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ON BEHALF OF

PRINCIPAL FINANCIAL GROUP

BEFORE A HEARING OF THE

UNITED STATES SENATE COMMITTEE ON FINANCE

ON

OPPORTUNITIES AND CHALLENGES IN THE U.S.-CHINA ECONOMIC RELATIONSHIP

MARCH 27, 2007

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Thank you, Chairman Baucus, Ranking Member Grassley, and members of the Committee, for the opportunity to testify today on "Opportunities and Challenges in the U.S.-China Economic Relationship".

I am Norman Sorensen, President and CEO of Principal International, Inc. a wholly owned subsidiary of the Principal Financial Group. I testify before you today in my current role at the Principal Financial Group, and with the perspective as Chairman of the International Committee of the American Council of Life Insurers. The Principal Financial Group is an Iowa-based financial services company focused on retirement benefits and asset management, both here in the United States and overseas. As the nation's 401(k) leader we have a particular interest in providing long term savings for employers, employees, and individuals which will benefit them during their retirement years.[1] A focus on pension products has served us well as we've accumulated over $250 billion in assets under management from 16 million customers, serviced by our 15,100 employees (9,396 staff in Iowa) in 11 countries.

The retirement savings vehicles that have been successful here in the United States have been emulated and modified in other markets as well. In newly developing countries in which the Principal Financial Group operates, savings have been significant and the seeds for wealth creation have been planted. In Hong Kong, the Mandatory Provident Pension Fund has reached 2 million participants and comprises 85% of all employed persons, all since 2000. In Brazil, the voluntary pension system has accumulated $49 billion from 8 million participants since 1994. In Chile, a country of only 7 million workers (or 16 million people), the assets accumulated in their defined contribution pension system have reached $89 billion, or 70% of Chile's GDP.

That level of success has not yet reached China. By way of support to China's economic development, I was honored to be able to render testimony on May 11th, 2000 before the Committee on Banking and Financial Services of the U.S. House of Representatives on the subject of granting Permanent Normal Trade Relationship (PNTR) status to China, which culminated in China being allowed to join the World Trade Organization. I was further honored to be able to render testimony on May 17th, 2005 before the Sub-committee on Trade of the Committee on Ways and Means of the U.S. House of Representatives on the subject of liberalization of financial services trade with China, and opening China's financial markets to U.S. companies.

In spite of the progress made by China in the past seven years in opening up its financial services markets, much still needs to be done to provide future financial and retirement security to Chinese households. China has a very basic social support program, which has been the

[1] The Principal ranks number one in plans among companies that provide both administrative and investment services – 2006 Spectrem Group analysis of fully-bundled 401(k) providers.

predominant government vehicle for the provision of benefits for those who are able to work within a state-owned enterprise. Up until this year, there was no formal retirement savings program in China.

That is why the new Enterprise Annuity Pension System is so crucial for China and the support of their retirement social safety net. The Enterprise Annuity (EA), a program similar to our 401(k) system, is also critical for retirement benefits-focused companies like Principal Financial Group. In the spring of 2005, Chinese regulators started establishing an enterprise annuity system as a second pillar individual account, defined contribution retirement program. Conservatively, our estimates indicate that within 10 years the assets under management for this program should be close to $100 billion. Within 25 years they should reach $1 trillion, which is how long it has taken the U.S. 401(k) system to reach its current $3 trillion in assets. Participating in this type of growth is paramount for firms in worldwide retirement benefits leadership positions. The Principal has proven that it can successfully adapt to local market conditions and thrive.

From the Principal Financial Group point of view, we believe we have already developed a significant success story within China as evidenced by our robust asset management company, CCB Principal Asset Management Co., and yet we began operations less than two years ago. Evidence of this success includes the following milestones:

- Joint venture asset management partnership with China Construction Bank. This bank is the third largest in China and was ranked 11th out of the top 1,000 global banks by The Banker Magazine with respect to capital adequacy. The bank has 14,250 bank branches, 300,000 employees and over US$667 billion in total assets, as of June 30, 2006.
- Rolled out four mutual funds since November of 2005 with the most recent retail mutual fund accumulating US$1.25billion (RMB 10 billion) in subscriptions in a single day.
- The joint venture has also earned awards for most innovative fund and also awards for sales distribution excellence.
- The Principal has integrated some of its own staff and processes into the fund company in an effort to develop worldwide best practices within the Chinese asset management industry.

All of these accomplishments are significant and have come about within a relatively short period of time. We have become one of the major asset management players in China (20 out of 60), but there is much yet to achieve, and we hope that regulatory changes in China will make that possible.

The Principal, along with many other U.S. life insurance and financial services companies, sees great promise in the Chinese retirement security market. We believe that development of the Chinese EA market represents a fortuitous win–win opportunity for the U.S. and China – one which we should all work to expand.

It is in this vein that our industry has and will continue to encourage the discussion on "building the enterprise annuity market to support the Chinese social safety net" under the framework of the current Strategic Economic Dialogue (SED) led by Treasury Secretary Henry Paulson. This extremely broad and influential bilateral dialogue should be leveraged to support allowing U.S. financial service providers to access the Chinese enterprise annuity market on an unrestricted basis. Such an outcome would bring our world class products and expertise to meet China's need for increased private retirement savings products.

As ACLI International Committee Chair, I was with ACLI's CEO, Governor Frank Keating in Beijing in January meetings with Chinese officials and U.S. insurers. The objectives of those meetings are included in a February 27th letter from Governor Keating to the Honorable Henry M. Paulson, Secretary of the Treasury. A copy of the letter is attached to my statement. We currently have a tremendous opportunity through the SED to elevate the importance of this issue in the minds of Chinese leaders. Doing so will empower economic reform in China, while simultaneously opening a vast market to U.S. Financial Services providers.

1. Enterprise Annuity

The Principal Financial Group and ACLI welcome the creation of the Enterprise Annuity Pension system. However, the rules and standards for the provision of EA services remain unclear. The regulations currently prevent one company from providing a comprehensive package of services (custodian, administration, asset management, and trustee). China should clarify the regulatory framework to authorize single provider plans under a single license, which would enable a "one stop shop" to improve cost effectiveness of the plans, particularly for small and medium enterprises in China.

The EA pension system needs changes and this is precisely the right time to implement them. The system is in a nascent stage and changes would not unduly harm or competitively impact either domestic or foreign providers. In fact, the changes identified would help to grow the market substantially, increasing the participation of employers and employees, and decreasing the future pension debt burden on the Chinese government.

EA System - Needed Changes:

Tax Incentives: A number of provinces in China have issued policies that provide various levels of tax incentives for corporate EA contributions, while many others do not have such policies in place. On the employee side, there is no individual income tax incentive for EA contributions. We believe that tax incentives are necessary for promoting private pensions and are crucial to the healthy development of the pension market. Therefore, we recommend that the State Tax Bureau and the Ministry of Finance enact unified national tax incentive policies for both employer and employee contributions to EA.

Foreign Participation Limit: Foreign participation in the enterprise annuity market should be encouraged in the interest of introducing tested professional pension management experiences from other mature pension markets in the world to the fledgling EA market in China. As pension is included in China's WTO commitments under the section covering life insurance, we believe that foreign equity ownership in all EA service provider entities should be allowed up to (at least) the same current limit as life insurance companies (50%).

This limit however should represent a floor and not a ceiling, and as part of SED and in support of building momentum for the WTO's Doha Round Negotiations, the Principal, along with ACLI, call for the Government of China removing this limitation and allowing 100% ownership, as further expressed in the ACLI SED priorities letter I have previously referenced.

Master Trust Plan: The EA rules as they stand now do not allow master trust plans, hence all EA plans have to be set up as individual trusts. This makes small plans unattractive to service providers. There is a strong need on the part of medium and small size companies for such plans in order to enjoy good quality service at a lower cost. Current rules effectively shut the small companies out of the enterprise annuity market. We encourage the Ministry of Labor and Social Security (MOLSS) to work with various other Chinese regulators to allow EA service providers to offer master trusts such that the medium and small size market can also be covered.

Pension Asset Investment: EA rules stipulate that no more than 20% of EA assets can be direct equity investments and no more than 30% can be investments in equity-related investment. This significantly limits the potential for higher long term returns for pension assets. In addition, the kinds of investment options allowed for EA assets are rather limited, too. We believe that a higher percentage should be allowed in equities, and that EA service providers should be allowed a broader range of investment options. This will help ensure a higher long term return for pension assets while at the same time allowing for prudent diversification to control risks. In addition, there should be a timeline for allowing pension assets to be partially invested overseas to further diversify their risk. Adding to offshore investments is a formula that has worked well for other markets, namely Chile where 30% of the assets can be invested offshore and the expectation is within two years to increase that level to 60%. It is a natural evolution in an effort to further diversify and insulate the system from local country risks as evidenced by Mexico enhancing their offshore allocations in the last two years.

In a recent global retirement benefits study, Principal Financial Group found that only 15% of Chinese respondents have tried to figure out how much money they will need to have saved by the time they retire so that they can live comfortably in retirement. Perhaps this poor planning is because almost half expect financial support from their families when they retire and almost a quarter expect to live with their children or relatives. Another reason may be that Chinese households receive advice about financial and retirement planning from magazines and newspapers (33%), television and radio (28%), or friends and relatives (17%), rather than banks (3%) or insurance or pension companies (2%) or other recognized sources of expertise.

Pension Regulator: While MOLSS (Ministry of Labor and Social Security) is the main regulator for EA, a lot of collaboration is needed between MOLSS and the other financial service regulators such as China Securities Regulatory Commission (CSRC), China Banking Regulatory Commission (CBRC), and China Insurance Regulatory Commission (CIRC). Further, it requires a lot of work and manpower to set up and run a well-regulated private pension market in China and much more dedicated and focused resources are needed at the regulator level, without which the policy making and approval process would naturally be slow. We believe that it is vital to have a fully staffed centralized decision-making pension regulator with dedicated resources so as to ensure that the EA regulatory system remains sound and healthy.

2. Financial Services Industry

We at Principal are very supportive of the objectives called for by the broad array of U.S. financial services companies for China and its financial services reforms. While the Chinese authorities agreed to wide-sweeping modifications in order to join the World Trade Organization, ACLI have outlined where some gaps still exist in the treatment of U.S. and global insurance companies.

Our objectives are simple and universal:

- Freedom to choose our juridical form of establishment (branch, subsidiary or joint-venture);

- The ability of a foreign financial firm to own 100% of its operations;

- Non-discriminatory treatment of foreign companies;

- Full transparency in regulation, supervision and establishment of a centralized administrative procedures process.

ACLI's highest priority for improved market access in China is the removal of equity limitations on foreign life insurance providers, and we believe China has the opportunity to show leadership by removing this restriction and allowing increases in the equity investment of foreign companies consistent with prudential regulation and the interests of current investors. Thus, we would urge China to remove the limitation on foreign ownership.

In conclusion, I sincerely appreciate the interest of the Committee, and ask for your support to leverage the Strategic Economic Dialogue to realize a positive outcome from the SED's next meeting in Washington in late May. Our industry and I are assiduously working with the Departments of Treasury, State, Labor, Commerce, and HHS, along with the Office of the U.S. Trade Representative to advocate for positive commercial outcomes from the SED, and I would be pleased to keep you informed of our efforts.

Thank you.

//ACLI
Financial Security. For Life.

Frank Keating
President & Chief Executive Officer

February 27, 2007

The Honorable Henry M. Paulson
Secretary
Department of the Treasury
1500 Pennsylvania Avenue, N.W.
Washington, DC 20220

Dear Secretary Paulson:

To continue the expansion of the global economic relationship between the United States and the People's Republic of China, the American Council of Life Insurers (ACLI) requests that an important element be included under the newly-created Strategic Economic Dialogue (SED): the critical need to assure long-term financial security for the rapidly aging societies of both our countries, in the current Chinese lexicon "Supporting the Social Safety Net".

To achieve this we propose two issues be included under the SED Services Dialogue which we feel are optimally convergent with the broad range of topics to be included in SED and at the same time support U.S. financial services export priorities.

First, the U.S. financial services industry would like to see China increase its openness to foreign investment in its financial services sector. Greater foreign participation would advance China's goals of strengthening and modernizing its financial services sector and the U.S. goal of unlocking China's precautionary savings and stimulating domestic demand-led growth in China. Increased foreign investment also would allow U.S. providers greater opportunities to provide new and innovative products from life insurance to health insurance to pensions. To attract more investment, China will need to provide national treatment for foreign firms, transparent licensing procedures, and liberalization of corporate juridical form (branch, subsidiary or joint venture), including moves toward one hundred percent foreign ownership. The latter step is especially important in the current global trade environment as it would demonstrate China's positive leadership in the WTO Doha negotiations.

Second, as a specific example of new access that would advance the broad goals of the Strategic Economic Dialogue, the U.S. financial services industry requests that the Chinese Government complete and implement the new Enterprise Annuity (EA) pension regulations without delay.

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This new national pension program should be managed by private companies or Joint Ventures owned or controlled by domestic or U.S. insurers, asset managers or banks, with a simplified single license including asset management, record keeping, trusteeship and custodial services. The EA system should allow U.S. financial services companies to operate on a nationwide, unrestricted basis under reasonable minimum capital requirements.

ACLI and its members, all of whom are actively engaged in advocacy on Capitol Hill, believe that adoption by the Chinese Government of these measures within the scope of the Strategic Economic Dialogue would significantly advance the rapid progress of the SED and, equally important, would help remove structural impediments in China's financial sector that impede progress on other U.S. priorities.

ACLI along with our educational affiliate the International Pension Foundation, are prepared to organize academic and policy stakeholder forums in Beijing and Washington in advance of the next SED to lay groundwork in support of governmental discussion of these topics. I and our entire membership appreciate the Administration's leadership and are prepared to support in every way.

Sincerely,

Frank Keating