

Business Owner Market Study

A Balancing Act – Priorities vs. Plans

Introduction

The impact of small businesses on the United States economy is monumental. According to the U.S. Small Business Administration (SBA), small businesses comprise about 44 percent of the total U.S. private-sector payroll. The SBA defines a small business as having fewer than 500 individuals. Small businesses collectively represent nearly 98 percent of all employer firms and half of all private-sector workers in this country.

The nearly 30 million small businesses in the United States play a vital role in the economic well-being of our country. From 1993 through the third quarter of 2008, small-business owners provided nearly two-thirds of all net new jobs.¹

¹ U.S. Small Business Administration, Office of Advocacy, September 2009

Executive Summary

The Principal Financial Group® has continually reinforced its commitment to keep its finger on the pulse of the small-business market by contracting with Harris Interactive to conduct national business-owner research. For the fourth time, the same framework was used to ask business owners the following overarching questions:

- How would you rank benefits in order of importance based on your priorities as a business owner?
- What benefits do you currently offer?
- If you're not currently offering a benefit, how likely are you to offer each benefit in the next 12 months?
- If you're currently offering a benefit, how likely are you to change each benefit in the next 12 months?





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Executive Summary, *continued*

The survey found that business owners' stated priorities often don't match the benefits they actually possess for the business or themselves, or those they offer to their employees. As shown in Table 1, business owners' top three priorities address business needs, employee benefits needs, and personal financial needs.

Table 1: The Top Three Priorities for Business Owners		
Business Needs	Employee Benefit Needs	Personal Financial Needs
<p>Business Protection is ranked first in priority as business owners recognize the value of protecting their businesses and keeping them viable and active. Twenty-three percent of businesses have taken action to secure key-person life insurance compared with only 14 percent in 2008. While this demonstrates a positive trend toward business protection, additional business planning may help business owners ensure their businesses are taken care of.</p>	<p>Group Health Benefits is ranked second in terms of importance across the board regardless of employee size or business owner's gender. Yet the percentage of group benefits offered hasn't changed; 42 percent of business owners offered health insurance both in 2008 and 2010. However, 32 percent of business owners stated that they plan to change their current health insurance in the next 12 months.</p>	<p>Income Protection is ranked third in priority, up from fifth in 2008. Although income protection is a higher priority in 2010, only one in four business owners – 24 percent -- has an individual disability insurance (IDI) policy, and only 4 percent plan to purchase IDI in the next 12 months.</p>

A look at stated priorities compared with actual benefit offerings in place indicates business owners may be experiencing difficulty achieving the balance they desire to protect their businesses' needs, their employees' benefit needs, and their own personal financial needs.

The survey also identified business owners' most important goals as well as their perceived issues for the coming year. The No. 1 stated goal is business growth, followed by business owners' continued involvement in their businesses following retirement and business stability.

The survey also looked at business owners' plans for transitioning their companies once they're ready to retire. Their short-term plans may be inadequate to enable them to achieve their long-term goals.

Implications

The discrepancy between priorities and actions may be a result of an operational focus and limited resources during challenging economic conditions. However, it also may be due to a lack of awareness of possible solutions – revealing a need for education around the needs of business owners and the wide array of solutions available to help them meet those needs.

Business owners are trying to balance their personal financial needs with the financial needs of their businesses and employees. While business owners focus on all aspects of their businesses, options exist to offer more employee benefits and to add plans to address their business needs. These plans also may address business owners' personal financial needs to help ensure the success of their business.

Business owners focus more on short-term goals than on planning for the future of their businesses, a practice that may adversely impact their long-term goals. For example, the lack of an exit plan could lead to numerous challenges when business owners are ready or need to transition out of their businesses. In addition, ignoring wealth-transfer planning could lead to negative personal financial outcomes.

Business owners recognize the importance of their key employees.² Special benefit packages and plans are designed for key employees to help business owners recruit, retain and reward these employees during and after the recent economic recession.

Business Owner Issues

Business owners were asked to respond to these issues for the upcoming year:

- Financial well-being in retirement
- Business goals
- Concerns in recruiting/retaining key employees
- Staffing plans
- Business lessons learned from the recession
- Impact of the recession on their businesses
- Anticipated business recovery

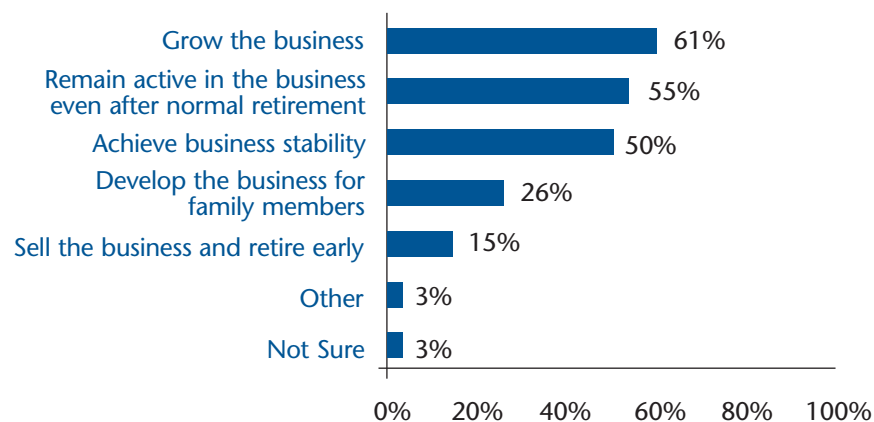
Financial well-being in retirement. More than four in 10 (44 percent) cite the ability to afford good medical care in retirement as their top concern. Nearly two out of five (39 percent) are concerned about being able to enjoy the same quality of life they currently enjoy, and 35 percent are most concerned about the cost of inflation, which may decrease their purchasing power. Again, the ability for business owners to plan ahead can help them overcome some of the concerns they may face in retirement.

Business goals. Business owners identified business growth as their No. 1 goal as shown in Chart 1. While half of them want to achieve business stability, even more indicate the desire to remain active in the business even after retirement.

² Key employees are vital to small businesses, which typically include highly visible and highly compensated employees whose performances most affect the financial success of the business.

Business Owner Issues, *continued*

Chart1 - Which of the following business goals apply to your business?



Concerns in recruiting/retaining key employees. Business owners – especially those who own businesses with large numbers of employees – recognize the importance of recruiting and retaining key employees.

- One in three owners of businesses with 50-99 employees (32 percent) are concerned about recruiting key employees in the next 12 months.
- More than one in three business owners with 200-499 employees (36 percent) are concerned about retaining key employees in the next 12 months.
- Of business owners who hope to add to their staffs in the next 12 months, 30 percent are concerned about recruiting and 27 percent are concerned about retaining key employees.

Staffing plans for the next year. The recent economic recession is holding business owners back from adding jobs in the next twelve months. While 68 percent of business owners plan to maintain the same staff level, the good news is that 20 percent plan to add to staff while only 6 percent plan to reduce staff. With the current unemployment rate above 9.5 percent, job growth will help with the momentum of an economic recovery.

Lessons learned from the recent economic recession. Many business owners have been through recessions before; of all qualified respondents, 80 percent have been in business six years or longer. The most-cited lesson learned for business owners (26 percent) was to be more diversified with their assets. In other words, business owners need to plan more effectively so their businesses are not the biggest parts of their wealth. Only one quarter of business owners (25 percent) responded that they feel the need to have an exit strategy in place.

Impact of recent economic recession on business. Thirty-six percent of business owners called the recession's impact as "disruptive but manageable." One in three respondents (33 percent) said the recession caused their businesses to become smaller or less profitable.

Anticipated business recovery. Finally, almost four in 10 business owners (36 percent) say it will take more than a year for their business to recover from the recent economic recession. However, of the business owners surveyed, almost a third (30 percent) indicated their businesses didn't suffer so no business recovery is needed.

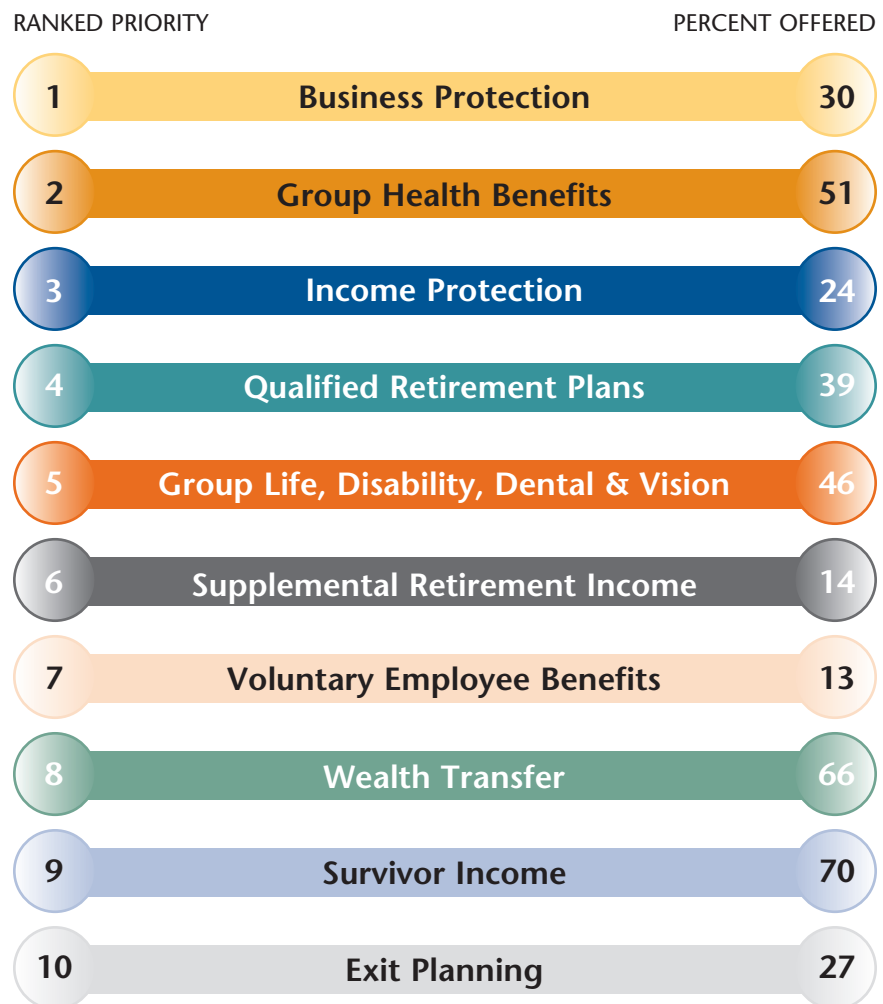
“You can go from ‘looks great’ to the brink of financial collapse in a matter of a few months.”

- Business owner's response when asked to identify lessons learned from the financial recession

Business Owners' Priorities

Business owners were asked to rank 10 benefit categories (see each section for definitions) from highest to lowest based on order of importance. They also were asked to identify the benefits they currently offer for their business, for themselves, and for their employees. The stated importance of those benefits is displayed on the left side of the graphic below, and the percent of business owners who actually offer that benefit are listed on the right.

Business Owner Key Findings Ranked Priority and Percent Offered



First Priority: Business Protection

Business Protection includes plans to help protect the integrity, cash flow and value of the business from the loss of a key employee due to death, disability, or termination of employment. These benefits help the business overcome additional expenses associated with recruiting and training new key employees or help keep the doors of the business open.

Although this ranked first in terms of business-owner priority, survey results show only one out of three business owners (30 percent) has a business protection plan in place.

- The most common form of protection offered is key person life insurance (23 percent), a significant increase from 14 percent in 2008.
- Approximately three out of four respondents (76 percent) who currently do not offer a plan report they will not add business protection in the next 12 months; however, among those who have plans in place, more than two-thirds (68 percent) indicate their plans have been reviewed within the last two years.
- However, fewer than 1 in 10 (9 percent) of business owners have key person disability insurance, and fewer than 1 in 20 (4 percent) have a disability overhead expense plan in place.

CONCLUSION: A few business owners have taken additional action over the last few months to help protect their businesses with key person life insurance. This business protection need was ranked second the last time the research was conducted, demonstrating that business owners are trying to protect their businesses financially during the recent economic recession.

Second Priority: Group Health Benefits

Group Health Benefits are employer-sponsored benefit plans that provide health insurance and other health-related benefits generally to all employees and their dependents.

The survey showed that fewer than half of business owners (42 percent) offer comprehensive health insurance to their employees – the same percentage as in 2008. As firm size increases, so does the likelihood that the business will offer health insurance. For example, only 29 percent of firms with two to nine employees offer health insurance as opposed to 80 percent of firms with 200 to 499 employees. Overall, health savings accounts (HSAs) and wellness services are offered by 14 percent and 10 percent, respectively.

Health insurance costs have risen 129 percent in the last 10 years. In fact, health premiums have risen almost five times as much as the overall rate of inflation since 2000.³

CONCLUSION: Given the current economic and regulatory environment in addition to increased health care costs, some business owners have been forced to terminate their health plans while preventing others, including newer businesses, from instituting one in the first place.⁴ Our research shows 63 percent of business owners that do not currently offer group health benefits do not plan to add any of these benefits in the next 12 months.

Key Person Life Insurance is insurance on the life of a key employee to help reimburse an employer for the economic loss caused by the death of the employee.

Key Person Disability Insurance is an individual disability insurance policy designed to provide business owners with the funds necessary to compensate for the loss of a key employee due to a total disability.

Disability Overhead Expense Insurance reimburses an owner for covered overhead expenses up to a specified amount when a disability occurs.

Comprehensive Health Insurance is a variety of benefit design options that may include managed care provisions, employee-level choice of benefit designs and providers, and coordination of benefits.

Health Savings Accounts are tax-advantaged trusts or custodial accounts created for the benefit of individuals covered under a qualified High Deductible Health Plan (HDHP).

Wellness services are designed to effectively encourage a lowering of claims costs by preventing claims from being incurred through overall health improvement.

³ "Employers, Workers, and the Future of Employment-Based Health Benefits." EBRI Issue Brief #339. February 2010

⁴ National Federation of Independent Businesses, Small Business Problems & Priorities, June 2008

Third Priority: Income Protection

Income Protection is designed to protect business owners in the event of a disabling illness or injury. Individual Disability Insurance (IDI) helps replace a portion of income lost due to a disability.

Results of the survey showed that only one-quarter (24 percent) of business owners have individual disability insurance (IDI) plans for themselves. This percentage decreased from the 31 percent reported in the prior study AND is not expected to increase drastically, as only 4 percent of business owners plan to purchase income protection in the next 12 months. About two-thirds of business owners (64 percent) are more open to reviewing their income protection plans than they have been in the past – likely a result of the recent economic recession.

CONCLUSION: A disconnect exists between business owners' stated priorities and their actions. Although income protection is now identified as a more important priority – ranking fifth in 2008 and third in 2010 – the number of business owners who own income protection plans decreased from 2008 to 2010. Business owners recognize the need for income protection, especially in this economic environment, but other factors play in to their purchase decisions. According to the First Quarter 2010 Well-Being Index from The Principal, the main reasons for not purchasing individual disability insurance include: perceived cost, coverage from other carriers, and a belief that it's not necessary.

401(k) plan – A defined contribution (DC) plan permits employees to contribute a portion of their pay on a pre-tax or after-tax basis, also known as an elective deferral.

SEP (Simplified Employee Pension IRA) – A retirement plan established by a business owner or self-employed individuals for themselves and eligible employees.

Profit Sharing – A qualified retirement plan established by an employer for the benefit of its employees and their beneficiaries in which contributions may vary each year according to the company's actual profits.

SIMPLE (Savings Incentive Match Plan for Employees IRA) – A retirement plan established by business owners, including self-employed individuals.

Fourth Priority: Qualified Retirement Plans

Qualified Retirement Plans are defined contribution and defined benefit retirement solutions that include plans such as 401(k), traditional defined benefit, profit sharing, SIMPLE IRAs and SEP IRAs. These benefits are generally made available to all eligible employees.

Survey results showed that almost four of 10 business owners (39 percent) offer qualified retirement plans to their employees. The most commonly offered retirement plan is a 401(k) plan (23 percent), followed by profit sharing (8 percent), SIMPLE (6 percent), and SEP (4 percent).

Larger companies are significantly more likely than smaller companies to offer a 401(k) plan to their employees. For example, 79 percent of companies with 200 to 499 employees offer a 401(k) plan compared with 28 percent of companies with 10 to 49 employees.

Of the business owners who don't currently offer a qualified retirement plan to their employees, approximately one in 10 (10 percent) plan to implement a retirement plan in the next 12 months.

CONCLUSION: Qualified retirement plans remain a steadfast opportunity for employees to save for retirement by taking advantage of employer contributions and investment options. Offering a qualified retirement plan also provides benefits to the business owner, such as tax benefits for both business owners and employees, a convenient way to save for retirement, and a means of attracting and retaining top talent.

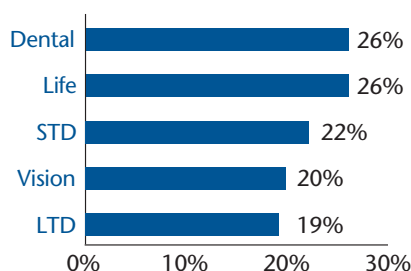
Fifth Priority: Group Non-Medical Benefits

Group Non-Medical Benefits are employer-sponsored plans including life, short-term disability (STD), long-term disability (LTD), dental and vision insurance. Supplemental disability programs that provide individual disability income insurance for key employees are also included in this benefit category. The employer can pay all or part of the premium.

The research showed:

- The priority ranking for group non-medical benefits remained unchanged from the previous study despite the recent economic recession.
- More than half of business owners surveyed (54 percent) do not offer any group non-medical employee benefits.
- Dental and life insurance are the most commonly offered non-medical benefits. Both are offered by more than one quarter (26 percent) of business owners.
- The percent of non-medical benefits offered increases with the size of the business. For example: while only 13 percent of business owners with two to nine employees offer dental benefits, 76 percent of business owners with 200 to 499 employees offer them.
- Only a small percentage of business owners – 1 percent to 5 percent – plan to add non-medical coverage in the next 12 months. On the other hand, few business owners (1 percent to 3 percent) plan to drop coverage, and as many as 5 percent plan to convert to voluntary or reduce coverage.
- Supplemental disability programs are offered by 11 percent of business owners. About half of business owners – 53 percent – pay the entire premium. Executives and other highly compensated individuals usually choose this option because their earnings are higher than group long-term disability coverage (31 percent).

Current Non-Medical Offerings:



“Taking care of key people will keep them around.”

- Business owner's response when asked why offering supplemental disability program is important.

CONCLUSION: Small-business owners recognize the need to provide strong benefit packages to their employees, and they consider group non-medical benefits among their top five benefit priorities. However, many business owners have taken a wait-and-see approach – potentially attributable to the recent economic recession and uncertainty due to health care reform – when it comes to enhancing their benefit offerings.

Executive Bonus Plan (IRC

Section 162) – The plan involves the purchase of financial products for select employees. The employer pays the premium, which is included in the taxable wages of the employee. The employee owns the product and all rights to the product. The employer has no rights or ownership of the financial product.

Deferred Compensation (defined contribution)

– A compensation arrangement established by business owners to provide retirement income to select employee(s). The contractual commitment is between an employer and the participant(s) that specifies how plan distributions will be paid. The plan usually includes an account balance.

Deferred Compensation (defined benefit)

– A compensation arrangement established by business owners to provide retirement income to select employee(s). The contractual commitment is between an employer and the participant(s) that specifies how plan distributions will be paid. The promised benefit is usually paid as an annual income stream or future monthly benefit.

Sixth Priority: Supplemental Retirement Plans

Supplemental Retirement Plans may include nonqualified supplemental retirement benefits and are generally offered only to key employees whose performance most affects the success of the business. These benefits can help recruit, reward and retain key employees and help them make up for lost benefits due to government restrictions placed on qualified retirement plans.

The research showed that only 14 percent of business owners offer some type of supplemental retirement plans for themselves or their key employees. Among business owners with 200 to 499 employees, the use of executive bonus plans continues to increase; 24 percent of business owners offer them, compared with 17 percent in 2008. Owners of larger companies (200 to 499 employees) are significantly **more** likely to offer nonqualified deferred compensation (defined benefit plans at 12 percent or defined contribution plans at 11 percent) as compared with business owners with two to nine employees (defined benefit plans at 3 percent or defined contribution plans at 2 percent).

With regard to qualified plan contribution limits:

- Nearly two-thirds of business owners (64 percent) indicate that they or their key employees are limited in the amount they are allowed to contribute to their qualified retirement plans.
- However, most business owners (81 percent) do not offer supplemental retirement plans that can help overcome this limitation.

CONCLUSION: An imbalance exists between business owners' offerings and their key employees' retirement needs. These results indicate a need for business owners to find ways to provide retirement savings opportunities beyond their companies' qualified retirement plans.

Seventh Priority: Voluntary Benefits

Voluntary Benefits are employer-sponsored benefits that require premiums to be paid by employees, usually through payroll deduction. These benefits may include life, short- and long-term disability, dental, vision, long-term care, cancer care, critical illness and accident insurance.

From the research:

- The most commonly offered voluntary benefits, in order of frequency, include dental, life, accident, long-term disability and cancer insurance.
- Among business owners who offer voluntary benefits, most (52 percent) say they offer them to attract and retain employees; 48 percent say they do so to improve worker morale or satisfaction.
- A combination of group and one-on-one meetings, offered by 38 percent of business owners, are the most popular enrollment methods used to educate employees.

CONCLUSION: Given the uncertainty associated with the economy and health care reform, business owners are taking a wait-and-see approach with regard to enhancing their employee benefit packages. Having voluntary benefits in place, however, enables business owners to control expenses and attract and retain employees; it also enables business owners to offer a broad portfolio of employee benefits.

Eighth Priority: Wealth Transfer

Wealth Transfer is the preparation of plans and/or agreements to ensure that all assets – personal and business – are in place to meet business owners' lifetime objectives and are distributed in the most equitable and efficient manner consistent with goals and objectives.

Of the business owners surveyed, 66 percent of business owners have some type of plan in place for wealth transfer. Almost half of all business owners (47 percent) have a will in place. Our research also shows that:

- In 2010, 15 percent of business owners possess a family trust, a significant difference as only 7 percent did so in 2008.
- In 2010, 8 percent of business owners possess an Irrevocable Life Insurance Trust (ILIT), a significant difference, as only 3 percent did so in 2008.

CONCLUSION: The area of wealth transfer demonstrated the greatest number of significant changes in any benefit category. More business owners took action to preserve and plan for the wealth they still have left.

Yet half of business owners are putting their families and businesses at risk by having neglected to create a will.

Ninth Priority: Survivor Income

Survivor Income includes individual life insurance for business owners, which may help protect their families in the event of a business owner's premature death. Survivor income also provides solutions for business owners to help their families achieve specific financial objectives.

Business owners tend to have more life insurance than key employees and rank-and-file employees. Our research shows that 70 percent of business owners have life insurance, while LIMRA research shows that 56 percent of individuals with incomes of \$100,000 and more³ – which have a greater likelihood of including key employees – have life insurance. Of all U.S. households, slightly more than four in 10 (44 percent) have individual life insurance, representing a 50-year low.⁵

CONCLUSION: Business owners have more life insurance than the affluent market (incomes of \$100,000 or higher) and all U.S. households. Yet 30 percent are placing their families and their businesses at risk by neglecting to have individual life insurance coverage. Even affluent households – those earning \$100,000 or more – lack sufficient life insurance. One-third said they do not have enough coverage, according to LIMRA research.

Will - A document outlining how much wealth will be transferred upon death. Three common provisions include naming a guardian for children, creating trusts and naming an executor.

Family Trust (Credit Shelter Trust) - The trust is designed to minimize federal estate taxes for the benefit of the family. It typically passes on the one million exemption of the first spouse to die to the children instead of the surviving spouse.

Irrevocable Life Insurance Trust – A trust in which the grantor transfers life insurance to the trust, and retains no rights to revoke, terminate or modify the trust.

⁵ 2010 LIMRA 2010 Life Ownership Study

Death Buy-Sell – This agreement establishes a predetermined business price and a buyer for the business interest when a partner or owner dies. Life insurance is commonly used to help provide the funding needed for the buy-sell agreement.

Disability Buy-Sell – An agreement establishes a predetermined business price and a buyer for the business interest when a partner becomes disabled.

Retirement Exit Planning – Exit planning helps business owners set exit goals and help maximize financial return when the business is transferred and may help minimize the tax liability.

Tenth Priority: Exit Planning

Exit Planning includes formal agreements established by and between business owners, family members, key employees or other third parties to help provide for the continuation or sale of the business.

Our research shows:

- Only one-quarter of business owners (27 percent) have an exit plan, leaving the vast majority of business owners without a plan to leave their businesses.
- Of those who currently have a plan in place, only two in 10 business owners (18 percent) have funded a buy-sell plan with life insurance, and slightly more than one in 10 (11 percent) have funded a buy-sell plan with disability buy-out insurance.
- Business owners who plan to add staff in the next 12 months are significantly **more** likely to have specific types of plans in place compared with business owners who plan to maintain their employee base.
 - Nineteen percent of business owners who plan to add staff have a retirement exit plan in place compared with 8 percent of business owners who plan to maintain their employee base.
 - Thirty-one percent of business owners who plan to add staff own a buy-sell plan funded with life insurance compared with 14 percent of business owners who plan to maintain their employee base.
- In addition, business owners generally seem ill-prepared to take any action to exit their businesses, as more than six in 10 (62 percent) have never had a business valuation. Without a business valuation, business owners may not know the full worth of their businesses, or they may not know if an offer to buy is lucrative.
- Almost a third of business owners (31 percent) do not plan to retire. Of those who do plan to, three in 10 (30 percent) plan to sell their businesses to outside parties; yet as stated above, almost two-thirds have never sought a business valuation.

CONCLUSION: When business owners do plan to sell their businesses, their asking prices might not reflect actual market value. Business valuations need to be updated over time since about half (45%) plan to retire at least five years from now. That time frame may allow them to work through the challenges of the recent economic recession, help them to grow their businesses and improve their personal financial situations.

“My intentions are to pass the helm to family members already involved in day-to-day activities. However, if a lucrative offer is made by an outside entity and greatly benefits the company and keeps the company integrity and valuation then that might also be considered.”

- Business owner's response when asked, “What are your plans for your business when you retire?”

Overall Considerations for Business Owners

- Review your current benefit offering, making sure it reflects your goals and priorities for yourself, your key employees and your business.
- Work with a financial advisor to draft a comprehensive benefit plan that balances the need to meet your financial needs as well as those of your key employees and the business as a whole.
- Take note of the benefits you don't offer, evaluating your need for them in terms of current "pain points" or areas of need.
- Educate yourself about available and recommended benefits. Ask for input from a financial advisor and from other business owners.
- Recognize the importance of networking with business peers in your community.
- Learn best practices and ways to improve your benefit offerings to improve both the short-term operations and long-term planning of your business, the business you worked so hard to build.
- Avoid allowing short-term necessities to cloud the need for long-term planning.

Research Methodology

The survey was conducted by Harris Interactive® and includes 511 online interviews conducted from July 13, 2010, to August 9, 2010. Interviews were conducted using our Harris Interactive® Small Business Panel.

Respondents qualified for this survey if they met the following criteria:

- United States residents age 21 and older
- Currently employed, either full-time, part-time or self-employed
- Business owner of at least 5 percent of the company
- Actively manage their business
- Own a company with between 2 and 500 employees, with quotas by completed interviews as follows:
 - Business owners with 2-9 employees (n=104)
 - Business owners with 10-49 employees (n=102)
 - Business owners with 50-99 employees (n=103)
 - Business owners with 100-199 employees (n=101)
 - Business owners with 200-499 employees (n=101)

Results were weighted for company size based on the number of employees, entity type, and annual sales. Potential respondents for this survey were selected from among those who have agreed to participate in Harris Interactive® surveys. Because the sample is based on those who agreed to be invited to participate in the Harris Interactive® online research panel, no estimates of theoretical sampling error can be calculated.

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About Harris Interactive®

Harris Interactive is one of the world's leading custom market research firms, leveraging research, technology, and business acumen to transform relevant insight into actionable foresight. Known widely for the Harris Poll and for pioneering innovative research methodologies, Harris offers expertise in a wide range of industries including healthcare, technology, public affairs, energy, telecommunications, financial services, insurance, media, retail, restaurant, and consumer package goods. Serving clients in over 215 countries and territories through our North American, European, and Asian offices and a network of independent market research firms, Harris specializes in delivering research solutions that help us – and our clients – stay ahead of what's next. For more information, please visit www.harrisinteractive.com.



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