

THE PRINCIPAL FINANCIAL
GROUP IS ASKING YOU
TO MAKE AN IMPORTANT
DECISION ABOUT OUR
ORGANIZATION'S FUTURE

THIS SPECIAL GUIDE ADDRESSES THE ISSUES OF PARTICULAR INTEREST TO EMPLOYEE BENEFIT PLAN CUSTOMERS AND PROVIDES AN OVERVIEW OF OUR PLAN TO CONVERT TO A STOCK COMPANY.

- A message from the Chairman and the President and Chief Executive Officer
- Frequently asked questions...and answers... about the demutualization and how it affects you as a policyholder
- Information on the cards in your package, and instructions on what to do with each of them

A MESSAGE FROM THE CHAIRMAN AND THE PRESIDENT AND CHIEF EXECUTIVE OFFICER A FUTURE OF STRENGTH AND STABILITY

Dear Policyholder:

We are sending you this letter because as a Principal Life Insurance Company (Principal Life) policyholder, you are also a member of Principal Mutual Holding Company, the parent company of Principal Life. As a member, you have certain membership interests in Principal Mutual Holding Company, including the right to vote on our proposed Plan of Conversion, which was adopted by our Board of Directors on March 31, 2001.

For more than 120 years, our customers have counted on us to deliver innovative solutions that help them meet their financial goals. Through our uncompromising focus on quality and customer service, the Principal Financial Group® (all the companies affiliated with Principal Mutual Holding Company) has become an industry leader, with some 13 million customers and \$113.0 billion in assets under management as of March 31, 2001. And Principal Life, our flagship company, continues to receive consistently high financial strength ratings.

From this position of strength, the Principal Mutual Holding Company Board of Directors has unanimously voted to adopt a plan for converting the company into a publicly held stock company, through a process called demutualization. This demutualization builds on a reorganization that began in 1998. At that time we adopted a mutual insurance holding company structure, with Principal Mutual Holding Company as the parent company, and Principal Life converted to a stock life insurance company.

We believe this demutualization will provide the Principal Financial Group with the capital structure needed to pursue growth through strategic acquisitions, to develop new products and services and to invest in technology. We further believe that pursuing these strategic opportunities will strengthen our leadership position, provide additional security for customers and truly be in the best interests of our policyholders.

If the Plan of Conversion is approved, all membership interests in Principal Mutual Holding Company will be extinguished and Eligible Policyholders will receive compensation in the form of stock, cash or policy credits. **The demutualization will not diminish your Principal Life policy or contract benefits, values, guarantees or dividend eligibility, nor will the demutualization increase your Principal Life policy or contract premiums or contributions. Owners of dividend paying policies will continue to be eligible for dividends as declared by the Board of Directors of Principal Life.** As always, dividends are not guaranteed and may vary from year to year.

The Board of Directors has determined that the Plan of Conversion is fair and equitable to policyholders and the demutualization is in the best interests of both our policyholders and the company. On behalf of the Board, we strongly urge you to vote in favor of the Plan of Conversion.

If you have any questions, or need help with any of the materials contained in this package, please call us toll free at 1-866-781-1368 between the hours of 7 a.m. and 7 p.m., Central Daylight Time or visit our website at www.principal.com. We look forward to your continued support.

Sincerely,



David J. Drury
Chairman



J. Barry Griswell
President and Chief Executive Officer

POLICYHOLDER

QUESTIONS AND ANSWERS

Here are answers to the most frequently asked questions about our proposed demutualization. **Additional information can be found in the Policyholder Information Booklet Parts One and Two, included in this mailing and on our website at www.principal.com.**

1. | What is demutualization?

Demutualization is the process of converting from a mutual insurance company (or in our case, a mutual insurance holding company) into a stock company pursuant to a detailed, written Plan of Conversion (the “Plan”). As a member of Principal Mutual Holding Company, you have certain membership interests, including the right to vote on certain matters and the right to participate in the distribution of any residual value in the unlikely event of a liquidation of Principal Mutual Holding Company. As part of the demutualization, Eligible Policyholders exchange their membership interests for compensation, and all membership interests are terminated. The compensation will be in the form of stock, cash or policy/contract enhancements (“Policy Credits”). As part of the demutualization process, Principal Financial Group, Inc., the new parent company of Principal Life Insurance Company (“Principal Life”), will sell stock to the public in an initial public offering (“IPO”).

2. | Why is Principal Mutual Holding Company planning to convert into a stock company?

Demutualization will help us leverage our strength and leadership in a rapidly changing financial services industry. Demutualization provides us with the capital structure needed to pursue growth through strategic acquisitions, to develop new products and services and to invest in technology. We believe that pursuing these strategic opportunities will strengthen our leadership position, provide additional security for customers and be in the best interests of our policyholders. Please see the section entitled “The Demutualization – Reasons for Demutualization” in the Policyholder Information Booklet Part One, for a more detailed discussion of why Principal Mutual Holding Company is planning to convert into a stock company.

3. | How will the demutualization affect my insurance policy or annuity contract?

Your policy or contract will not be adversely affected by the demutualization and will remain in force according to its terms. The demutualization will not diminish the benefits, values, or guarantees under your Principal Life policy or contract. The demutualization will not increase premiums or contributions. Principal Life will continue to honor all contracts and guarantees made to policyholders. Owners of dividend paying policies will continue to be eligible for dividends as declared by the Board of Directors of Principal Life. As always, dividends are not guaranteed and will vary due to factors like investment and mortality experience.

4. | What will I receive if the Plan is approved?

If you are an Eligible Policyholder, you will receive compensation in the form of stock or cash in exchange for your membership interests in our mutual insurance holding company. Eligible Policyholders are policyholders with eligible Principal Life policies or contracts in force on March 31, 2000, one year prior to the adoption of the Plan by the Board of Directors of Principal Mutual Holding Company (the “Board”), AND who own an eligible policy or contract continuously from that date until the effective date of the demutualization. Eligible Policyholders who receive this Guide will receive Principal Financial Group, Inc. common stock or cash.

At this time, we do not know the exact amount of your compensation. Demutualization compensation will be based on an allocation of shares to each Eligible Policyholder. At a minimum, all Eligible Policyholders will receive 100 shares of Principal Financial Group, Inc. common stock (or the equivalent in cash), subject to adjustment as provided in the Plan. We have estimated the number of shares to be allocated to you on your Policyholder Record Card (Card 2). This is a preliminary **estimate** only and is subject to change. We will determine your **actual** number of allocated shares after the **effective date** of the demutualization, which will be the date the IPO closes. Please see “Compensation – Allocation of Shares” in the Policyholder Information Booklet Part One, for a more detailed discussion of how compensation is allocated to Eligible Policyholders.

5. | What membership interests will I be giving up?

The membership interests that will be given up upon demutualization consist primarily of the right to elect the Board and the right to participate in any distribution of surplus in the unlikely event of a liquidation of Principal Mutual Holding Company. In addition, under Iowa law, in the unlikely event of a Principal Life insolvency proceeding, the assets of the new stock holding company would not be available to pay policy claims, whereas, prior to demutualization, the assets of the mutual holding company are available for such purpose.

6. | Is there an approval process for demutualization?

The Plan must be approved by two-thirds of the policyholders who vote on adoption of the Plan. The Iowa Insurance Commissioner must also approve the Plan, which addresses the purpose of demutualization, eligibility rules, allocation of

POLICYHOLDER

QUESTIONS AND ANSWERS

policyholder compensation, voting, required approvals and other matters. A copy of the Plan, along with a summary of its exhibits, is included in the Policyholder Information Booklet Part One.

7. | Why should I vote?

Your vote is important because the demutualization is one of the most important events in our history. For the demutualization to become effective, approval by two-thirds of the policyholders who vote is needed. Policyholders eligible to vote are policyholders who owned an insurance policy or annuity contract that was issued by Principal Life and was in force on March 31, 2001, the date the Board adopted the Plan.

8. | Why should I vote "Yes"?

A "Yes" vote is important for two primary reasons. First, the demutualization will allow us to operate and compete more effectively and continue to meet the needs of our customers. Second, a "Yes" vote will help approve a Plan under which Eligible Policyholders will receive compensation in exchange for their membership interests in Principal Mutual Holding Company.

9. | How do I vote?

To vote, mark either the "Yes" or "No" box on your Ballot Card (Card 1), then sign, date and return it in the enclosed, postage-paid envelope by Tuesday, July 17, 2001. Please be sure that all policyholders sign and date the card. If you prefer, you may vote in person at the special meeting of members (the "Special Members' Meeting") at 9:00 a.m., Central Daylight Time, on Tuesday, July 24, 2001, at 711 High Street, Des Moines, Iowa. Please do not send your Ballot Card (or other Cards) to your Principal Life agent or representative.

10. | What are the risks of demutualization?

There are risks associated with ownership of common stock. Also, a public company incurs additional costs related to being a public company in order to operate its business. Please see "Summary – How will our demutualization benefit Principal Life and its policyholders?" and "The Demutualization – Differences between Mutual Insurance Holding Companies and Stock Companies" in the Policyholder Information Booklet Part One.

11. | What happens if the Plan is approved?

If the Plan is approved by at least two-thirds of the policyholders who vote and by the Iowa Insurance Commissioner, Principal Financial Group, Inc. would then need to close the IPO for the demutualization to become effective. All membership interests in Principal Mutual Holding Company would then be extinguished, and Eligible Policyholders would subsequently

receive compensation in exchange for their membership interests. Principal Financial Group, Inc. would be a publicly traded stock company and the new parent company of Principal Life..

12. | What happens if the Plan is not approved?

Should the Plan not become effective for any reason (including, for example, if at least two-thirds of the voting policyholders or the Iowa Insurance Commissioner do not approve the Plan), Principal Mutual Holding Company will remain a mutual insurance holding company, policyholders will retain their membership interests and no compensation will be paid to Eligible Policyholders.

13. | When will the Initial Public Offering (IPO) take place?

We currently expect the IPO will take place in the latter part of 2001 or first part of 2002. Actual timing could be delayed based on prevailing market conditions, but the Plan permits the IPO to occur within 12 months of approval of the Plan by the Iowa Insurance Commissioner, unless this period is extended by us with approval of the Commissioner. The demutualization will become effective upon the closing of the IPO.

14. | How soon after the IPO will I receive my compensation?

We will send you confirmation of your compensation as soon as reasonably practicable after closing of the IPO. If your compensation is in the form of Principal Financial Group, Inc. common stock or Policy Credits, you will receive written confirmation, and if your compensation is in the form of cash, you will receive a check. In any event, we will distribute compensation and send confirmation no later than 75 days after the effective date of the demutualization, unless the Iowa Insurance Commissioner approves a later date.

15. | Can I choose the type of compensation I want to receive?

Generally, yes. Your Policyholder Record Card (Card 2) shows the type of compensation you are eligible to receive. For estimated allocated shares eligible for a cash election, please refer to the instruction guide for Ballot and other Cards.

- If you prefer cash, mark that box on the Form of Compensation Card (Card 4) and sign, date and mail the card before July 17, 2001 (to ensure arrival before the Special Members' Meeting on July 24, 2001)
- If you prefer stock, do not complete or return the card. If you do not return the Form of Compensation Card (Card 4), you will automatically receive common stock, because that is your default form of compensation.

There may be a limit on the amount of funds available to distribute as cash (please see the Policyholder Information Booklet Part One, “Limit on Amounts Available for Cash and Policy Credit Compensation”). However, Eligible Policyholders who are allocated 100 or fewer shares of Principal Financial Group, Inc. common stock are guaranteed to receive cash, if they so elect.

If your Policyholder Record Card (Card 2) indicates that your policy or contract is eligible for cash only, you do not have the option to receive stock. If your Policyholder Record Card indicates that your policy or contract is eligible for Policy Credits only, you do not have the option to receive stock or cash with respect to that policy.

16. | What is my Default Compensation?

Default Compensation is the form of compensation you will receive if you are an Eligible Policyholder and you do not elect to receive a different form of compensation. Your Default Compensation depends on the type of policy or contract that you own. Please see the “Compensation Table” in the Policyholder Information Booklet Part One to determine your Default Compensation.

17. | If I receive stock, will I receive a stock certificate?

No, your shares will be held for your benefit by Mellon Investor Services, the transfer agent. This saves you the trouble of safekeeping original stock certificates. You will receive a notice confirming the number of shares issued to you as a result of the demutualization. At any time after you receive this notice, you may request a stock certificate. You may sell your shares at any time after you receive the notice, even if you do not request a stock certificate. If you are an employee benefit plan subject to ERISA, special rules, including rules relating to the holding of plan assets in trust, may apply to you. See the Policyholder Information Booklet Part One.

18. | What do I need to do if I have a welfare benefit plan governed by ERISA?

For most customers who purchased group health (such as medical, dental or vision), life, accident or disability insurance for employer-employee groups, that insurance constitutes an employee welfare benefit plan under the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), unless the employer is a governmental entity or a church, or the plan is otherwise exempt from ERISA. You should consult your own legal advisor if you have any questions about whether your plan is subject to ERISA. If an employer’s plan is subject to ERISA, the employer has multiple roles with respect to that plan: employer of the participants, non-fiduciary plan sponsor and fiduciary (as plan administrator) within the meaning of ERISA. An employer needs to consider each decision that it

must make in light of each of the particular roles that the employer is playing in making that decision. If you are an employer that maintains an ERISA plan, the decisions that you will need to make include the following:

- Determine if the Plan is in the best interest of participants and beneficiaries in your welfare benefit plan.
- Review the demutualization compensation options as provided on your Form of Compensation (Card 4).
- Decide what to do with the demutualization compensation. You may want to consult with your tax, legal or benefits advisor in making your decisions.

19. | How do I determine if the Plan is in the best interest of my plan’s participants and beneficiaries?

You should carefully review all the enclosed information. We cannot advise you on these issues. However, Iowa law contains substantial safeguards designed to protect policyholders’ interests. The Iowa Insurance Commissioner has hired investment banking, legal and actuarial experts to evaluate the Plan. Before the Plan can become effective, the Commissioner must find that the Plan is fair and equitable to Principal Mutual Holding Company and policyholders of Principal Life. You may also wish to seek legal and other professional advice.

20. | What compensation options will be available to my group insurance policy?

Review your Form of Compensation Card (Card 4) for the options specific to your policy. Generally two options will be available:

- (1) Cash
- (2) Common Stock

21. | What is the difference between the Cash Option and the Common Stock Option?

The cash option involves a direct cash payment to you, which would be made by check. The common stock option provides you with shares of common stock of Principal Financial Group, Inc. There may be a limit on the amount of funds available to distribute as cash. Therefore, some policyholders who are allocated more than 100 shares may receive Principal Financial Group, Inc. common stock even though they elected cash.

22. | Whether I elect the Cash Option or the Common Stock Option, is there anything special I need to do?

If you choose either of these options, you need to be aware that a trust may be required in light of federal employee benefits rules that may prohibit a reversion of assets to the plan sponsor. Alternatively, based on guidance provided by the Department

of Labor (“DOL”), demutualization compensation (including stock compensation) may be immediately applied to enhance plan benefits under existing, supplemental or new insurance policies or contracts; applied toward future participant premium payments; or otherwise held by an insurance company on behalf of the plan without the use of a trust. Further, the DOL has indicated that under certain conditions, (a) demutualization cash compensation can be placed in an interest-bearing account and promptly applied for plan purposes and (b) demutualization stock compensation can be placed in a custodial account and promptly applied for plan purposes. Please see Question #24 below for more information.

You should also be aware that if the compensation belongs to the plan, receipt of cash or common stock by plan sponsors of a plan that has no trustee creates issues and uncertainties as to tax treatment of the compensation. You may wish to seek legal and other professional advice regarding these matters.

23. | If the Plan is approved, what should I do with the demutualization compensation?

If your insurance policy is part of an employee plan that is subject to ERISA, what you do with the compensation must comply with ERISA requirements. ERISA imposes many requirements that may affect what you can do with the compensation. For example, ERISA generally requires that all plan assets be held in a separate trust or by an insurance company for the benefit of plan participants. Also, ERISA requires that plan assets be applied solely for the benefit of plan participants and beneficiaries. The first thing you must do is determine whether the compensation you will receive is yours to keep or whether it is a “plan asset” that belongs to your welfare benefit plan. Many factors can affect whether all or any part of the demutualization compensation will constitute plan assets that must be used for the benefit of participants, but one key factor is whether employees have paid any part of the premiums for the group insurance involved. **You should consult with your legal, tax or benefits advisor to determine what you should do in your particular situation.**

An employer who retains any compensation for its own account (rather than for plan purposes) runs substantial risks. The retention of such compensation could be viewed as a reversion of plan assets to the plan sponsor, which could result in ERISA violations and severe penalties. Retention of any compensation that is a plan asset could also constitute a “prohibited transaction” under ERISA, resulting in the imposition of penalties.

If your insurance program is not an ERISA-regulated plan, you will need to take into account any applicable state law, including insurance law, in your jurisdiction, as well as the documents and instruments that govern your insurance program.

24. | Once I determine what portion, if any, of the demutualization compensation constitutes plan assets, what should I do with the demutualization compensation?

If all or a portion of your compensation constitutes plan assets, you could place those assets in trust until they are appropriately expended in accordance with the terms of the plan. Alternatively, as discussed in Question #22 above, cash compensation may be immediately applied to enhance plan benefits or pay or subsidize future premium payments. According to guidance recently provided by the DOL, if your employee welfare benefit plan is not otherwise required to have a trust, you will not need to establish a trust solely to hold demutualization compensation if you meet certain requirements outlined by the DOL. Specifically, you would need to take that portion of the compensation that constitutes plan assets and place it in an interest-bearing account, in the case of cash, or in a custodial account, in the case of stock, in the name of the plan. The assets placed in this account must (a) consist solely of proceeds received on behalf of the plan in connection with the demutualization, (b) be placed in the applicable account as soon as reasonably possible following receipt and (c) within twelve (12) months following receipt, be used for the payment of participants’ premiums, used for plan benefit enhancements or distributed to plan participants. The recently provided DOL guidance indicates that, if you follow these requirements, you will not be deemed to be in violation of the general trust requirement of Section 403 of ERISA. There are, however, issues and uncertainties as to the tax treatment of the compensation by non-trusteed plan sponsors. You may want to talk with your tax, legal or benefits advisor for help in making your decision.

With respect to the allocation of the compensation among plan participants, allocation should be made in a manner determined to be fair and equitable under the circumstances. Again, you may want to talk with your tax, legal or benefits advisor for help in making this decision.

25. | If my compensation is only the equivalent of the cost of my group insurance for a few month’s time (up to 12 months), is there something simple I can do, particularly if I receive cash?

Yes, you may be able to use the compensation to prepay employee premiums for that group insurance. Of course, that presumes that you have decided that the proper use of the

compensation is to benefit current and future participants in the employee welfare benefit plan to which your group insurance relates. You can simply endorse the check over to Principal Life Insurance Company or send us your check for that amount, along with a brief written instruction to us to apply the amount to prepay your group insurance premiums. Because our account for prepaid premiums is not an interest-bearing account, this may not be a suitable option for any amount that would not be used up within a short period, but this may be a convenient approach for you in the right circumstances. You should discuss with your tax, legal or benefits advisor whether this approach is appropriate under your circumstances.

26. | If my compensation is more than the cost of my plan's group insurance for a year, do I have any options?

The guidance provided by the DOL indicates that if you do not place that compensation in a trust, then within 12 months of receipt you will need to apply that compensation to pay premiums or distribute it to enhance participant benefits under the plan. If the compensation you receive is more than the cost of the plan's group insurance for that 12-month period, and if enhanced benefits or distributions to participants are not appropriate for your plan or don't use up the balance of the compensation, there may be an additional option if your group insurance policy contains provisions for experience premium refunds and premium stabilization reserves (generally groups with 100 or more eligible employees) Contact us toll-free at 1-866-781-1368.

27. | What are the tax consequences of receiving demutualization compensation?

For plan sponsors of a plan that has no trustee, the receipt of cash or common stock that is a plan asset creates issues and uncertainties as to the tax treatment of that compensation.

If the policyholder is a tax exempt trust, for example, a voluntary employees beneficiary association or "VEBA", that is tax-exempt under Section 501(c)(9) of the Internal Revenue Code, the receipt of compensation will not result in income tax liability for the trust.

Regardless of the form of compensation you receive, you must sign and return Taxpayer Identification Card (Card 3).

Without the certification required on Card 3, we may be required by law to withhold 31% of any cash payment and any future stock dividends, and you may be subject to a \$50 IRS penalty.

We urge you to consult your tax advisor for definitive answers on your own situation.

28. | Will management become entitled to compensation as a result of the demutualization?

Our officers, directors and employees will not receive stock or cash compensation at the time of the demutualization other than what they may receive as Eligible Policyholders or as participants in an employee benefit plan that is an Eligible Policyholder. However, our officers, directors and employees may receive stock or options to purchase stock pursuant to benefit plans established or amended in connection with the demutualization. Please see "Acquisition of Common Stock by Officers, Directors and Employees" in the Policyholder Information Booklet Part One, for a more detailed discussion of stock-based compensation (and the limitations on that compensation) for officers, directors and employees.

29. | Can I call my agent with questions?

Because of regulatory restrictions, your agent or other company representative is not allowed to give you advice about the demutualization. However, our trained representatives (at the toll-free number below) can help answer questions on the Plan or on completing the enclosed Cards.

NEED MORE INFORMATION?

We have established a Demutualization Information Center where trained representatives can help you complete the enclosed Cards or answer questions you have about the Plan. The Demutualization Information Center will be open between the hours of 7:00 a.m. and 7:00 p.m., Central Daylight Time. The toll-free number is 1-866-781-1368 or write us at: Demutualization Information Center, P. O. Box 4425, South Hackensack, New Jersey 07606-2025.

INSTRUCTION GUIDE FOR BALLOT AND OTHER CARDS

This guide provides instructions for completing the enclosed ballot and other cards. Please read both sides of each card and complete as indicated.

- 1 Mark an "X" in one of the boxes to vote Yes (for the Plan) or No (against the Plan). A ballot with both boxes marked or neither box marked will not be counted.
- 2 Indicate a name or address change (for the demutualization only) by writing changes on the reverse side of this card.
- 3 Sign and date where indicated, complete and return the Card(s) in the enclosed envelope. If the policy(s) or contract(s) has more than one owner, all owners must sign the ballot and Form of Compensation Cards. A ballot that is not signed will not be counted.
- 4 This represents your policyholder identification number. It appears on the front of every card.

BALLOT CARD (Card 1)

Policyholder ID **4**

1 Yes, I vote FOR
 No, I vote AGAINST

Please vote by placing an "X" in one of the boxes to the left, signing and dating below. You must place an "X" in one and only one box, and you must sign below for your vote to be counted. All ballots must be received by the close of the Special Members Meeting on July 24, 2001.

2 **Proposal:** To approve the Plan of Conversion of Principal Mutual Holding Company, for conversion to a stock company, including the Mergers whereby the converted Principal Mutual Holding Company will merge with and into Principal Iowa Newco, Inc., and the other transactions set forth in the Plan of Conversion.

The Board of Directors unanimously approved the Plan of Conversion and the Mergers and recommends that you vote FOR the proposal.

3 ALL POLICYHOLDERS MUST SIGN

SIGNATURE **3** DATE

SIGNATURE DATE

Sign exactly as your name appears to the left. When signing as attorney, executor, administrator, trustee or guardian, give full title as such.
Questions? Call our Demutualization Information Center toll free at 1-866-781-1368 weekdays, 7 a.m. to 7 p.m., Central Daylight Time or visit www.principal.com.

PLEASE MARK YOUR VOTE, SIGN, DATE AND MAIL THIS CARD PROMPTLY, USING THE ENCLOSED ENVELOPE.

- 5 Card 2 shows your eligible, in force policy(s) and contract(s) as of March 31, 2001, the date the Plan was adopted by the Board, and the corresponding possible form(s) of compensation for each policy and contract, if applicable. If you believe this information is inaccurate or incomplete, please call 1-866-781-1368.
- 6 Card 2 indicates the total number of estimated allocated shares of stock on which your compensation will be based. This number is preliminary and subject to change.
- 7 Some allocated shares may be eligible for cash election. Card 2 indicates how many of the estimated shares are eligible for a cash election. Use Card 4 to elect cash if you are eligible. If Card 2 indicates that you are eligible only for Policy Credits, you will automatically receive Policy Credits and you do not need to complete Card 4.

POLICYHOLDER RECORD CARD (Card 2)

Policyholder ID **5**

If the Plan of Conversion becomes effective, Eligible Policyholders will receive compensation based on an allocation of shares. Your total estimated allocated shares, shown below, is only a preliminary calculation and is subject to change. **WARNING:** To be an Eligible Policyholder, you must own an eligible Principal Life policy or contract continuously from March 31, 2000 until the Effective Date of the Plan of Conversion, which is expected to be in the latter part of 2001 or the first part of 2002.

TOTAL ESTIMATED ALLOCATED SHARES:	6
ESTIMATED ALLOCATED SHARES ELIGIBLE FOR CASH ELECTION ON CARD 4:	7

Questions? Call our Demutualization Information Center toll free at 1-866-781-1368 weekdays, 7 a.m. to 7 p.m., Central Daylight Time or visit www.principal.com.

RETAIN THIS CARD - DO NOT RETURN

READ IMPORTANT INFORMATION ON REVERSE SIDE.

Please read the Policyholder Information Booklet Part One for important information about Principal Mutual Holding Company's proposed plan to convert into a stock company.

If you are eligible to vote only and not eligible for compensation, you will have Cards 1 and 2 only. Policyholders eligible for compensation will also have Cards 3 and 4.

8 Taxpayer Identification Number ("TIN") is your Social Security Number (or Employer Identification Number if the policyholder is a trust, corporation or other entity). If your TIN is missing or incorrect, write the correct number here and fill in the boxes, corresponding to the numbers you have indicated in each box, in blue or black ink. If the number is correct, you must still sign and return Card 3. In either case, please read the Certification information (on the front of this Card 3) before signing and return Card 3 in the enclosed envelope. **Without certification, we may be required by law to withhold 31% of any cash payment and any future stock dividends and you may be subject to a \$50 IRS penalty.**

TAXPAYER IDENTIFICATION CARD (Card 3)

Principal Financial Group

Policyholder ID

IS THIS YOUR CORRECT TAXPAYER IDENTIFICATION **8** IF NOT, PLEASE CORRECT IN THE SPACE PROVIDED

SUBSTITUTE W-9

You must complete and return this card to confirm and certify your taxpayer identification number. Without certification, we may be required by law to withhold 31% of any cash payment and any future stock dividends payable to you, and you may be subject to a \$50 IRS penalty.

Certification: Under penalties of perjury, I declare that I have examined the information on this form and to the best of my knowledge and belief it is true, correct, and complete. I further certify under penalties of perjury that:

(1) The number shown on this form is my correct taxpayer identification number (or I am waiting for a number to be issued to me); (2) I am not subject to backup withholding because (a) I am exempt from backup withholding, or (b) I have not been notified by the Internal Revenue Service (IRS) that I am subject to backup withholding as a result of failure to report all interest or dividends, or (c) the IRS has notified me that I am no longer subject to backup withholding; and (3) I am a U.S. person (including a U.S. resident alien).

SIGNATURE DATE

READ IMPORTANT INFORMATION ON REVERSE SIDE.

9 Card 4 shows your estimated number of allocated shares that are eligible for cash election.

10 The form of compensation you are eligible to receive is shown on Card 2. If you are eligible to receive cash for some or all of your estimated allocated shares and prefer cash, you must elect cash by marking an "X" in the box on Card 4 and return Card 4 in the enclosed envelope. If Card 2 indicates that you are eligible only for Policy Credits, you will automatically receive Policy Credits and you do not need to complete Card 4.

FORM OF COMPENSATION CARD (Card 4)

Principal Financial Group

Policyholder ID

DO NOT return this card if you prefer stock.

9 Estimate of the total number of allocated shares eligible for cash election.

Mark this box ("X") to elect cash for all allocated shares eligible for cash election. **10**

ALL POLICYHOLDERS MUST SIGN

SIGNATURE DATE

SIGNATURE DATE

Sign exactly as your name appears to the left. When signing as attorney, executor, administrator, trustee or guardian, give full title as such. Mark, sign, date and mail this card promptly, using the enclosed envelope.

Questions? Call our Demutualization Information Center toll free at 1-866-791-1368 weekdays, 7 a.m. to 7 p.m., Central Daylight Time or visit www.principal.com.

READ IMPORTANT INFORMATION ON THE REVERSE SIDE.

PLEASE NOTE:

There may be a limit on the amount of funds available to distribute as cash. Eligible Policyholders who are allocated 100 or fewer shares and who elect cash will receive cash. Since it is possible there will not be enough cash to distribute to all policyholders who prefer cash, some policyholders who are allocated more than 100 shares may receive stock even though they elected to receive cash on Card 4. Please refer to "Limit on Amounts Available for Cash and Policy Credit Compensation" in the Policyholder Information Booklet Part I.

Our demutualization will in no way diminish your policy or contract benefits, values or guarantees, or obligations of Principal Life to you as a policyholder. Policy dividends will continue to be paid, as declared, on policies eligible to receive dividends. As always, dividends are not guaranteed and may vary from year to year.

PRINCIPAL MUTUAL HOLDING COMPANY'S
DEMUTUALIZATION GUIDE:

ISSUES FOR EMPLOYERS AND PLAN
FIDUCIARIES TO CONSIDER

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I. EXECUTIVE OVERVIEW

This Guide is for owners of Principal Life Insurance Company (“Principal Life”) group insurance contracts, which provide benefits under a group life, health (medical, dental and vision) disability (LTD and STD) or other welfare benefit plan for employees. We recognize that our proposed demutualization, and the resulting payment of compensation to eligible policyholders, raise issues for employers beyond the normal course of administering their welfare benefit plans. This guide is intended to help employers understand and address these issues. It is not intended as legal advice, and in certain cases, employers may need to consult their own tax, legal or benefits advisors in analyzing their own situation.

Background

The Board of Directors of Principal Mutual Holding Company (the “Board”) unanimously approved and adopted our Plan of Conversion (“the Plan”) on March 31, 2001. The principal feature of the Plan is the conversion of Principal Mutual Holding Company from a mutual insurance holding company (“MIHC”) into a stock holding company, a form of conversion known as “demutualization”. Until the effective date of the demutualization, Principal Mutual Holding Company is an MIHC governed by its members, who are policyholders of Principal Life.

The purpose of the demutualization is to maximize flexibility to raise additional capital, allowing us to operate and compete more effectively and continue to meet the needs of our customers. **Please remember, the demutualization will not diminish benefits, values or guarantees under Principal Life policies or contracts, nor will the demutualization increase premiums or contributions.**

Because Principal Mutual Holding Company is a mutual insurance holding company organized under the laws of Iowa, our demutualization is governed by Iowa law, which requires that the Plan be approved by two-thirds of the policyholders who cast votes. The Plan will not become effective unless, after conducting a public hearing, the

Iowa Insurance Commissioner approves the Plan based on a finding, among other things, that the Plan is fair and equitable to the Company and its policyholders. In connection with the demutualization, the membership interests of Principal Life’s policyholders in Principal Mutual Holding Company will be extinguished and Eligible Policyholders will receive compensation in exchange for those membership interests. Under Iowa law, to be eligible for demutualization compensation, a policyholder must have had an eligible Principal Life insurance policy or contract in force on March 31, 2000 (the date one year prior to the Board’s adoption of the Plan) and own an eligible policy or contract continuously from March 31, 2000, through the effective date of the demutualization. Policyholders who are not “Eligible Policyholders” will not receive any compensation in the demutualization.

Key Issues

As a group insurance policyholder, you will face a number of key issues:

You must determine whether your plan is subject to ERISA. This will depend on a number of factors, including the type of insurance you provide, the type of employer that sponsors the plan, whether and to what extent employees pay for their benefits and whether they pay with pre-tax or after-tax dollars.

You must decide whether to vote in favor of or against the Plan. We urge you to review the information included in this package. We cannot advise policyholders on this issue, but you should be aware that Iowa law contains substantial procedural safeguards designed to protect policyholders’ interests. The Iowa Insurance Commissioner has hired investment banking, legal and actuarial experts to evaluate the Plan. Before the Commissioner can approve the Plan, the Commissioner must find the Plan fair and equitable to the Company and its policyholders. To approve the Plan, the Commissioner must also approve the allocation of compensation among policyholders. The allocation has been reviewed by independent actuarial experts hired by Principal Mutual Holding Company, and those experts have given an opinion that the allocation is fair and equitable to Eligible Policyholders.

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You will need to decide whether you want your compensation to be in the form of stock or cash. This is addressed in more detail in Section II, Compensation.

You will need to determine what to do with the stock or cash you receive. You will first have to determine whether the compensation is yours to keep or whether all or part of it belongs to the welfare benefit plan that is funded by the group policy. If any part of the compensation belongs to the plan, that portion is a “plan asset”, and it might have to be held in a trust to comply with ERISA. Also, if any portion of the compensation belongs to the plan, you must determine how it should be allocated among or applied for the benefit of the various participants and beneficiaries under the plan.

You may need to take certain actions with respect to the compensation you receive, such as setting up a trust or other special account or allocating or applying the compensation to or for the benefit of plan participants and beneficiaries. This is addressed in more detail in Section III, Guidelines for Plan Sponsors.

You should also understand the tax consequences associated with different forms of compensation, which are addressed in Section IV, Tax and Other Issues.

As a group insurance policyholder, you will face a number of decisions relating to Principal Mutual Holding Company’s Plan of Conversion. Plan sponsors and plan fiduciaries will need to analyze which of these decisions are governed by the fiduciary duty standards imposed by ERISA and which may be considered non-fiduciary because they are decided as a business matter strictly as an employer, such as plan design issues. See Section V, Fiduciary Information.

II. COMPENSATION

Risks to employer of retaining compensation.

An employer who simply retains the demutualization compensation for its own account (rather than using it for plan purposes) runs substantial risks. For example, the retention could constitute a “prohibited transaction” under ERISA, resulting in penalties. The retention could also

render the employer vulnerable to lawsuits instituted either by participants or the U.S. Department of Labor (the “DOL”) for breach of ERISA fiduciary duties.

Forms of compensation available. Under our Plan, eligible group insurance policyholders (who purchased their group insurance policies to provide various insurance benefits for their employees) will be entitled to receive compensation in the form of common stock or cash. **If you do not make an election, you will be deemed to have elected common stock.**

Limitations on funds available. You should be aware that there may be a limit on the amount of funds available to distribute as cash to Eligible Policyholders allocated more than 100 shares. Some policyholders who are allocated more than 100 shares may receive stock even though they elected to receive cash. If you are allocated 100 shares or fewer and you elect cash, you will receive cash.

Options available to you. The Form of Compensation Card (Card 4) included in your package will indicate the options available to your plan. Policyholders receiving cash will receive an amount of cash equal to the final number of shares of common stock that they are allocated in the demutualization multiplied by the price at which the common stock is sold in the initial public offering (the “IPO Price”).

Electing compensation. As you review the materials enclosed with this Guide explaining how to elect the form of compensation you prefer, please keep in mind the following:

- When you choose common stock or cash, you may have to establish a trust or special account to hold the common stock or cash for the benefit of the plan. For more details, see Section III, Guidelines For Plan Sponsors.
- Your decision regarding how to use and/or allocate the demutualization compensation may influence what form of compensation you prefer (stock or cash).

For your convenience as you work through these issues, we have included the definition of “fiduciary” under Section 3(21) of ERISA, as well as “fiduciary duties” under Department of Labor regulations, in Section V of this guide.

III. GUIDELINES FOR PLAN SPONSORS

Having provided an overview, we now want to specifically address some practical issues you will face, such as:

- Is your plan subject to ERISA?
- Is the compensation that you will receive yours to keep, or is it a plan asset that belongs to the welfare benefit plan?
- If all or part of the compensation is a plan asset, what should you do with that compensation?

Is your plan subject to ERISA?

You first must determine whether your insurance plan is an employee welfare benefit plan that is subject to ERISA. This will depend on a number of factors including, among other things, the type of employer that maintains the plan and the type of benefits provided by the plan. Plans maintained by governmental entities are not subject to ERISA, no matter what kind of benefits they provide. Also, plans maintained by churches and certain church-controlled entities are exempt from ERISA, unless the plan sponsor affirmatively elects to have the plan be governed by ERISA.

The type of benefits that your insurance plan provides will also affect whether it is subject to ERISA. Generally, ERISA applies to insurance plans that provide “welfare” benefits. Common types of welfare benefits include health (medical, dental, vision), life and disability insurance benefits.

Some plans that would otherwise be governed by ERISA are exempt under the ERISA statute or DOL regulations. For example, an insurance plan will generally be exempt from ERISA if participation in it is completely voluntary, the employer makes the plan available without endorsing it, the employee pays the entire cost of coverage from his or her own after-tax pay and the employer’s role with respect to the plan is limited to permitting the insurer to advertise the plan to employees, deducting premiums from employees’ after-tax pay and remitting those premiums to the insurer.

If you have any uncertainty about whether your plan is subject to ERISA, you should consult your own tax, legal or benefits advisor.

If your plan is not subject to ERISA, then state law and the terms of your plan documents will govern what you can and cannot do with the compensation you receive.

Is the compensation yours to keep or is it a “plan asset” that belongs to the welfare benefit plan?

If your plan is subject to ERISA, then ERISA will govern whether all or part of the compensation you receive belongs to the plan and what you may do with that portion of the compensation. ERISA generally requires that all ERISA plan assets be held in a separate trust. There are exceptions to the trust requirement for plan assets that consist of insurance policies or annuity contracts or assets that are held by an insurance company (for example, in separate accounts). As a result, in many cases where an employer sponsors its group life, health or disability plans and funds those plans through Principal Life group insurance policies, the employer itself will be the record owner of those policies. If the plan already has a separate trust (for example, a Section 501(c)(9) trust known as a “VEBA”), the policy may have been issued to the trustee, in which case the compensation will be payable to the trustee, as owner. But in most cases there is no trust for a welfare benefit plan and the compensation will be distributed to the employer, as record owner of the policy. Therefore, the first thing you must do is determine whether the compensation you receive is yours to keep or is a “plan asset” that belongs to your welfare benefit plan.

Many factors may affect whether all or any part of the demutualization compensation constitutes plan assets and, if so, what you should do with that compensation. One key factor is whether employees have paid some portion of contributions or premiums for the group insurance coverage involved. If so, some or all of the compensation may be a “plan asset” subject to ERISA. You should consult your tax, legal or benefits advisor to identify and discuss all of the facts that will affect whether all or part of the compensation belongs to the plan and what you should do with it.

If your insurance program is not an ERISA-regulated plan, then what you may do with the compensation will depend upon any applicable state law, including insurance law, in your jurisdiction, and upon the documents and instruments governing your plan.

Authorities that may be helpful in determining whether your compensation is a plan asset.

1. The DOL's Position on "Experience-Rated Refunds"

Some group insurance contracts are "experience-rated", which means that at the end of a policy year, the policyholder may be entitled to a premium refund, credit or dividend depending upon claims experience for that policy during the year. The DOL has addressed whether the employer may retain the refund as its own or whether all or part of the refund is a "plan asset" that must be applied for plan purposes.

The DOL has concluded that premium refunds, credits or dividends paid by an insurer as a result of favorable claim experience on insurance policies providing welfare benefits should be treated as plan assets to the extent they are attributable to employee contributions. Accordingly, if the employer pays all of the premium under the policy, and the employees do not contribute at all, the DOL's position is that the employer may keep the refund. If the entire premium is paid by the employees, the entire refund is a "plan asset" and may not be retained by the employer. In the case of a plan where the employer and the employee both contribute to the cost of coverage, the refund must be prorated accordingly. However, in the DOL's view, ERISA Section 403(c)(1) will prohibit any distribution to a sponsoring employer of experience-rated dividends, refunds or credits in excess of the total premiums paid by the employer out of its own general assets.

Demutualization compensation is not a dividend, premium credit or refund of premium, but it is compensation to the policyholder for the extinguishing of his or her membership interest in the mutual company. Nevertheless, there is some indication that the DOL would apply this same analysis to compensation in a demutualization. In each Prohibited Transaction Exemption granted by the DOL in connection with prior demutualizations, the DOL has noted: "In general, it is the Department's view that, if an insurance policy (including an annuity contract) is purchased with assets of an employee benefit plan, including participant contributions, and if there exists any participants covered under the plan...at the time when [the insurer] incurs the obligation to distribute Common Stock, Cash or Policy Credits, then such consideration would constitute an asset of such Plan".

2. *Ruocco v. Batemen*, 903 F.2d 1232 (9th Cir. 1990)

In this case, the employer owned a long-term disability insurance policy issued by UNUM (then Union Mutual). The premiums were paid, for the most part, through employee contributions. When Union Mutual demutualized, the compensation (in this case, stock and warrants) was paid to the employer, as record owner of the policy. The employer attempted to retain the compensation for itself, but the employees sued and succeeded in recovering a portion of the compensation for themselves.

3. *Corley v. Hecht*, 530 F. Supp. 1155 (D.D.C. 1982)

Here, the employer maintained a contributory group life insurance plan for employees. Under this particular policy, the actual cost of the insurance coverage for any year could not be finally determined until after the close of the plan year. In one year, the cost of coverage actually exceeded the sum of the contributions the employer had withheld from the employees' paychecks. The employer made a voluntary payment to the insurer to make up the shortfall. Then, in a later year, the ultimate cost of coverage was less than the amount that had been withheld and paid over as premium, and so a payment in the nature of a dividend was returned to the employer. Out of this payment, the employer reimbursed itself for the voluntary payment it had made in the prior year. An employee sued on the theory that the dividend was a plan asset and that the employer's retention of any part of it violated the prohibited transaction and fiduciary rules of ERISA.

The court carefully examined the specific terms of the plan documents and the insurance policy and found that reimbursement was consistent with those terms and did not violate ERISA.

The lesson in *Corley v. Hecht* is that the terms of the welfare plan documents, the insurance contracts and communications to employees can be important in resolving who ultimately will be entitled to the compensation. Employers and their consultants should review all plan documentation and employee communications, focusing on terms dealing with refunds, dividends or credits. It may be advisable to amend certain plan provisions prior to the receipt of any compensation.

4. DOL Advisory Opinion 81-11A (the “Tandy Letter”)

The Tandy Letter involved an employer that sponsored a death benefit plan for employees. If an employee died while in active employment, the employer was obligated to pay a death benefit to the employee’s beneficiary. The employer purchased insurance policies covering the lives of the eligible employees and named itself as the owner and the beneficiary under those policies. The policies were to cover the employer’s potential liability for benefits under the plan, but they were never held out to the employees as being the source of those benefits.

The DOL was asked whether the policies were assets of the plan, and it responded that they were not. The policies belonged to the employer under these circumstances. While the opinion did not deal with demutualization compensation, the opinion supports the position that any membership interest associated with these policies would also have been treated as belonging to the employer, and not the plan, with the result that any compensation paid upon extinguishment of that membership interest would belong to the employer.

Summary

Some employers may reach the conclusion, based on the foregoing authorities or the advice of their consultants, that the compensation they receive is not a plan asset. If the compensation is not a plan asset, the employer may retain the compensation for itself and use it for any purpose that it sees fit.

In other cases, particularly where employees have contributed toward the cost of coverage under their policy, the employer may conclude that some or all of the compensation is a plan asset.

If all or part of the compensation is a plan asset, what alternatives are available?

Generally

Employers should be aware of the general rule in Section 403 of ERISA which requires assets of an employee benefit plan to be held in trust. There is an exception to the general rule under which insurance policies and assets held by an insurance company are not required to be held in trust.

Options if a trust is already in place for the plan (for example a VEBA).

If there is already a trust in place for the plan – for example, if there is a Section 501(c)(9) “voluntary employees beneficiary association” or “VEBA” – the stock or cash could be transferred to the VEBA to satisfy the ERISA trust requirement. The safer course of action would be to transfer the insurance policy into the name of the VEBA trustee prior to the effective date of the demutualization so that the VEBA trustee would receive the compensation directly. This avoids having the compensation pass through the hands of the employer – which would avoid the question of whether the compensation should be treated as taxable income to the employer or whether the employer should be viewed simply as an agent receiving and delivering over to the VEBA property that at all times belonged to the plan.

Options for employers with welfare plans, not funded through VEBAs, owned by an employer, into which premiums are paid and from which benefits are paid.

In a recent information letter issued in connection with another demutualization, the DOL stated that if an employer is not otherwise required to maintain a trust for its ERISA plan, the plan sponsor does not have to establish a trust solely to hold demutualization compensation, if all the following requirements are satisfied:

- The employer is not otherwise required to maintain a trust for its welfare plan under Section 403 of ERISA (for example, because the plan is funded solely by insurance contracts and all employee contributions are promptly transmitted to the insurer).
- The assets not held in trust consist solely of compensation received by the employer as a policyholder in connection with a demutualization.
- The demutualization compensation is placed in the name of the plan in an interest-bearing account (in the case of cash) or a custodial account (in the case of stock), as soon as reasonably possible following receipt and the compensation is applied to plan benefit enhancements as soon as reasonably possible but no later than 12 months following receipt.
- The assets are subject to the control of a designated plan fiduciary.
- The designated fiduciary maintains all documents and records required by ERISA in connection with the receipt, holding and application of the demutualization compensation.

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You may want to consult with your own legal counsel to determine whether and how the DOL's recent information letter may be helpful to you.

The DOL's information letter and other DOL guidance indicate that plan sponsors have a number of options for applying and allocating the "plan assets" portion of demutualization compensation. Under appropriate circumstances, these options may include the following:

1. Prepay premiums. Depending upon the type of policy and the amount of compensation involved, it may be possible to use the compensation to prepay employee premiums under the policy for some period of time. This would allow employees to enjoy a "premium holiday", or period when withholding contributions from their paychecks could be suspended.

2. Increase benefits. Another alternative would be to amend the welfare benefit plan to increase existing benefits or provide new benefits for participants and apply the compensation towards the cost of the increased benefits.

3. Use compensation to pay plan expenses. ERISA allows plan assets to be used to pay reasonable administrative expenses of a plan. The demutualization proceeds could be applied to pay administrative expenses, such as the costs of producing the SPD (Summary Plan Description) or preparing the Form 5500 annual report. Care should be taken that any compensation that constitutes plan assets is used to pay only the administrative expenses of the plan and not employer costs (for example, costs relating to design, optional amendment and termination, which are arguably plan sponsor costs and not administrative expenses).

4. Distribute compensation to participants. The employer could decide to distribute the "plan assets" portion of the compensation directly to plan participants. There are no hard and fast rules as to how the compensation should be allocated among participants or how the distribution would be taxed.

With respect to the allocation of the compensation among participants, in the absence of any authoritative guidance, an employer should allocate in a manner he or she determines to be fair and equitable under the circumstances. In some

cases, a simple per capita allocation to each active participant may be appropriate, while in others, the amount allocated might depend on the amount each employee contributed under the plan (assuming the records are available). The employer should also consider whether an allocation to former employees or retirees would be appropriate, although we are not aware of any instance when this was required.

With respect to taxation, the amount distributed to an employee may constitute a non-taxable return of the premium or it may constitute miscellaneous ordinary income. It is possible that the IRS may assert that the distribution constitutes "wages", but that analysis seems flawed, as the amounts are not being paid by the employer for services, but represent a distribution from the plan of demutualization compensation. Employers should consult with their tax advisor on these issues.

5. Fund for future benefits/claims. For certain employer groups (generally groups with 100 or more eligible employees and whose group policy allows for experience premium refunds at the end of a policy year), Principal Life is prepared to hold the cash portion of any demutualization proceeds in your plan's premium stabilization reserve. This option is available only if you elect to receive cash. If you think your plan qualifies under this option and you are interested in pursuing the option, please contact us by using the toll-free number shown in this Guide.

Arrangements that may be exempt from ERISA. As discussed above at the beginning of this Section, under some group policies, the insurer extends the coverage opportunity directly to employees and the employer's only involvement is to collect and pay the employees' contributions through the mechanism of after-tax payroll deductions. These arrangements are generally not subject to ERISA. They are exempt from ERISA because the employer's role is minimal and the arrangements are not characterized as plans "established or maintained by an employer" as provided in Section 3(1) of ERISA. Employers with such arrangements should continue to limit their involvement so as to retain the ERISA "safe harbor" exemption. One requirement necessary to retain that exemption is that the employer receive "...no consideration in the form of cash or otherwise in connection with the program...". Accordingly, an employer with such an arrangement should not keep any

part of the demutualization compensation for itself. The DOL has expressed the view that an employer who votes with respect to a demutualization and then receives compensation as the nominal policyholder and elects the method of allocating it among the covered employees should not be viewed as having an involvement with the arrangement that would jeopardize its exemption from ERISA coverage. This is a technical area, however, and employers are urged to consult their tax, legal or benefit advisors.

IV. TAX AND OTHER ISSUES

The compensation received by a policyholder under our Plan should be treated as having been received in exchange for the policyholder's membership interest in Principal Mutual Holding Company. The IRS has ruled that compensation received for a membership interest has a "zero basis" for tax purposes, so the entire value of the compensation would be considered gain to the policyholder in the year the demutualization becomes effective. The gain from the disposition of an asset (the membership interest) would be reported and accounted for similar to the gain from the sale of any other asset, such as gain from the sale of stock. The information provided below describes if and when this gain is taxable.

Tax-exempt Trust. If the policyholder is a tax-exempt trust established under a welfare benefit plan (for example, a Section 501(c)(9) "VEBA") the receipt of compensation will not result in income tax liability for the trust. Employers with VEBAs should be aware, however, that there are certain circumstances under which a VEBA that has become overfunded can create liability for "unrelated business income tax". The rules governing the funding of VEBAs are complex and they are beyond the scope of this Guide. Employers and their consultants should consider whether these rules, which are found primarily in Section 419 and Section 419A of the Internal Revenue Code, will apply to their arrangements.

Non-Trusteed Welfare Plans. For non-trusteed welfare plans, the policyholder is most likely to be the plan sponsor. When the plan sponsor receives either cash or common stock compensation, the tax treatment of that compensation is uncertain.

A plan sponsor who elects common stock or cash compensation for the plan could immediately establish a Section 501(c)(9) VEBA trust and deposit the compensation into the trust. In that case, the plan sponsor could take the position that the compensation never belonged to the sponsor, but belonged to the plan and the sponsor received it as agent for the plan and immediately placed it in trust in compliance with the ERISA Section 403(a) trust requirement. The sponsor would not reflect the receipt of the compensation on its own books or tax reports. The compensation would be reflected instead on the Form 5500 filed for the plan. There is, however, no published authority, ruling, regulation or case law confirming this treatment and, in fact, there is an Internal Revenue Service ("IRS") private letter ruling (PLR 200011063, December 20, 1999) in which the IRS ruled that the employer would have taxable income and a corresponding deduction (within limits) for the contribution to the VEBA. **This is why the Policyholder Information Booklet Part One recommends that sponsors of non-trusteed plans who elect cash or common stock establish a trust and transfer the contract to it prior to the conversion.** This procedure avoids the uncertainty that arises when the compensation passes through the hands of the employer.

When Compensation is Used To Pay Expenses.

Similarly, issues arise when an employer elects to apply the compensation to pay benefits or plan expenses. For example, suppose an employer receiving compensation in the form of cash decides to use the cash to pay the plan's consultants for their work in preparing a summary plan description or the plan's Form 5500. These are normally considered administrative expenses properly chargeable against plan assets. However, it is not clear in this case whether the employer should reflect the cash as income and then deduct the administrative expense or, more consistently with the "plan asset" theory, record nothing on its books or tax returns and reflect the income and expense items on the plan's Form 5500. Again, establishing a trust in advance of the effective date of the demutualization resolves the uncertainty, but it may involve more expense than is warranted by the amount of compensation.

When Compensation Belongs to the Employer. In some cases, an employer may determine that the compensation is not a plan asset, but belongs to the employer. For example, some employers have always paid all

of the premiums and other costs of their plans from their own general assets without any employee contributions and without a VEBA or other trust. In that case, the employer, and not the plan, would be entitled to retain the demutualization compensation, and the tax consequences are well established. The receipt of common stock will be tax free. Taxable income, in the form of capital gain, would be recognized when the shares are sold. The receipt of cash would be taxable as capital gain, and would be long-term or short-term depending upon whether the policyholder has owned its policy for more than one year prior to the receipt of the cash.

DOL & IRS Reporting. We are not required to file any reports or information returns with the DOL regarding the payment of demutualization consideration to a policyholder. In a number of cases involving prior demutualizations, the DOL has conducted compliance audits to determine whether employers have properly dealt with the compensation they received. In the event of such an audit or investigation, the DOL would be entitled to obtain information as to the identity of the payee and the amount paid.

As to the IRS, generally, payments in the form of cash of \$10 or more to individuals, not corporations, will be reported on Form 1099.

Section 406(a) of ERISA generally prohibits transactions between employee benefit plans and parties related to those plans (so-called “parties in interest” or “disqualified persons”). Principal Life may be a party in interest or disqualified person with respect to many employee benefit plans holding Principal Life group insurance contracts. If so, the exchange that occurs in a demutualization, where a plan policyholder receives compensation in exchange for its membership interest, could be viewed as prohibited under ERISA and the Code.

We have applied to the DOL for an exemption from the prohibited transaction rules to permit plan policyholders to receive compensation in the demutualization. The DOL has issued similar exemptions in other demutualizations and we

expect them to issue an exemption for our conversion. Policyholders who are subject to ERISA will receive a special notice when the DOL publishes the exemption in proposed form in the Federal Register.

V. FIDUCIARY INFORMATION

As a group insurance policyholder, you will face a number of decisions relating to Principal Mutual Holding Company’s Plan of Conversion. Plan sponsors and plan fiduciaries will need to analyze which of these decisions are governed by the fiduciary duty standards imposed by ERISA and which may be considered non-fiduciary because they are decided as a business matter strictly as an employer, such as plan design issues.

“Fiduciary” Defined. Section 3(21) of ERISA provides that a “fiduciary” is a person who exercises any discretionary authority or discretionary control respecting management of a plan or exercises any authority or control respecting management or disposition of its assets. A person will also be a fiduciary of a plan to the extent he or she has any discretionary authority or discretionary responsibility in the administration of the plan. Fiduciaries are held to the highest standards of care known to the law, including the requirement to act “solely in the interest of the participants and beneficiaries” of the plan. See Section 404(a)(1) of ERISA.

You should remember that if the policy is an asset of the plan, which means that the plan is entitled to the compensation, those parties with discretion over the disposition of the compensation will be fiduciaries under ERISA. They must exercise their discretion solely in the interests of the participants and beneficiaries. The fact that an employer is listed as the record owner of a group insurance policy, and is the party to whom the compensation is distributed, is not determinative of whether the employer will be subject to ERISA’s fiduciary standards in dealing with the compensation.

Fiduciary Duties. Section 404(a)(1)(B) of ERISA requires that a fiduciary discharge his duties with respect to a plan “... with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.”

This duty of prudence requires a fiduciary to give appropriate consideration to those facts and circumstances that the fiduciary knows or should know are relevant to the particular investment or investment course of action involved. For example, an employer sponsoring a group life insurance program might conclude that shares of stock are not an investment that is appropriate for its welfare benefit plan, which is not funded by any investments other than the insurance policy. Another employer may sponsor a defined benefit pension plan and may determine that the shares of stock are a potentially favorable investment for the plan and choose to retain them for the plan. The decision whether to continue to retain the shares, or withdraw them for sale, is also an investment decision to be made in conformity with ERISA DOL regulations.

If your plan is subject to ERISA and your group insurance contract is entitled to compensation that will belong to that plan, what do these fiduciary rules require you to do?

The fiduciary must first decide whether the implementation of the Plan will be in the best interest of the plan’s participants and beneficiaries. This will determine how the fiduciary will vote on the Plan of Conversion. The fiduciary should undertake a careful

review of the Policyholder Information Booklet Parts One and Two and this Guide.

Once the fiduciary has decided how to vote, the fiduciary must then decide whether to receive compensation in the form of stock or cash. This is essentially an investment decision, one that will largely turn on the type of plan concerned and how it is funded. This investment decision should be made in conformity with the DOL regulations, particularly Reg. § 2550.404a-1, 29 C.F.R. § 2550.404a-1, dealing with investment duties, and with consideration of the type of plan involved.

Non-Fiduciary Decisions

There are other decisions to be made that might fall into the same category as “plan design” and be considered non-fiduciary decisions that need not comply with the ERISA fiduciary rules. For example, a profit sharing or Section 401(k) plan ordinarily has a formula for allocating employer contributions and fund earnings among participants. If a plan sponsor wished to change this formula to provide for a different allocation for the compensation received from us in the demutualization, the plan could be amended to do so (taking into account the applicable nondiscrimination rules). Arguably, in deciding to adopt such an amendment, the plan sponsor would not be acting as a fiduciary, but it would be exercising business judgment as to appropriate plan design. Plan sponsors should consult with their own benefit counsel or advisors on this issue. Of course, the amendment would still have to comply with the technical rules of ERISA and the Code (e.g., no prohibited discrimination, no reduction of accrued benefits, etc.).

POLICYHOLDERS' PACKAGE, SPECIAL MEMBERS' MEETING & PUBLIC HEARING

YOUR PACKAGE INCLUDES:

- Policyholder Guide – Please read the instructions in this guide, and promptly complete, sign and return Cards 1 and 3, and, if applicable, Card 4. This Guide includes issues for employers and plan fiduciaries to consider.
- Ballot and Other Cards (Policyholders will receive Cards 1 and 2. Policyholders eligible for demutualization compensation will receive Cards 3 and 4).

CARD NUMBER	CARD NAME	WHAT YOU NEED TO DO
1	Ballot Card	Complete, sign and mail
2	Policyholder Record Card	Retain this card for your records
3	Taxpayer Identification Card	Complete, sign and mail
4	Form of Compensation Card	Complete, sign and mail only if: <ul style="list-style-type: none">• You are eligible to elect cash and• You prefer to receive cash rather than stock

- Policyholder Information Booklet (Parts One and Two).
- A postage-paid Business Reply return envelope. If you have misplaced the envelope, you may send the Cards to Demutualization Information Center, Church Street Station, P.O. Box 1481, New York, New York 10277-1481. Mailed Cards must be received prior to the close of the Special Members' Meeting on July 24, 2001.

ALL POLICYHOLDERS ARE INVITED TO THE FOLLOWING:

SPECIAL MEMBERS' MEETING*

Principal Mutual Holding Company
July 24, 2001, 9:00 a.m., Central Daylight Time
Corporate One Auditorium
711 High Street
Des Moines, Iowa 50392

PUBLIC HEARING BEFORE THE INSURANCE COMMISSIONER OF THE STATE OF IOWA*

July 25, 2001, 9:30 a.m., Central Daylight Time
Wallace Building Auditorium
State Capitol Complex
East 9th and Grand Avenue
Des Moines, Iowa 50319

*You are not required to attend the Special Members' Meeting or the Public Hearing in order to continue your policy or receive compensation under the Plan. For more details on the Special Members' Meeting or the Public Hearing, please refer to the Policyholder Information Booklet Part One. You may vote on the plan by (1) mailing in the ballot or (2) appearing in person at the Special Members' Meeting.

DEMUTUALIZATION INFORMATION CENTER

We have established a Demutualization Information Center to assist you. Because of regulatory restrictions, your agent or other company representative is not allowed to give you advice about the demutualization. However, our trained representatives can help answer your questions on the Plan or on completing the enclosed Cards.

THE TOLL-FREE NUMBER IS:

1-866-781-1368
(7 a.m. – 7 p.m., Central Daylight Time, weekdays)

OR WRITE US AT:

Demutualization Information Center
P. O. Box 4425
South Hackensack, New Jersey 07606-2025