RABBITT LINDA D
Form 4
January 04, 2006

FORM 4

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

OMB APPROVAL

OMB Number:	3235-0287
Expires:	January 31, 2005
Estimated average burden hours per response...	0.5

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STATEMENT OF CHANGES IN BENEFICIAL OWNERSHIP OF SECURITIES

Filed pursuant to Section 16(a) of the Securities Exchange Act of 1934, Section 17(a) of the Public Utility Holding Company Act of 1935 or Section 30(h) of the Investment Company Act of 1940

(Print or Type Responses)

1. Name and Address of Reporting Person *
RABBITT LINDA D

(Last) (First) (Middle)

901 N GLEBE ROAD

(Street)

ARLINGTON, VA 22203

(City) (State) (Zip)

2. Issuer Name **and** Ticker or Trading Symbol
Watson Wyatt Worldwide, Inc. [WW]

3. Date of Earliest Transaction (Month/Day/Year)
12/30/2005

4. If Amendment, Date Original Filed(Month/Day/Year)

5. Relationship of Reporting Person(s) to Issuer

(Check all applicable)

__X__ Director _____ 10% Owner
_____ Officer (give title below) _____ Other (specify below)

6. Individual or Joint/Group Filing(Check Applicable Line)
_X_ Form filed by One Reporting Person
___ Form filed by More than One Reporting Person

Table I - Non-Derivative Securities Acquired, Disposed of, or Beneficially Owned

1.Title of Security (Instr. 3)	2. Transaction Date (Month/Day/Year)	2A. Deemed Execution Date, if any (Month/Day/Year)	3. Transaction Code (Instr. 8)		4. Securities Acquired (A) or Disposed of (D) (Instr. 3, 4 and 5)			5. Amount of Securities Beneficially Owned Following Reported Transaction(s) (Instr. 3 and 4)	6. Ownership Form: Direct (D) or Indirect (I) (Instr. 4)	7. Nature of Indirect Beneficial Ownership (Instr. 4)
			Code	V	Amount	(A) or (D)	Price			
Class A Common Stock	12/30/2005		A		307	A	$ 0	6,810	D	

Reminder: Report on a separate line for each class of securities beneficially owned directly or indirectly.

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SEC 1474 (9-02)

Table II - Derivative Securities Acquired, Disposed of, or Beneficially Owned
(*e.g.*, puts, calls, warrants, options, convertible securities)

1. Title of Derivative Security (Instr. 3)	2. Conversion or Exercise Price of Derivative Security	3. Transaction Date (Month/Day/Year)	3A. Deemed Execution Date, if any (Month/Day/Year)	4. Transaction Code (Instr. 8)		5. Number of Derivative Securities Acquired (A) or Disposed of (D) (Instr. 3, 4, and 5)		6. Date Exercisable and Expiration Date (Month/Day/Year)		7. Title and Amount of Underlying Securities (Instr. 3 and 4)		8. Price of Derivative Security (Instr. 5)	9. Nu Deriv Secur Bene Owne Follo Repo Trans (Instr
				Code	V	(A)	(D)	Date Exercisable	Expiration Date	Title	Amount or Number of Shares		

Reporting Owners

Reporting Owner Name / Address	Relationships			
	Director	10% Owner	Officer	Other
RABBITT LINDA D 901 N GLEBE ROAD ARLINGTON, VA 22203	X			

Signatures

/s/Cindy Boyle, attorney-in-fact	01/04/2006
**Signature of Reporting Person	Date

Explanation of Responses:

* If the form is filed by more than one reporting person, *see* Instruction 4(b)(v).

** Intentional misstatements or omissions of facts constitute Federal Criminal Violations. *See* 18 U.S.C. 1001 and 15 U.S.C. 78ff(a).

Note: File three copies of this Form, one of which must be manually signed. If space is insufficient, *see* Instruction 6 for procedure.
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1,314.6

1,401.7

1,343.1

Greater than six to nine months

6.1

14.5

279.3

415.5

285.4

430.0

Greater than nine to twelve months

11.5

10.3

486.8

904.1

498.3

914.4

Greater than twelve months

Explanation of Responses:

		3.5
		6.5
		111.3
		435.2
		114.8
		441.7
Total fixed maturity securities, available-for-sale		
	$	102.3
	$	130.0
	$	8,685.1
	$	6,203.0
	$	8,787.4

$

6,333.0

Mortgage Loans

Mortgage loans consist primarily of commercial mortgage loans on real estate. The carrying amount of our commercial mortgage loan portfolio was $10,643.1 million and $11,279.3 million as of June 30, 2009 and December 31, 2008, respectively. Commercial mortgage loans on real estate are generally reported at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances. Commercial mortgage loans held for sale are carried at the lower of cost or fair value, less cost to sell, and reported as mortgage loans in the statements of financial position.

Commercial mortgage loans play an important role in our investment strategy by:

- providing strong risk-adjusted relative value in comparison to other investment alternatives;

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- 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 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 of primarily non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of credit oriented retail properties, manufacturing office properties and general-purpose industrial properties. In addition, we have a $230.5 million and $261.3 million short-term high rate portfolio of mortgages held within the Global Asset Management segment as of June 30, 2009 and December 31, 2008, respectively.

The following commercial mortgage portfolio is diversified by geographic region and specific collateral property for the periods indicated:

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	June 30, 2009		December 31, 2008	
	Carrying amount	Percent of total	Carrying amount	Percent of total
	($ in millions)			
Geographic distribution				
New England	$ **451.7**	**4.2** %	$ 459.4	4.1 %
Middle Atlantic	**1,734.3**	**16.3**	1,794.8	15.9
East North Central	**968.3**	**9.1**	974.9	8.6
West North Central	**538.7**	**5.1**	550.0	4.9
South Atlantic	**2,713.3**	**25.5**	2,849.9	25.2
East South Central	**317.4**	**3.0**	323.2	2.9
West South Central	**751.0**	**7.1**	775.9	6.9
Mountain	**876.2**	**8.2**	900.3	8.0
Pacific	**2,389.1**	**22.4**	2,707.9	24.0
Valuation allowance	**(96.9)**	**(0.9)**	(57.0)	(0.5)
Total	$ **10,643.1**	**100.0** %	$ 11,279.3	100.0 %
Property type distribution				
Office	$ **2,806.1**	**26.4** %	$ 2,894.7	25.7 %
Retail	**2,877.2**	**27.0**	3,004.5	26.7
Industrial	**2,583.0**	**24.3**	2,688.1	23.8
Apartments	**1,558.0**	**14.6**	1,832.6	16.2
Hotel	**499.5**	**4.7**	507.0	4.5
Mixed use/other	**416.2**	**3.9**	409.4	3.6
Valuation allowance	**(96.9)**	**(0.9)**	(57.0)	(0.5)
Total	$ **10,643.1**	**100.0** %	$ 11,279.3	100.0 %

Credit extensions in the state of California accounted for 19% and 20% of our commercial mortgage loan portfolio as of June 30, 2009 and December 31, 2008, 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.

Our commercial loan portfolio is highly diversified by borrower. As of June 30, 2009 and December 31, 2008, 31% and 30%, respectively, of the commercial mortgage loan portfolio was comprised of mortgage loans with principal balances of less than $10.0 million. The total number of commercial mortgage loans outstanding was 1,169 and 1,223 as of June 30, 2009 and December 31, 2008, respectively. The average loan size of our commercial mortgage portfolio was $9.2 million as of June 30, 2009 and $9.3 million as of December 31, 2008.

Commercial Mortgage Loan Credit Monitoring. We actively monitor and manage our commercial mortgage loan portfolio. Substantially all loans within the portfolio are analyzed regularly and are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. Based on ongoing monitoring, mortgage loans with a likelihood of becoming delinquent are identified and placed on an internal watch list . Among criteria which 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.

We review our mortgage loan portfolio and analyze the need for a valuation allowance for any loan which is delinquent for 60 days or more, in process of foreclosure, restructured, on the watch list or which currently has a valuation allowance. We categorize loans that are 60 days or more delinquent, loans in process of foreclosure and loans to borrowers in bankruptcy that are delinquent as problem loans. Valuation allowances have been recognized on problem loans. Potential problem loans are loans placed on an internal watch list for which management has concerns as to the ability of the borrower to comply with the present loan payment terms and which may result in the loan becoming a problem or being restructured. The decision whether to

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classify a performing loan 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 or Pay Rate of the mortgages have been reduced as restructured loans. We also consider matured loans that are refinanced at below market rates as restructured.

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, 2009	December 31, 2008
	($ in millions)	
Total commercial mortgages	**$ 10,643.1**	$ 11,279.3
Problem commercial mortgages (1)	**$ 145.7**	$ 69.0
Potential problem commercial mortgages (2)	**268.2**	110.0
Restructured commercial mortgages (3)	**18.8**	5.5
Total problem, potential problem and restructured commercial mortgages	**$ 432.7**	$ 184.5
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	**4.07%**	1.64%

(1) Includes six mortgages held within the Global Asset Management segment as of June 30, 2009, and three mortgages held within the Global Asset Management segment as of December 31, 2008. Five of these loans totaling $48.6 million were in foreclosure as of June 30, 2009, and one mortgage loan totaling $26.0 million was in foreclosure as of December 31, 2008. In addition, the Corporate segment holds two mortgages in foreclosure as of June 30, 2009.

(2) Potential problem commercial mortgages include $36.5 million in mortgages held by the Global Asset Management segment at June 30, 2009, and $48.0 million at December 31, 2008.

(3) Includes three mortgages held within the Global Asset Management segment totaling $18.8 million at June 30, 2009, and one mortgage totaling $5.5 million at December 31, 2008.

Commercial Mortgage Loan Valuation Allowance The valuation allowance for commercial mortgage loans includes a loan specific allowance for impaired loans and a provision for losses based on past loss experience believed to be adequate to absorb estimated probable credit losses. The changes in the valuation allowance are reported in net income on our consolidated statements of operations.

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

When a valuation allowance is established, subsequent recoveries are credited to the valuation allowance and subsequent losses may be charged to the valuation allowance. The determination of the calculation and the adequacy of the mortgage loan loss provision based on past experience and current portfolio statistics are subjective. Our periodic evaluation and assessment of the adequacy of the provision for losses and the need for mortgage impairments is based on known and inherent risks in the portfolio, adverse situations that may affect the borrower s ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component of the allowance is subjective, as it requires estimating the amounts and timing of future cash flows expected to be received on impaired loans.

The current portfolio statistics and past loss experience produced a commercial mortgage loan general valuation allowance for the Principal Life general account totaling $27.2 million as of June 30, 2009. Our financial position is sensitive to changes in estimated cash flows from mortgages, the value of the collateral and changes in the economic environment in general. The valuation allowance for PFG increased by $39.9 million for the six months ended June 30, 2009, and increased by $14.2 million for the year ended December 31, 2008. These increases are primarily related to net specific reserves taken on certain problem loans of $42.7 million and $16.2 million for the six months ended June 30, 2009, and the year ended December 31, 2008, respectively. The net specific reserves include $33.8 million and $16.1 million related to mortgages held within the

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Global Asset Management segment for the six months ended June 30, 2009 and the year ended December 31, 2008, respectively.

The following table represents our commercial mortgage valuation allowance for the periods indicated:

	June 30, 2009	December 31, 2008
	($ in millions)	
Balance, beginning of period	**$ 57.0**	$ 42.8
Provision	**54.9**	42.9
Releases	**(15.0)**	(28.7)
Balance, end of period	**$ 96.9**	$ 57.0
Valuation allowance as % of carrying value before reserves	**.90%**	.50%

Real Estate

Real estate consists primarily of commercial equity real estate. As of June 30, 2009 and December 31, 2008, the carrying amount of equity real estate investment was $969.3 million, or 2%, and $915.2 million, or 1%, 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 $955.2 million and $779.8 million as of June 30, 2009 and December 31, 2008, 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, 2009 and for the year ended December 31, 2008, there were no such impairment adjustments.

The carrying amount of real estate held for sale as of June 30, 2009, was $14.1 million. There were no valuation allowances as of June 30, 2009. The carrying amount of real estate held for sale as of December 31, 2008, was $135.4 million, net of valuation allowance of $3.5 million. 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 and West South Central regions of the United States as of June 30, 2009. By property type, there is a concentration in office, industrial site buildings, and retail that represented approximately 77% of the equity real estate portfolio as of June 30, 2009.

Other Investments

Our other investments totaled $1,528.5 million as of June 30, 2009, compared to $2,162.4 million as of December 31, 2008. Derivatives assets accounted for $1,293.3 million in other investments as of June 30, 2009. The remaining invested assets include equity method investments, which include properties owned jointly with venture partners and operated by the partners.

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International Investment Operations

Of our invested assets, $4.0 billion were held by our International Asset Management and Accumulation segment as of June 30, 2009. Our international investment operations consist of the investments of Principal International. Principal Global Investors advises each Principal International affiliate on investment policies and strategies that are consistent with the products they offer. 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, 2009 and December 31, 2008, were fixed maturity securities, other investments and residential mortgage loans. The following table excludes invested assets of the separate accounts.

	June 30, 2009		December 31, 2008	
	Carrying amount	% of total	Carrying amount	% of total
		($ in millions)		
Fixed maturity securities Public	**$ 2,526.9**	**63%**	$ 2,134.2	64%
Equity securities	**41.0**	**1**	40.8	1
Mortgage loans Residential	**562.9**	**14**	479.9	14
Real estate	**5.3**		4.2	
Policy loans	**18.9**	**1**	15.0	1
Other investments	**862.2**	**21**	654.2	20
Total invested assets	**4,017.2**	**100%**	3,328.3	100%
Cash and cash equivalents	**33.9**		71.0	
Total invested assets and cash	**$ 4,051.1**		$ 3,399.3	

Investments in equity method subsidiaries and direct financing leases accounted for $462.4 million and $333.0 million, respectively, of other investments as of June 30, 2009. Investments in equity method subsidiaries and direct financing leases accounted for $377.2 million and $265.4 million, respectively, of other investments as of December 31, 2008. We are in the process of negotiating the terms of renewal for our joint venture in Brazil, which is reported as an equity method subsidiary. The remaining other investments as of June 30, 2009, and December 31, 2008, are primarily related to other short-term investments and derivative assets.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Explanation of Responses:

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 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

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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, approximately $16.6 billion, or 99%, 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 post-retirement benefit obligations.

Duration-Managed. Our exposure to interest rate risk stems largely from our substantial holdings of guaranteed fixed rate liabilities in our U.S. Asset Accumulation segment. We actively manage the duration of assets and liabilities in these products by minimizing the difference between the two. We have established a maximum tolerance for this difference and seek to stay within this tolerance.

As of June 30, 2009, the difference between the asset and liability durations on our primary duration-managed portfolio was +0.08, as compared to -0.17 as of December 31, 2008. This duration gap indicates that, as of June 30, 2009, the sensitivity of the fair value of our assets to interest rate movements is greater than that of the fair value of our liabilities. Our goal is to minimize the duration gap. Currently, our guidelines indicate that total duration gap between the asset and liability portfolios should be within +/-0.25. The value of the assets in this portfolio was $28,116.8 million and $29,440.1 million as of June 30, 2009 and December 31, 2008, 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 single premium 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, 2009, the weighted-average difference between the asset and liability durations on these portfolios was +0.08, as compared to +0.09 as of December 31, 2008. This duration gap indicates that, as of June 30, 2009, the sensitivity of the fair value of our assets to interest rate movements is greater 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 $20,621.2 million and $18,017.3 million as of June 30, 2009 and December 31, 2008, 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 $4,485.0 million and $4,866.0 million as of June 30, 2009 and December 31, 2008, respectively.

Using the assumptions and data in effect as of June 30, 2009, we estimate that a 100 basis point immediate, parallel increase in interest rates decreases the net fair value of our portfolio by approximately $38.0 million, compared with an estimated $34.0 million increase as of December 31, 2008. 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).

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Risk Management Strategy	Value of total assets (in millions)	Duration of assets	Net duration gap	Net fair value change (in millions)
	June 30, 2009			
Primary duration-managed	$ 28,116.8	3.34	0.08	$ (21.9)
Duration-monitored	20,621.2	4.21	0.08	(16.1)
Non duration-managed	4,485.0	5.04	N/A	N/A
Total	$ 53,223.0			$ (38.0)

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 aggregate fair value of long-term debt was $1,914.3 million and $1,096.1 million, as of June 30, 2009 and December 31, 2008, respectively. As of June 30, 2009, a 100 basis point immediate, parallel decrease in interest rates would increase the fair value of debt by approximately $115.7 million, as compared to an estimated $59.4 million increase as of December 31, 2008. Debt is not recorded at fair value on the statement of financial position.

Using the assumptions and data in effect as of June 30, 2009, we estimate that a 100 basis point immediate, parallel decrease or increase in interest rates would increase or decrease, respectively, the fair value for each category of long-term debt as presented in the following table.

	June 30, 2009 Fair value (no accrued interest)		
	-100 basis point change	No change (in millions)	+100 basis point change
8.2% notes payable, due 2009	$ 444.2	$ 442.7	$ 440.9
3.31% notes payable, due 2011	62.9	61.5	60.1
3.63% notes payable, due 2011	32.5	31.7	30.9
7.875% notes payable, due 2014	439.2	421.6	404.8
8.875% notes payable, due 2019	393.2	367.4	343.8
6.05% notes payable, due 2036	524.6	465.5	416.4
8% surplus notes payable, due 2044	82.2	74.9	68.7
Non-recourse mortgages and notes payable	50.6	48.4	49.2
Other mortgages and notes payable	0.6	0.6	0.6
Total long-term debt	$ 2,030.0	$ 1,914.3	$ 1,815.4

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 various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, swaptions, futures, treasury lock agreements and options. 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

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liabilities as well as an entire portfolio. Occasionally, we will sell a callable investment-type agreement and will use written interest rate swaptions to transform the callable liability into a fixed term liability.

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, 2009				
			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	$ 23,651.7	5.56	$ (159.9)	$ (138.7)	$ (129.4)
Futures	51.1	0.23	(3.8)	(0.7)	2.3
Total	$ 23,702.8		$ (163.7)	$ (139.4)	$ (127.1)

(1) Based on maturity date.

We use U.S. Treasury futures to manage our over/under commitment position, and our position in these contracts changes daily.

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 maturity securities and demand deposits purchased and our international operations.

We estimate that as of June 30, 2009, 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 June 30, 2008. However, fluctuations in foreign currency exchange rates do affect the translation of local operating earnings and equity into our consolidated financial statements.

For our International Asset Management and Accumulation 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 $119.3 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of June 30, 2009, as compared to an estimated $100.3 million, or 10%, reduction as of December 31, 2008. 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 $3.2 million, or 11%, reduction in the quarterly operating earnings of our international operations for the three months ended June 30, 2009, as compared to an estimated $2.1 million, or 7%, reduction for the three months ended June 30, 2008. In addition, 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 $5.2 million, or 11%, reduction in the operating earnings of our international operations for the six months ended June 30, 2009, as compared to an estimated $6.0 million, or 9%, reduction for the six months ended June 30, 2008.

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 maturity securities 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 $3,428.0 million and $4,269.2 million as of June 30, 2009 and December 31, 2008, respectively. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturity securities was $2,004.2 million and $2,005.4 million as of June 30, 2009 and December 31, 2008, respectively.

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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 $24.1 million as of both June 30, 2009 and December 31, 2008, 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 $60.9 million and $52.1 million as of June 30, 2009 and December 31, 2008, 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 2009 or 2008.

Equity Risk

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in a particular common stock. As of June 30, 2009 and December 31, 2008, the fair value of our equity securities was $382.9 million and $400.7 million, respectively. As of June 30, 2009, a 10% decline in the value of the equity securities would result in an unrealized loss of $38.3 million, as compared to an estimated unrealized loss of $40.1 million as of December 31, 2008.

We are also exposed to the risk that asset-based fees decrease as a result of declines in assets under management due to change in investment prices and the risk that asset management fees calculated by reference to performance could be lower. We estimate that an immediate 10% decline in the Standard & Poor s index, followed by a 2% per quarter increase would reduce our annual operating earnings by approximately four to six percent. 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 and other costs.

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 contacts 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 by purchasing options that match the product s profile. We economically hedge the GMWB exposure 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 change in fair value of the GMWB embedded derivative of $(9.3) million and $(3.5) million for the three months ended June 30, 2009 and 2008, respectively, and $10.2 million and $2.1 million for the six months ended June 30, 2009 and 2008, respectively. We recognized a pre-tax gain (loss) on the derivatives used to economically hedge our GMWB market risk, which includes equity risk, of $(112.1) million and $(12.1) million for the three months ended June 30, 2009 and 2008, respectively, and $(128.9) million and $4.8 million for the six months ended June 30, 2009 and 2008, respectively. The implementation of SFAS 157 in 2008 resulted in the incorporation of a spread reflecting our own creditworthiness and additional risk margins in the valuation of the GMWB embedded derivative. Throughout the latter part of 2008 and continuing into the first quarter of 2009, the spread reflecting our own credit risk increased, which drove a significant increase in the discount rates applied, thereby reducing the fair value of the embedded derivative liability. During the second quarter of 2009, the spread reflecting our own credit risk decreased, thereby increasing the fair value of the embedded derivative liability to somewhat offset the decrease in fair value of the embedded derivative liability that occurred in late 2008 and the first quarter of 2009. In 2009, this resulted in the income statement impact from the changes in fair value of the embedded derivative being different than the income statement impact from the changes in fair value of the

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associated hedging instruments. Additionally, reflecting the actual and expected changes in value of the GMWB embedded derivative and the associated hedging instruments in our gross profits resulted in a $74.6 million and $35.9 million pre-tax decrease in DPAC amortization for the three and six months ended June 30, 2009, respectively. For the three and six months ended June 30, 2008, the impact on DPAC amortization was not material.

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 sometimes purchase credit default swaps to hedge credit exposures in our investment portfolio. 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 3, Derivative Financial Instruments.

We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of $492.3 million and $549.0 million as of June 30, 2009 and December 31, 2008, respectively. We had credit exposure through credit default swaps with a notional amount of $200.0 million as of both June 30, 2009 and December 31, 2008, by investing $200.0 million in various tranches of synthetic collateralized debt obligations. In addition, we sold credit default swaps creating replicated assets with a notional amount of $1,164.9 million and $1,199.9 million as of June 30, 2009 and December 31, 2008, 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 which 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;
- limiting exposure to A+ credit or better;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;
- implementing credit support annex (collateral) agreements with selected counterparties to further limit counterparty exposures, which provide for netting of exposures, and
- daily monitoring of counterparty credit ratings, exposure 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 3, Derivative Financial Instruments.

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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 $1,399.2 million; however, including collateral received our exposure would be reduced to $1,086.9 million. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, 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 $416.6 million, which is reduced to $104.3 million with pledged collateral at June 30, 2009. As of June 30, 2009, we held total collateral of $312.3 million in the form of cash and securities and we posted $236.9 million in cash and securities as collateral to our counterparties. We have not incurred any losses on derivative financial instruments due to counterparty nonperformance. As of June 30, 2009, any deterioration in our derivative counterparties credit would not materially impact our financial statements.

Effects of Inflation

The impact of inflation in the United States or in the other countries in which we operate, has not had a material effect on our annual consolidated operations over the past three years. However, we may be materially affected by inflation in the future.

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, 2009, and have concluded that our disclosure controls and procedures are effective.

PART II OTHER INFORMATION

Explanation of Responses:

Explanation of Responses:

Item 1. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 7, Contingencies, Guarantees and Indemnifications under the caption, Litigation and Regulatory Contingencies, which is incorporated here by this reference.

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, 2008. 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. We are not aware

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of any material changes to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

Explanation of Responses:

Period	Total number of shares (or units) purchased(1)		Average price paid per share (or unit)	Total number of shares (or units) purchased as part of publicly announced plans or programs		Maximum number (or approximate dollar value) of shares (or units) that may yet be purchased under the plans or programs (in millions) (2)
January 1, 2009 January 31, 2009	**1,697**	**$**	**22.13**		**$**	**250.0**
February 1, 2009 February 28, 2009	**136,948**	**$**	**16.83**		**$**	**250.0**
March 1, 2009 March 31, 2009	**67,054**	**$**	**9.56**		**$**	**250.0**
April 1, 2009 April 30, 2009	**20,532**	**$**	**8.63**		**$**	**250.0**
May 1, 2009 May 31, 2009	**851**	**$**	**18.86**		**$**	**250.0**
June 1, 2009 June 30, 2009	**27,189**	**$**	**18.94**		**$**	**250.0**
Total	**254,271**					

(1) Reflects the number of shares of common stock utilized to execute certain stock incentive awards in 2009.

(2) During November 2007, our Board of Directors authorized a share repurchase program of up to $500.0 million of our outstanding common stock. As of June 30, 2009, $250.0 million remained under the November 2007 authorization. We suspended purchases of our common stock effective October 13, 2008, under the existing share repurchase program.

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

At our annual meeting of stockholders on May 19, 2009, the stockholders elected J. Barry Griswell as a Class III director for a term expiring at our 2010 annual meeting, and three Class II directors each for a term expiring at our 2012 annual meeting. The voting results were as follows:

Explanation of Responses:

	SHARES VOTED FOR	SHARES VOTED AGAINST	SHARES ABSTAINING
J. Barry Griswell	139,377,182	4,082,617	1,730,293
Richard L. Keyser	139,633,705	3,765,120	1,791,267
Arjun K. Mathrani	139,355,568	4,010,220	1,824,304
Elizabeth E. Tallett	127,468,255	15,936,855	1,784,982

The directors whose terms of office continued and the years their terms expire are as follows:

Explanation of Responses:

CLASS I DIRECTORS   TERM EXPIRES IN 2011

Explanation of Responses:

Betsy J. Bernard

Jocelyn Carter-Miller

Gary E. Costley

William T. Kerr

Explanation of Responses:

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CLASS III DIRECTORS   TERM EXPIRES IN 2010

Explanation of Responses:

Michael T. Dan

C. Daniel Gelatt

Sandra L. Helton

Larry D. Zimpleman

Explanation of Responses:

In addition, the stockholders approved an amendment to our employee stock purchase plan, increasing the number of shares of common stock available for issuance under the plan by 7,740,757 shares. The voting results on this item were as follows:

FOR	AGAINST	ABSTAIN
120,693,164	2,129,600	1,966,535

In the last agenda item, the stockholders ratified the appointment of Ernst & Young LLP as our independent auditors for 2009. The voting results were as follows:

Explanation of Responses:

FOR	AGAINST	ABSTAIN
142,440,358	1,177,010	1,572,724

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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, 2009, 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 Stockholders Equity, (iv) Consolidated Statements of Cash Flows and (v) Notes to Consolidated Financial Statements, tagged as blocks of text.

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Explanation of Responses:

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SIGNATURE

Explanation of Responses:

Explanation of Responses:

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 5, 2009	By	/s/ Terrance J. Lillis Terrance J. Lillis Senior Vice President and Chief Financial Officer Duly Authorized Officer, Principal Financial Officer, and Chief Accounting Officer

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Exhibit Index

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