and related balances for our equity method subsidiaries. The DPAC and related balances of the equity method subsidiaries are not included in the total DPAC balance listed above as they are not fully consolidated.

(2) Net investment return represents net investment income plus net realized capital gains (losses).

## Recent Event

### *Catalyst Health Solutions, Inc.*

In July 2012, Catalyst Health Solutions, Inc. merged with a wholly-owned subsidiary of SXC Health Solutions Corp. As a shareholder of Catalyst Health Solutions, Inc., we realized an after-tax gain of approximately $126.0 million. The gain will be reported as a net realized capital gain in the third quarter of 2012.

## Transactions Affecting Comparability of Results of Operations

### *Acquisitions*

We entered into acquisition agreements for the following businesses during 2012 and 2011.

***Claritas Administração de Recursos Ltda./Claritas Investments, Ltd.*** On April 2, 2012, we finalized the purchase of a 60% indirect ownership in Claritas Administração de Recursos Ltda./Claritas Investments, Ltd. ( Claritas ), a leading Brazilian mutual fund and asset management company. The Sao Paulo-based company manages equity funds, balanced funds, managed accounts and other strategies for affluent clients and institutions through its multi-channel distribution network. Claritas had $1.8 billion in AUM at the time of acquisition and is consolidated within the Principal International segment.

***Origin Asset Management LLP.*** On October 3, 2011, we finalized the purchase of a 74% interest in Origin Asset Management LLP ( Origin ), a global equity specialist based in London. The initial payment was $63.6 million. Origin had $2.6 billion in AUM in global and international equities at the time of the acquisition and is consolidated within the Principal Global Investors segment.

***HSBC AFORE, S.A. de C.V.*** On August 8, 2011, we finalized the purchase of our 100% interest in HSBC AFORE, S.A. de C.V. ( HSBC AFORE ), a Mexican pension business, from HSBC Bank for $206.1 million. In addition, we and HSBC Bank have established a distribution arrangement for the distribution of Principal AFORE s products through HSBC Bank s extensive network in Mexico. HSBC AFORE was merged into our Principal AFORE pension company, which is consolidated within the Principal International segment.

***Finisterre Capital LLP and Finisterre Holdings Limited.*** On July 1, 2011, we finalized the purchase of a 51% interest in Finisterre Capital LLP and Finisterre Holdings Limited, (together Finisterre Capital ), an emerging markets debt investor based in London. The initial payment was $84.6 million, with a possible additional contingent payment of up to $30.0 million in 2013, dependent upon performance targets. Finisterre Capital had $1.7 billion in AUM at the time of acquisition and is accounted for on the equity method within the Principal Global Investors segment.

***Other***

***Individual Life Insurance Amortization.*** During the first quarter of 2012, our individual life insurance business changed its basis for amortizing DPAC and other actuarial balances on a portion of our universal life insurance products. The actuarial balances for these products are now amortized based on estimated gross revenues instead of EGPs. This change required an unlocking of the actuarial balances to reflect the pattern of estimated gross revenues, which resulted in volatility within certain income statement line items. Specifically, fee revenues decreased $46.6 million; benefits, claims and settlement expenses increased $87.9 million; and operating expenses decreased $139.6 million. However, on a net basis the impact was a net gain of $3.3 million after-tax, which is not material.

***Individual Life Insurance Assumption Changes.*** During the second quarter of 2011, we updated premium assumptions in our individual life insurance business, which impacts comparability between reported time periods. Specifically, fee revenues increased $4.9 million; benefits, claims and settlement expenses increased $43.1 million; and operating expenses increased $14.9 million. Given the large magnitude of the assumption changes, we removed the after-tax impact of $(34.5) million from operating earnings and reported it as an other after-tax adjustment in order to aid in comparability at the segment level.

***Catalyst Health Solutions, Inc.*** In early April 2011, we sold a portion of our interest in Catalyst Health Solutions, Inc., which is accounted for on the equity method. The $46.0 million after-tax gain was reported as a net realized capital gain in the second quarter of 2011. The remaining portion of the investment continued to be accounted for as an equity method investment.

***Group Medical Insurance Business.*** On September 30, 2010, we announced our decision to exit the group medical insurance business (insured and administrative services only) and entered into an agreement with United Healthcare Services, Inc. to renew group medical insurance coverage for our customers as the business transitions. The exiting of the group medical insurance business

does not yet qualify for discontinued operations treatment under U.S. GAAP. Therefore, the results of operations for the group medical insurance business are still included in our consolidated income from continuing operations.

With the exception of corporate overhead, amounts related to our group medical insurance business previously included in segment operating earnings have been removed from operating earnings for all periods presented and are reported as other after-tax adjustments. The operating revenues associated with our exited group medical insurance business were $4.0 million and $180.8 million for the three months ended June 30, 2012 and 2011, respectively, and $22.9 million and $435.7 million for the six months ended June 30, 2012 and 2011, respectively. The other after-tax adjustments associated with the after-tax earnings (loss) of our exited group medical insurance business were $(4.0) million and $18.8 million for the three months ended June 30, 2012 and 2011, respectively, and $(5.5) million and $35.9 million for the six months ended June 30, 2012 and 2011, respectively.

**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 financial results. Principal International segment operating earnings were negatively impacted by $6.4 million and $8.4 million for the three and six months ended June 30, 2012, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

**Stock-Based Compensation Plans**

For information related to our Stock-Based Compensation Plans, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 11, Stock-Based Compensation Plans.

**Employee and Agent Benefits Expense**

The 2012 annual defined benefit pension expense for substantially all of our employees and certain agents is expected to be $122.1 million pre-tax, which is a $29.4 million increase from the 2011 pre-tax pension expense of $92.7 million. This increase is primarily due to a decrease in the discount rates as of December 31, 2011, increasing the service cost, interest cost, and gain/loss amortization. Pre-tax pension expense of $30.8 million and $61.5 million was reflected in the determination of net income for the three and six months ended June 30, 2012, respectively. The expected long-term return on plan assets used to develop the 2012 expense remained at the same 8.00% used to develop the 2011 expense. The discount rate as of December 31, 2011, used to develop the 2012 expense decreased to 5.15%, down from the 5.65% as of December 31, 2010, 5.80% as of March 31, 2011, 5.70% as of June 30, 2011, and 5.25% as of September 30, 2011.

The 2012 annual other postretirement employee benefit ( OPEB ) plan expense (income) for retired employees is expected to be $(55.9) million pre-tax, which is a $2.1 million decrease from the 2011 pre-tax OPEB plan income of $(58.0) million. This decrease in income is primarily due to a reduction in the prior service credit to be recognized. The 2011 expense included $(5.1) million in one-time credits due to the curtailment from the group medical insurance business exit. Pre-tax (income) of $(13.0) million and $(25.9) million was reflected in the determination of net income for the three and six months ended June 30, 2012, respectively. The expected long-term return on plan assets used to develop the expense (income) in 2012 remained at the same 7.30% used to develop the 2011 expense. The discount rate as of December 31, 2011, used to develop the 2012 expense (income) decreased to 5.15%, down from the 5.65% as of December 31, 2010, 5.80% as of March 31, 2011, 5.70% as of June 30, 2011 and 5.25% as of September 30, 2011.

**Recent Accounting Changes**

For recent accounting changes, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies under the captions, Accounting Changes and Recent Accounting Pronouncements.

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**Results of Operations**

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

| | For the three months ended June 30, | | | For the six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | Increase (decrease) | 2012 | 2011 | Increase (decrease) |
| | (in millions) | | | | | |
| Revenues: | | | | | | |
| Premiums and other considerations | **$ 681.3** | $ 751.9 | **$** (70.6) | **$ 1,361.1** | $ 1,549.0 | **$** (187.9) |
| Fees and other revenues | **636.1** | 633.2 | 2.9 | **1,234.1** | 1,256.2 | (22.1) |
| Net investment income | **801.0** | 873.6 | (72.6) | **1,625.8** | 1,733.4 | (107.6) |
| Net realized capital gains, excluding impairment losses on available-for-sale securities | **32.2** | 88.3 | (56.1) | **54.3** | 82.7 | (28.4) |
| Total other-than-temporary impairment losses on available-for-sale securities | **(49.1)** | (40.9) | (8.2) | **(82.8)** | (54.9) | (27.9) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income | **17.1** | (9.7) | 26.8 | **22.0** | (48.1) | 70.1 |
| Net impairment losses on available-for-sale securities | **(32.0)** | (50.6) | 18.6 | **(60.8)** | (103.0) | 42.2 |
| Net realized capital gains (losses) | **0.2** | 37.7 | (37.5) | **(6.5)** | (20.3) | 13.8 |
| Total revenues | **2,118.6** | 2,296.4 | (177.8) | **4,214.5** | 4,518.3 | (303.8) |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses | **1,110.0** | 1,193.9 | (83.9) | **2,322.5** | 2,382.8 | (60.3) |
| Dividends to policyholders | **49.5** | 52.9 | (3.4) | **99.8** | 106.5 | (6.7) |
| Operating expenses | **724.1** | 739.4 | (15.3) | **1,280.1** | 1,457.3 | (177.2) |
| Total expenses | **1,883.6** | 1,986.2 | (102.6) | **3,702.4** | 3,946.6 | (244.2) |
| Income before income taxes | **235.0** | 310.2 | (75.2) | **512.1** | 571.7 | (59.6) |
| Income taxes | **50.9** | 61.0 | (10.1) | **109.1** | 113.7 | (4.6) |
| Net income | **184.1** | 249.2 | (65.1) | **403.0** | 458.0 | (55.0) |
| Net income attributable to noncontrolling interest | **2.7** | 23.6 | (20.9) | **11.9** | 42.2 | (30.3) |
| Net income attributable to Principal Financial Group, Inc. | **181.4** | 225.6 | (44.2) | **391.1** | 415.8 | (24.7) |
| Preferred stock dividends | **8.3** | 8.3 | | **16.5** | 16.5 | |
| Net income available to common stockholders | $ **173.1** | $ 217.3 | $ (44.2) | $ **374.6** | $ 399.3 | $ (24.7) |

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

**Net Income Available to Common Stockholders**

Net income available to common stockholders decreased primarily due to a $46.0 million after-tax gain associated with the sale of a portion of our interest in Catalyst Health Solutions, Inc. in the second quarter of 2011 with no corresponding activity in the second quarter of 2012.

**Total Revenues**

Premiums decreased $157.7 million for the Corporate segment primarily due to a reduction in average covered medical members in our exited group medical insurance business. Partially offsetting this decrease was a $70.2 million increase in Retirement and Investor Services segment premiums primarily due to an increase in sales of single premium group annuities with life contingencies in our full service payout business.

Net investment income decreased primarily due to lower investment yields in our U.S. operations and lower inflation-based investment returns on average invested assets and cash as a result of lower inflation in Chile. For additional information, see Investments Investment Results.

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain invested assets and our decision to sell invested assets. Net realized capital gains decreased primarily due to a gain in the second quarter of 2011 associated with the sale of a portion of our interest in Catalyst Health Solutions, Inc. and equity market losses versus gains, which were partially offset by gains versus losses on the GMWB embedded derivative and related hedging instruments. For additional information, see Investments Investment Results.

**Total Expenses**

Benefits, claims and settlement expenses decreased $119.2 million for the Corporate segment primarily due to a reduction in average covered medical members in our exited group medical insurance business. In addition, U.S. Insurance Solutions segment benefits, claims and settlement expenses decreased $37.6 million primarily due to updated premium assumptions in our individual life insurance business in second quarter of 2011. Principal International segment benefits, claims and settlement expenses also decreased $27.4 million primarily due to lower inflation-based interest crediting rates to customers and the weakening of the Chilean peso against the U.S. dollar. Partially offsetting these decreases was a $100.3 million increase in benefits, claims and settlement expenses for the Retirement and Investor Services segment primarily due to an increase in change in reserves resulting from an increase in sales of single premium group annuities with life contingencies in our full service payout business.

Operating expenses decreased $67.5 million for the Corporate segment primarily due to a prior year contribution made to The Principal Financial Group Foundation, Inc. and a reduction in corporate overhead expenses needed to support the exited group medical insurance business. Partially offsetting this decrease was a $30.7 million increase for the Retirement and Investor Services segment primarily due to higher staff related costs, including pension and other postretirement benefits. In addition, Principal Global Investors segment operating expenses increased $8.8 million primarily due to higher compensation and operating costs resulting from continued investment in the global business model and other one-time costs during the period. Principal International segment operating expenses also increased $8.5 million primarily due to transaction costs related to the Claritas acquisition in Brazil and higher compensation costs across the segment.

**Income Taxes**

The effective income tax rates were 22% and 20% for the three months ended June 30, 2012 and 2011, respectively. The effective income tax rate for the three months ended June 30, 2012, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the interest exclusion from taxable income. The effective income tax rate for the three months ended June 30, 2011, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the inclusion of income attributable to noncontrolling interest in income before income taxes with no corresponding change in income taxes reported by us as the controlling interest.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

**Net Income Available to Common Stockholders**

Net income available to common stockholders decreased primarily due to a $46.0 million after-tax gain associated with the sale of a portion of our interest in Catalyst Health Solutions, Inc. in the second quarter of 2011 with no corresponding activity through the first six months of 2012, which was partially offset by lower other-than-temporary impairments on fixed maturities, available-for-sale.

**Total Revenues**

Premiums decreased $382.9 million for the Corporate segment primarily due to a reduction in average covered medical members in our exited group medical insurance business. Partially offsetting this decrease was a $149.9 million increase in Retirement and Investor Services segment premiums primarily due to an increase in sales of single premium group annuities with life contingencies in our full service payout business.

Fees decreased $36.5 million for our U.S. Insurance Solutions segment primarily due to unlocking of unearned revenue associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012 offset by growth in the universal life and variable universal life lines of business. In addition, fees decreased $35.6 million for our Corporate segment primarily

due to a reduction in average fee-for-service members in our exited group medical insurance business. Partially offsetting these decreases was a $25.2 million increase in fees for our Principal International segment primarily due to higher investment management fees driven by higher average AUM in Mexico as a result of the HSBC AFORE acquisition. In addition, fees for our Principal Global Investors segment increased $18.9 million primarily due to an increase in average AUM and higher real estate transaction fees resulting from higher transaction volumes.

Net investment income decreased primarily due to lower investment yields in our U.S. operations. For additional information, see Investments Investment Results.

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain invested assets and our decision to sell invested assets. Net realized capital losses decreased primarily due to gains on the GMWB embedded derivative and related hedging instruments and lower other-than-temporary impairments on fixed maturities, available-for-sale, which were partially offset by a gain associated with the sale of a portion of our interest in Catalyst Health Solutions, Inc.in 2011 with no corresponding activity in 2012. For additional information, see Investments Investment Results.

**Total Expenses**

Benefits, claims and settlement expenses decreased $292.7 million for the Corporate segment primarily due to a reduction in average covered medical members in our exited group medical insurance business. Partially offsetting this decrease was a $142.8 million increase in benefits, claims and settlement expenses for the Retirement and Investor Services segment primarily due to an increase in change in reserves resulting from an increase in sales of single premium group annuities with life contingencies in our full service payout business. In addition, benefits, claims and settlement expenses for our U.S. Insurance Solutions segment increased $78.5 million primarily due to unlocking associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012.

U.S. Insurance Solutions operating expenses decreased $140.2 million primarily due to unlocking associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012. In addition, operating expenses for our Corporate segment decreased $106.7 million primarily due to a reduction in corporate overhead expenses needed to support the exited group medical insurance business and a prior year contribution made to The Principal Financial Group Foundation, Inc. Partially offsetting these decreases was a $34.6 million increase in operating expenses for our Retirement and Investor Services segment primarily due to higher staff related costs, including pension and other postretirement benefits.

**Income Taxes**

The effective income tax rates were 21% and 20% for the six months ended June 30, 2012 and 2011, respectively. The effective income tax rate for the six months ended June 30, 2012, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the interest exclusion from taxable income. The effective income tax rate for the six months ended June 30, 2011, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the inclusion of income attributable to noncontrolling interest in income before income taxes with no corresponding change in income taxes reported by us as the controlling interest.

**Results of Operations by Segment**

For results of operations by segment see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Segment Information.

**Retirement and Investor Services Segment**

***Retirement and Investor Services Segment Summary Financial Data***

Growth in earnings of the segment should generally track with, yet will typically be less than, the percentage growth in account values. This trend may vary due to changes in business and/or product mix. 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 following table presents the Retirement and Investor Services account value rollforward for the periods indicated:

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in billions) | | | |
| Account values, beginning of period | **$ 197.9** | $ 184.6 | **$ 183.3** | $ 178.3 |
| Net cash flow | **2.4** | 1.2 | **4.9** | 1.5 |
| Credited investment performance | **(2.5)** | 1.4 | **9.8** | 7.4 |
| Other | | (0.1) | **(0.2)** | (0.1) |
| Account values, end of period | **$ 197.8** | $ 187.1 | **$ 197.8** | $ 187.1 |

The following table presents certain summary financial data relating to the Retirement and Investor Services segment for the periods indicated:

| | For the three months ended June 30, 2012 | 2011 | Increase (decrease) | For the six months ended June 30, 2012 | 2011 | Increase (decrease) |
|---|---|---|---|---|---|---|
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Premiums and other considerations | **$ 173.2** | $ 103.0 | $ 70.2 | **$ 326.7** | $ 176.8 | $ 149.9 |
| Fees and other revenues | **368.5** | 370.3 | (1.8) | **739.2** | 733.4 | 5.8 |
| Net investment income | **539.5** | 570.9 | (31.4) | **1,070.4** | 1,151.9 | (81.5) |
| Total operating revenues | **1,081.2** | 1,044.2 | 37.0 | **2,136.3** | 2,062.1 | 74.2 |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses, including dividends to policy holders | **543.2** | 504.0 | 39.2 | **1,063.6** | 985.8 | 77.8 |
| Operating expenses | **356.6** | 337.4 | 19.2 | **704.2** | 670.5 | 33.7 |
| Total expenses | **899.8** | 841.4 | 58.4 | **1,767.8** | 1,656.3 | 111.5 |
| Operating earnings before income taxes | **181.4** | 202.8 | (21.4) | **368.5** | 405.8 | (37.3) |
| Income taxes | **39.7** | 48.1 | (8.4) | **83.2** | 97.0 | (13.8) |
| Operating earnings | **$ 141.7** | $ 154.7 | $ (13.0) | **$ 285.3** | $ 308.8 | $ (23.5) |

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

**Operating Earnings**

Operating earnings decreased $5.2 million in our individual annuities business primarily due to a decrease in investment income stemming from lower asset prepayment fee income and investment yields and an increase in DPAC amortization expense resulting from declining equity markets in the second quarter of 2012. In addition, operating earnings decreased $4.5 million in our full service accumulation business primarily due to shifts in mix of business, economic pressures on fee revenue and higher staff related costs, including pension and other postretirement benefits. Furthermore, operating earnings decreased $1.0 million in our Principal Funds business primarily due to higher staff related costs, including pension and other postretirement benefits, and to a lesser extent, higher distribution expenses resulting from an increase in sales.

**Operating Revenues**

Premiums increased $59.8 million in our full service payout business primarily due to an increase in sales of single premium group annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. In addition, premiums increased $10.4 million in our individual annuities business primarily due to an increase in sales of annuities with life contingencies stemming from expanding opportunities with our bank distribution partners.

Fees decreased $7.5 million in our full service accumulation business primarily due to shifts in mix of business and economic pressures. Partially offsetting the decrease in fees were $4.5 million and $1.5 million increases in our Principal Funds and individual annuities businesses, respectively, primarily due to higher fee income stemming from an increase in average account values.

Net investment income decreased primarily due to lower investment yields.

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**Total Expenses**

Benefits, claims and settlement expenses increased $58.3 million in our full service payout business primarily due to an increase in change in reserves resulting from an increase in sales of single premium group annuities with life contingencies. Partially offsetting the increase in benefits, claims and settlement expenses was an $18.5 million decrease in our investment only business primarily due to a decrease in cost of interest credited stemming from lower variable crediting rates and a decline in average account values resulting from scheduled maturities of medium-term notes.

Operating expenses increased $7.1 million and $4.2 million in our full service accumulation and individual annuities businesses, respectively, primarily due to higher staff related costs, including pension and other postretirement benefits. To a lesser extent, operating expenses increased in our individual annuities business due to an increase in DPAC amortization expense resulting from declining equity markets in the second quarter of 2012. In addition, operating expenses increased $6.1 million in our Principal Funds business primarily due to higher staff related costs, including pension and other postretirement benefits, and to a lesser extent, higher distribution expenses resulting from an increase in sales.

**Income Taxes**

The effective income tax rates for the segment were 22% and 24% for the three months ended June 30, 2012 and 2011, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

**Operating Earnings**

Operating earnings decreased $8.1 million in our individual annuities business primarily due to lower investment yields and, to a lesser extent, a favorable separate account dividend received deduction true-up in 2011 compared to a negative separate account dividend received deduction true-up in 2012. In addition, operating earnings decreased $7.1 million in our full service accumulation business primarily due to shifts in mix of business, economic pressures on fee revenue and higher staff related costs, including pension and other postretirement benefits. Furthermore, operating earnings decreased $3.6 million in our bank and trust services business primarily due to an estimated expense for a legal settlement accrual in 2012.

**Operating Revenues**

Premiums increased $129.9 million in our full service payout business primarily due to an increase in sales of single premium group annuities with life contingencies. The single premium product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore tends to vary from period to period. In addition, premiums increased $20.0 million in our individual annuities business primarily due to an increase in sales of annuities with life contingencies stemming from expanding opportunities with our bank distribution partners.

Fees increased $10.1 million and $4.2 million in our Principal Funds and individual annuities businesses, respectively, primarily due to higher fee income stemming from an increase in average account values. Partially offsetting the increase in fees was an $8.9 million decrease in our full service accumulation business primarily due to shifts in mix of business and economic pressures.

Net investment income decreased primarily due to lower investment yields.

**Total Expenses**

Benefits, claims and settlement expenses increased $123.6 million in our full service payout business primarily due to an increase in change in reserves resulting from an increase in sales of single premium group annuities with life contingencies. Partially offsetting the increase in benefits, claims and settlement expenses was a $35.7 million decrease in our investment only business primarily due to a decrease in cost of interest credited stemming from lower variable crediting rates and a decline in average account values resulting from scheduled maturities of medium-term notes.

Operating expenses increased $12.7 million in our Principal Funds business primarily due to higher staff related costs and higher distribution expenses resulting from an increase in sales. In addition, operating expenses increased $8.8 million and $7.5 million in our full service accumulation and individual annuities businesses, respectively, primarily due to higher staff related costs, including pension and other postretirement benefits.

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**Income Taxes**

The effective income tax rates for the segment were 23% and 24% for the six months ended June 30, 2012 and 2011, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income.

**Principal Global Investors Segment**

***Principal Global Investors Segment Summary Financial Data***

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

The following table presents the AUM rollforward for assets managed by Principal Global Investors for the periods indicated:

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in billions) | | | |
| AUM, beginning of period | **$ 242.2** | $ 222.9 | **$ 227.8** | $ 220.1 |
| Net cash flow | **2.9** | 0.7 | **6.6** | (3.2) |
| Investment performance | **(0.9)** | 3.0 | **11.3** | 10.1 |
| Other | **(0.3)** | (0.6) | **(1.8)** | (1.0) |
| AUM, end of period | **$ 243.9** | $ 226.0 | **$ 243.9** | $ 226.0 |

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

| | For the three months ended June 30, 2012 | 2011 | Increase (decrease) | For the six months ended June 30, 2012 | 2011 | Increase (decrease) |
|---|---|---|---|---|---|---|
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Fees and other revenues | **$ 138.5** | $ 132.2 | $ 6.3 | **$ 272.6** | $ 253.7 | $ 18.9 |
| Net investment income | **2.6** | 4.1 | (1.5) | **6.6** | 7.9 | (1.3) |
| Total operating revenues | **141.1** | 136.3 | 4.8 | **279.2** | 261.6 | 17.6 |
| Expenses: | | | | | | |
| Total expenses | **111.4** | 102.6 | 8.8 | **222.1** | 201.6 | 20.5 |

| | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Operating earnings before income taxes and noncontrolling interest | | **29.7** | | 33.7 | | (4.0) | | **57.1** | | 60.0 | | (2.9) |
| Income taxes | | **8.9** | | 11.5 | | (2.6) | | **18.9** | | 20.1 | | (1.2) |
| Operating earnings attributable to noncontrolling interest | | **2.6** | | 1.4 | | 1.2 | | **3.8** | | 2.5 | | 1.3 |
| Operating earnings | **$** | **18.2** | $ | 20.8 | $ | (2.6) | **$** | **34.4** | $ | 37.4 | $ | (3.0) |

***Three and Six Months Ended June 30, 2012 Compared to Three and Six Months Ended June 30, 2011***

**Operating Earnings**

Operating earnings decreased primarily due to higher compensation and operating costs resulting from continued investment in the global business model and other one-time costs during the current period. These increases in expenses were partially offset by higher fee revenues driven by an increase in average AUM, as well as increased real estate transaction fees resulting from higher transaction volumes.

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**Income Taxes**

The effective income tax rates for the segment were 30% and 33% for the three and six months ended June 30, 2012, respectively, and 34% for both the three and six months ended June 30, 2011. The effective income tax rates for the three and six months ended June 30, 2012 and 2011, were lower than the U.S. statutory rate, primarily due to the inclusion of income attributable to noncontrolling interest in operating earnings before income taxes with no corresponding change in income taxes reported by us as the controlling interest.

**Principal International Segment**

***Principal International 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 local currency profits. Net customer cash flow and market performance are the two main drivers of local currency AUM growth. Net customer cash flow reflects our ability to attract and retain client deposits. Market performance reflects the investment returns on our underlying AUM. The percentage growth or decline in the earnings of our Principal International segment will generally track with the percentage growth or decline 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. AUM of our foreign subsidiaries is translated into U.S. dollar equivalents at the end of the reporting period using the spot foreign exchange rates. Revenue and expenses for our foreign subsidiaries are translated into U.S. dollar equivalents at the average foreign exchange rates for the reporting period.

The following table presents the Principal International segment AUM rollforward for the periods indicated:

| | For the three months ended June 30, | | For the six months ended June 30, | |
|---|---|---|---|---|
| | **2012** | **2011** | **2012** | **2011** |
| | | (in billions) | | |
| AUM, beginning of period | **$ 59.2** | $ 48.5 | **$ 52.8** | $ 45.8 |
| Net cash flow | **2.3** | 1.8 | **4.6** | 3.1 |
| Investment performance | **1.4** | 1.1 | **3.6** | 1.7 |
| Operations acquired (1) | **1.8** | | **1.8** | |
| Effect of exchange rates | **(4.3)** | 1.7 | **(2.3)** | 2.7 |
| Other | **(0.1)** | (0.1) | **(0.2)** | (0.3) |
| AUM, end of period | **$ 60.3** | $ 53.0 | **$ 60.3** | $ 53.0 |

(1) Reflects the acquisition of Claritas in Brazil in April 2012.

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The following table presents certain summary financial data of the Principal International segment for the periods indicated.

| | For the three months ended June 30, | | | For the six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | 2012 | 2011 | Increase (decrease) | 2012 | 2011 | Increase (decrease) |
| | | | (in millions) | | | |
| Operating revenues: | | | | | | |
| Premiums and other considerations | **$ 64.5** | $ 57.0 | $ 7.5 | **$ 148.3** | $ 123.8 | $ 24.5 |
| Fees and other revenues | **50.5** | 38.2 | 12.3 | **100.7** | 75.5 | 25.2 |
| Net investment income | **95.6** | 132.0 | (36.4) | **224.1** | 234.0 | (9.9) |
| Total operating revenues | **210.6** | 227.2 | (16.6) | **473.1** | 433.3 | 39.8 |
| Expenses: | | | | | | |
| Benefits, claims, and settlement expenses | **122.1** | 149.1 | (27.0) | **292.4** | 281.6 | 10.8 |
| Operating expenses | **50.5** | 41.4 | 9.1 | **100.8** | 86.0 | 14.8 |
| Total expenses | **172.6** | 190.5 | (17.9) | **393.2** | 367.6 | 25.6 |
| Operating earnings before income taxes and noncontrolling interest | **38.0** | 36.7 | 1.3 | **79.9** | 65.7 | 14.2 |
| Income taxes | **1.0** | 0.4 | 0.6 | **1.2** | 1.6 | (0.4) |
| Operating earnings attributable to noncontrolling interest | **0.1** | | 0.1 | | | |
| Operating earnings | **$ 36.9** | $ 36.3 | $ 0.6 | **$ 78.7** | $ 64.1 | $ 14.6 |

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

**Operating Earnings**

Operating earnings increased primarily due to higher fees driven by higher average AUM in Mexico as a result of the HSBC AFORE acquisition, which was partially offset by the weakening of the Latin American currencies against the U.S. dollar and lower investment returns on assets not backing segment insurance products as a result of lower inflation in Chile.

**Operating Revenues**

Premiums increased $7.4 million in Chile primarily due to higher sales of single premium annuities with life contingencies, which was partially offset by the weakening of the Chilean peso against the U.S. dollar.

Fees and other revenues increased primarily due to higher investment management fees driven by higher average AUM in Mexico as a result of the HSBC AFORE acquisition, which was partially offset by the weakening of the Mexican peso against the U.S. dollar.

Net investment income decreased primarily due to lower inflation-based investment returns on average invested assets and cash as a result of lower inflation in Chile.

**Total Expenses**

Benefits, claims and settlement expenses decreased $26.5 million in Chile primarily due to lower inflation-based interest crediting rates to customers and the weakening of the Chilean peso against the U.S. dollar, which were partially offset by an increase in the change in reserves related to higher sales of single premium annuities with life contingencies.

Operating expenses increased primarily due to transaction costs related to the Claritas acquisition in Brazil and higher compensation expenses across the segment.

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### Income Taxes

The effective income tax rates for the segment were 3% and 1% for the three months ended June 30, 2012 and 2011, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to the presentation of taxes on our share of earnings generated from our equity method investments. Specifically, our share of earnings generated from equity method investments, net of foreign taxes incurred, are reported within net investment income whereas any residual U.S. tax expense or benefit related to equity method investments is reported in income taxes. Lower tax rates of foreign jurisdictions also contributed to the lower effective income tax rates.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

### Operating Earnings

Operating earnings increased primarily due to higher fees driven by higher average AUM in Mexico as a result of the HSBC AFORE acquisition and higher earnings in our equity method investment in Brazil. These increases were partially offset by the weakening of the Latin American currencies against the U.S. dollar and higher compensation expenses across the segment.

### Operating Revenues

Premiums increased $24.4 million in Chile primarily due to higher sales of single premium annuities with life contingencies.

Fees and other revenues increased primarily due to higher investment management fees driven by higher average AUM in Mexico as a result of the HSBC AFORE acquisition, which was partially offset by the weakening of the Mexican peso against the U.S. dollar.

Net investment income decreased primarily due to lower inflation-based investment returns on average invested assets and cash as a result of lower inflation in Chile, which was partially offset by higher average invested assets in Chile.

### Total Expenses

Benefits, claims and settlement expenses increased $10.8 million in Chile primarily due to an increase in the change in reserves related to higher sales of single premium annuities with life contingencies, which was partially offset by lower inflation-based interest crediting rates to customers.

Operating expenses increased primarily due to higher compensation expenses across the segment, transaction costs related to the Claritas acquisition in Brazil and higher present value of future profits and DPAC amortization and as a result of net unlocking and true-up adjustments in Mexico.

**Income Taxes**

The effective income tax rate for the segment was 2% for both the six months ended June 30, 2012 and 2011. The effective income tax rate was lower than the U.S. statutory rate primarily due to taxes on our share of earnings generated from our equity method investments. Specifically, our share of earnings generated from equity method investments, net of foreign taxes incurred, are reported within net investment income whereas any residual U.S. tax expense or benefit related to equity method investments is reported in income taxes. Lower tax rates of foreign jurisdictions also contributed to the lower effective income tax rates.

**U.S. Insurance Solutions Segment**

***Individual Life Insurance Trends***

Our life insurance premiums and fees are influenced by both economic and industry trends. We have been primarily focused on marketing our universal and variable universal life insurance products. As such, premiums related to our traditional life insurance products continued to decline. To address recent economic and industry trends, we introduced new term products in 2011.

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

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in millions) | | | |
| Universal and variable universal life insurance fee revenues (1) | **$ 120.5** | $ 110.6 | **$ 193.2** | $ 226.1 |
| Traditional life insurance premiums | **125.8** | 128.7 | **249.0** | 253.4 |

(1) Fee revenues reflects a $46.6 million reduction due to unlocking of unearned revenue associated with the change in basis for amortizing DPAC and other actuarial balances for the six months ended June 30, 2012.

***Specialty Benefits Insurance Trends***

Premium and fees in our specialty benefits insurance business are also influenced by economic and industry trends. Premium and fees have risen more slowly in recent years due to more moderate increases in underlying salaries and lower membership in existing group contracts. Over the past year, we are seeing signs of improvement in both areas.

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

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 |
|---|---|---|---|---|
| | (in millions) | | | |
| Premium and fees: | | | | |
| Group dental and vision insurance | **$ 144.2** | $ 139.0 | **$ 287.8** | $ 274.2 |
| Group life insurance | **82.9** | 80.9 | **163.8** | 161.0 |
| Group disability insurance | **74.3** | 68.8 | **143.6** | 137.1 |
| Individual disability insurance | **57.9** | 53.3 | **115.0** | 105.5 |
| Wellness | **2.2** | 2.6 | **5.0** | 5.2 |

***U.S. Insurance Solutions Segment Summary Financial Data***

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

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

| | For the three months ended June 30, | | | For the six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | **2012** | **2011** | **Increase (decrease)** | **2012** | **2011** | **Increase (decrease)** |
| | | | **(in millions)** | | | |
| Operating revenues: | | | | | | |
| Premiums and other considerations | **$ 443.6** | $ 434.2 | $ 9.4 | **$ 883.4** | $ 862.8 | $ 20.6 |
| Fees and other revenues (1) | **134.1** | 123.8 | 10.3 | **221.4** | 253.2 | (31.8) |
| Net investment income | **173.8** | 172.7 | 1.1 | **343.7** | 346.7 | (3.0) |
| Total operating revenues | **751.5** | 730.7 | 20.8 | **1,448.5** | 1,462.7 | (14.2) |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses (1) | **443.3** | 439.3 | 4.0 | **970.5** | 849.3 | 121.2 |
| Dividends to policyholders | **49.0** | 52.3 | (3.3) | **98.8** | 105.4 | (6.6) |
| Operating expenses (1) | **185.8** | 167.2 | 18.6 | **231.6** | 358.2 | (126.6) |
| Total expenses | **678.1** | 658.8 | 19.3 | **1,300.9** | 1,312.9 | (12.0) |
| Operating earnings before income taxes | **73.4** | 71.9 | 1.5 | **147.6** | 149.8 | (2.2) |
| Income taxes | **23.2** | 22.9 | 0.3 | **47.2** | 47.4 | (0.2) |
| Operating earnings | **$ 50.2** | $ 49.0 | $ 1.2 | **$ 100.4** | $ 102.4 | $ (2.0) |

(1) For further details related to the impact associated with the change in basis for amortizing DPAC and other actuarial balances on results for the six months ended June 30, 2012 see, Transactions Affecting Comparability of Results of Operations Individual Life Insurance Amortization.

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

**Operating Earnings**

Operating earnings in our individual life insurance business increased $3.9 million due to lower claims. Operating earnings decreased $2.7 million in our specialty benefits insurance business primarily due to lower investment yields and higher staff related costs, including pension and other postretirement benefits.

**Operating Revenues**

Premiums increased $16.9 million in our specialty benefits insurance business due to growth in the block of business. Premiums decreased $7.5 million in our individual life insurance business due to higher reinsurance premiums in the universal life and variable universal life lines of business and the expected continued decline from our traditional life insurance business.

Fees and other revenues increased $10.3 million in our individual life insurance business due to growth in the universal life and variable universal life lines of business.

**Total Expenses**

Benefits, claims and settlement expenses increased $14.2 million in our specialty benefits insurance business primarily due to growth in the block of business. Benefits, claims and settlement expenses decreased $10.2 million in our individual life insurance business due to lower claims.

Operating expenses increased $13.1 million in our individual life insurance business primarily due to higher DPAC amortization related to lower claims. Operating expenses increased $5.5 million in our specialty benefits insurance business due primarily due to growth in the block of business and higher staff related costs, including pension and other postretirement benefits.

**Income Taxes**

The effective income tax rate for the segment was 32% for both the three months ended June 30, 2012 and 2011. The effective income tax rate was lower than the U.S. statutory rate primarily due to interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

Operating earnings decreased $6.7 million in our specialty benefits insurance business primarily due to lower investment yields and higher staff related costs, including pension and other postretirement benefits. Operating earnings in our individual life insurance business increased $4.7 million primarily due to the favorable net impact of the unlocking associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012.

**Operating Revenues**

Premiums increased $31.6 million in our specialty benefits insurance business due to growth in the block of business. Premiums decreased $11.0 million in our individual life insurance business due to higher reinsurance premiums in the universal life and variable universal life lines of business and the expected continued decline from our traditional life insurance business.

Fees and other revenues decreased $32.4 million in our individual life insurance business primarily due to the unlocking of unearned revenue associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012 offset by growth in the universal life and variable universal life lines of business.

**Total Expenses**

Total expenses decreased $47.4 million in our individual life insurance business primarily due to unlocking associated with the change in basis for amortizing DPAC and other actuarial balances in the first quarter of 2012. Total expenses increased $35.4 million in

our specialty benefits insurance business due to growth in the block of business and higher staff related costs, including pension and other postretirement benefits.

**Income Taxes**

The effective income tax rate for the segment was 32% for both the six months ended June 30, 2012 and 2011. The effective income tax rate was lower than the U.S. statutory rate primarily due to interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

**Corporate Segment**

***Corporate Segment Summary Financial Data***

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

| | For the three months ended June 30, | | | For the six months ended June 30, | | |
|---|---|---|---|---|---|---|
| | **2012** | **2011** | **Increase (decrease)** | **2012** | **2011** | **Increase (decrease)** |
| | | | **(in millions)** | | | |
| Operating revenues: | | | | | | |
| Total operating revenues | **$ (48.1)** | $ (39.9) | $ (8.2) | **$ (93.4)** | $ (73.7) | $ (19.7) |
| Expenses: | | | | | | |
| Total expenses | **(11.1)** | (3.9) | (7.2) | **(12.0)** | (1.8) | (10.2) |
| Operating losses before income taxes, preferred stock dividends and noncontrolling interest | **(37.0)** | (36.0) | (1.0) | **(81.4)** | (71.9) | (9.5) |
| Income tax benefits | **(14.5)** | (15.4) | 0.9 | **(28.3)** | (27.4) | (0.9) |
| Preferred stock dividends | **8.3** | 8.3 | | **16.5** | 16.5 | |
| Operating earnings (losses) attributable to noncontrolling interest | **(0.1)** | 2.9 | (3.0) | **(0.1)** | 2.9 | (3.0) |
| Operating losses | **$ (30.7)** | $ (31.8) | $ 1.1 | **$ (69.5)** | $ (63.9) | $ (5.6) |

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

**Operating Losses**

Operating losses decreased primarily due to a reduction in corporate overhead expenses needed to support the exited group medical insurance business.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

**Operating Losses**

Operating losses increased due a decrease in earnings on average invested assets for the segment, representing capital that has not been allocated to any other segment and a change in income tax reserves established for IRS tax matters. Partially offsetting these increases was a reduction in corporate overhead expenses needed to support the exited group medical insurance business.

**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 structure has an impact on our ability to meet cash flow needs as an organization. Following is a simplified organizational structure.

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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.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term payment obligations. We will continue our prudent capital management practice of regularly exploring options available to us to maximize capital flexibility, including accessing the capital markets and careful attention to and management of expenses.

Our liquidity is supported by a portfolio of U.S. government and agency and residential pass-through government-backed securities, of which we held $4.4 billion as of June 30, 2012, that may be utilized to bolster our liquidity position, as collateral for secured borrowing transactions with various third parties or by disposing of the securities in the open market, if needed. As of June 30, 2012, approximately $10.1 billion, or 98%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. Our life insurance and annuity liabilities contain provisions limiting early surrenders.

As of June 30, 2012 and December 31, 2011, we had short-term credit facilities with various financial institutions in an aggregate amount of $914.7 million and $725.0 million, respectively. As of June 30, 2012 and December 31, 2011, we had $262.9 million and $105.2 million, respectively, of outstanding borrowings related to our credit facilities, with $15.7 million of assets pledged as support as of June 30, 2012. None of these credit arrangements, other than our commercial paper back-stop facility, are committed facilities. Due to the financial strength and the strong relationships we have with these providers, as well as the small size of these facilities, we are comfortable that there is a very low risk that the financial institutions would not be able to fund these facilities. During the first quarter of 2012, we refinanced our $579.0 million revolving credit agreement that serves as a back-stop to our commercial paper program. The new facility, effective March 30, 2012, was increased to $800.0 million. This facility provides 100% back-stop support for our commercial paper program. The credit agreement is broken into two tranches, a $500.0 million four year facility that matures in March 2016, and a $300 million 364 day facility. The four year facility is set up with PFG, PFS and Principal Life as co-borrowers, the 364-day facility is for Principal Life only. The facility is supported by eighteen banks, most if not all of which have other relationships with us. We have no reason to believe that our current providers would be unable or unwilling to fund the facility if necessary. As of June 30, 2012 and December 31, 2011, commercial paper outstanding was $222.0 million and $50.0 million, respectively.

***The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc.*** The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and raise capital to meet operating and growth needs. Dividends from Principal Life, our primary subsidiary, are limited by Iowa law. Under Iowa laws, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa ( the Commissioner ) to pay stockholder dividends or make any other distribution if such distributions would exceed certain statutory limitations. Iowa law gives the Commissioner discretion to disapprove requests for distributions in excess of these limits. In general, the current statutory limitations are 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. Based on these limitations, Principal Life could distribute approximately $507.7 million in 2012. Total stockholder dividends paid by Principal Life to its parent as of June 30, 2012, were $350.0 million.

***Operations.*** Our primary consolidated cash flow sources are premiums from 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 3. 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.

Net cash provided by operating activities was $ 1,502.0 million and $1,785.5 million for the six months ended June 30, 2012, and 2011, respectively. From our insurance business, we typically generate positive cash flows from operating activities, as premiums collected from our insurance products and income received from our investments exceed policy acquisition costs, benefits paid, redemptions and operating expenses. These positive cash flows are then invested to support the obligations of our insurance and investment products and required capital supporting these products. Our cash flows from operating activities are affected by the timing of premiums, fees and investment income received and benefits and expenses paid. The decrease in cash provided by operating activities in 2012 compared to 2011 was primarily due to fluctuations in receivables and payables associated with the timing of settlement as well as a decrease in sales of development real estate properties in the current year compared to 2011.

Net cash used in investing activities was $826.8 million for the six months ended June 30, 2012, compared to net cash provided by investing activities of $793.9 million for the six months ended June 30, 2011. The increase in cash used in investing activities in 2012 compared to 2011 was primarily the result of an increase in net purchases of investments in 2012 compared to net sales and maturities of investments in 2011.

Net cash used in financing activities was $1,862.5 million and $2,287.2 million for the six months ended June 30, 2012 and 2011, respectively. The decrease in cash used in financing activities was primarily due to a decrease in net withdrawals of investment contracts, for which we have had net withdrawals in both 2012 and 2011 primarily due to our decision to scale back our investment only business as well as an increase in proceeds from short-term borrowings in 2012. These were partially offset by an increase in common stock dividends in 2012 as a result of moving to a quarterly dividend beginning in 2012.

***Shelf Registration.*** On May 24, 2011, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2008. Under our current shelf registration, we have the ability to issue in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration.

***Preferred Stock Dividend Restrictions and Payments.*** The certificates of designation for the Series A and B Preferred Stock restrict the declaration of preferred dividends if we fail to meet specified capital adequacy, net income or stockholders equity levels. As of June 30, 2012, we have no preferred dividend restrictions. The dividend payments on our preferred stock are not mandatory or cumulative, as our Board of Directors approves each quarterly dividend payment.

***Short-Term Debt.*** The components of short-term debt as of June 30, 2012 and December 31, 2011, were as follows:

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | (in millions) | | | |
| Commercial paper | $ | **222.0** | $ | 50.0 |
| Other recourse short-term debt | | **40.9** | | 55.2 |
| Total short-term debt | $ | **262.9** | $ | 105.2 |

***Long-Term Debt.*** As of June 30, 2012, there have been no significant changes to long-term debt since December 31, 2011.

***Stockholders Equity.*** The following table summarizes our return of capital to common stockholders.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | (in millions) | | | |
| Dividends to stockholders | $ | **(108.0)** | $ | (213.7) |
| Repurchase of common stock | | **(203.2)** | | (556.4) |
| Total cash returned to stockholders | $ | **(311.2)** | $ | (770.1) |

For additional stockholders equity information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Stockholders Equity.

***Capitalization***

Our capital structure as of June 30, 2012 and December 31, 2011, consisted of debt and equity summarized as follows:

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | (in millions) | |
| Debt: | | |
| Short-term debt | **$ 262.9** | $ 105.2 |
| Long-term debt | **1,576.9** | 1,564.8 |
| Total debt | **1,839.8** | 1,670.0 |
| Stockholders equity: | | |
| Equity excluding AOCI | **8,872.2** | 8,759.9 |
| Total capitalization excluding AOCI | **$ 10,712.0** | $ 10,429.9 |
| Debt to equity excluding AOCI | **21%** | 19% |
| Debt to capitalization excluding AOCI | **17%** | 16% |

As of June 30, 2012, we had $527.9 million of excess capital in the holding companies, consisting of cash and highly liquid assets available for debt maturities, interest, preferred stock dividends and other holding company obligations. In addition, we continue to maintain sufficient capital levels in Principal Life based on our current financial strength ratings.

***Contractual Obligations and Contractual Commitments***

As of June 30, 2012, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2011.

***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 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 2, Variable Interest Entities.

***Guarantees and Indemnifications.*** As of June 30, 2012, there have been no significant changes to guarantees and indemnifications since December 31, 2011. For guarantee and indemnification information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Contingencies, Guarantees and Indemnifications under the caption, Guarantees and Indemnifications.

***Financial Strength Rating and Credit Ratings***

Our ratings are influenced by the relative ratings of our peers/competitors as well as many other 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.

A.M. Best Company, Inc., Fitch Rating Ltd., Moody s Investors Service and S&P publish financial strength ratings on U.S. life insurance companies that are indicators of an insurance company s ability to meet contractholder and policyholder obligations. These rating agencies also assign credit ratings on non-life insurance entities, such as PFG and PFS. Credit ratings are indicators of a debt issuer s ability to meet the terms of debt obligations in a timely manner, and are important factors in overall funding profile and ability to access external capital. Such ratings are not a recommendation to buy, sell or hold securities. Ratings are subject to revision or withdrawal at any time by the assigning rating agency.

A.M. Best, Fitch, Moody s and S&P maintain a stable outlook on the U.S. life insurance sector. However, these rating agencies note that current challenges for the industry such as global sovereign uncertainty, equity market volatility, impact of sustained low interest rates, weakness in the real estate market, lingering unemployment and weak consumer confidence are putting pressure on the stable outlook.

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The financial strength ratings of Principal Life and Principal National Life Insurance Company were upgraded by S&P from A with a positive outlook to A+ with a stable outlook in June 2012, and were affirmed with no change in outlook by Fitch in June 2012, by Moody s in August 2011 and by A.M. Best in December 2011.

The following table summarizes our significant financial strength and debt ratings from the major independent rating organizations. The debt ratings shown are indicative ratings. Outstanding issuances are rated the same as indicative ratings unless otherwise noted. Actual ratings can differ from indicative ratings based on contractual terms.

| | A.M. Best | Fitch | Standard & Poor s | Moody s |
|---|---|---|---|---|
| **Principal Financial Group** | | | | |
| Senior Unsecured Debt (1) | a- | | BBB+ | Baa1 |
| Preferred Stock (2) | bbb | | BBB- | Baa3 |
| **Principal Financial Services** | | | | |
| Senior Unsecured Debt | a- | | BBB+ | |
| Commercial Paper | AMB-1 | | A-2 | P-2 |
| **Principal Life Insurance Company** | | | | |
| Insurer Financial Strength | A+ | AA- | A+ | Aa3 |
| Commercial Paper | AMB-1+ | | A-1 | P-1 |
| Surplus Notes | a | | A- | A2 |
| Enterprise Risk Management Rating | | | Strong | |
| **Principal National Life Insurance Company** | | | | |
| Insurer Financial Strength | A+ | AA- | A+ | Aa3 |

(1) Moody s has rated Principal Financial Group s senior debt issuance A3

(2) S&P has rated Principal Financial Group s preferred stock issuance BB

**Fair Value Measurement**

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels for disclosure purposes. The fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and gives the lowest priority (Level 3) to unobservable inputs. An asset or liability s classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Fair Value Measurements for further details, including a reconciliation of changes in Level 3 fair value measurements.

As of June 30, 2012, 39% of our net assets (liabilities) were Level 1, 57% were Level 2 and 4% were Level 3. Excluding separate account assets as of June 30, 2012, 1% of our net assets (liabilities) were Level 1, 98% were Level 2 and 1% were Level 3.

As of December 31, 2011, 41% of our net assets (liabilities) were Level 1, 55% were Level 2 and 4% were Level 3. Excluding separate account assets as of December 31, 2011, 3% of our net assets (liabilities) were Level 1, 96% were Level 2 and 1% were Level 3.

**Changes in Level 3 fair value measurements**

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of June 30, 2012, were $4,747.5 million as compared to $4,647.3 million as of December 31, 2011. The increase was primarily related to gains on other invested assets and real estate included in our separate account assets. This increase was largely offset by transfers out of Level 3 into Level 2 for certain fixed maturities, available-for-sale due to our obtaining prices from third party pricing vendors or using internal models based on substantially observable market information versus relying on broker quotes or utilizing significant unobservable inputs.

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of June 30, 2011, were $4,625.8 million as compared to $4,691.4 million as of December 31, 2010. The decrease was primarily due to settlements of fixed maturities, available-for-sale and fixed maturities, trading and net sales and settlements of separate account assets. To a lesser extent, the decrease was due to net transfers out of Level 3 into Level 2 for certain long-term bonds in our separate accounts due to our obtaining prices from third party vendors versus relying on broker quotes or internal pricing models. These decreases in Level 3 assets were largely offset by gains on other invested assets and real estate included in our separate accounts assets.

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## Investments

We had total consolidated assets as of June 30, 2012, of $152.1 billion, of which $67.2 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 June 30, 2012, were predominantly 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 maturities and commercial mortgage loans. The remainder is invested in other investments, residential mortgage loans, real estate and equity securities. In addition, policy loans are included in our invested assets.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying amount | % of total | Carrying amount | % of total |
| | | ($ in millions) | | |
| Fixed maturities: | | | | |
| Public | **$ 35,613.9** | **53%** | $ 35,350.3 | 53% |
| Private | **14,956.2** | **22** | 14,628.1 | 22 |
| Equity securities | **363.3** | **1** | 481.9 | 1 |
| Mortgage loans: | | | | |
| Commercial | **9,824.7** | **14** | 9,396.6 | 14 |
| Residential | **1,333.9** | **2** | 1,330.6 | 2 |
| Real estate held for sale | **58.6** | | 44.8 | |
| Real estate held for investment | **1,115.5** | **2** | 1,048.1 | 2 |
| Policy loans | **867.8** | **1** | 885.1 | 1 |
| Other investments | **3,096.8** | **5** | 2,985.8 | 5 |
| Total invested assets | **67,230.7** | **100%** | 66,151.3 | 100% |
| Cash and cash equivalents | **1,646.6** | | 2,833.9 | |
| Total invested assets and cash | **$ 68,877.3** | | $ 68,985.2 | |

### Investment Results

#### *Net Investment Income*

The following table presents the yield and investment income, excluding net realized capital gains and losses, for our invested assets for the periods indicated. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period. The yields for fixed maturities and equity securities are calculated using amortized cost and cost, respectively. All other yields are calculated using carrying amounts.

| | For the three months ended June 30, 2012 | | 2011 | | Increase (decrease) 2012 vs. 2011 | | For the six months ended June 30, 2012 | | 2011 | | Increase (decrease) 2012 vs. 2011 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount |
| | ($ in millions) | | | | | | | | | | | |
| Fixed maturities | **5.1%** | **$ 617.5** | 5.7% | $ 683.0 | (0.6)% | $ (65.5) | **5.2%** | **$ 1,258.5** | 5.6% | $ 1,350.1 | (0.4)% | $ (91.6) |
| Equity securities | **2.5** | **3.3** | 2.8 | 4.0 | (0.3) | (0.7) | **4.0** | **8.4** | 2.9 | 7.9 | 1.1 | 0.5 |
| Mortgage loans commercial | **5.7** | **140.5** | 6.0 | 140.9 | (0.3) | (0.4) | **5.8** | **279.7** | 5.9 | 280.7 | (0.1) | (1.0) |
| Mortgage loans residential | **5.4** | **18.1** | 7.2 | 26.3 | (1.8) | (8.2) | **6.0** | **40.1** | 6.4 | 47.2 | (0.4) | (7.1) |
| Real estate | **4.8** | **13.6** | 7.2 | 18.2 | (2.4) | (4.6) | **4.3** | **24.6** | 9.0 | 46.7 | (4.7) | (22.1) |
| Policy loans | **6.2** | **13.6** | 6.5 | 14.5 | (0.3) | (0.9) | **6.3** | **27.6** | 6.5 | 28.9 | (0.2) | (1.3) |
| Cash and cash equivalents | **0.5** | **2.1** | 0.4 | 2.0 | 0.1 | 0.1 | **0.4** | **4.3** | 0.3 | 3.4 | 0.1 | 0.9 |
| Other investments | **1.7** | **12.8** | 0.8 | 5.7 | 0.9 | 7.1 | **1.6** | **24.2** | 0.8 | 10.3 | 0.8 | 13.9 |
| Total before investment expenses | **4.9** | **821.5** | 5.4 | 894.6 | (0.5) | (73.1) | **5.0** | **1,667.4** | 5.3 | 1,775.2 | (0.3) | (107.8) |
| Investment expenses | **(0.1)** | **(20.5)** | (0.1) | (21.0) | | 0.5 | **(0.1)** | **(41.6)** | (0.1) | (41.8) | | 0.2 |
| Net investment income | **4.8%** | **$ 801.0** | 5.3% | $ 873.6 | (0.5)% | $ (72.6) | **4.9%** | **$ 1,625.8** | 5.2% | $ 1,733.4 | (0.3)% | $ (107.6) |

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***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

Net investment income decreased due to lower reinvestment yields within our fixed maturities portfolio as well as lower inflation-based investment returns on average invested assets and cash, most notably fixed maturities as a result of lower inflation in Chile.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

Net investment income decreased due to lower reinvestment yields within our fixed maturities portfolio as well as a decrease due to gains on the sale of development real estate in the prior year with no corresponding activity in the current year.

***Net Realized Capital Gains (Losses)***

The following table presents the contributors to net realized capital gains and losses for our invested assets for the periods indicated.

| | For the three months ended June 30, 2012 | For the three months ended June 30, 2011 | Increase (decrease) 2012 vs. 2011 | For the six months ended June 30, 2012 | For the six months ended June 30, 2011 | Increase (decrease) 2012 vs. 2011 |
|---|---|---|---|---|---|---|
| | | | (in millions) | | | |
| Fixed maturities, available-for-sale credit impairments (1) | **$ (32.0)** | $ (43.5) | $ 11.5 | **$ (60.8)** | $ (93.7) | $ 32.9 |
| Fixed maturities, available-for-sale - other | **2.7** | 1.6 | 1.1 | **15.6** | 2.6 | 13.0 |
| Fixed maturities, trading | **(2.0)** | 3.3 | (5.3) | **1.0** | (1.3) | 2.3 |
| Equity securities credit impairments | | (4.5) | 4.5 | | (2.4) | 2.4 |
| Derivatives and related hedge activities (2) | **48.2** | (9.3) | 57.5 | **44.7** | (34.5) | 79.2 |
| Commercial mortgages | **(3.4)** | (4.4) | 1.0 | **(7.9)** | (12.2) | 4.3 |
| Other gains (losses) | **(13.3)** | 94.5 | (107.8) | **0.9** | 121.2 | (120.3) |
| Net realized capital gains (losses) | **$ 0.2** | $ 37.7 | $ (37.5) | **$ (6.5)** | $ (20.3) | $ 13.8 |

(1) Includes credit impairments as well as losses on sales of fixed maturities to reduce credit risk, net of realized credit recoveries on the sale of previously impaired securities. Credit gains on sales, excluding associated foreign currency fluctuations that are included in derivatives and related hedging activities, were a net gain of $0.0 million and $2.6 million for the three months ended June 30, 2012 and 2011, respectively and $0.0 million and $7.3 million for the six months ended June 30, 2012 and 2011, respectively.

(2) Includes fixed maturities, available-for-sale impairment-related net gains of $0.0 million and $0.4 for the six months ended June 30, 2012 and 2011, respectively, which were hedged by derivatives reflected in this line. There were no fixed maturities available-for-sale

impairment-related net gains in this line for the three months ended June 30, 2012 and 2011.

***Three Months Ended June 30, 2012 Compared to Three Months Ended June 30, 2011***

Net realized capital losses on fixed maturities, available-for-sale - credit impairments decreased primarily due to lower impairments on commercial mortgage-backed and other asset-backed securities as a result of improved market conditions.

Net realized capital gains on derivatives and related hedge activities increased due to gains versus losses on the GMWB embedded derivatives, including increased gains from changes in the spread reflecting our own creditworthiness, and related hedging instruments. These gains were partially offset by losses versus gains on currency forwards and currency swaps not designated as hedging instruments due to changes in exchange rates.

Other net realized capital losses increased due to equity market losses versus gains and a $70.9 million gain in the second quarter of 2011 resulting from the sale of a portion of our interest in Catalyst Health Solutions, Inc., which is accounted for on the equity method.

***Six Months Ended June 30, 2012 Compared to Six Months Ended June 30, 2011***

Net realized capital losses on fixed maturities, available-for-sale - credit impairments decreased primarily due to lower impairments on commercial mortgage-backed and other asset-backed securities as a result of improved market conditions.

Net realized capital gains on derivatives and related hedge activities increased due to gains versus losses on the GMWB embedded derivatives and related hedging instruments.

Other net realized capital gains decreased due to lower equity market gains and a $70.9 million gain in the second quarter of 2011 resulting from the sale of a portion of our interest in Catalyst Health Solutions, Inc., which is accounted for on the equity method.

**U.S. Investment Operations**

Of our invested assets, $61.7 billion were held by our U.S. operations as of June 30, 2012. Our U.S. invested assets are managed primarily by our Principal Global Investors segment. 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 two 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 and
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves.

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 June 30, 2012, there are twelve members on the Investment Committee, one of whom is a member 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 maturities we purchase. Teams of security analysts, organized by industry, analyze and monitor these investments. In addition, we have teams who specialize in RMBS, CMBS, ABS, municipals and below investment grade securities. Our analysts monitor issuers held in the portfolio 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 of the issuer. 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 loan 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 substantially all 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 typically 65% or less loan-to-value ratio and a debt service coverage ratio of at least 1.5 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The following table presents loan-to-value and debt service coverage ratios for our brick and mortar commercial mortgages, excluding Principal Global Investors segment mortgages:

| | Weighted average loan-to-value ratio | | Debt service coverage ratio | |
|---|---|---|---|---|
| | **June 30, 2012** | **December 31, 2011** | **June 30, 2012** | **December 31, 2011** |
| New mortgages | **48%** | 45% | **3.1x** | 3.3x |
| Entire mortgage portfolio | **57%** | 60% | **2.1x** | 2.0x |

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 3. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk.

***Overall Composition of U.S. Invested Assets***

As shown in the following table, the major categories of U.S. invested assets are fixed maturities and commercial mortgage loans. The remainder is invested in other investments, real estate, residential mortgage loans and equity securities. 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 separate accounts.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | **Carrying amount** | **% of total** | **Carrying amount** | **% of total** |
| | | **($ in millions)** | | |
| Fixed maturities: | | | | |
| Public | **$ 32,147.1** | **52%** | $ 32,081.2 | 53% |
| Private | **14,956.2** | **24** | 14,628.1 | 24 |
| Equity securities | **259.1** | **1** | 395.9 | 1 |
| Mortgage loans: | | | | |
| Commercial | **9,814.0** | **16** | 9,386.0 | 15 |
| Residential | **713.3** | **1** | 746.0 | 1 |
| Real estate held for sale | **51.2** | | 36.6 | |
| Real estate held for investment | **1,114.7** | **2** | 1,047.3 | 2 |
| Policy loans | **843.2** | **1** | 861.6 | 1 |
| Other investments | **1,807.5** | **3** | 1,783.5 | 3 |
| Total invested assets | **61,706.3** | **100%** | 60,966.2 | 100% |
| Cash and cash equivalents | **1,491.4** | | 2,741.7 | |
| Total invested assets and cash | **$ 63,197.7** | | $ 63,707.9 | |

***Fixed Maturities***

Fixed maturities consist of publicly traded and privately placed bonds, asset-backed securities, redeemable preferred stock and certain nonredeemable preferred stock. Included in the privately placed category as of June 30, 2012 and December 31, 2011, were $9.6 billion and $9.1 billion, respectively, of securities subject to certain holding periods and resale restrictions pursuant to Rule 144A of the Securities Act of 1933. Fixed maturities include trading portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. We held $152.2 million and $279.1 million of these trading securities as of June 30, 2012 and December 31, 2011, respectively.

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Fixed maturities were diversified by category of issuer, as shown in the following table for the periods indicated.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying amount | % of total | Carrying amount | % of total |
| | ($ in millions) | | | |
| U.S. government and agencies | **$ 951.6** | **2%** | $ 1,004.7 | 2% |
| States and political subdivisions | **3,019.4** | **6** | 3,041.1 | 7 |
| Non-U.S. governments | **692.9** | **2** | 676.1 | 1 |
| Corporate - public | **18,988.6** | **40** | 19,194.4 | 41 |
| Corporate - private | **12,414.3** | **26** | 11,920.7 | 26 |
| Residential mortgage-backed pass-through securities | **3,374.3** | **7** | 3,421.3 | 7 |
| Commercial mortgage-backed securities | **3,748.4** | **8** | 3,425.7 | 7 |
| Residential collateralized mortgage obligations | **1,211.9** | **3** | 1,403.8 | 3 |
| Asset-backed securities | **2,701.9** | **6** | 2,621.5 | 6 |
| Total fixed maturities | **$ 47,103.3** | **100%** | $ 46,709.3 | 100% |

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 Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation 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 varying levels of credit protection, diversification and reduced event risk depending on the securities owned and composition of the loan pool. CMBS are predominantly comprised of large pool securitizations that are diverse by property type, borrower and geographic dispersion. The risks to any CMBS deal are determined by the credit quality of the underlying loans and how those loans perform over time. Another key risk is the vintage of the underlying loans and the state of the markets during a particular vintage. In the CMBS market, there is a material difference in the outlook for the performance of loans originated in 2005 and earlier relative to loans originated in 2006 through 2008. For loans originated prior to 2006, underwriting assumptions were more conservative regarding required debt service coverage and loan-to-value ratios. For the 2006 through 2008 vintages, real estate values peaked and the underwriting expectations were that values would continue to increase, which makes those loan values more sensitive to market declines. The 2009 through 2012 vintages represent a return to debt service coverage ratios and loan-to-value ratios that more closely resemble loans originated prior to 2006.

We purchase ABS to diversify the overall credit risks of the fixed maturities 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 from 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 held in our U.S. operation s fixed maturities portfolio was 26% and 26% of total fixed maturities as of June 30, 2012 and December 31, 2011, respectively. It is comprised of corporate and foreign government fixed maturities. The following table presents the carrying amount of our international exposure for our U.S. operation s fixed maturities portfolio for the periods indicated.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | (in millions) | | | |
| European Union | **$** | **4,301.0** | $ | 4,132.1 |
| United Kingdom | | **2,448.8** | | 2,329.5 |
| Australia/New Zealand | | **1,422.2** | | 1,490.1 |
| Asia-Pacific | | **1,212.1** | | 1,172.3 |
| Latin America | | **870.4** | | 868.8 |
| Other countries (1) | | **2,087.2** | | 2,139.8 |
| Total | **$** | **12,341.7** | $ | 12,132.6 |

(1) Includes exposure from 13 countries as of June 30, 2012 and 14 countries as of December 31, 2011.

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International fixed maturities are determined by the country of domicile of the parent entity of an individual asset. All international fixed maturities 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 maturities investments and we are within those internal limits. Exposure to Canada is not included in our international exposure. As of June 30, 2012 and December 31, 2011, our investments in Canada totaled $1,775.9 million and $1,749.1 million, respectively.

Economic and fiscal conditions in select European countries, including Greece, Ireland, Italy, Portugal and Spain, continue to cause credit concerns particularly to financial institutions and banks with exposure to the European periphery region. Our exposure to the region within our U.S. investment operations fixed maturities portfolio is modest and manageable, representing 2.3% and 2.4% of total fixed maturities as of June 30, 2012 and December 31, 2011, respectively. Additionally, we did not hold any sovereign debt issuances of the selected countries and had not bought or sold credit protection on sovereign issuances as of June 30, 2012 and December 31, 2011.

The fixed maturities within our U.S. operations portfolio with exposure to the region are primarily corporate credit issuances of large multinational companies where the majority of revenues are coming from outside the country where the parent company is domiciled. Our experience indicates multinational companies have demonstrated better market price performance and credit ratings stability. As of June 30, 2012, 94% of our total portfolio exposure consists of investment grade bonds with an average price of 98 (carrying value/amortized cost) and a weighted average time to maturity of 5 years.

The following table presents the carrying amount of our European periphery zone fixed maturities exposure for the periods indicated:

| | June 30, 2012 (in millions) | | | | | |
|---|---|---|---|---|---|---|
| **Select European Exposure** | **Greece** | **Ireland** | **Italy** | **Portugal** | **Spain** | **Total** |
| Non-Sovereign: | | | | | | |
| Financial institutions | $ | **$ 62.9** | **$ 57.4** | $ | **$ 162.3** | **$ 282.6** |
| Non-financial institutions | **7.6** | **261.9** | **224.6** | **21.6** | **272.1** | **787.8** |
| Total | **$ 7.6** | **$ 324.8** | **$ 282.0** | **$ 21.6** | **$ 434.4** | **$ 1,070.4** |

| | December 31, 2011 (in millions) | | | | | |
|---|---|---|---|---|---|---|
| **Select European Exposure** | **Greece** | **Ireland** | **Italy** | **Portugal** | **Spain** | **Total** |
| Non-Sovereign: | | | | | | |
| Financial institutions | $ | $ 62.1 | $ 53.7 | $ | $ 152.2 | $ 268.0 |
| Non-financial institutions | 7.1 | 295.5 | 223.9 | 19.9 | 284.5 | 830.9 |
| Total | $ 7.1 | $ 357.6 | $ 277.6 | $ 19.9 | $ 436.7 | $ 1,098.9 |

For further details on our International investment operations exposure to these European countries, see International Investment Operations Fixed Maturities Exposure.

***Fixed Maturities Credit Concentrations.*** One aspect of managing credit risk is through industry, issuer and asset class diversification. Our credit concentrations are managed to established limits. The following table presents our top ten exposures as of June 30, 2012.

| | | **Amortized cost (in millions)** |
|---|---|---|
| Berkshire Hathaway Inc. | $ | **209.1** |
| General Electric Co. | | **205.1** |
| AT&T Inc. | | **196.5** |
| Wells Fargo & Co. | | **176.5** |
| Bank of America Corp. | | **159.8** |
| Rabobank Netherlands | | **158.4** |
| JPMorgan Chase & Co. | | **156.0** |
| Verizon Communications Inc. | | **154.5** |
| Credit Suisse Group AG (1) | | **151.4** |
| Republic of Korea | | **150.7** |
| Total top ten exposures | $ | **1,718.0** |

(1) Includes actual counterparty exposure.

***Fixed Maturities Valuation and Credit Quality.*** Valuation techniques for the fixed maturities portfolio vary by security type and the availability of market data. The use of different pricing techniques and their assumptions could produce different financial results. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Fair Value Measurements for further details regarding our pricing methodology. Once prices are determined, they are reviewed by pricing analysts for reasonableness based on asset class and observable market data. In addition, investment analysts who are familiar with specific securities review prices for reasonableness through direct interaction with external sources, review of recent trade activity or use of internal models. All fixed maturities placed on the watch list are periodically analyzed by investment analysts or analysts that focus on troubled securities ( Workout Group ). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. 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. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative and unobservable inputs.

The Securities Valuation Office ( SVO ) of the National Association of Insurance Commissioners ( NAIC ) monitors the bond investments of insurers for regulatory capital and reporting purposes and, when required, assigns securities to one of six investment categories. For certain bonds, the NAIC designations closely mirror the Nationally Recognized Statistical Rating Organizations ( NRSRO ) credit ratings. For most corporate 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 S&P. 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 S&P.

However, for loan-backed and structured securities, as defined by the NAIC, the NAIC rating is not always equivalent to an NRSRO rating as described below. For non-agency RMBS, PIMCO Advisors models and assigns the NAIC ratings. For CMBS, Blackrock Solutions undertakes the modeling and assignment of those NAIC ratings. Other loan-backed and structured securities may be subject to an intrinsic price matrix as provided by the NAIC. This may result in a final designation being higher or lower than the NRSRO credit rating.

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The following table presents our total fixed maturities by NAIC designation and the equivalent ratings of the NRSROs as of the periods indicated as well as the percentage, based on fair value, that each designation comprises.

| | | June 30, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|---|
| 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 | **$ 26,683.4** | **$ 28,450.4** | **60%** | $ 26,802.2 | $ 28,115.1 | 60% |
| 2 | BBB | **14,450.3** | **15,288.1** | **33** | 14,570.4 | 15,195.9 | 33 |
| 3 | BB | **2,610.8** | **2,383.3** | **5** | 2,537.5 | 2,405.8 | 5 |
| 4 | B | **687.5** | **530.0** | **1** | 759.1 | 582.3 | 1 |
| 5 | CCC and lower | **398.9** | **319.4** | **1** | 329.4 | 255.5 | 1 |
| 6 | In or near default | **247.9** | **132.1** | | 273.4 | 154.7 | |
| | Total fixed maturities | **$ 45,078.8** | **$ 47,103.3** | **100%** | $ 45,272.0 | $ 46,709.3 | 100% |

Fixed maturities include 19 securities with an amortized cost of $220.9 million, gross gains of $11.2 million, gross losses of $0.6 million and a carrying amount of $231.5 million as of June 30, 2012, that are still pending a review and assignment of a rating by the SVO. Due to the timing of when fixed maturities are purchased, legal documents are filed and the review by the SVO is completed, 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.

***Commercial Mortgage-Backed Securities and Home Equity Asset-Backed Securities Portfolios.*** As of June 30, 2012, based on amortized cost, 54% of our CMBS portfolio had ratings of A or higher and 35% was issued in 2005 or before and 12% of our ABS home equity portfolio had ratings of A or higher and 87% was issued in 2005 or before.

The following tables present our exposure by credit quality, based on the lowest NRSRO designation, and year of issuance ( vintage ) for our CMBS portfolio as of the periods indicated.

| | June 30, 2012 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & Prior | **$ 55.6** | **$ 55.4** | **$ 75.1** | **$ 75.7** | **$ 43.2** | **$ 43.6** | **$ 73.5** | **$ 70.7** | **$ 144.0** | **$ 103.6** | **$ 391.4** | **$ 349.0** |
| 2004 | **86.0** | **89.5** | **56.9** | **58.3** | **46.8** | **45.7** | **23.2** | **18.2** | **117.1** | **93.2** | **330.0** | **304.9** |
| 2005 | **341.2** | **369.3** | **43.8** | **49.0** | **40.0** | **38.4** | **70.5** | **59.8** | **245.4** | **155.5** | **740.9** | **672.0** |
| 2006 | **152.3** | **160.6** | **4.8** | **5.6** | **90.4** | **96.8** | **37.7** | **38.8** | **177.6** | **116.4** | **462.8** | **418.2** |
| 2007 | **194.8** | **192.7** | **30.9** | **34.5** | **160.1** | **181.2** | **232.8** | **253.5** | **718.5** | **443.2** | **1,337.1** | **1,105.1** |
| 2008 | **11.3** | **11.9** | **15.0** | **17.0** | **28.4** | **33.1** | **15.0** | **15.6** | **31.4** | **29.3** | **101.1** | **106.9** |
| 2009 | **112.2** | **115.9** | **88.0** | **92.9** | | | | | | | **200.2** | **208.8** |
| 2010 | **60.9** | **66.1** | **68.7** | **70.8** | | | | | | | **129.6** | **136.9** |
| 2011 | **101.3** | **104.0** | **87.9** | **91.0** | | | | | | | **189.2** | **195.0** |
| 2012 | **92.2** | **92.6** | **157.1** | **159.0** | | | | | | | **249.3** | **251.6** |
| Total | **$ 1,207.8** | **$ 1,258.0** | **$ 628.2** | **$ 653.8** | **$ 408.9** | **$ 438.8** | **$ 452.7** | **$ 456.6** | **$ 1,434.0** | **$ 941.2** | **$ 4,131.6** | **$ 3,748.4** |

| | December 31, 2011 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & Prior | $ 147.0 | $ 142.3 | $ 81.3 | $ 81.4 | $ 72.2 | $ 70.2 | $ 94.6 | $ 85.2 | $ 117.8 | $ 79.9 | $ 512.9 | $ 459.0 |
| 2004 | 146.5 | 149.6 | 56.8 | 56.9 | 45.2 | 41.6 | 25.1 | 18.8 | 79.4 | 54.7 | 353.0 | 321.6 |
| 2005 | 362.0 | 392.4 | 43.5 | 48.0 | 18.3 | 17.1 | 77.5 | 61.6 | 225.0 | 128.7 | 726.3 | 647.8 |
| 2006 | 203.4 | 209.2 | 4.8 | 5.6 | 58.6 | 62.9 | 14.6 | 14.5 | 151.9 | 89.9 | 433.3 | 382.1 |
| 2007 | 292.2 | 288.9 | 22.8 | 25.1 | 152.7 | 165.2 | 300.8 | 306.6 | 637.2 | 347.8 | 1,405.7 | 1,133.6 |
| 2008 | | | 15.0 | 16.3 | 33.1 | 36.4 | | | 38.1 | 32.7 | 86.2 | 85.4 |
| 2009 | 123.6 | 127.5 | 16.1 | 16.3 | | | | | | | 139.7 | 143.8 |
| 2010 | 76.2 | 80.8 | 7.7 | 7.6 | | | | | | | 83.9 | 88.4 |
| 2011 | 165.3 | 164.0 | | | | | | | | | 165.3 | 164.0 |
| Total | $ 1,516.2 | $ 1,554.7 | $ 248.0 | $ 257.2 | $ 380.1 | $ 393.4 | $ 512.6 | $ 486.7 | $ 1,249.4 | $ 733.7 | $ 3,906.3 | $ 3,425.7 |

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The following tables present our exposure by credit quality, based on the lowest NRSRO designation, and vintage for our ABS home equity portfolio supported by subprime first lien mortgages as of the periods indicated.

| | June 30, 2012 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & Prior | $ **2.5** | $ **2.5** | $ **5.0** | $ **5.0** | $ **11.6** | $ **11.1** | $ **20.0** | $ **19.3** | $ **147.3** | $ **118.0** | $ **186.4** | $ **155.9** |
| 2004 | | | | | **22.6** | **21.7** | **3.3** | **3.3** | **45.3** | **37.5** | **71.2** | **62.5** |
| 2005 | | | | | **3.0** | **3.1** | | | **71.8** | **48.3** | **74.8** | **51.4** |
| 2006 | | | | | | | | | **14.2** | **11.4** | **14.2** | **11.4** |
| 2007 | | | | | | | | | **37.0** | **30.1** | **37.0** | **30.1** |
| Total | $ **2.5** | $ **2.5** | $ **5.0** | $ **5.0** | $ **37.2** | $ **35.9** | $ **23.3** | $ **22.6** | $ **315.6** | $ **245.3** | $ **383.6** | $ **311.3** |

| | December 31, 2011 | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & Prior | $ 12.3 | $ 12.3 | $ 7.3 | $ 7.0 | $ 12.7 | $ 12.0 | $ 61.2 | $ 54.8 | $ 102.7 | $ 77.1 | $ 196.2 | $ 163.2 |
| 2004 | 1.5 | 1.4 | 12.6 | 11.9 | 8.4 | 7.8 | 2.1 | 2.1 | 47.1 | 38.3 | 71.7 | $ 61.5 |
| 2005 | | | 3.0 | 3.1 | | | | | 67.8 | 43.3 | 70.8 | $ 46.4 |
| 2006 | | | | | | | | | 14.9 | 9.5 | 14.9 | $ 9.5 |
| 2007 | | | | | | | | | 37.2 | 27.8 | 37.2 | $ 27.8 |
| Total | $ 13.8 | $ 13.7 | $ 22.9 | $ 22.0 | $ 21.1 | $ 19.8 | $ 63.3 | $ 56.9 | $ 269.7 | $ 196.0 | $ 390.8 | $ 308.4 |

***Fixed Maturities Watch List.*** We monitor any decline in the credit quality of fixed maturities 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 the present value of the restructured 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.

The following table presents the total carrying amount of our fixed maturities portfolio, as well as its problem, potential problem and restructured fixed maturities for the periods indicated.

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | ($ in millions) | |
| Total fixed maturities (public and private) | $ **47,103.3** | $ 46,709.3 |
| Problem fixed maturities (1) | $ **357.2** | $ 343.5 |

| | | | | |
|---|---|---|---|---|
| Potential problem fixed maturities | | **162.3** | | 166.3 |
| Restructured problem fixed maturities | | **15.3** | | 14.6 |
| Total problem, potential problem and restructured fixed maturities | **$** | **534.8** | $ | 524.4 |
| Total problem, potential problem and restructured fixed maturities as a percent of total fixed maturities | | **1.14%** | | 1.12% |

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(1) The problem fixed maturities carrying amount is net of other-than-temporary impairment losses.

***Fixed Maturities Impairments.*** 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.

Each reporting period, 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. 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; (4) for structured securities, the adequacy of the expected cash flows and (5) our intent to sell the security or whether it is more likely than not we will be required to sell the security before recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized. For additional details, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments.

We would not consider a security with unrealized losses to be other than temporarily impaired when it is not our intent to sell the security, it is not more likely than not that we would be required to sell the security before recovery of the amortized cost, which may be maturity, and we expect to recover the amortized cost basis. However, we do sell securities under certain circumstances, such as when we have evidence of a change in the issuer s creditworthiness, when we anticipate poor relative future performance of securities, 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.

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 not sell the security prior to recovery of its amortized cost. Any of these situations could result in a charge to net income in a future period.

The net realized loss relating to other-than-temporary credit impairments and credit related sales of fixed maturities was $60.8 million and $97.2 million for the six months ended June 30, 2012 and 2011, respectively.

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***Fixed Maturities Available-for-Sale***

The following tables present our fixed maturities available-for-sale by industry category and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in AOCI, as of the periods indicated.

| | June 30, 2012 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Carrying amount |
| | (in millions) | | | |
| Finance Banking | $ 4,584.4 | $ 137.4 | $ 350.7 | $ 4,371.1 |
| Finance Brokerage | 370.6 | 21.3 | 2.8 | 389.1 |
| Finance Finance Companies | 221.4 | 10.9 | 1.2 | 231.1 |
| Finance Financial Other | 536.6 | 74.3 | 0.3 | 610.6 |
| Finance Insurance | 2,894.9 | 227.0 | 43.3 | 3,078.6 |
| Finance REITS | 1,038.9 | 42.9 | 10.8 | 1,071.0 |
| Industrial Basic Industry | 1,649.3 | 138.1 | 3.9 | 1,783.5 |
| Industrial Capital Goods | 2,055.5 | 170.9 | 4.5 | 2,221.9 |
| Industrial Communications | 2,174.0 | 196.1 | 23.4 | 2,346.7 |
| Industrial Consumer Cyclical | 1,533.3 | 150.8 | 5.1 | 1,679.0 |
| Industrial Consumer Non-Cyclical | 3,256.4 | 310.9 | 1.8 | 3,565.5 |
| Industrial Energy | 1,917.3 | 227.5 | 1.8 | 2,143.0 |
| Industrial Other | 469.3 | 32.8 | 1.4 | 500.7 |
| Industrial Technology | 863.0 | 63.7 | 2.8 | 923.9 |
| Industrial Transportation | 613.0 | 52.3 | 6.9 | 658.4 |
| Utility Electric | 2,766.0 | 291.3 | 20.0 | 3,037.3 |
| Utility Natural Gas | 990.8 | 117.7 | 1.5 | 1,107.0 |
| Utility Other | 249.9 | 27.4 | | 277.3 |
| FDIC guaranteed | 5.0 | | | 5.0 |
| Government guaranteed | 1,143.5 | 127.1 | 3.6 | 1,267.0 |
| Total corporate securities | 29,333.1 | 2,420.4 | 485.8 | 31,267.7 |
| | | | | |
| Residential mortgage-backed pass-through securities | 3,070.7 | 200.5 | 0.2 | 3,271.0 |
| Commercial mortgage-backed securities | 4,128.1 | 161.1 | 544.3 | 3,744.9 |
| Residential collateralized mortgage obligations | 1,199.3 | 30.8 | 32.1 | 1,198.0 |
| Asset-backed securities Home equity (1) | 383.6 | 0.5 | 72.8 | 311.3 |
| Asset-backed securities All other | 1,942.6 | 29.1 | 0.8 | 1,970.9 |
| Collateralized debt obligations Credit | 83.0 | | 47.8 | 35.2 |
| Collateralized debt obligations CMBS | 95.3 | 2.1 | 20.8 | 76.6 |
| Collateralized debt obligations Loans | 245.1 | 0.8 | 4.8 | 241.1 |
| Collateralized debt obligations ABS | 15.0 | | 1.8 | 13.2 |
| Total mortgage-backed and other asset-backed securities | 11,162.7 | 424.9 | 725.4 | 10,862.2 |
| | | | | |
| U.S. government and agencies | 790.9 | 34.1 | 0.9 | 824.1 |
| States and political subdivisions | 2,638.4 | 232.4 | 1.4 | 2,869.4 |
| Non-U.S. governments | 566.7 | 126.3 | 0.1 | 692.9 |
| Total fixed maturities, available-for-sale | $ 44,491.8 | $ 3,238.1 | $ 1,213.6 | $ 46,516.3 |

(1) This exposure is all related to sub-prime mortgage loans.

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Carrying amount |
| | (in millions) | | | |
| Finance Banking | $ 4,520.7 | $ 79.9 | $ 445.5 | $ 4,155.1 |
| Finance Brokerage | 381.0 | 15.4 | 6.7 | 389.7 |
| Finance Finance Companies | 216.2 | 8.9 | 4.7 | 220.4 |
| Finance Financial Other | 532.4 | 55.5 | 1.1 | 586.8 |
| Finance Insurance | 2,966.3 | 227.2 | 73.0 | 3,120.5 |
| Finance REITS | 1,015.2 | 28.3 | 22.0 | 1,021.5 |
| Industrial Basic Industry | 1,656.6 | 135.3 | 5.4 | 1,786.5 |
| Industrial Capital Goods | 2,133.0 | 146.8 | 14.3 | 2,265.5 |
| Industrial Communications | 2,033.2 | 179.9 | 23.8 | 2,189.3 |
| Industrial Consumer Cyclical | 1,606.7 | 130.5 | 12.4 | 1,724.8 |
| Industrial Consumer Non-Cyclical | 3,084.0 | 286.3 | 3.7 | 3,366.6 |
| Industrial Energy | 1,978.4 | 220.9 | 1.2 | 2,198.1 |
| Industrial Other | 596.1 | 32.5 | 3.9 | 624.7 |
| Industrial Technology | 851.3 | 57.7 | 9.3 | 899.7 |
| Industrial Transportation | 626.2 | 45.7 | 10.3 | 661.6 |
| Utility Electric | 2,709.6 | 276.0 | 18.9 | 2,966.7 |
| Utility Natural Gas | 1,034.2 | 100.2 | 1.8 | 1,132.6 |
| Utility Other | 197.1 | 20.1 | | 217.2 |
| FDIC guaranteed | 80.0 | 0.6 | | 80.6 |
| Government guaranteed | 1,219.0 | 107.8 | 7.8 | 1,319.0 |
| Total corporate securities | 29,437.2 | 2,155.5 | 665.8 | 30,926.9 |
| | | | | |
| Residential mortgage-backed pass-through securities | 3,130.8 | 185.6 | 0.7 | 3,315.7 |
| Commercial mortgage-backed securities | 3,894.3 | 117.0 | 597.6 | 3,413.7 |
| Residential collateralized mortgage obligations | 1,408.1 | 32.0 | 51.5 | 1,388.6 |
| Asset-backed securities Home equity (1) | 390.8 | 0.2 | 82.6 | 308.4 |
| Asset-backed securities All other | 1,808.0 | 68.1 | 2.9 | 1,873.2 |
| Collateralized debt obligations Credit | 82.8 | | 34.4 | 48.4 |
| Collateralized debt obligations CMBS | 98.7 | 1.6 | 18.5 | 81.8 |
| Collateralized debt obligations Loans | 203.2 | 0.3 | 8.8 | 194.7 |
| Collateralized debt obligations ABS | 15.0 | | 1.1 | 13.9 |
| Total mortgage-backed and other asset-backed securities | 11,031.7 | 404.8 | 798.1 | 10,638.4 |
| | | | | |
| U.S. government and agencies | 772.3 | 32.8 | | 805.1 |
| States and political subdivisions | 2,670.0 | 218.2 | 5.5 | 2,882.7 |
| Non-U.S. governments | 580.7 | 96.3 | 0.9 | 676.1 |
| Total fixed maturities, available-for-sale | $ 44,491.9 | $ 2,907.6 | $ 1,470.3 | $ 45,929.2 |

(1) This exposure is all related to sub-prime mortgage loans.

Of the $1,213.6 million in gross unrealized losses as of June 30, 2012, there were $4.9 million in losses attributed to securities scheduled to mature in one year or less, $68.9 million attributed to securities scheduled to mature between one to five years, $35.8 million attributed to securities scheduled to mature between five to ten years, $378.6 million attributed to securities scheduled to mature after ten years and $725.4 million related to mortgage-backed and other ABS that are not classified by maturity year. As of June 30, 2012, we were in a $2,024.5 million net unrealized gain position as compared to a $1,437.3 million net unrealized gain position as of December 31, 2011. Of the $587.2 million increase in net unrealized gains for the six months ended June 30, 2012, an approximate $0.2 billion of the increase can be attributed to an

approximate 7 basis points decrease in interest rates in addition to other market factors that increased unrealized gains.

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***Fixed Maturities Available-for-Sale Unrealized Losses.*** We believe that our long-term fixed maturities 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 maturities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of cash flow. During the first half of 2012, we did not actively increase our investment in available-for-sale below investment grade assets. While Principal Life s general account investment returns have improved due to the below investment grade asset class, we manage its growth strategically by limiting it to no more than 10% of the total fixed maturities portfolios.

We invest in privately placed fixed maturities 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 presents our fixed maturities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses, including the other-than-temporary impairment losses reported in OCI, as of the periods indicated.

| | June 30, 2012 | | | | December 31, 2011 | | | |
|---|---|---|---|---|---|---|---|---|
| | Amortized cost | Gross unrealized gains | Gross unrealized losses | Carrying amount | Amortized cost | Gross unrealized gains | Gross unrealized losses | Carrying amount |
| | (in millions) | | | | | | | |
| Investment grade: | | | | | | | | |
| Public | **$ 28,251.8** | **$ 2,258.5** | **$ 312.6** | **$ 30,197.7** | $ 28,497.9 | $ 1,989.8 | $ 435.0 | $ 30,052.7 |
| Private | **12,463.2** | **895.1** | **236.2** | **13,122.1** | 12,298.2 | 757.4 | 373.8 | 12,681.8 |
| Below investment grade: | | | | | | | | |
| Public | **1,871.8** | **27.9** | **348.0** | **1,551.7** | 1,834.4 | 21.3 | 365.1 | 1,490.6 |
| Private | **1,905.0** | **56.6** | **316.8** | **1,644.8** | 1,861.4 | 139.1 | 296.4 | 1,704.1 |
| Total fixed maturities, available-for-sale | **$ 44,491.8** | **$ 3,238.1** | **$ 1,213.6** | **$ 46,516.3** | $ 44,491.9 | $ 2,907.6 | $ 1,470.3 | $ 45,929.2 |

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

| | June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Public | | Private | | Total | |
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |
| Three months or less | **$ 576.6** | **$ 5.8** | **$ 345.0** | **$ 6.0** | **$ 921.6** | **$ 11.8** |
| Greater than three to six months | **147.5** | **7.6** | **145.2** | **2.2** | **292.7** | **9.8** |
| Greater than six to nine months | **116.3** | **3.3** | **36.8** | **0.6** | **153.1** | **3.9** |
| Greater than nine to twelve months | **321.1** | **12.1** | **236.1** | **9.7** | **557.2** | **21.8** |
| Greater than twelve to twenty-four months | **445.0** | **40.1** | **374.6** | **22.4** | **819.6** | **62.5** |

| | | | | | | |
|---|---|---|---|---|---|---|
| Greater than twenty-four to thirty-six months | **93.9** | **14.8** | **5.4** | **1.0** | **99.3** | **15.8** |
| Greater than thirty-six months | **933.4** | **228.9** | **886.2** | **194.3** | **1,819.6** | **423.2** |
| Total fixed maturities, available-for-sale | **$ 2,633.8** | **$ 312.6** | **$ 2,029.3** | **$ 236.2** | **$ 4,663.1** | **$ 548.8** |

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| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Public | | Private | | Total | |
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |
| Three months or less | $ 897.5 | $ 14.1 | $ 472.0 | $ 4.9 | $ 1,369.5 | $ 19.0 |
| Greater than three to six months | 1,022.9 | 33.7 | 747.1 | 24.0 | 1,770.0 | 57.7 |
| Greater than six to nine months | 420.3 | 40.7 | 337.4 | 20.2 | 757.7 | 60.9 |
| Greater than nine to twelve months | 61.8 | 5.5 | 65.2 | 3.4 | 127.0 | 8.9 |
| Greater than twelve to twenty-four months | 135.0 | 15.8 | 184.5 | 20.5 | 319.5 | 36.3 |
| Greater than twenty-four to thirty-six months | 65.7 | 16.3 | 30.0 | 5.5 | 95.7 | 21.8 |
| Greater than thirty-six months | 1,122.5 | 308.9 | 1,138.0 | 295.3 | 2,260.5 | 604.2 |
| Total fixed maturities, available-for-sale | $ 3,725.7 | $ 435.0 | $ 2,974.2 | $ 373.8 | $ 6,699.9 | $ 808.8 |

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on below investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

| | June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | Public | | Private | | Total | |
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |
| Three months or less | **$ 69.5** | **$ 1.1** | **$ 184.3** | **$ 3.1** | **$ 253.8** | **$ 4.2** |
| Greater than three to six months | **4.9** | | **53.0** | **4.5** | **57.9** | **4.5** |
| Greater than six to nine months | **26.4** | **1.1** | **17.4** | **1.0** | **43.8** | **2.1** |
| Greater than nine to twelve months | **57.2** | **2.8** | **45.5** | **1.9** | **102.7** | **4.7** |
| Greater than twelve to twenty-four months | **79.9** | **17.9** | **46.2** | **10.6** | **126.1** | **28.5** |
| Greater than twenty-four to thirty-six months | **3.6** | **0.3** | **18.3** | **4.4** | **21.9** | **4.7** |
| Greater than thirty-six months | **702.0** | **324.8** | **433.7** | **291.3** | **1,135.7** | **616.1** |
| Total fixed maturities, available-for-sale | **$ 943.5** | **$ 348.0** | **$ 798.4** | **$ 316.8** | **$ 1,741.9** | **$ 664.8** |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | Public | | Private | | Total | |
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| Three months or less | $ 123.4 | $ 3.6 | $ 72.3 | $ 6.3 | $ 195.7 | $ 9.9 |
| Greater than three to six months | 71.3 | 8.1 | 165.4 | 12.4 | 236.7 | 20.5 |
| Greater than six to nine months | 74.3 | 11.5 | 30.8 | 1.9 | 105.1 | 13.4 |
| Greater than nine to twelve months | 16.9 | 9.5 | 29.5 | 1.6 | 46.4 | 11.1 |
| Greater than twelve to twenty-four months | 42.2 | 11.8 | 18.9 | 4.4 | 61.1 | 16.2 |
| Greater than twenty-four to thirty-six months | 17.9 | 3.6 | 1.3 | 0.3 | 19.2 | 3.9 |
| Greater than thirty-six months | 693.0 | 317.0 | 483.5 | 269.5 | 1,176.5 | 586.5 |
| Total fixed maturities, available-for-sale | $ 1,039.0 | $ 365.1 | $ 801.7 | $ 296.4 | $ 1,840.7 | $ 661.5 |

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on fixed maturities available-for-sale where the estimated fair value had declined and remained below amortized cost by 20% or more as of the periods indicated.

| | June 30, 2012 | | | | | |
|---|---|---|---|---|---|---|
| | 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 | **$ 5.2** | **$ 1.3** | **$ 133.0** | **$ 42.8** | **$ 138.2** | **$ 44.1** |
| Greater than three to six months | **7.2** | **6.9** | **24.1** | **10.3** | **31.3** | **17.2** |
| Greater than six to nine months | | | **28.6** | **14.1** | **28.6** | **14.1** |
| Greater than nine to twelve months | **42.0** | **24.1** | **264.5** | **139.1** | **306.5** | **163.2** |
| Greater than twelve months | **178.5** | **278.7** | **428.1** | **407.1** | **606.6** | **685.8** |
| Total fixed maturities, available-for-sale | **$ 232.9** | **$ 311.0** | **$ 878.3** | **$ 613.4** | **$ 1,111.2** | **$ 924.4** |

| | December 31, 2011 | | | | | |
|---|---|---|---|---|---|---|
| | 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 | $ 42.4 | $ 14.0 | $ 231.7 | $ 75.5 | $ 274.1 | $ 89.5 |
| Greater than three to six months | 74.4 | 32.2 | 587.3 | 263.9 | 661.7 | 296.1 |
| Greater than six to nine months | 18.2 | 11.6 | 77.6 | 47.2 | 95.8 | 58.8 |
| Greater than nine to twelve months | 3.5 | 1.6 | 6.9 | 8.5 | 10.4 | 10.1 |
| Greater than twelve months | 171.9 | 262.4 | 452.8 | 387.6 | 624.7 | 650.0 |
| Total fixed maturities, available-for-sale | $ 310.4 | $ 321.8 | $ 1,356.3 | $ 782.7 | $ 1,666.7 | $ 1,104.5 |

***Mortgage Loans***

Mortgage loans consist of commercial mortgage loans on real estate and residential mortgage loans. The carrying amount of our commercial mortgage loan portfolio was $9,814.0 million and $9,386.0 million as of June 30, 2012 and December 31, 2011, respectively. The carrying amount of our residential mortgage loan portfolio was $713.3 million and $746.0 million as of June 30, 2012 and December 31, 2011, respectively.

***Commercial Mortgage Loans.*** We generally report commercial mortgage loans on real estate at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances.

Commercial mortgage loans play an important role in our investment strategy by:

- providing strong risk-adjusted relative value in comparison to other investment alternatives;
- enhancing total returns and
- providing strategic portfolio diversification.

As a result, we have focused on constructing a solid, high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages originated with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of credit oriented retail properties, office properties and general-purpose industrial properties.

Our commercial mortgage loan portfolio is diversified by geography and specific collateral property type. Commercial mortgage lending in the state of California accounted for 19% and 22% of our commercial mortgage loan portfolio as of June 30, 2012 and December 31, 2011, respectively. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building s design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses, by building and geographic fault lines, the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

The typical borrower in our commercial loan portfolio is a single purpose entity or single asset entity. As of June 30, 2012 and December 31, 2011, the total number of commercial mortgage loans outstanding was 973 and 975, of which 70% and 71% were for loans with principal balances less than $10 million, respectively. The average loan size of our commercial mortgage portfolio was $10.1 million and $9.7 million as of June 30, 2012 and December 31, 2011, respectively.

***Commercial Mortgage Loan Credit Monitoring.*** For further details on monitoring and management of our commercial mortgage loan portfolio, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Credit Monitoring.

We categorize loans that are 60 days or more delinquent, loans in process of foreclosure and loans with borrowers or credit tenants in bankruptcy that are delinquent as problem loans. Valuation allowances or charge-offs have been recognized on most problem loans. We categorize loans that are delinquent less than 60 days where the default is expected to be cured and loans with borrowers or credit tenants in bankruptcy that are current as potential problem loans. The decision whether to classify a loan delinquent less than 60 days as a potential problem involves significant subjective judgments by management as to the likely future economic conditions and developments with respect to the borrower. We categorize loans for which the original note rate has been reduced below market and loans for which the principal has been reduced as restructured loans. We also consider loans that are refinanced more than one year beyond the original maturity or call date at below market rates as restructured.

There has been a decrease in the total level of problem, potential problem and restructured commercial mortgages during 2012 primarily due to loan payoffs, foreclosures, and improvement in collateral occupancies and values. The South Atlantic regions account for over 80% of the problem, potential problem and restructured commercial mortgages as of June 30, 2012. The South Atlantic, Pacific, and East North Central regions accounted for over 90% of the problem, potential problem, and restructured commercial mortgages as of December 31, 2011. Office properties accounted for over half of the problem, potential problem and restructured commercial mortgages as of June 30, 2012. Office and apartment properties accounted for over half of the problem, potential problem and restructured commercial mortgages as of December 31, 2011.

The following table presents the carrying amounts of problem, potential problem and restructured commercial mortgages relative to the carrying amount of all commercial mortgages for the periods indicated.

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | ($ in millions) | |
| Total commercial mortgages | **$ 9,814.0** | $ 9,386.0 |
| Problem commercial mortgages | **$ 44.6** | $ 112.7 |

| | | | | |
|---|---|---|---|---|
| Potential problem commercial mortgages | | **134.0** | | 152.8 |
| Restructured problem commercial mortgages | | **6.8** | | 7.5 |
| Total problem, potential problem and restructured commercial mortgages | **$** | **185.4** | $ | 273.0 |
| Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages | | **1.89%** | | 2.91% |

***Commercial Mortgage Loan Valuation Allowance.*** The valuation allowance for commercial mortgage loans includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. For further details on the commercial mortgage valuation allowance, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Valuation Allowance.

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The valuation allowance decreased $15.5 million for the six months ended June 30, 2012, and decreased $15.8 million for the year ended December 31, 2011. The decrease in the level of valuation allowance during 2012 and 2011 was related to the same market factors as those causing the decrease in the level of problem, potential problem and restructured commercial mortgages during the six months ended June 30, 2012. The South Atlantic region accounts for the highest level of reserves at both June 30, 2012 and December 31, 2011.

The following table represents our commercial mortgage valuation allowance for the periods indicated.

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | ($ in millions) | |
| Balance, beginning of period | **$ 64.8** | $ 80.6 |
| Provision | **10.4** | 17.0 |
| Charge-offs | **(25.9)** | (32.9) |
| Recoveries | | 0.1 |
| Balance, end of period | **$ 49.3** | $ 64.8 |
| Valuation allowance as % of carrying value before reserves | **0.50%** | 0.69% |

***Residential Mortgage Loans.*** The residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of $552.7 million and $611.0 million and first lien mortgages with an amortized cost of $196.3 million and $171.0 million as of June 30, 2012 and December 31, 2011, respectively, primarily held by our Bank and Trust Services business. The home equity loans are generally second lien mortgages made up of closed-end loans and lines of credit. Non-performing residential mortgage loans, which are defined as loans 90 days or greater delinquent plus non-accrual loans, totaled $37.7 million and $24.0 million as of June 30, 2012 and December 31, 2011, respectively. We establish the residential mortgage loan valuation allowance at levels considered adequate to absorb probable losses within the portfolio based on management s evaluation of the size and current risk characteristics of the portfolio. Such evaluation considers numerous factors, including, but not limited to net charge-off trends, loss forecasts, collateral values, geographic location, borrower credit scores, delinquency rates, industry condition and economic trends. The changes in the valuation allowance are reported in net realized capital gains (losses) on our consolidated statements of operations.

Our residential mortgage loan portfolio, and in particular our home equity loan portfolio, experienced an increase in loss severity from sustained elevated levels of unemployment along with continued depressed collateral values beginning in 2010. While these factors continue to drive charge-offs, loss rates are showing signs of stabilization and the portfolio balance is declining. The following table represents our residential mortgage valuation allowance for the periods indicated.

| | June 30, 2012 | December 31, 2011 |
|---|---|---|
| | ($ in millions) | |
| Balance, beginning of period | **$ 36.0** | $ 37.7 |
| Provision | **13.3** | 28.5 |
| Charge-offs | **(15.6)** | (33.4) |
| Recoveries | **2.0** | 3.2 |
| Balance, end of period | **$ 35.7** | $ 36.0 |
| Valuation allowance as % of carrying value before reserves | **4.8%** | 4.6% |

***Real Estate***

Real estate consists primarily of commercial equity real estate. As of June 30, 2012 and December 31, 2011, the carrying amount of our equity real estate investment was $1,165.9 million, or 2%, and $1,083.9 million, or 2%, of U.S. invested assets, respectively. Our commercial equity real estate is held in the form of wholly owned real estate, real estate acquired upon foreclosure of commercial mortgage loans and majority owned interests in real estate joint ventures.

Equity real estate is categorized as either real estate held for investment or real estate held for sale. Real estate held for investment totaled $1,114.7 million and $1,047.3 million as of June 30, 2012 and December 31, 2011, respectively. The carrying value of real estate held for investment is generally adjusted for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized losses and, accordingly, are reflected in our consolidated results of operations. For the six months ended June 30, 2012 and year ended December 31, 2011, there were no such impairment adjustments.

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The carrying amount of real estate held for sale was $51.2 million and $36.6 million as of June 30, 2012 and December 31, 2011, respectively. There were no valuation allowances as of June 30, 2012 or December 31, 2011. Once we identify a real estate property to be sold and commence a plan for marketing the property, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Equity real estate is distributed across geographic regions of the country with larger concentrations in the South Atlantic, West South Central, and Pacific regions of the United States as of June 30, 2012. By property type, there is a concentration in office, industrial, and retail that represented approximately 78% of the equity real estate portfolio as of June 30, 2012.

***Other Investments***

Our other investments totaled $1,807.5 million as of June 30, 2012, compared to $1,783.5 million as of December 31, 2011. Derivative assets accounted for $1,115.7 million and $1,156.5 million in other investments as of June 30, 2012 and December 31, 2011, respectively. The remaining invested assets include equity method investments, which include real estate properties owned jointly with venture partners and operated by the partners.

**International Investment Operations**

Of our invested assets, $5.5 billion were held by our Principal International segment as of June 30, 2012. The assets are managed by either our Principal Global Investors segment or by the local Principal International affiliate. Due to the regulatory constraints in each country, each company maintains its own investment policies. As shown in the following table, the major categories of international invested assets as of June 30, 2012 and December 31, 2011, were fixed maturities, other investments, residential mortgage loans and equity securities. In addition, policy loans are included in our invested assets. The following table excludes invested assets of the separate accounts.

| | June 30, 2012 | | December 31, 2011 | |
|---|---|---|---|---|
| | Carrying amount | % of total | Carrying amount | % of total |
| | ($ in millions) | | | |
| Fixed maturities - Public | **$ 3,466.8** | **63%** | $ 3,269.1 | 63% |
| Equity securities | **104.2** | **2** | 86.0 | 2 |
| Mortgage loans: | | | | |
| Commercial | **10.7** | | 10.6 | |
| Residential | **620.6** | **11** | 584.6 | 11 |
| Real estate held for sale | **7.4** | | 8.2 | |
| Real estate held for investment | **0.8** | | 0.8 | |
| Policy loans | **24.6** | **1** | 23.5 | 1 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other investments | | **1,289.3** | **23** | | 1,202.3 | 23 |
| Total invested assets | | **5,524.4** | **100%** | | 5,185.1 | 100% |
| Cash and cash equivalents | | **155.2** | | | 92.2 | |
| Total invested assets and cash | **$** | **5,679.6** | | $ | 5,277.3 | |

Investments in equity method subsidiaries and direct financing leases accounted for $663.9 million and $565.7 million, respectively, of other investments as of June 30, 2012, and $667.5 million and $507.5 million, respectively, of other investments as of December 31, 2011. The remaining other investments as of both June 30, 2012 and December 31, 2011, are primarily related to derivative assets and other short-term investments.

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***Fixed Maturities Exposure***

Economic and fiscal conditions in select European countries, including Greece, Ireland, Italy, Portugal and Spain, continue to cause credit concerns particularly to financial institutions and banks with exposure to the European periphery region. Our exposure to the region within our International investment operations fixed maturities portfolio is manageable, representing 7.1% and 7.7% of our total International invested assets as of June 30, 2012 and December 31, 2011, respectively. Portfolio holdings with exposure to this region consist of fixed maturities issued in the same countries as our International operations by local subsidiaries of the European parent. Nearly all of the exposure is to bonds issued in Chile. In addition, we did not hold any sovereign debt issuances of the selected countries and had not bought or sold credit protection on sovereign issuances as of June 30, 2012 and December 31, 2011.

Financial sector exposure is to local subsidiary banks, subject to local capital requirements and banking regulation. The current financial exposure carries an average AA local rating from S&P and the average time to maturity is 18 years. Non-financial sector exposure consists primarily of infrastructure bonds, which are backed by the project itself, often with minimum revenue guarantees from the government. The current non-financial exposure carries an average AA- local rating from S&P. The current Italian exposure has an average time to maturity of 14 years. In addition, the current Spanish exposure has an average time to maturity of 14 years. As of June 30, 2012, our total portfolio exposure had an average price of 108 (carrying value/amortized cost).

The following table presents the carrying amount of our European periphery zone fixed maturities exposure for the periods indicated.

| | June 30, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| **Select European Exposure** | **Italy** | **Spain** | **Total** | **Italy** | **Spain** | **Total** |
| | | | (in millions) | | | |
| Non-Sovereign: | | | | | | |
| Financial institutions | $ | $ 252.7 | $ 252.7 | $ | $ 241.5 | $ 241.5 |
| Non-financial institutions | 28.7 | 123.0 | 151.7 | 52.5 | 112.4 | 164.9 |
| Total | $ 28.7 | $ 375.7 | $ 404.4 | $ 52.5 | $ 353.9 | $ 406.4 |

For further details on our U.S. investment operations exposure to these European countries, see U.S. Investment Operations Fixed Maturities.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk Exposures and Risk Management**

Market risk is the risk that we will incur losses due to adverse fluctuations in market rates and prices. Our primary market risk exposure is to changes in interest rates, although we also have exposures to changes in equity prices and foreign currency exchange rates.

We enter into market-sensitive instruments primarily for purposes other than trading. The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges by using the following approaches:

- rebalance our existing asset or liability portfolios;
- control the risk structure of newly acquired assets and liabilities or
- use derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

**Interest Rate Risk**

Interest rate risk is the risk that we will incur economic losses due to adverse changes in interest rates. One source of interest rate risk is the inherent difficulty in obtaining assets that mature or have their rate reset at the exact same time as the liabilities they support. Assets may have to be reinvested or sold in the future to meet the liability cash flows in unknown interest rate environments. Secondly, there may be timing differences between when new liabilities are priced and when assets are purchased or procured that can cause fluctuations in profitability if interest rates move materially in the interim. A third source of interest rate risk is the prepayment options embedded within asset and liability contracts that can alter the cash flow profiles from what was originally expected.

One of the measures we use to quantify our exposure to interest rate risk is duration. To calculate duration, we project asset and liability cash flows. These cash flows are discounted to a net present value basis using a spot yield curve, which is a blend of the spot yield curves for each of the asset types in the portfolio. Duration is calculated by re-calculating these cash flows, re-determining the net present value based upon an alternative level of interest rates, and determining the percentage change in fair value.

We manage interest rate risks in a number of ways. Differences in durations between assets and liabilities are measured and kept within acceptable tolerances. Derivatives are also commonly used to mitigate interest rate risk due to cash flow mismatches and timing differences. Prepayment risk is controlled by limiting our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer. We also require additional yield on these investments to compensate for the risk the issuer will exercise such option. Prepayment risk is also controlled by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times. For example, as of June 30, 2012, approximately $10.1 billion, or 98%, of our institutional GICs and funding agreements cannot be redeemed by contractholders prior to maturity.

We are also exposed to interest rate risk based upon the discount rate assumption used for purposes of valuing our pension and other postretirement benefit obligations.

**Duration-Managed.** Our exposure to interest rate risk stems largely from our substantial holdings of guaranteed fixed rate liabilities in our Retirement and Investor Services segment. We actively manage the duration of assets and liabilities in these products by minimizing the difference between the two.

As of June 30, 2012, the difference between the asset and liability durations on our primary duration-managed portfolio was -0.08, as compared to -0.35 as of December 31, 2011. This duration gap indicates that, as of June 30, 2012, the sensitivity of the fair value of our assets to interest rate movements is less than that of the fair value of our liabilities. Our goal is to minimize the duration gap. Currently, our guidelines indicate that total duration gaps between the asset and liability portfolios should be within +/-0.25. The value of the assets in this portfolio was $26,060.1 million and $26,811.6 million as of June 30, 2012 and December 31, 2011, respectively.

**Duration-Monitored.** For products such as whole life insurance and term life insurance that are less sensitive to interest rate risk, and for other products such as individual fixed deferred annuities, we manage interest rate risk based on a modeling process that considers the target average life, maturities, crediting rates and assumptions of policyholder behavior. As of June 30, 2012, the estimated weighted-average difference between the asset and liability durations on these portfolios was -3.54, as compared to -3.03 as of December 31, 2011. This duration gap indicates that, as of June 30, 2012, the sensitivity of the fair value of our assets to interest rate movements is less than that of the fair value of our liabilities. We attempt to monitor this duration gap consistent with our overall risk/reward tolerances. The value of the assets in these portfolios was $26,139.1 million and $25,650.8 million as of June 30, 2012 and December 31, 2011, respectively.

**Non Duration-Managed.** We also have a block of participating general account pension business that passes most of the actual investment performance of the assets to the customer. The investment strategy of this block is to maximize investment return to the customer on a best efforts basis, and there is little or no attempt to manage the duration of this portfolio since there is little or no interest rate risk. The value of the assets in these portfolios was $5,294.4 million and $5,400.0 million as of June 30, 2012 and December 31, 2011, respectively.

Using the assumptions and data in effect as of June 30, 2012, we estimate that a 100 basis point immediate, parallel increase in interest rates increases the net fair value of our portfolio by approximately $946.5 million, compared with an estimated $871.9 million increase as of December 31, 2011. The following table details the estimated changes by risk management strategy. The table also gives the weighted-average duration of the asset portfolio for each category, and the net duration gap (i.e., the weighted-average difference between the asset and liability durations).

| | June 30, 2012 | | | |
|---|---|---|---|---|
| **Risk Management Strategy** | **Value of total assets (in millions)** | **Duration of assets** | **Net duration gap** | **Net fair value change (in millions)** |
| Primary duration-managed | **$ 26,060.1** | **3.76** | **(0.08)** | **$ 20.8** |
| Duration-monitored | **26,139.1** | **4.31** | **(3.54)** | **925.7** |
| Non duration-managed | **5,294.4** | **3.78** | **N/A** | **N/A** |
| Total | **$ 57,493.6** | | | **$ 946.5** |

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value

measurements provide a representation of interest rate sensitivity, they are based on our portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing portfolio transactions in response to new business, management s assessment of changing market conditions and available investment opportunities.

**Debt Issued and Outstanding.** The primary risk for our long-term borrowings is interest rate risk at the time of maturity or early redemption, when we may be required to refinance these obligations. We continue to monitor the interest rate environment and to evaluate refinancing opportunities as maturity dates approach.

The aggregate fair value of long-term debt, excluding accrued interest, was $1,819.3 million and $1,750.7 million, as of June 30, 2012 and December 31, 2011, respectively. As of June 30, 2012, we estimate that a 100 basis point immediate, parallel decrease in interest rates would increase the fair value of debt by approximately $122.9 million, as compared to an estimated $129.1 million increase as of December 31, 2011. As of June 30, 2012, we estimate that a 100 basis point immediate, parallel increase in interest rates would decrease the fair value of debt by approximately $133.4 million, as compared to an estimated $118.1 million decrease as of December 31, 2011. Debt is not recorded at fair value on the consolidated statements of financial position.

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase or decrease does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our long-term debt obligations at a point in time and may not be representative of future obligations. These exposures will change as a result of ongoing changes to our outstanding long-term debt obligations.

**Use of Derivatives to Manage Interest Rate Risk.** We use or have previously used various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, interest rate collars, swaptions and futures. We use interest rate swaps and futures contracts to hedge changes in interest rates subsequent to the issuance of an insurance liability, such as a guaranteed investment contract, but prior to the purchase of a supporting asset, or during periods of holding assets in anticipation of near term liability sales. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities. They can be used to change the sensitivity to the interest rate of specific assets and liabilities as well as an entire portfolio. We use interest rate collars to manage interest rate risk related to guaranteed minimum interest rate liabilities in our individual annuities contracts. We purchase swaptions to offset existing exposures. Occasionally, we have sold a callable investment-type agreement and used written interest rate swaptions to transform the callable liability into a fixed term liability.

Derivatives in our portfolio with interest rate sensitivity were in a net liability position with a fair value of $322.7 million and $424.6 million as of June 30, 2012 and December 31, 2011, respectively. The following table shows the interest rate sensitivity of our derivatives measured in terms of fair value. These exposures will change as a result of ongoing portfolio and risk management activities.

| | June 30, 2012 | | | | |
|---|---|---|---|---|---|
| | | | Fair value (no accrued interest) | | |
| | Notional amount | Weighted average term (years) (1) | -100 basis point change | No change | +100 basis point change |
| | | | ($ in millions) | | |
| Interest rate swaps | $ 18,674.8 | 5.33 | $ (341.1) | $ (367.7) | $ (390.5) |
| Interest rate collars | 500.0 | 10.65 | 94.5 | 44.2 | 23.2 |

| | | | | | |
|---|---|---|---|---|---|
| Swaptions | **325.0** | **3.22** | **0.2** | **1.3** | **4.1** |
| Futures | **66.5** | **0.23** | **(5.8)** | **(0.5)** | **4.8** |
| Total | **$ 19,566.3** | | **$ (252.2)** | **$ (322.7)** | **$ (358.4)** |

(1) Based on maturity date.

Our selection of a 100 basis point immediate, parallel increase or decrease in interest rates is a hypothetical rate scenario we use to determine potential risk. While a 100 basis point immediate, parallel increase or decrease does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our derivative portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing derivative transactions.

**Foreign Currency Risk**

Foreign currency risk is the risk that we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements issued to nonqualified institutional investors in the international market, foreign currency-denominated fixed maturities and our international operations.

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We estimate that as of June 30, 2012, a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we are exposed would result in no material change to the net fair value of our foreign currency denominated instruments identified above because we effectively hedge foreign currency denominated instruments to minimize exchange rate impacts, which is consistent with our estimate as of December 31, 2011. However, fluctuations in foreign currency exchange rates do affect the translation of operating earnings and equity of our international operations into our consolidated financial statements.

For our Principal International segment, we estimate that a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we were exposed would have resulted in a $183.7 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of June 30, 2012, as compared to an estimated $167.8 million, or 10%, reduction as of December 31, 2011. We estimate that a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a $4.4 million, or 12%, reduction in the operating earnings of our international operations for the three months ended June 30, 2012, as compared to an estimated $4.0 million, or 11%, reduction for the three months ended June 30, 2011. In addition, we estimate that a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a $9.0 million, or 11%, reduction in the operating earnings of our international operations for the six months ended June 30, 2012, as compared to an estimated $7.4 million, or 11%, reduction for the six months ended June 30, 2011.

The selection of a 10% immediate unfavorable change in all currency exchange rates should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. These exposures will change as a result of a change in the size and mix of our foreign operations.

**Use of Derivatives to Manage Foreign Currency Risk.** The foreign currency risk on funding agreements and fixed maturities is mitigated by using currency swaps that swap the foreign currency interest and principal payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities was $2,311.3 million and $2,454.3 million as of June 30, 2012 and December 31, 2011, respectively. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturities was $1,232.2 million and $1,390.1 million as of June 30, 2012 and December 31, 2011, respectively.

With regard to our international operations, we attempt to do as much of our business as possible in the functional currency of the country of operation. At times, however, we are unable to do so, and in these cases, we use foreign exchange derivatives to economically hedge the resulting risks. Our operations in Chile had currency swaps with a notional amount of $80.8 million and $75.4 million as of June 30, 2012 and December 31, 2011, respectively, which were used to swap cash flows on U.S. dollar-denominated bonds to a local currency. Chile also utilized currency forwards with a notional amount of $193.6 million and $147.3 million as of June 30, 2012 and December 31, 2011, respectively, in order to mitigate currency exposure related to bonds denominated in currencies other than Chilean pesos.

Additionally, from time to time we take measures to hedge our net equity investments in our foreign subsidiaries from currency risks. There were no outstanding net equity investment hedges in 2012 or 2011.

**Equity Risk**

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in common stock prices. As of June 30, 2012 and December 31, 2011, the fair value of our equity securities was $363.3 million and $481.9 million, respectively. As of June 30, 2012, we estimate that a 10% decline in the value of the equity securities would result in an unrealized loss of $36.3 million, as compared to an estimated unrealized loss of $48.2 million as of December 31, 2011.

We are also exposed to the risk that asset-based fees decrease as a result of declines in assets under management due to changes in investment prices and the risk that asset management fees calculated by reference to performance could be lower. The risk of decreased asset-based and asset management fees could also impact our estimates of total gross profits used as a basis for amortizing deferred policy acquisition costs and other actuarial balances. We estimate that an immediate 10% decline in the S&P index, followed by a 2% per quarter increase would reduce our annual operating earnings by approximately four to six percent.

The selection of a 10% unfavorable change in the equity markets should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. Our exposure will change as a result of changes in our mix of business.

We also have equity risk associated with (1) fixed deferred annuity contracts that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a GMWB rider that allows the customer to receive at least the principal deposit back through withdrawals of a specified annual amount, even if the account value is reduced to zero; (3) variable annuity

contracts that have a guaranteed minimum death benefit ( GMDB ) that allows the death benefit to be paid, even if the account value has fallen below the GMDB amount; (4) investment-type contracts in which the return is tied to an external equity index and (5) investment-type contracts in which the return is subject to minimum contractual guarantees. We are also subject to equity risk based upon the assets that support our benefit plans.

**Use of Derivatives to Manage Equity Risk.** We economically hedge the fixed deferred annuity product, where the interest credited is linked to an external equity index, by purchasing options that match the product s profile. We economically hedge the GMWB exposure, which includes interest rate risk and equity risk, using futures, options and interest rate swaps. We economically hedge the investment contract exposure to an external equity index using equity call options.

The fair value of both the GMWB embedded derivative and associated hedging instruments are sensitive to financial market conditions and the variance related to the change in fair value of these items for a given period is largely dependent on market conditions at the end of the period. We recognized a pre-tax gain (loss) on the derivatives used to economically hedge our GMWB market risk of $96.5 million and $19.5 million for the three months ended June 30, 2012 and 2011, respectively and $(16.5) million and $(12.7) million for the six months ended June 30, 2012 and 2011, respectively. We recognized a pre-tax gain (loss) on the change in fair value of the GMWB embedded derivative that is primarily related to market risk impacts (excluding spread reflecting our own creditworthiness) of $(116.4) million and $(25.2) million for the three months ended June 30, 2012 and 2011, respectively and $21.7 million and $(2.3) million for the six months ended June 30, 2012 and 2011, respectively. Additionally, we recognized a pre-tax gain on the change in value of the GMWB liability related to other factors of $72.8 million and $35.0 million for the three months ended June 30, 2012 and 2011, respectively and $4.2 million and $8.1 million for the six months ended June 30, 2012 and 2011, respectively, primarily related to incorporating a spread reflecting our own creditworthiness. We reflect the actual and expected changes in value of the GMWB embedded derivative and the associated hedging instruments in our estimated gross profits, which resulted in a pre-tax increase (decrease) in DPAC amortization of $25.3 million and $13.7 million for the three months ended June 30, 2012 and 2011, respectively, and $(0.5) million and $(1.0) million for the six months ended June 30, 2012 and 2011, respectively.

**Credit Risk**

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. Our ability to manage credit risk is essential to our business and our profitability. See Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations Investments for additional information about credit risk.

**Use of Derivatives to Diversify or Hedge Credit Risk.** We purchase credit default swaps to hedge credit exposures in our investment portfolio and total return swaps to hedge our investment portfolio from credit losses. We sell credit default swaps to offer credit protection to investors. When selling credit protection, if there is an event of default by the referenced name, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security. For further information on credit derivatives sold, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Derivative Financial Instruments under the caption, Credit Derivatives Sold.

We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of $380.8 million and $607.0 million and total return swaps of $100.0 million and $15.0 million as of June 30, 2012 and December 31, 2011, respectively. We had credit exposure through credit default swaps with a notional amount of $140.0 million and $147.4 million as of June 30, 2012 and December 31, 2011, respectively, by investing in various tranches of synthetic collateralized debt obligations. In addition, we sold credit default swaps creating replicated assets with a notional amount of $849.7 million and $775.9 million as of June 30, 2012 and December 31, 2011, respectively.

**Derivative Counterparty Risk**

In conjunction with our use of derivatives, we are exposed to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- obtaining approval of all new counterparties by the Investment Committee;
- establishing exposure limits that take into account non-derivative exposure we have with the counterparty as well as derivative exposure;
- performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;
- diversifying our risk across numerous approved counterparties;
- implementing credit support annex (collateral) agreements ( CSAs ) with a majority of our counterparties to further limit counterparty exposures, which provide for netting of exposures;
- limiting exposure to A credit or better for counterparties without CSAs;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction and
- daily monitoring of counterparty credit ratings, exposures and associated collateral levels.

We believe the risk of incurring losses due to nonperformance by our counterparties is manageable. For further information on derivatives, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Derivative Financial Instruments.

Based on our accounting policy, our disclosed exposure measures the fair value of derivatives that have become favorable to us and, therefore, is a combined credit exposure if all of the involved counterparties failed to fulfill their obligations. In the hypothetical scenario where all of our counterparties fail to fulfill their obligations, our exposure would be $1,190.2 million; however, including collateral received our exposure would be reduced to $902.8 million at June 30, 2012. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Derivative Financial Instruments under the caption, Exposure.

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. Netting positive and negative exposures would yield an exposure of $282.9 million, which is reduced to zero with pledged collateral at June 30, 2012. As of June 30, 2012, we held total collateral of $287.4 million in the form of cash and securities and we posted $435.2 million in cash and securities as collateral to our counterparties. We have not incurred any material losses on derivative financial instruments due to counterparty nonperformance. As a result of our management of our counterparty risk and the collateralization of our derivative portfolio, any deterioration in our derivative counterparties credit would not materially impact our financial statements as of June 30, 2012.

## Item 4. Controls and Procedures

### Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Disclosure Controls and Procedures**

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer, Larry D. Zimpleman, and our Chief Financial Officer, Terrance J. Lillis, have reviewed and evaluated our disclosure controls and procedures as of June 30, 2012, and have concluded that our disclosure controls and procedures are effective.

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

Disclosure concerning material legal proceedings can be found in Part I, Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Contingencies, Guarantees and Indemnifications under the caption, Litigation and Regulatory Contingencies and Part I, Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 5, Income Taxes, which are incorporated here by this reference.

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**Item 1A. Risk Factors**

In addition to the other information set forth in this report, consideration should be given to the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2011. If any of those factors were to occur, they could materially adversely affect our business, financial condition or future results, and could cause actual results to differ materially from those expressed in forward-looking statements in this report. There have been no material changes with respect to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2011.

**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

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

**Issuer Purchases of Equity Securities**

| Period | Total number of shares purchased (1) | Average price paid per share | Total number of shares purchased as part of publicly announced programs | Maximum dollar value of shares that may yet be purchased under the programs (in millions) (2) |
|---|---|---|---|---|
| January 1, 2012 January 31, 2012 | 675 | $ 26.21 | | $ |
| February 1, 2012 February 29, 2012 | 285,323 | 27.84 | | 100.0 |
| March 1, 2012 March 31, 2012 | 2,048,998 | 27.43 | 1,823,735 | 50.0 |
| April 1, 2012 April 30, 2012 | 1,053,173 | 28.41 | 1,043,764 | 20.4 |
| May 1, 2012 May 31, 2012 | 1,313,839 | 25.69 | 1,302,493 | 186.9 |
| June 1, 2012 June 30, 2012 | 3,081,269 | 24.46 | 3,080,200 | 111.5 |
| Total | 7,783,277 | | 7,250,192 | |

(1) Includes the number of shares of common stock utilized to execute certain stock incentive awards and shares purchased as part of publicly announced programs.

(2) In February 2012, our Board of Directors authorized a repurchase program of up to $100.0 million of our outstanding common stock. This program was completed in May 2012. Our Board of Directors authorized a repurchase program in May 2012 of up to $200.0 million of our outstanding common stock.

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**Item 6. Exhibits**

| Exhibit Number | Description |
| --- | --- |
| 12 | Statement Regarding Computation of Ratio of Earnings to Fixed Charges |
| 31.1 | Certification of Larry D. Zimpleman |
| 31.2 | Certification of Terrance J. Lillis |
| 32.1 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman |
| 32.2 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis |
| 101 | The following materials from Principal Financial Group, Inc. s Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Consolidated Financial Statements. |

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## SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

| | | |
|---|---|---|
| | PRINCIPAL FINANCIAL GROUP, INC. | |
| Dated: August 1, 2012 | By | /s/ Terrance J. Lillis<br>Terrance J. Lillis<br>Senior Vice President and Chief Financial Officer<br><br>Duly Authorized Officer, Principal Financial Officer, and Chief Accounting Officer |

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**Exhibit Index**

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