

PRINCIPAL FINANCIAL GROUP INC

Form 10-Q

October 28, 2015

[Table of Contents](#)

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

**x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

For the quarterly period ended September 30, 2015

OR

**o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE
ACT OF 1934**

1-16725

(Commission file number)

PRINCIPAL FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of incorporation or organization)

42-1520346

(I.R.S. Employer Identification Number)

711 High Street, Des Moines, Iowa 50392

(Address of principal executive offices)

(515) 247-5111

(Registrant's telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☒

Accelerated filer ☐

Non-accelerated filer ☐
(Do not check if a smaller reporting company)

Smaller reporting company ☐

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ☐ No ☒

The total number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of October 21, 2015, was 292,751,140.

Table of Contents

PRINCIPAL FINANCIAL GROUP, INC.

TABLE OF CONTENTS

| | Page |
|--|-------------|
| <u>Part I - FINANCIAL INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Financial Statements</u> | 3 |
| <u>Consolidated Statements of Financial Position at September 30, 2015 (Unaudited) and December 31, 2014</u> | 3 |
| <u>Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014</u> | 4 |
| <u>Unaudited Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2015 and 2014</u> | 5 |
| <u>Unaudited Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2015 and 2014</u> | 6 |
| <u>Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2015 and 2014</u> | 7 |
| <u>Notes to Unaudited Consolidated Financial Statements - September 30, 2015</u> | 8 |
| <u>Item 2.</u> | |
| <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u> | 91 |
| <u>Item 3.</u> | |
| <u>Quantitative and Qualitative Disclosures about Market Risk</u> | 127 |
| <u>Item 4.</u> | |
| <u>Controls and Procedures</u> | 133 |
| <u>Part II - OTHER INFORMATION</u> | |
| <u>Item 1.</u> | |
| <u>Legal Proceedings</u> | 133 |
| <u>Item 1A.</u> | |
| <u>Risk Factors</u> | 133 |
| <u>Item 2.</u> | |
| <u>Unregistered Sales of Equity Securities and Use of Proceeds</u> | 134 |
| <u>Item 6.</u> | |
| <u>Exhibits</u> | 135 |
| <u>Signature</u> | 136 |

[Table of Contents](#)**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Principal Financial Group, Inc.****Consolidated Statements of Financial Position**

| | September 30, 2015 (Unaudited) | December 31, 2014 |
|--|--------------------------------------|----------------------|
| | (in millions) | |
| Assets | | |
| Fixed maturities, available-for-sale (2015 and 2014 include \$261.1 million and \$278.2 million related to consolidated variable interest entities) | \$ 49,780.6 | \$ 49,670.8 |
| Fixed maturities, trading (2015 and 2014 both include \$100.4 million related to consolidated variable interest entities) | 710.2 | 604.6 |
| Equity securities, available-for-sale (2015 includes \$315.8 million related to consolidated variable interest entities) | 465.3 | 123.0 |
| Equity securities, trading (2015 and 2014 include \$321.2 million and \$345.3 million related to consolidated variable interest entities) | 869.1 | 840.2 |
| Mortgage loans | 12,232.1 | 11,811.6 |
| Real estate (2015 and 2014 include \$298.9 million and \$284.9 million related to consolidated variable interest entities) | 1,415.0 | 1,344.6 |
| Policy loans | 822.8 | 829.2 |
| Other investments (2015 and 2014 include \$36.8 million and \$40.6 million related to consolidated variable interest entities and \$56.6 million and \$127.2 million measured at fair value under the fair value option) | 3,270.4 | 3,209.8 |
| Total investments | 69,565.5 | 68,433.8 |
| Cash and cash equivalents | 2,514.2 | 1,863.9 |
| Accrued investment income | 566.8 | 505.9 |
| Premiums due and other receivables | 1,401.6 | 1,213.0 |
| Deferred acquisition costs | 3,145.0 | 2,993.0 |
| Property and equipment | 611.6 | 590.2 |
| Goodwill | 1,005.2 | 1,007.4 |
| Other intangibles | 1,398.9 | 1,323.5 |
| Separate account assets (2015 and 2014 include \$32,827.6 million and \$34,655.4 million related to consolidated variable interest entities) | 134,045.8 | 140,072.8 |
| Other assets | 1,110.8 | 1,083.5 |
| Total assets | \$ 215,365.4 | \$ 219,087.0 |
| Liabilities | | |
| Contractholder funds (2015 includes \$329.2 million related to consolidated variable interest entities) | \$ 35,115.2 | \$ 34,726.7 |
| Future policy benefits and claims | 25,521.7 | 24,036.6 |
| Other policyholder funds | 819.5 | 812.7 |
| Short-term debt | 221.6 | 28.0 |
| Long-term debt (2015 and 2014 include \$38.2 million and \$82.3 million related to consolidated variable interest entities) | 3,286.1 | 2,531.2 |
| Income taxes currently payable | 16.7 | 11.5 |
| Deferred income taxes | 878.8 | 1,035.3 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | |
|---|---------------------|---------------------|
| Separate account liabilities (2015 and 2014 include \$32,827.6 million and \$34,655.4 million related to consolidated variable interest entities) | 134,045.8 | 140,072.8 |
| Other liabilities (2015 and 2014 include \$340.7 million and \$344.0 million related to consolidated variable interest entities, of which \$64.7 million and \$71.0 million are measured at fair value under the fair value option) | 5,696.2 | 5,542.2 |
| Total liabilities | 205,601.6 | 208,797.0 |
| Redeemable noncontrolling interest | 78.0 | 58.0 |
| Stockholders' equity | | |
| Series A preferred stock, par value \$.01 per share with liquidation preference of \$100 per share 0.0 million and 3.0 million shares authorized, issued and outstanding in 2015 and 2014 | | |
| Series B preferred stock, par value \$.01 per share with liquidation preference of \$25 per share 0.0 million and 10.0 million shares authorized, issued and outstanding in 2015 and 2014 | | 0.1 |
| Common stock, par value \$.01 per share 2,500.0 million shares authorized, 466.0 million and 462.7 million shares issued, and 293.5 million and 293.9 million shares outstanding in 2015 and 2014 | 4.7 | 4.6 |
| Additional paid-in capital | 9,524.2 | 9,945.5 |
| Retained earnings | 6,734.7 | 6,114.1 |
| Accumulated other comprehensive income (loss) | (524.4) | 50.4 |
| Treasury stock, at cost (172.5 million and 168.8 million shares in 2015 and 2014) | (6,118.9) | (5,930.7) |
| Total stockholders' equity attributable to Principal Financial Group, Inc. | 9,620.3 | 10,184.0 |
| Noncontrolling interest | 65.5 | 48.0 |
| Total stockholders' equity | 9,685.8 | 10,232.0 |
| Total liabilities and stockholders' equity | \$ 215,365.4 | \$ 219,087.0 |

See accompanying notes.

[Table of Contents](#)**Principal Financial Group, Inc.****Consolidated Statements of Operations****(Unaudited)**

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|----------|--|------------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions, except per share data) | | | |
| Revenues | | | | |
| Premiums and other considerations | \$ 1,557.1 | \$ 875.8 | \$ 4,155.9 | \$ 2,514.8 |
| Fees and other revenues | 891.9 | 884.5 | 2,744.2 | 2,569.7 |
| Net investment income | 753.5 | 770.4 | 2,267.3 | 2,444.1 |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | 46.0 | (24.5) | 11.1 | 105.0 |
| Net other-than-temporary impairment (losses) recoveries on available-for-sale securities | (6.5) | (7.3) | 6.9 | 18.5 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | (1.1) | (14.6) | (28.0) | (82.5) |
| Net impairment losses on available-for-sale securities | (7.6) | (21.9) | (21.1) | (64.0) |
| Net realized capital gains (losses) | 38.4 | (46.4) | (10.0) | 41.0 |
| Total revenues | 3,240.9 | 2,484.3 | 9,157.4 | 7,569.6 |
| Expenses | | | | |
| Benefits, claims and settlement expenses | 1,869.6 | 1,113.8 | 5,160.5 | 3,609.7 |
| Dividends to policyholders | 40.7 | 44.2 | 123.5 | 134.5 |
| Operating expenses | 961.4 | 932.5 | 2,751.6 | 2,647.7 |
| Total expenses | 2,871.7 | 2,090.5 | 8,035.6 | 6,391.9 |
| Income before income taxes | 369.2 | 393.8 | 1,121.8 | 1,177.7 |
| Income taxes | 68.3 | 141.0 | 126.9 | 281.6 |
| Net income | 300.9 | 252.8 | 994.9 | 896.1 |
| Net income attributable to noncontrolling interest | 0.5 | 3.9 | 14.5 | 30.7 |
| Net income attributable to Principal Financial Group, Inc. | 300.4 | 248.9 | 980.4 | 865.4 |
| Preferred stock dividends | | 8.2 | 16.5 | 24.7 |
| Excess of redemption value over carrying value of preferred shares redeemed | | | 8.2 | |
| Net income available to common stockholders | \$ 300.4 | \$ 240.7 | \$ 955.7 | \$ 840.7 |
| Earnings per common share | | | | |
| Basic earnings per common share | \$ 1.02 | \$ 0.78 | \$ 3.24 | \$ 2.78 |
| Diluted earnings per common share | \$ 1.01 | \$ 0.77 | \$ 3.20 | \$ 2.75 |
| Dividends declared per common share | \$ 0.38 | \$ 0.34 | \$ 1.12 | \$ 0.94 |

See accompanying notes.

Table of Contents**Principal Financial Group, Inc.****Consolidated Statements of Comprehensive Income****(Unaudited)**

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|----------|--|------------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Net income | \$ 300.9 | \$ 252.8 | \$ 994.9 | \$ 896.1 |
| Other comprehensive income (loss), net: | | | | |
| Net unrealized gains (losses) on available-for-sale securities | 28.3 | (73.9) | (221.0) | 296.6 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale | 1.0 | 11.0 | 17.9 | 48.9 |
| Net unrealized gains on derivative instruments | 10.3 | 29.2 | 22.0 | 42.3 |
| Foreign currency translation adjustment | (263.2) | (195.8) | (438.3) | (208.4) |
| Net unrecognized postretirement benefit obligation | 11.9 | 3.6 | 35.9 | 10.7 |
| Other comprehensive income (loss) | (211.7) | (225.9) | (583.5) | 190.1 |
| Comprehensive income | 89.2 | 26.9 | 411.4 | 1,086.2 |
| Comprehensive income (loss) attributable to noncontrolling interest | (13.8) | (2.7) | (4.5) | 23.9 |
| Comprehensive income attributable to Principal Financial Group, Inc. | \$ 103.0 | \$ 29.6 | \$ 415.9 | \$ 1,062.3 |

See accompanying notes.

Table of Contents**Principal Financial Group, Inc.****Consolidated Statements of Stockholders' Equity****(Unaudited)**

| | Series A preferred stock | Series B preferred stock | Common stock | Additional paid-in capital | Retained earnings | Accumulated other comprehensive income (loss) (in millions) | Treasury stock | Noncontrolling interest | Total stockholders equity |
|---|--------------------------------|--------------------------------|-----------------|----------------------------------|----------------------|---|-------------------|----------------------------|---------------------------------|
| Balances at January 1, 2014 | \$ | \$ 0.1 | \$ 4.6 | \$ 9,798.9 | \$ 5,405.4 | \$ 183.2 | \$ (5,708.0) | \$ 92.8 | \$ 9,777.0 |
| Common stock issued | | | | 69.6 | | | | | 69.6 |
| Stock-based compensation and additional related tax benefits | | | | 62.3 | (4.5) | | | | 57.8 |
| Treasury stock acquired, common | | | | | | | (222.5) | | (222.5) |
| Dividends to common stockholders | | | | | (276.7) | | | | (276.7) |
| Dividends to preferred stockholders | | | | | (24.7) | | | | (24.7) |
| Distributions to noncontrolling interest | | | | | | | | (22.9) | (22.9) |
| Contributions from noncontrolling interest | | | | | | | | 7.1 | 7.1 |
| Purchase of subsidiary shares from noncontrolling interest | | | | (0.4) | | | | (41.5) | (41.9) |
| Adjustments to redemption amount of redeemable noncontrolling interest | | | | (13.5) | (19.7) | | | | (33.2) |
| Net income (excludes \$8.3 million attributable to redeemable noncontrolling interest) | | | | | 865.4 | | | 22.4 | 887.8 |
| Other comprehensive income (excludes \$(1.5) million attributable to redeemable noncontrolling interest) | | | | | | 196.9 | | (5.3) | 191.6 |
| Balances at September 30, 2014 | \$ | \$ 0.1 | \$ 4.6 | \$ 9,916.9 | \$ 5,945.2 | \$ 380.1 | \$ (5,930.5) | \$ 52.6 | \$ 10,369.0 |
| Balances at January 1, 2015 | \$ | \$ 0.1 | \$ 4.6 | \$ 9,945.5 | \$ 6,114.1 | \$ 50.4 | \$ (5,930.7) | \$ 48.0 | \$ 10,232.0 |
| Common stock issued | | | 0.1 | 71.4 | | | | | 71.5 |
| Stock-based compensation and additional related tax benefits | | | | 71.6 | (4.9) | | | | 66.7 |
| Treasury stock acquired, common | | | | | | | (188.2) | | (188.2) |
| Dividends to common stockholders | | | | | (330.2) | | | | (330.2) |
| Dividends to preferred stockholders | | | | | (16.5) | | | | (16.5) |
| Preferred stock redemption | | (0.1) | | (541.7) | (8.2) | | | | (550.0) |
| Distributions to noncontrolling interest | | | | | | | | (13.7) | (13.7) |
| Contributions from noncontrolling interest | | | | | | | | 6.7 | 6.7 |
| | | | | (19.0) | | (10.3) | | 12.8 | (16.5) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | | | | | | | |
|---|----|----|----|-----|-------|---------|----|---------|----|---------|-------|-----------|----|------|---------|---------|
| Purchase of subsidiary shares from noncontrolling interest | | | | | | | | | | | | | | | | |
| Adjustments to redemption amount of redeemable noncontrolling interest | | | | | (3.6) | | | | | | | | | | (3.6) | |
| Net income (excludes \$1.5 million attributable to redeemable noncontrolling interest) | | | | | | 980.4 | | | | | 13.0 | | | | 993.4 | |
| Other comprehensive loss (excludes \$(17.7) million attributable to redeemable noncontrolling interest) | | | | | | | | (564.5) | | | (1.3) | | | | (565.8) | |
| Balances at September 30, 2015 | \$ | \$ | \$ | 4.7 | \$ | 9,524.2 | \$ | 6,734.7 | \$ | (524.4) | \$ | (6,118.9) | \$ | 65.5 | \$ | 9,685.8 |

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.
Consolidated Statements of Cash Flows
(Unaudited)

| | For the nine months ended September 30, | |
|---|--|-----------|
| | 2015 | 2014 |
| | (in millions) | |
| Operating activities | | |
| Net income | \$ 994.9 | \$ 896.1 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Amortization of deferred acquisition costs | 223.2 | 282.8 |
| Additions to deferred acquisition costs | (289.4) | (291.8) |
| Accrued investment income | (60.9) | (13.0) |
| Net cash flows for trading securities | (177.5) | (47.8) |
| Premiums due and other receivables | (165.4) | 85.0 |
| Contractholder and policyholder liabilities and dividends | 2,660.2 | 1,211.4 |
| Current and deferred income taxes (benefits) | (95.3) | 204.3 |
| Net realized capital (gains) losses | 10.0 | (41.0) |
| Depreciation and amortization expense | 149.3 | 122.8 |
| Mortgage loans held for sale, sold or repaid, net of gain | | 8.4 |
| Real estate acquired through operating activities | (32.4) | (43.6) |
| Real estate sold through operating activities | 53.3 | 146.1 |
| Stock-based compensation | 66.7 | 58.4 |
| Other | (13.7) | (380.5) |
| Net adjustments | 2,328.1 | 1,301.5 |
| Net cash provided by operating activities | 3,323.0 | 2,197.6 |
| Investing activities | | |
| Available-for-sale securities: | | |
| Purchases | (7,052.6) | (6,596.0) |
| Sales | 1,410.8 | 1,871.5 |
| Maturities | 5,020.5 | 4,499.3 |
| Mortgage loans acquired or originated | (1,658.0) | (1,614.2) |
| Mortgage loans sold or repaid | 1,175.3 | 1,319.8 |
| Real estate acquired | (255.8) | (246.8) |
| Net purchases of property and equipment | (96.3) | (117.5) |
| Purchase of interests in subsidiaries, net of cash acquired | (293.7) | |
| Net change in other investments | (17.0) | 56.6 |
| Net cash used in investing activities | (1,766.8) | (827.3) |
| Financing activities | | |
| Issuance of common stock | 71.5 | 69.6 |
| Acquisition of treasury stock | (188.2) | (222.5) |
| Proceeds from financing element derivatives | 0.2 | 14.9 |
| Payments for financing element derivatives | (60.9) | (41.5) |
| Excess tax benefits from share-based payment arrangements | 15.2 | 8.6 |
| Purchase of subsidiary shares from noncontrolling interest | (22.5) | (222.4) |
| Dividends to common stockholders | (330.2) | (276.7) |
| Dividends to preferred stockholders | (16.5) | (24.7) |
| Preferred stock redemption | (550.0) | |
| Issuance of long-term debt | 800.4 | 36.5 |
| Principal repayments of long-term debt | (52.6) | (100.3) |
| Net proceeds from (repayments of) short-term borrowings | 197.2 | (20.5) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | |
|---|-------------------|-------------------|
| Investment contract deposits | 4,190.3 | 4,184.3 |
| Investment contract withdrawals | (4,974.3) | (5,864.3) |
| Net increase (decrease) in banking operation deposits | 24.9 | (2.3) |
| Other | (10.4) | (10.0) |
| Net cash used in financing activities | (905.9) | (2,471.3) |
| Net increase (decrease) in cash and cash equivalents | 650.3 | (1,101.0) |
| Cash and cash equivalents at beginning of period | 1,863.9 | 2,371.8 |
| Cash and cash equivalents at end of period | \$ 2,514.2 | \$ 1,270.8 |

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (PFG), its majority-owned subsidiaries and its consolidated variable interest entities (VIEs), have been prepared in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2015, are not necessarily indicative of the results that may be expected for the year ended December 31, 2015. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2014, included in our Form 10-K for the year ended December 31, 2014, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2014, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

In February 2015, we announced planned changes to our organizational structure to better align businesses, distribution teams and product offerings for future growth. We plan to implement these changes during 2015 and will report our consolidated financial statements under the new structure in our December 31, 2015, Form 10-K. The changes are not expected to have a material impact on our consolidated financial statements.

Recent Accounting Pronouncements

| Description | Date of adoption | Effect on our consolidated financial statements or other significant matters |
|---|------------------|--|
| <i>Standards not yet adopted:</i> | | |
| Revenue recognition | January 1, 2018 | We are currently evaluating the impact this guidance will have on our consolidated financial statements. |
| This authoritative guidance replaces all general and most industry specific revenue recognition guidance currently prescribed by U.S. GAAP. The core principle is that an entity recognizes revenue to reflect the transfer of a promised good or service to customers in an amount that reflects the | | |

consideration to which the entity expects to be entitled in exchange for that good or service.

| | | |
|---|-------------------|--|
| Short-duration insurance contracts This authoritative guidance requires additional disclosures related to short-duration insurance contracts. | December 31, 2016 | We are currently evaluating the impact this guidance will have on our consolidated financial statements. |
| Net asset value per share as a practical expedient for fair value This authoritative guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. | January 1, 2016 | The guidance is not expected to have a material impact on our consolidated financial statements. |
| Simplifying the presentation of debt issuance costs This authoritative guidance requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. | January 1, 2016 | The guidance is not expected to have a material impact on our consolidated financial statements. |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| Description | Date of adoption | Effect on our consolidated financial statements or other significant matters |
|---|-------------------------|--|
| Consolidations This authoritative guidance makes changes to both the variable interest and voting interest consolidation models and eliminates the investment company deferral for portions of the variable interest model. The amendments in the standard impact the consolidation analysis for interests in investment companies and limited partnerships and similar entities. | January 1, 2016 | We are currently evaluating the impact this guidance will have on our consolidated financial statements. |
| Standards adopted: Discontinued operations This authoritative guidance amends the definition of discontinued operations and requires entities to provide additional disclosures associated with discontinued operations, as well as disposal transactions that do not meet the discontinued operations criteria. The guidance requires discontinued operations treatment for disposals of a component or group of components of an entity that represents a strategic shift that has or will have a major impact on an entity's operations or financial results. The guidance also expands the scope to disposals of equity method investments and businesses that, upon initial acquisition, qualify as held for sale. | January 1, 2015 | This guidance was adopted prospectively and did not have a material impact on our consolidated financial statements. |
| Foreign currency cumulative translation adjustment This authoritative guidance clarifies how the cumulative translation adjustment related to a parent's investment in a foreign entity should be released when certain transactions related to the foreign entity occur. | January 1, 2014 | The guidance was adopted prospectively and did not have a material impact on our consolidated financial statements. |

Separate Accounts

The separate accounts are legally segregated and are not subject to the claims that arise out of any of our other business. The client, rather than us, directs the investments and bears the investment risk of these funds. The separate account assets represent the fair value of funds that are separately administered by us for contracts with equity, real estate and fixed income investments and are presented as a summary total within the consolidated statements of financial position. An equivalent amount is reported as separate account liabilities, which represent the obligation to return the monies to the client. We receive fees for mortality, withdrawal and expense risks, as well as administrative, maintenance and investment advisory services that are included in the consolidated statements of operations. Net deposits, net investment income and realized and unrealized capital gains and losses of the separate accounts are not reflected in the consolidated statements of operations.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Separate account assets and separate account liabilities include certain international retirement accumulation products where the segregated funds and associated obligation to the client are consolidated within our financial statements. We have determined that summary totals are the most meaningful presentation for these funds.

At September 30, 2015 and December 31, 2014, the separate account assets include a separate account valued at \$173.3 million and \$205.4 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Goodwill and Other Intangibles

On September 1, 2015, we completed our purchase of AXA's Mandatory Provident Fund (MPF) and Occupational Retirement Schemes Ordinance (ORSO) pension business in Hong Kong for \$335.5 million. As part of the transaction, we entered into an exclusive 15-year distribution agreement with AXA to provide co-branded pension products through AXA's agency network in Hong Kong. AXA's MPF and ORSO pension business is consolidated within our Principal International segment. The purchase price resulted in intangible assets and goodwill.

2. Variable Interest Entities

We have relationships with and may have a variable interest in various types of special purpose entities. Following is a discussion of our interest in entities that meet the definition of a VIE. When we are the primary beneficiary, we are required to consolidate the entity in our financial statements. The primary beneficiary of a VIE is defined as the enterprise with (1) the power to direct the activities of a VIE that most significantly impact the entity's economic performance and (2) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. For VIEs that are investment companies, the primary beneficiary is the enterprise who absorbs the majority of the entity's expected losses, receives a majority of the expected residual returns or both. On an ongoing basis, we assess whether we are the primary beneficiary of VIEs in which we have a relationship.

Consolidated Variable Interest Entities

Grantor Trusts

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

Collateralized Private Investment Vehicles

We invest in synthetic collateralized debt obligations, collateralized bond obligations, collateralized loan obligations and other collateralized structures, which are VIEs due to insufficient equity to sustain the entities (collectively known as collateralized private investment vehicles). The performance of the notes of these structures is primarily linked to a synthetic portfolio by derivatives; each note has a specific loss attachment and detachment point. The notes and related derivatives are collateralized by a pool of permitted investments. The investments are held by a trustee and can only be liquidated to settle obligations of the trusts. These obligations primarily include derivatives and the notes due at maturity or termination of the trusts. We determined we are the primary beneficiary for one of these entities because we act as the investment manager of the underlying portfolio and we have an ownership interest.

Commercial Mortgage-Backed Securities

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

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Mandatory Retirement Savings

We hold an equity interest in Chilean mandatory privatized social security funds in which we provide asset management services. We determined that the mandatory privatized social security funds, which also include contributions for voluntary pension savings, voluntary non-pension savings and compensation savings accounts, are VIEs. This is because the equity holders as a group lack the power, due to voting rights or similar rights, to direct the activities of the entity that most significantly impact the entity's economic performance and also because equity investors are protected from below-average market investment returns relative to the industry's return, due to a regulatory guarantee that we provide. Further we concluded that we are the primary beneficiary through our power to make decisions and our variable interest in the funds. The purpose of the funds, which reside in legally segregated entities, is to provide long-term retirement savings. The obligation to the client is directly related to the assets held in the funds and, as such, we present the assets as separate account assets and the obligation as separate account liabilities within our consolidated statements of financial position.

Principal International Hong Kong offers retirement pension schemes in which we provide trustee, administration and asset management services to employers and employees under the Hong Kong MPF and ORSO pension schemes. Each pension scheme has various guaranteed and non-guaranteed constituent funds, or investment options, in which customers can invest their money. The guaranteed funds provide either a guaranteed rate of return to the customer or a minimum guarantee on withdrawals under certain qualifying events. We have determined the guaranteed funds are VIEs due to the fact the equity holders, as a group, lack the obligation to absorb expected losses due to the guarantee we provide. We concluded that we are the primary beneficiary because we have the obligation to absorb losses that could be potentially significant to the VIE. Therefore, we consolidate the underlying assets and liabilities of the funds and present as separate accounts or within the general account, depending on the terms of the guarantee.

Real Estate

We invest in several real estate limited partnerships and limited liability companies. The entities invest in real estate properties. Certain of these entities are VIEs based on the combination of our significant economic interest and related voting rights. We determined we are the primary beneficiary as a result of our power to control the entities through our significant ownership. Due to the nature of these real estate investments, the investment balance will fluctuate as we purchase and sell interests in the entities and as capital expenditures are made to improve the underlying real estate.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

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

| | Grantor trusts | Collateralized private investment vehicles | CMBS | Mandatory retirement savings | Real estate | Total |
|--|-------------------|---|---------|------------------------------------|-------------|-------------|
| September 30, 2015 | | | | | | |
| Fixed maturities, available-for-sale | \$ 261.1 | \$ | \$ | \$ | \$ | \$ 261.1 |
| Fixed maturities, trading | | 100.4 | | | | 100.4 |
| Equity securities, available-for-sale | | | | 315.8 | | 315.8 |
| Equity securities, trading | | | | 321.2 | | 321.2 |
| Real estate | | | | | 298.9 | 298.9 |
| Other investments | | | 25.1 | | 11.7 | 36.8 |
| Cash | | | | | 7.8 | 7.8 |
| Accrued investment income | 0.4 | | 0.2 | | 1.9 | 2.5 |
| Premiums due and other receivables | | | | | 2.0 | 2.0 |
| Separate account assets | | | | 32,827.6 | | 32,827.6 |
| Other assets | | | | | (0.9) | (0.9) |
| Total assets | \$ 261.5 | \$ 100.4 | \$ 25.3 | \$ 33,464.6 | \$ 321.4 | \$ 34,173.2 |
| Contractholder funds | \$ | \$ | \$ | \$ 329.2 | \$ | \$ 329.2 |
| Long-term debt | | | | | 38.2 | 38.2 |
| Income taxes currently payable | | | | | (0.1) | (0.1) |
| Deferred income taxes | 1.6 | | | | (1.0) | 0.6 |
| Separate account liabilities | | | | 32,827.6 | | 32,827.6 |
| Other liabilities (1) | 236.7 | 87.2 | | | 16.8 | 340.7 |
| Total liabilities | \$ 238.3 | \$ 87.2 | \$ | \$ 33,156.8 | \$ 53.9 | \$ 33,536.2 |
| December 31, 2014 | | | | | | |
| Fixed maturities, available-for-sale | \$ 278.2 | \$ | \$ | \$ | \$ | \$ 278.2 |
| Fixed maturities, trading | | 100.4 | | | | 100.4 |
| Equity securities, trading | | | | 345.3 | | 345.3 |
| Real estate | | | | | 284.9 | 284.9 |
| Other investments | | | 35.0 | | 5.6 | 40.6 |
| Cash | | | | | 4.7 | 4.7 |
| Accrued investment income | 0.4 | | 0.2 | | 1.4 | 2.0 |
| Separate account assets | | | | 34,655.4 | | 34,655.4 |
| Other assets | | | | | 0.3 | 0.3 |
| Total assets | \$ 278.6 | \$ 100.4 | \$ 35.2 | \$ 35,000.7 | \$ 296.9 | \$ 35,711.8 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | | | |
|--------------------------------|----|-------|----|------|----|-----|----------|----------|----|-------|----|----------|
| Long-term debt | \$ | | \$ | | \$ | | \$ | | \$ | 82.3 | \$ | 82.3 |
| Income taxes currently payable | | | | | | | | | | 10.6 | | 10.6 |
| Deferred income taxes | | 1.5 | | | | | | | | (0.4) | | 1.1 |
| Separate account liabilities | | | | | | | 34,655.4 | | | | | 34,655.4 |
| Other liabilities (1) | | 239.1 | | 85.6 | | 4.8 | | | | 14.5 | | 344.0 |
| Total liabilities | \$ | 240.6 | \$ | 85.6 | \$ | 4.8 | \$ | 34,655.4 | \$ | 107.0 | \$ | 35,093.4 |

(1) Grantor trusts contain an embedded derivative of a forecasted transaction to deliver the underlying securities; the collateralized private investment vehicle includes derivative liabilities and an obligation to redeem notes at maturity or termination of the trusts.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

We did not provide financial or other support to investees designated as VIEs for the periods ended September 30, 2015 and December 31, 2014.

Unconsolidated Variable Interest Entities

Invested Securities

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

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

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

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

We have invested in partnerships and other funds, some of which are classified as VIEs. Some of these entities have returns in the form of income tax credits. These entities are classified as VIEs as the general partners do not have equity investments at risk in the entities. We have determined we are not the primary beneficiary because we are not the general partner, who makes all the significant decisions for the entities. Other limited partnerships and fund interests have returns from investment income. These entities are classified as VIEs as the decision makers

do not have equity investments at risk in the entities. We have determined we are not the primary beneficiary because we do not make the significant decisions for the entities or our variable interest does not absorb the majority of the variability of the entities' net assets.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

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

| | Asset carrying value | Maximum exposure to loss (1) |
|---|----------------------|---------------------------------|
| | (in millions) | |
| September 30, 2015 | | |
| Fixed maturities, available-for-sale: | | |
| Corporate | \$ 462.3 | \$ 358.6 |
| Residential mortgage-backed pass-through securities | 2,680.2 | 2,572.2 |
| Commercial mortgage-backed securities | 3,861.2 | 3,808.8 |
| Collateralized debt obligations | 633.0 | 655.9 |
| Other debt obligations | 4,535.6 | 4,494.5 |
| Fixed maturities, trading: | | |
| Residential mortgage-backed pass-through securities | 27.6 | 27.6 |
| Commercial mortgage-backed securities | 44.1 | 44.1 |
| Collateralized debt obligations | 38.6 | 38.6 |
| Other investments: | | |
| Other limited partnership and fund interests | 210.7 | 210.7 |
| December 31, 2014 | | |
| Fixed maturities, available-for-sale: | | |
| Corporate | \$ 456.7 | \$ 353.3 |
| Residential mortgage-backed pass-through securities | 2,822.9 | 2,702.9 |
| Commercial mortgage-backed securities | 3,975.5 | 3,896.9 |
| Collateralized debt obligations | 504.1 | 521.2 |
| Other debt obligations | 4,616.4 | 4,583.4 |
| Fixed maturities, trading: | | |
| Residential mortgage-backed pass-through securities | 34.4 | 34.4 |
| Commercial mortgage-backed securities | 1.5 | 1.5 |
| Collateralized debt obligations | 39.4 | 39.4 |
| Other debt obligations | 0.2 | 0.2 |
| Other investments: | | |
| Other limited partnership and fund interests | 188.2 | 188.2 |

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

Sponsored Investment Funds

We are the investment manager for certain money market mutual funds that are deemed to be VIEs. We are not the primary beneficiary of these VIEs since our involvement is limited primarily to being a service provider, and our variable interest does not absorb the majority of the variability of the entities' net assets. As of September 30, 2015 and December 31, 2014, these VIEs held \$1.3 billion and \$1.4 billion in total assets, respectively. We have no contractual obligation to contribute to the funds.

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

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****3. Investments****Fixed Maturities and Equity Securities**

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred securities. Equity securities include mutual funds, common stock, nonredeemable preferred stock and regulatory required investments. We classify fixed maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 10, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders' equity, net of adjustments associated with deferred acquisition costs (DAC) and related actuarial balances, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). Mark-to-market adjustments related to certain securities carried at fair value with an investment objective to realize economic value through mark-to-market changes are reflected in net investment income.

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

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

| | Amortized cost | Gross unrealized gains | Gross unrealized losses (in millions) | Fair value | Other-than- temporary impairments in AOCI (1) |
|---------------------------------------|-------------------|------------------------------|--|------------|--|
| September 30, 2015 | | | | | |
| Fixed maturities, available-for-sale: | | | | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | |
|---|----|----------|----|---------|----|-------|----|----------|----|-------|
| U.S. government and agencies | \$ | 1,507.6 | \$ | 39.7 | \$ | 3.7 | \$ | 1,543.6 | \$ | |
| Non-U.S. governments | | 645.6 | | 145.3 | | 3.2 | | 787.7 | | |
| States and political subdivisions | | 4,245.0 | | 231.4 | | 20.7 | | 4,455.7 | | |
| Corporate | | 29,851.0 | | 1,866.9 | | 439.2 | | 31,278.7 | | 4.8 |
| Residential mortgage-backed pass-through securities | | 2,572.2 | | 113.0 | | 5.0 | | 2,680.2 | | |
| Commercial mortgage-backed securities | | 3,808.8 | | 103.0 | | 50.6 | | 3,861.2 | | 81.2 |
| Collateralized debt obligations | | 655.9 | | 1.2 | | 24.1 | | 633.0 | | 1.3 |
| Other debt obligations | | 4,499.4 | | 60.8 | | 19.7 | | 4,540.5 | | 60.2 |
| Total fixed maturities, available-for-sale | \$ | 47,785.5 | \$ | 2,561.3 | \$ | 566.2 | \$ | 49,780.6 | \$ | 147.5 |
| Total equity securities, available-for-sale | \$ | 469.1 | \$ | 8.5 | \$ | 12.3 | \$ | 465.3 | | |

December 31, 2014

Fixed maturities, available-for-sale:

| | | | | | | | | | | |
|---|----|----------|----|---------|----|-------|----|----------|----|-------|
| U.S. government and agencies | \$ | 1,085.6 | \$ | 39.1 | \$ | 2.9 | \$ | 1,121.8 | \$ | |
| Non-U.S. governments | | 704.4 | | 188.3 | | 1.6 | | 891.1 | | |
| States and political subdivisions | | 3,916.8 | | 291.3 | | 4.1 | | 4,204.0 | | |
| Corporate | | 29,308.3 | | 2,442.6 | | 215.9 | | 31,535.0 | | 18.4 |
| Residential mortgage-backed pass-through securities | | 2,702.9 | | 126.3 | | 6.3 | | 2,822.9 | | |
| Commercial mortgage-backed securities | | 3,896.9 | | 141.5 | | 62.9 | | 3,975.5 | | 88.9 |
| Collateralized debt obligations | | 521.2 | | 3.5 | | 20.6 | | 504.1 | | 1.3 |
| Other debt obligations | | 4,583.4 | | 57.5 | | 24.5 | | 4,616.4 | | 66.9 |
| Total fixed maturities, available-for-sale | \$ | 46,719.5 | \$ | 3,290.1 | \$ | 338.8 | \$ | 49,670.8 | \$ | 175.5 |
| Total equity securities, available-for-sale | \$ | 125.1 | \$ | 7.7 | \$ | 9.8 | \$ | 123.0 | | |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

(1) Excludes \$144.5 million and \$167.5 million as of September 30, 2015 and December 31, 2014, respectively, of net unrealized gains on impaired fixed maturities, available-for-sale related to changes in fair value subsequent to the impairment date, which are included in gross unrealized gains and gross unrealized losses.

The amortized cost and fair value of fixed maturities available-for-sale at September 30, 2015, by expected maturity, were as follows:

| | Amortized cost | (in millions) | Fair value |
|---|----------------|---------------|-------------|
| Due in one year or less | \$ | 2,649.9 | \$ 2,679.5 |
| Due after one year through five years | | 13,017.0 | 13,461.3 |
| Due after five years through ten years | | 8,303.2 | 8,581.8 |
| Due after ten years | | 12,279.1 | 13,343.1 |
| Subtotal | | 36,249.2 | 38,065.7 |
| Mortgage-backed and other asset-backed securities | | 11,536.3 | 11,714.9 |
| Total | \$ | 47,785.5 | \$ 49,780.6 |

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

Net Realized Capital Gains and Losses

Net realized capital gains and losses on sales of investments are determined on the basis of specific identification. In general, in addition to realized capital gains and losses on investment sales and periodic settlements on derivatives not designated as hedges, we report gains and losses related to the following in net realized capital gains (losses): other-than-temporary impairments of securities and subsequent realized recoveries, mark-to-market adjustments on certain trading securities, mark-to-market adjustments on certain seed money investments, fair value hedge and cash flow hedge ineffectiveness, mark-to-market adjustments on derivatives not designated as hedges, changes in the mortgage loan valuation allowance provision and impairments of real estate held for investment. Investment gains and losses on sales of certain real estate held for sale due to investment strategy and mark-to-market adjustments on certain securities carried at fair value with an investment objective to realize economic value through mark-to-market changes are reported as net investment income and are excluded from net realized capital gains (losses). The major components of net realized capital gains (losses) on investments are summarized as follows:

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|-----------|--|---------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Fixed maturities, available-for-sale: | | | | |
| Gross gains | \$ 2.5 | \$ 6.0 | \$ 15.7 | \$ 45.0 |
| Gross losses | (2.3) | (2.9) | (5.6) | (20.8) |
| Net impairment losses | (7.6) | (21.7) | (21.4) | (69.5) |
| Hedging, net | 4.7 | (21.5) | (31.2) | (20.0) |
| Fixed maturities, trading | (2.1) | 9.5 | (6.4) | 32.0 |
| Equity securities, available-for-sale: | | | | |
| Gross gains | 0.3 | | 0.3 | 0.2 |
| Gross losses | (1.8) | (0.1) | (1.8) | (0.2) |
| Net impairment recoveries (losses) | | (0.2) | 0.3 | 5.5 |
| Equity securities, trading | (12.4) | 9.1 | (8.5) | 18.7 |
| Mortgage loans | (1.3) | (12.0) | (1.4) | (10.6) |
| Derivatives | 54.0 | (2.0) | 59.0 | 1.9 |
| Other | 4.4 | (10.6) | (9.0) | 58.8 |
| Net realized capital gains (losses) | \$ 38.4 | \$ (46.4) | \$ (10.0) | \$ 41.0 |

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were \$331.7 million and \$437.1 million for the three months ended September 30, 2015 and 2014, and \$1,213.0 million and \$1,744.6 million for the nine months ended September 30, 2015 and 2014, respectively.

Other-Than-Temporary Impairments

We have a process in place to identify fixed maturity and equity securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers' credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Each reporting period, all securities are reviewed to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; (4) for structured securities, the adequacy of the expected cash flows; (5) for fixed maturities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and (6) for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized.

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

Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities, were as follows:

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|-----------|--|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Fixed maturities, available-for-sale | \$ (6.5) | \$ (7.1) | \$ 6.6 | \$ 13.0 |
| Equity securities, available-for-sale | | (0.2) | 0.3 | 5.5 |
| Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities | (6.5) | (7.3) | 6.9 | 18.5 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from OCI (1) | (1.1) | (14.6) | (28.0) | (82.5) |
| Net impairment losses on available-for-sale securities | \$ (7.6) | \$ (21.9) | \$ (21.1) | \$ (64.0) |

(1) Represents the net impact of (a) gains resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI and (b) losses resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold.

We estimate the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The ABS cash flow estimates are based on security specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate security cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or liquidations using bond specific facts and circumstances including timing, security interests and loss severity.

The following table provides a rollforward of accumulated credit losses for fixed maturities with bifurcated credit losses. The purpose of the table is to provide detail of (1) additions to the bifurcated credit loss amounts recognized in net realized capital gains (losses) during the period and (2) decrements for previously recognized bifurcated credit losses where the loss is no longer bifurcated and/or there has been a positive change in expected cash flows or accretion of the bifurcated credit loss amount.

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|--|---|-------------|--|-------------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Beginning balance | \$ (134.7) | \$ (185.7) | \$ (144.4) | \$ (235.4) |
| Credit losses for which an other-than-temporary impairment was not previously recognized | (4.3) | (2.2) | (5.9) | (6.1) |
| Credit losses for which an other-than-temporary impairment was previously recognized | (3.2) | (21.0) | (11.3) | (65.5) |
| Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold | 3.8 | 18.0 | 20.0 | 112.0 |
| Net reduction for positive changes in cash flows expected to be collected and amortization (1) | 2.2 | 1.5 | 5.2 | 5.6 |
| Foreign currency translation adjustment | 0.4 | | 0.6 | |
| Ending balance | \$ (135.8) | \$ (189.4) | \$ (135.8) | \$ (189.4) |

(1) Amounts are recognized in net investment income.

Gross Unrealized Losses for Fixed Maturities and Equity Securities

For fixed maturities and equity securities available-for-sale with unrealized losses, including other-than-temporary impairment losses reported in OCI, the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position are summarized as follows:

| | Less than twelve months | | September 30, 2015 Greater than or equal to twelve months | | Total | |
|---|----------------------------|-------------------------------|---|-------------------------------|---------------|-------------------------------|
| | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses |
| | (in millions) | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| U.S. government and agencies | \$ 218.0 | \$ 3.5 | \$ 39.7 | \$ 0.2 | \$ 257.7 | \$ 3.7 |
| Non-U.S. governments | 42.0 | 1.3 | 18.6 | 1.9 | 60.6 | 3.2 |
| States and political subdivisions | 582.4 | 20.1 | 6.4 | 0.6 | 588.8 | 20.7 |
| Corporate | 5,446.5 | 229.1 | 1,223.3 | 210.1 | 6,669.8 | 439.2 |
| Residential mortgage-backed pass-through securities | 260.3 | 1.6 | 154.8 | 3.4 | 415.1 | 5.0 |
| Commercial mortgage-backed securities | 682.6 | 7.2 | 296.0 | 43.4 | 978.6 | 50.6 |
| Collateralized debt obligations | 372.6 | 2.9 | 151.2 | 21.2 | 523.8 | 24.1 |
| Other debt obligations | 753.0 | 4.3 | 360.3 | 15.4 | 1,113.3 | 19.7 |
| Total fixed maturities, available-for-sale | \$ 8,357.4 | \$ 270.0 | \$ 2,250.3 | \$ 296.2 | \$ 10,607.7 | \$ 566.2 |
| Total equity securities, available-for-sale | \$ 0.7 | \$ 0.2 | \$ 33.7 | \$ 12.1 | \$ 34.4 | \$ 12.3 |

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Of the total amounts, Principal Life's consolidated portfolio represented \$10,100.0 million in available-for-sale fixed maturities with gross unrealized losses of \$537.6 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 82% were investment grade (rated AAA through BBB-) with an average price of 95 (carrying value/amortized cost) at September 30, 2015. Gross unrealized losses in our fixed maturities portfolio increased during the nine months ended September 30, 2015, due primarily to widening of credit spreads.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life's consolidated portfolio held 1,038 securities with a carrying value of \$7,986.8 million and unrealized losses of \$263.6 million reflecting an average price of 97 at September 30, 2015. Of this portfolio, 85% was investment grade (rated AAA through BBB-) at September 30, 2015, with associated unrealized losses of \$182.4 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life's consolidated portfolio held 356 securities with a carrying value of \$2,113.2 million and unrealized losses of \$274.0 million. The average rating of this portfolio was BBB+ with an average price of 89 at September 30, 2015. Of the \$274.0 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$43.4 million in unrealized losses with an average price of 87 and an average credit rating of BBB+. The remaining unrealized losses consist primarily of \$189.8 million within the corporate sector at September 30, 2015. The average price of the corporate sector was 85 and the average credit rating was BBB. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at September 30, 2015.

| Less than twelve months | | December 31, 2014 Greater than or equal to twelve months | | Total | |
|----------------------------|-------------------------------|--|-------------------------------|---------------|-------------------------------|
| Fair value | Gross unrealized losses | Fair value | Gross unrealized losses | Fair value | Gross unrealized losses |
| (in millions) | | | | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | |
|---|----|---------|----|------|----|---------|------------------------------|
| Fixed maturities, available-for-sale: | | | | | | | |
| U.S. government and agencies | \$ | 211.5 | \$ | 0.7 | \$ | 95.0 | \$ 2.2 \$ 306.5 \$ 2.9 |
| Non-U.S. governments | | 20.3 | | 1.4 | | 7.5 | 0.2 27.8 1.6 |
| States and political subdivisions | | 208.1 | | 0.7 | | 210.5 | 3.4 418.6 4.1 |
| Corporate | | 3,072.1 | | 76.8 | | 1,238.3 | 139.1 4,310.4 215.9 |
| Residential mortgage-backed pass-through securities | | 18.0 | | | | 395.3 | 6.3 413.3 6.3 |
| Commercial mortgage-backed securities | | 375.3 | | 3.0 | | 395.0 | 59.9 770.3 62.9 |
| Collateralized debt obligations | | 114.8 | | 1.0 | | 112.0 | 19.6 226.8 20.6 |
| Other debt obligations | | 971.2 | | 3.5 | | 432.7 | 21.0 1,403.9 24.5 |
| Total fixed maturities, available-for-sale | \$ | 4,991.3 | \$ | 87.1 | \$ | 2,886.3 | \$ 251.7 \$ 7,877.6 \$ 338.8 |
| Total equity securities, available-for-sale | \$ | 10.0 | \$ | | \$ | 36.0 | \$ 9.8 \$ 46.0 \$ 9.8 |

Of the total amounts, Principal Life's consolidated portfolio represented \$7,638.7 million in available-for-sale fixed maturities with gross unrealized losses of \$310.8 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 80% were investment grade (rated AAA through BBB-) with an average price of 96 (carrying value/amortized cost) at December 31, 2014. Gross unrealized losses in our fixed maturities portfolio decreased during the year ended December 31, 2014, due primarily to a decrease in interest rates.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life's consolidated portfolio held 685 securities with a carrying value of \$4,907.1 million and unrealized losses of \$85.4 million reflecting an average price of 98 at December 31, 2014. Of this portfolio, 77% was investment grade (rated AAA through BBB-) at December 31, 2014, with associated unrealized losses of \$44.4 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life's consolidated portfolio held 429 securities with a carrying value of \$2,731.6 million and unrealized losses of \$225.4 million. The average rating of this portfolio was A with an average price of 92 at December 31, 2014. Of the \$225.4 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$59.9 million in unrealized losses with an average price of 87 and an average credit rating of A-. The remaining unrealized losses consist primarily of \$113.0 million within the corporate sector at December 31, 2014. The average price of the corporate sector was 91 and the average credit rating was BBB+. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at December 31, 2014.

Net Unrealized Gains and Losses on Available-for-Sale Securities and Derivative Instruments

The net unrealized gains and losses on investments in fixed maturities available-for-sale, equity securities available-for-sale and derivative instruments in cash flow hedge relationships are reported as a separate component of stockholders' equity. The cumulative amount of net unrealized gains and losses on available-for-sale securities and derivative instruments in cash flow hedge relationships net of adjustments related to DAC and related actuarial balances and applicable income taxes was as follows:

| | September 30, 2015 | December 31, 2014 |
|--|--------------------|-------------------|
| | (in millions) | |
| Net unrealized gains on fixed maturities, available-for-sale (1) | \$ 2,076.3 | \$ 3,079.1 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale | (147.5) | (175.5) |
| Net unrealized losses on equity securities, available-for-sale | (3.8) | (2.1) |
| Adjustments for assumed changes in amortization patterns | (211.5) | (346.8) |
| Adjustments for assumed changes in policyholder liabilities | (542.3) | (1,078.6) |
| Net unrealized gains on derivative instruments | 188.1 | 160.1 |
| Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments | 92.7 | 88.9 |
| Provision for deferred income taxes | (484.8) | (576.8) |
| Net unrealized gains on available-for-sale securities and derivative instruments | \$ 967.2 | \$ 1,148.3 |

- (1) Excludes net unrealized gains (losses) on fixed maturities, available-for-sale included in fair value hedging relationships.

Mortgage Loans

Mortgage loans consist of commercial and residential mortgage loans. We evaluate risks inherent in our commercial mortgage loans in two classes: (1) brick and mortar property loans, including mezzanine loans, where we analyze the property's rent payments as support for the loan, and (2) credit tenant loans (CTL), where we rely on the credit analysis of the tenant for the repayment of the loan. We evaluate risks inherent in our residential mortgage loan portfolio in two classes: (1) home equity mortgages and (2) first lien mortgages. The carrying amount of our mortgage loan portfolio was as follows:

| | September 30, 2015 | December 31, 2014 |
|----------------------------|--------------------|-------------------|
| | (in millions) | |
| Commercial mortgage loans | \$ 11,179.8 | \$ 10,723.8 |
| Residential mortgage loans | 1,108.9 | 1,144.3 |
| Total amortized cost | 12,288.7 | 11,868.1 |
| Valuation allowance | (56.6) | (56.5) |
| Total carrying value | \$ 12,232.1 | \$ 11,811.6 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. We purchased \$73.2 million and \$35.6 million of residential mortgage loans during the three months ended September 30, 2015 and 2014, and \$216.3 million and \$115.7 million during the nine months ended September 30, 2015 and 2014, respectively. We sold \$17.5 million and \$0.0 million of residential mortgage loans during the three months ended September 30, 2015 and 2014, and \$60.3 million and \$0.0 million during the nine months ended September 30, 2015 and 2014, respectively. We purchased \$53.9 million and \$0.0 million of commercial mortgage loans during the three months ended September 30, 2015 and 2014, and \$200.8 million and \$33.4 million during the nine months ended September 30, 2015 and 2014, respectively. We sold \$0.0 million and \$0.0 million of commercial mortgage loans during the three months ended September 30, 2015 and 2014, and \$1.0 million and \$1.1 million during the nine months ended September 30, 2015 and 2014, respectively.

Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on stabilized properties. Our commercial mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows:

| | September 30, 2015 | | December 31, 2014 | |
|----------------------------|--------------------|---------------------|-------------------|---------------------|
| | Amortized cost | Percent of total | Amortized cost | Percent of total |
| | (\$ in millions) | | | |
| Geographic distribution | | | | |
| New England | \$ 522.4 | 4.7% | \$ 528.0 | 4.9% |
| Middle Atlantic | 3,149.7 | 28.2 | 2,951.0 | 27.5 |
| East North Central | 444.1 | 4.0 | 442.1 | 4.1 |
| West North Central | 275.8 | 2.5 | 233.3 | 2.2 |
| South Atlantic | 2,004.5 | 17.9 | 1,970.9 | 18.4 |
| East South Central | 214.9 | 1.9 | 197.4 | 1.8 |
| West South Central | 1,079.5 | 9.7 | 1,023.9 | 9.5 |
| Mountain | 879.7 | 7.9 | 772.0 | 7.2 |
| Pacific | 2,545.6 | 22.7 | 2,565.5 | 24.0 |
| International | 63.6 | 0.5 | 39.7 | 0.4 |
| Total | \$ 11,179.8 | 100.0% | \$ 10,723.8 | 100.0% |
| Property type distribution | | | | |
| Office | \$ 3,863.4 | 34.6% | \$ 3,646.1 | 34.0% |
| Retail | 2,633.8 | 23.6 | 2,512.1 | 23.4 |
| Industrial | 1,839.7 | 16.5 | 1,918.7 | 17.9 |
| Apartments | 2,379.8 | 21.3 | 2,200.5 | 20.5 |
| Hotel | 323.1 | 2.8 | 331.5 | 3.1 |
| Mixed use/other | 140.0 | 1.2 | 114.9 | 1.1 |
| Total | \$ 11,179.8 | 100.0% | \$ 10,723.8 | 100.0% |

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$234.1 million and \$283.4 million and first lien mortgages with an amortized cost of \$874.8 million and \$860.9 million as of September 30, 2015 and December 31, 2014, respectively.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Our residential home equity mortgages are concentrated in the United States and are generally second lien mortgages comprised of closed-end loans and lines of credit. The majority of our first lien loans are concentrated in the Chilean market.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Mortgage Loan Credit Monitoring*****Commercial Credit Risk Profile Based on Internal Rating***

We actively monitor and manage our commercial mortgage loan portfolio. All commercial mortgage loans are analyzed regularly and substantially all are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. The model stresses expected cash flows at various levels and at different points in time depending on the durability of the income stream, which includes our assessment of factors such as location (macro and micro markets), tenant quality and lease expirations. Our internal rating analysis presents expected losses in terms of a Standard & Poor's (S&P) bond equivalent rating. As the credit risk for commercial mortgage loans increases, we adjust our internal ratings downward with loans in the category B+ and below having the highest risk for credit loss. Internal ratings on commercial mortgage loans are updated at least annually and potentially more often for certain loans with material changes in collateral value or occupancy and for loans on an internal watch list.

Commercial mortgage loans that require more frequent and detailed attention than other loans in our portfolio are identified and placed on an internal watch list. Among the criteria that would indicate a potential problem are significant negative changes in ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

The amortized cost of our commercial mortgage loan portfolio by credit risk, as determined by our internal rating system expressed in terms of an S&P bond equivalent rating, was as follows:

| | September 30, 2015 | | |
|----------------|---------------------------|------------------------------|--------------|
| | Brick and mortar | CTL (in millions) | Total |
| A- and above | \$ 9,755.2 | \$ 187.5 | \$ 9,942.7 |
| BBB+ thru BBB- | 910.7 | 127.3 | 1,038.0 |
| BB+ thru BB- | 152.7 | 0.1 | 152.8 |
| B+ and below | 45.6 | 0.7 | 46.3 |
| Total | \$ 10,864.2 | \$ 315.6 | \$ 11,179.8 |

| | December 31, 2014 | |
|-------------------------|--------------------------|--------------|
| Brick and mortar | CTL | Total |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | (in millions) | | | | | |
|----------------|---------------|----------|----|-------|----|----------|
| A- and above | \$ | 9,115.8 | \$ | 168.8 | \$ | 9,284.6 |
| BBB+ thru BBB- | | 1,041.0 | | 178.5 | | 1,219.5 |
| BB+ thru BB- | | 148.3 | | | | 148.3 |
| B+ and below | | 69.8 | | 1.6 | | 71.4 |
| Total | \$ | 10,374.9 | \$ | 348.9 | \$ | 10,723.8 |

Residential Credit Risk Profile Based on Performance Status

Our residential mortgage loan portfolio is monitored based on performance of the loans. Monitoring on a residential mortgage loan increases when the loan is delinquent or earlier if there is an indication of impairment. We define non-performing residential mortgage loans as loans 90 days or greater delinquent or on non-accrual status.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

The amortized cost of our performing and non-performing residential mortgage loans was as follows:

| | Home equity | September 30, 2015 First liens (in millions) | Total |
|---------------|-------------|--|------------|
| Performing | \$ 222.2 | \$ 863.1 | \$ 1,085.3 |
| Nonperforming | 11.9 | 11.7 | 23.6 |
| Total | \$ 234.1 | \$ 874.8 | \$ 1,108.9 |

| | Home equity | December 31, 2014 First liens (in millions) | Total |
|---------------|-------------|---|------------|
| Performing | \$ 268.4 | \$ 847.6 | \$ 1,116.0 |
| Nonperforming | 15.0 | 13.3 | 28.3 |
| Total | \$ 283.4 | \$ 860.9 | \$ 1,144.3 |

Non-Accrual Mortgage Loans

Commercial and residential mortgage loans are placed on non-accrual status if we have concern regarding the collectability of future payments or if a loan has matured without being paid off or extended. Factors considered may include conversations with the borrower, loss of major tenant, bankruptcy of borrower or major tenant, decreased property cash flow for commercial mortgage loans or number of days past due and other circumstances for residential mortgage loans. Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income. Accrual of interest resumes after factors resulting in doubts about collectability have improved. Residential first lien mortgages in the Chilean market are carried on accrual for a longer period of delinquency than domestic loans, as assessment of collectability is based on the nature of the loans and collection practices in that market.

The amortized cost of mortgage loans on non-accrual status was as follows:

| | September 30, 2015 (in millions) | December 31, 2014 |
|-------------|-------------------------------------|-------------------|
| Commercial: | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | |
|------------------|----|------|----|------|
| Brick and mortar | \$ | 31.7 | \$ | 9.6 |
| Residential: | | | | |
| Home equity | | 11.9 | | 15.0 |
| First liens | | 7.6 | | 8.8 |
| Total | \$ | 51.2 | \$ | 33.4 |

The aging of our mortgage loans, based on amortized cost, was as follows:

September 30, 2015

| | 30-59 days past due | 60-89 days past due | 90 days or more past due | Total past due (in millions) | Current | Total loans | Recorded investment 90 days or more and accruing |
|-----------------------------|------------------------|------------------------|--------------------------------|------------------------------------|-------------|-------------|--|
| Commercial-brick and mortar | \$ 27.4 | \$ | \$ 4.4 | \$ 31.8 | \$ 10,832.4 | \$ 10,864.2 | \$ |
| Commercial-CTL | | | | | 315.6 | 315.6 | |
| Residential-home equity | 1.9 | 0.5 | 1.5 | 3.9 | 230.2 | 234.1 | |
| Residential-first liens | 18.9 | 5.8 | 10.4 | 35.1 | 839.7 | 874.8 | 4.1 |
| Total | \$ 48.2 | \$ 6.3 | \$ 16.3 | \$ 70.8 | \$ 12,217.9 | \$ 12,288.7 | \$ 4.1 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****December 31, 2014**

| | 30-59 days past due | 60-89 days past due | 90 days or more past due | Total past due (in millions) | Current | Total loans | Recorded investment 90 days or more and accruing |
|-----------------------------|--------------------------------|--------------------------------|---|---|----------------|--------------------|---|
| Commercial-brick and mortar | \$ | \$ 4.5 | \$ 0.7 | \$ 5.2 | \$ 10,369.7 | \$ 10,374.9 | \$ |
| Commercial-CTL | | | | | 348.9 | 348.9 | |
| Residential-home equity | 2.3 | 1.2 | 3.4 | 6.9 | 276.5 | 283.4 | |
| Residential-first liens | 24.2 | 7.0 | 12.1 | 43.3 | 817.6 | 860.9 | 4.5 |
| Total | \$ 26.5 | \$ 12.7 | \$ 16.2 | \$ 55.4 | \$ 11,812.7 | \$ 11,868.1 | \$ 4.5 |

Mortgage Loan Valuation Allowance

We establish a valuation allowance to provide for the risk of credit losses inherent in our portfolio. The valuation allowance includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. Mortgage loans on real estate are considered impaired when, based on current information and events, it is probable that we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine that a loan is impaired, a valuation allowance is established equal to the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. Estimated value is based on either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or fair value of the collateral. Subsequent changes in the estimated value are reflected in the valuation allowance. Amounts on loans deemed to be uncollectible are charged off and removed from the valuation allowance. The change in the valuation allowance provision is included in net realized capital gains (losses) on our consolidated statements of operations.

The valuation allowance is maintained at a level believed adequate by management to absorb estimated probable credit losses. Management's periodic evaluation and assessment of the valuation allowance adequacy is based on known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, portfolio delinquency information, underwriting standards, peer group information, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component is subjective, as it requires the estimation of timing and amount of future cash flows expected to be received on impaired loans.

We review our commercial mortgage loan portfolio and analyze the need for a valuation allowance for any loan that is delinquent for 60 days or more, in process of foreclosure, restructured, on the internal watch list or that currently has a valuation allowance. In addition to establishing allowance levels for specifically identified impaired commercial mortgage loans, management determines an allowance for all other loans in the portfolio for which historical experience and current economic conditions indicate certain losses exist. These loans are segregated by risk rating

level with an estimated loss ratio applied against each risk rating level. The loss ratio is generally based upon historic loss experience for each risk rating level as adjusted for certain current environmental factors management believes to be relevant.

For our residential mortgage loan portfolio, we separate the loans into several homogeneous pools, each of which consist of loans of a similar nature including but not limited to loans similar in collateral, term and structure and loan purpose or type. We evaluate loan pools based on aggregated risk ratings, estimated specific loss potential in the different classes of credits, and historical loss experience by pool type. We adjust these quantitative factors for qualitative factors of present conditions. Qualitative factors include items such as economic and business conditions, changes in the portfolio, value of underlying collateral and concentrations. Residential mortgage loan pools exclude loans that have been restructured or impaired, as those loans are evaluated individually.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

A rollforward of our valuation allowance and ending balances of the allowance and loan balance by basis of impairment method was as follows:

| | For the three months ended September 30, 2015 | | |
|--------------------------|--|--------------------------------------|--------------|
| | Commercial | Residential (in millions) | Total |
| Beginning balance | \$ 28.5 | \$ 27.4 | \$ 55.9 |
| Provision | 2.0 | (1.0) | 1.0 |
| Charge-offs | | (1.0) | (1.0) |
| Recoveries | | 0.8 | 0.8 |
| Effect of exchange rates | | (0.1) | (0.1) |
| Ending balance | \$ 30.5 | \$ 26.1 | \$ 56.6 |

| | For the nine months ended September 30, 2015 | | |
|---|---|--------------------------------------|--------------|
| | Commercial | Residential (in millions) | Total |
| Beginning balance | \$ 26.9 | \$ 29.6 | \$ 56.5 |
| Provision | 3.5 | 1.5 | 5.0 |
| Charge-offs | | (7.5) | (7.5) |
| Recoveries | 0.1 | 2.6 | 2.7 |
| Effect of exchange rates | | (0.1) | (0.1) |
| Ending balance | \$ 30.5 | \$ 26.1 | \$ 56.6 |
| Allowance ending balance by basis of impairment method: | | | |
| Individually evaluated for impairment | \$ 3.5 | \$ 8.0 | \$ 11.5 |
| Collectively evaluated for impairment | 27.0 | 18.1 | 45.1 |
| Allowance ending balance | \$ 30.5 | \$ 26.1 | \$ 56.6 |
| Loan balance by basis of impairment method: | | | |
| Individually evaluated for impairment | \$ 4.4 | \$ 24.7 | \$ 29.1 |
| Collectively evaluated for impairment | 11,175.4 | 1,084.2 | 12,259.6 |
| Loan ending balance | \$ 11,179.8 | \$ 1,108.9 | \$ 12,288.7 |

| | For the three months ended September 30, 2014 | | |
|-------------------|--|--------------------------------------|--------------|
| | Commercial | Residential (in millions) | Total |
| Beginning balance | \$ 26.4 | \$ 38.5 | \$ 64.9 |
| Provision | 1.4 | 6.5 | 7.9 |
| Charge-offs | | (15.1) | (15.1) |
| Recoveries | | 0.3 | 0.3 |
| Ending balance | \$ 27.8 | \$ 30.2 | \$ 58.0 |

For the nine months ended September 30, 2014

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | Commercial | Residential (in millions) | Total |
|---|-------------|------------------------------|-------------|
| Beginning balance | \$ 28.7 | \$ 41.1 | \$ 69.8 |
| Provision | (0.6) | 7.3 | 6.7 |
| Charge-offs | (0.3) | (20.8) | (21.1) |
| Recoveries | | 2.7 | 2.7 |
| Effect of exchange rates | | (0.1) | (0.1) |
| Ending balance | \$ 27.8 | \$ 30.2 | \$ 58.0 |
| Allowance ending balance by basis of impairment method: | | | |
| Individually evaluated for impairment | \$ 3.1 | \$ 9.4 | \$ 12.5 |
| Collectively evaluated for impairment | 24.7 | 20.8 | 45.5 |
| Allowance ending balance | \$ 27.8 | \$ 30.2 | \$ 58.0 |
| Loan balance by basis of impairment method: | | | |
| Individually evaluated for impairment | \$ 9.8 | \$ 29.6 | \$ 39.4 |
| Collectively evaluated for impairment | 10,587.0 | 1,176.5 | 11,763.5 |
| Loan ending balance | \$ 10,596.8 | \$ 1,206.1 | \$ 11,802.9 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Impaired Mortgage Loans**

Impaired mortgage loans are loans with a related specific valuation allowance, loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary or a loan modification has been classified as a troubled debt restructuring (TDR). Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. Our recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

| | | September 30, 2015 | | |
|-------------------------------------|----------------------------|---------------------------------|--------------------------|-----|
| | Recorded investment | Unpaid principal balance | Related allowance | |
| | | (in millions) | | |
| With no related allowance recorded: | | | | |
| Residential-first liens | \$ 3.2 | \$ 3.2 | \$ | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | 4.4 | 4.4 | | 3.5 |
| Residential-home equity | 14.4 | 15.4 | | 7.4 |
| Residential-first liens | 7.1 | 6.9 | | 0.6 |
| Total: | | | | |
| Commercial | \$ 4.4 | \$ 4.4 | \$ | 3.5 |
| Residential | \$ 24.7 | \$ 25.5 | \$ | 8.0 |

| | | December 31, 2014 | | |
|-------------------------------------|----------------------------|---------------------------------|--------------------------|-----|
| | Recorded investment | Unpaid principal balance | Related allowance | |
| | | (in millions) | | |
| With no related allowance recorded: | | | | |
| Commercial-brick and mortar | \$ 5.2 | \$ 6.7 | \$ | |
| Residential-first liens | 3.4 | 3.4 | | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | 4.4 | 4.4 | | 2.4 |
| Residential-home equity | 16.5 | 17.1 | | 8.2 |
| Residential-first liens | 7.2 | 7.2 | | 0.8 |
| Total: | | | | |
| Commercial | \$ 9.6 | \$ 11.1 | \$ | 2.4 |
| Residential | \$ 27.1 | \$ 27.7 | \$ | 9.0 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | For the three months ended September 30, 2015 | | For the nine months ended September 30, 2015 | |
|-------------------------------------|--|-------------------------------|---|-------------------------------|
| | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| | (in millions) | | | |
| With no related allowance recorded: | | | | |
| Commercial-brick and mortar | \$ | \$ | \$ 2.6 | \$ |
| Residential-first liens | 3.6 | | 3.3 | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | 4.4 | | 4.4 | 0.2 |
| Residential-home equity | 14.9 | 0.1 | 15.5 | 0.3 |
| Residential-first liens | 6.9 | | 7.2 | 0.1 |
| Total: | | | | |
| Commercial | \$ 4.4 | \$ | \$ 7.0 | \$ 0.2 |
| Residential | \$ 25.4 | \$ 0.1 | \$ 26.0 | \$ 0.4 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the three months ended September 30, 2014 | | For the nine months ended September 30, 2014 | |
|-------------------------------------|--|---------------------------------------|---|---------------------------------------|
| | Average recorded investment | Interest income recognized | Average recorded investment | Interest income recognized |
| | (in millions) | | | |
| With no related allowance recorded: | | | | |
| Commercial-brick and mortar | \$ 0.9 | \$ | \$ 11.2 | \$ 0.1 |
| Residential-first liens | 4.1 | | 4.3 | |
| With an allowance recorded: | | | | |
| Commercial-brick and mortar | 7.1 | 0.1 | 7.1 | 0.2 |
| Residential-home equity | 18.0 | 0.2 | 18.6 | 0.5 |
| Residential-first liens | 8.0 | | 8.5 | 0.1 |
| Total: | | | | |
| Commercial | \$ 8.0 | \$ 0.1 | \$ 18.3 | \$ 0.3 |
| Residential | \$ 30.1 | \$ 0.2 | \$ 31.4 | \$ 0.6 |

Mortgage Loan Modifications

Our commercial and residential mortgage loan portfolios include loans that have been modified. We assess loan modifications on a case-by-case basis to evaluate whether a TDR has occurred. The commercial mortgage loan TDRs were modified to delay or reduce principal payments and to increase, reduce or delay interest payments. For these TDR assessments, we have determined the loan rates are now considered below market based on current circumstances. The commercial mortgage loan modifications resulted in delayed cash receipts and a decrease in interest income. The residential mortgage loan TDRs include modifications of interest-only payment periods, delays in principal balloon payments, and interest rate reductions. Residential mortgage loan modifications resulted in delayed or decreased cash receipts and a decrease in interest income.

The following table includes information about outstanding loans that were modified and met the criteria of a TDR during the periods indicated. In addition, the table includes information for loans that were modified and met the criteria of a TDR within the past twelve months that were in payment default during the periods indicated:

| | For the three months ended September 30, 2015 | | | |
|-------------------------|--|--|--------------------------------|--|
| | TDRs | | TDRs in payment default | |
| | Number of contracts | Recorded investment (in millions) | Number of contracts | Recorded investment (in millions) |
| Residential-home equity | 2 | \$ | 1 | \$ |
| Total | 2 | \$ | 1 | \$ |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

For the three months ended September 30, 2014

| | TDRs | | TDRs in payment default | |
|-----------------------------|---------------------|-----------------------------------|-------------------------|-----------------------------------|
| | Number of contracts | Recorded investment (in millions) | Number of contracts | Recorded investment (in millions) |
| Commercial-brick and mortar | 2 | \$ 5.4 | 1 | \$ 0.7 |
| Residential-home equity | 37 | 1.6 | 1 | |
| Total | 39 | \$ 7.0 | 2 | \$ 0.7 |

For the nine months ended September 30, 2015

| | TDRs | | TDRs in payment default | |
|-------------------------|---------------------|-----------------------------------|-------------------------|-----------------------------------|
| | Number of contracts | Recorded investment (in millions) | Number of contracts | Recorded investment (in millions) |
| Residential-home equity | 13 | \$ 0.5 | 2 | \$ |
| Total | 13 | \$ 0.5 | 2 | \$ |

[Table of Contents](#)
Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

| | Number of contracts | For the nine months ended September 30, 2014 | | TDRs in payment default | |
|-----------------------------|------------------------|--|---|-------------------------|---|
| | | TDRs | Recorded investment (in millions) | Number of contracts | Recorded investment (in millions) |
| Commercial-brick and mortar | 4 | \$ | 10.5 | 1 | \$ 0.7 |
| Residential-home equity | 75 | | 2.9 | 3 | |
| Residential-first liens | 1 | | 0.1 | | |
| Total | 80 | \$ | 13.5 | 4 | \$ 0.7 |

Commercial mortgage loans that have been designated as a TDR have been previously reserved for in the mortgage loan valuation allowance at the estimated fair value of the underlying collateral reduced by the cost to sell.

Residential mortgage loans that have been designated as a TDR are specifically reserved for in the mortgage loan valuation allowance if losses result from the modification. Residential mortgage loans that have defaulted or have been discharged through bankruptcy are reduced to the expected collectible amount.

Securities Posted as Collateral

We posted \$947.7 million in fixed maturities, available-for-sale securities at September 30, 2015, to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements, Futures Commission Merchant (FCM) agreements, a lending arrangement and our obligation under funding agreements with the Federal Home Loan Bank of Des Moines (FHLB Des Moines). In addition, we posted \$2,480.2 million in commercial mortgage loans and home equity mortgages as of September 30, 2015, to satisfy collateral requirements associated with our obligation under funding agreements with the FHLB Des Moines. Since we did not relinquish ownership rights on these instruments, they are reported as fixed maturities, available-for-sale and mortgage loans, respectively, on our consolidated statements of financial position. Of the securities posted as collateral, \$110.0 million can be sold or repledged by the secured party.

Balance Sheet Offsetting

Financial assets subject to master netting agreements or similar agreements were as follows:

| | Gross amount of recognized assets (1) | Gross amounts not offset in the consolidated statements of financial position | | | Net amount |
|-------------------------------|---|---|------------------------|----|------------|
| | | Financial instruments (2) | Collateral received | | |
| | | (in millions) | | | |
| September 30, 2015 | | | | | |
| Derivative assets | \$ 820.2 | \$ (511.6) | \$ (292.0) | \$ | 16.6 |
| Reverse repurchase agreements | 72.6 | | (72.6) | | |
| Total | \$ 892.8 | \$ (511.6) | \$ (364.6) | \$ | 16.6 |
| December 31, 2014 | | | | | |
| Derivative assets | \$ 661.8 | \$ (479.5) | \$ (169.0) | \$ | 13.3 |
| Reverse repurchase agreements | 51.5 | | (51.5) | | |
| Total | \$ 713.3 | \$ (479.5) | \$ (220.5) | \$ | 13.3 |

(1) The gross amount of recognized derivative and reverse repurchase agreement assets are reported with other investments and cash and cash equivalents on the consolidated statements of financial position. The above excludes \$1.1 million and \$0.0 million of derivative assets as of September 30, 2015 and December 31, 2014, that are not subject to master netting agreements or similar agreements. The gross amounts of derivative and reverse repurchase agreement assets are not netted against offsetting liabilities for presentation on the consolidated statements of financial position.

(2) Represents amount of offsetting derivative liabilities that are subject to an enforceable master netting agreement or similar agreement that are not netted against the gross derivative assets for presentation on the consolidated statements of financial position.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

Financial liabilities subject to master netting agreements or similar agreements were as follows:

| | Gross amount of recognized liabilities (1) | Gross amounts not offset in the consolidated statements of financial position | | |
|---------------------------|--|---|-----------------------|------------|
| | | Financial instruments (2) | Collateral pledged | Net amount |
| | | (in millions) | | |
| September 30, 2015 | | | | |
| Derivative liabilities | \$ 805.2 | \$ (511.6) | \$ (164.5) | \$ 129.1 |
| December 31, 2014 | | | | |
| Derivative liabilities | \$ 786.0 | \$ (479.5) | \$ (220.6) | \$ 85.9 |

(1) The gross amount of recognized derivative liabilities are reported with other liabilities on the consolidated statements of financial position. The above excludes \$458.7 million and \$421.3 million of derivative liabilities as of September 30, 2015 and December 31, 2014, respectively, which are primarily embedded derivatives that are not subject to master netting agreements or similar agreements. The gross amounts of derivative liabilities are not netted against offsetting assets for presentation on the consolidated statements of financial position.

(2) Represents amount of offsetting derivative assets that are subject to an enforceable master netting agreement or similar agreement that are not netted against the gross derivative liabilities for presentation on the consolidated statements of financial position.

The financial instruments that are subject to master netting agreements or similar agreements include right of setoff provisions. Derivative instruments include provisions to setoff positions covered under the agreements with the same counterparties and provisions to setoff positions outside of the agreements with the same counterparties in the event of default by one of the parties. Derivative instruments also include collateral provisions. Collateral received and pledged is generally settled daily with each counterparty. See Note 4, Derivative Financial Instruments, for further details.

Repurchase and reverse repurchase agreements include provisions to setoff other repurchase and reverse repurchase balances with the same counterparty. Repurchase and reverse repurchase agreements also include collateral provisions with the counterparties. For reverse repurchase agreements we require the counterparties to pledge collateral with a value greater than the amount of cash transferred. We have the right but do not sell or repledge collateral received in reverse repurchase agreements. Repurchase agreements are structured as secured borrowings for all counterparties. We pledge fixed maturities available-for-sale, which the counterparties have the right to sell or repledge. Interest incurred on

repurchase agreements is reported as part of operating expense on the consolidated statements of operations. Net proceeds related to repurchase agreements are reported as a component of financing activities on the consolidated statements of cash flows. We did not have any outstanding repurchase agreements as of September 30, 2015 and December 31, 2014.

4. Derivative Financial Instruments

Derivatives are generally used to hedge or reduce exposure to market risks associated with assets held or expected to be purchased or sold and liabilities incurred or expected to be incurred. Derivatives are used to change the characteristics of our asset/liability mix consistent with our risk management activities. Derivatives are also used in asset replication strategies.

Types of Derivative Instruments

Interest Rate Contracts

Interest rate risk is the risk we will incur economic losses due to adverse changes in interest rates. Sources of interest rate risk include the difference between the maturity and interest rate changes of assets with the liabilities they support, timing differences between the pricing of liabilities and the purchase or procurement of assets and changing cash flow profiles from original projections due to prepayment options embedded within asset and liability contracts. We use various derivatives to manage our exposure to fluctuations in interest rates.

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

any party. Cash is paid or received based on the terms of the swap. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities and to mitigate the risks arising from timing mismatches between assets and liabilities (including duration mismatches). We also use interest rate swaps to hedge against changes in the value of assets we anticipate acquiring and other anticipated transactions and commitments. Interest rate swaps are used to hedge against changes in the value of the guaranteed minimum withdrawal benefit (GMWB) liability. The GMWB rider on our variable annuity products provides for guaranteed minimum withdrawal benefits regardless of the actual performance of various equity and/or fixed income funds available with the product.

Interest rate options, including interest rate caps and interest rate floors, which can be combined to form interest rate collars, are contracts that entitle the purchaser to pay or receive the amounts, if any, by which a specified market rate exceeds a cap strike interest rate, or falls below a floor strike interest rate, respectively, at specified dates. We use interest rate collars to manage interest rate risk related to guaranteed minimum interest rate liabilities in our individual annuities contracts and lapse risk associated with higher interest rates.

A swaption is an option to enter into an interest rate swap at a future date. We purchase swaptions to offset or modify existing exposures. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

In exchange-traded futures transactions, we agree to purchase or sell a specified number of contracts, the values of which are determined by the values of designated classes of securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. We enter into exchange-traded futures with regulated futures commissions merchants who are members of a trading exchange. We have used exchange-traded futures to reduce market risks from changes in interest rates and to alter mismatches between the assets in a portfolio and the liabilities supported by those assets.

Foreign Exchange Contracts

Foreign currency risk is the risk we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements we issue, foreign currency-denominated fixed maturities we invest in and the financial results of our international operations, including acquisition and divestiture activity. We use various derivatives to manage our exposure to fluctuations in foreign currency exchange rates.

Currency swaps are contracts in which we agree with other parties to exchange, at specified intervals, a series of principal and interest payments in one currency for that of another currency. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. The interest payments are primarily fixed-to-fixed rate; however, they may also be fixed-to-floating rate or floating-to-fixed rate. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date. We use currency swaps to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell.

Currency forwards are contracts in which we agree with other parties to deliver or receive a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell and to hedge the currency risk associated with a business combination. We used currency forwards during 2015 to hedge certain net investments in foreign operations. Currency forwards were not used for hedging any net investments in foreign operations during 2014.

Equity Contracts

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in common stock. We use various derivatives to manage our exposure to equity risk, which arises from products in which the interest we credit is tied to an external equity index as well as products subject to minimum contractual guarantees.

We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity and universal life products that credit interest based on changes in an external equity index. We use

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

exchange-traded futures and equity put options to hedge against changes in the value of the GMWB liability related to the GMWB rider on our variable annuity product, as previously explained. The premium associated with certain options is paid quarterly over the life of the option contract.

Credit Contracts

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in our investment portfolio. Credit derivatives are used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name's credit spread at the time the agreement is executed. In cases where we sell protection, we also buy a quality cash bond to match against the credit default swap, thereby entering into a synthetic transaction replicating a cash security. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Total return swaps are contracts in which we agree with other parties to exchange, at specified intervals, an amount determined by the difference between the previous price and the current price of a reference asset based upon an agreed upon notional principal amount plus an additional amount determined by the financing spread. We currently use futures traded on an exchange (exchange-traded) and total return swaps referencing equity indices to hedge our portfolio from potential credit losses related to systemic events.

Other Contracts

Embedded Derivatives. We purchase or issue certain financial instruments or products that contain a derivative instrument that is embedded in the financial instrument or product. When it is determined that the embedded derivative possesses economic characteristics that are not clearly or closely related to the economic characteristics of the host contract and a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is bifurcated from the host instrument for measurement purposes. The embedded derivative, which is reported with the host instrument in the consolidated statements of financial position, is carried at fair value.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

We have investment-type insurance contracts in which the return is tied to a leveraged inflation index. We economically hedge the risk associated with these investment-type insurance contracts.

We offer group annuity contracts that have guaranteed separate accounts as an investment option. We also offer funds with embedded fixed-rate guarantees as investment options in our defined contribution plans in Hong Kong.

We have structured investment relationships with trusts we have determined to be VIEs, which are consolidated in our financial statements. The notes issued by these trusts include obligations to deliver an underlying security to residual interest holders and the obligations contain an embedded derivative of the forecasted transaction to deliver the underlying security.

We have fixed deferred annuities and universal life contracts that credit interest based on changes in an external equity index. We also have certain variable annuity products with a GMWB rider, which allows the customer to make withdrawals of a specified annual amount, either for a fixed number of years or for the lifetime of the customer, even if the account value is fully exhausted. Declines in the equity markets may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these contracts, as previously explained.

Exposure

Our risk of loss is typically limited to the fair value of our derivative instruments and not to the notional or contractual amounts of these derivatives. We are also exposed to credit losses in the event of nonperformance of the counterparties. Our current credit exposure is limited to the value of derivatives that have become favorable to us. This credit risk is minimized by purchasing such agreements from financial institutions with high credit ratings and by establishing and monitoring exposure limits. We also utilize various credit enhancements, including collateral and credit triggers to reduce the credit exposure to our derivative instruments.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Derivatives may be exchange-traded or they may be privately negotiated contracts, which are usually referred to as over-the-counter (OTC) derivatives. Certain of our OTC derivatives are cleared and settled through central clearing counterparties (OTC cleared), while others are bilateral contracts between two counterparties (bilateral OTC). Our derivative transactions are generally documented under International Swaps and Derivatives Association, Inc. (ISDA) Master Agreements. Management believes that such agreements provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, we are permitted to set off our receivable from a counterparty against our payables to the same counterparty arising out of all included transactions. For reporting purposes, we do not offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements.

We posted \$249.0 million and \$271.6 million in cash and securities under collateral arrangements as of September 30, 2015 and December 31, 2014, respectively, to satisfy collateral requirements associated with our derivative credit support agreements and FCM agreements. These amounts include initial margin requirements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the ratings on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of September 30, 2015 and December 31, 2014, was \$585.8 million and \$656.2 million, respectively. Cleared derivatives have contingent features that require us to post excess margin as required by the FCM. The terms surrounding excess margin vary by FCM agreement. With respect to derivatives containing collateral triggers, we posted collateral and initial margin of \$249.0 million and \$271.6 million as of September 30, 2015 and December 31, 2014, respectively, in the normal course of business, which reflects netting under derivative agreements. If the credit-risk-related contingent features underlying these agreements were triggered on September 30, 2015, we would be required to post an additional \$90.4 million of collateral to our counterparties.

As of September 30, 2015 and December 31, 2014, we had received \$273.9 million and \$148.3 million, respectively, of cash collateral associated with our derivative credit support annex agreements and FCM agreements, for which we recorded a corresponding liability reflecting our obligation to return the collateral.

Notional amounts are used to express the extent of our involvement in derivative transactions and represent a standard measurement of the volume of our derivative activity. Notional amounts represent those amounts used to calculate contractual flows to be exchanged and are not paid or received, except for contracts such as currency swaps. Credit exposure represents the gross amount owed to us under derivative contracts as of the valuation date. The notional amounts and credit exposure of our derivative financial instruments by type were as follows:

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | September 30, 2015 | December 31, 2014 |
|---|--------------------|-------------------|
| | (in millions) | |
| Notional amounts of derivative instruments | | |
| <i>Interest rate contracts:</i> | | |
| Interest rate swaps | \$ 21,931.0 | \$ 19,182.6 |
| Interest rate options | 4,900.0 | 4,900.0 |
| Swaptions | 159.0 | 260.0 |
| Interest rate futures | 173.5 | 147.5 |
| <i>Foreign exchange contracts:</i> | | |
| Currency swaps | 1,831.6 | 1,975.5 |
| Currency forwards | 963.0 | 270.7 |
| <i>Equity contracts:</i> | | |
| Equity options | 3,558.2 | 3,293.4 |
| Equity futures | 563.4 | 498.1 |
| <i>Credit contracts:</i> | | |
| Credit default swaps | 1,095.9 | 1,234.5 |
| Total return swaps | 90.0 | 90.0 |
| Futures | 15.6 | 10.5 |
| <i>Other contracts:</i> | | |
| Embedded derivatives | 9,773.2 | 9,235.7 |
| Total notional amounts at end of period | \$ 45,054.4 | \$ 41,098.5 |
| Credit exposure of derivative instruments | | |
| <i>Interest rate contracts:</i> | | |
| Interest rate swaps | \$ 632.9 | \$ 510.8 |
| Interest rate options | 40.1 | 41.0 |
| <i>Foreign exchange contracts:</i> | | |
| Currency swaps | 112.6 | 97.1 |
| Currency forwards | 3.9 | 1.4 |
| <i>Equity contracts:</i> | | |
| Equity options | 72.4 | 30.2 |
| <i>Credit contracts:</i> | | |
| Credit default swaps | 13.1 | 13.3 |
| Total gross credit exposure | 875.0 | 693.8 |
| Less: collateral received | 308.4 | 183.5 |
| Net credit exposure | \$ 566.6 | \$ 510.3 |

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

The fair value of our derivative instruments classified as assets and liabilities was as follows:

| | Derivative assets (1) | | Derivative liabilities (2) | |
|---|-----------------------|-------------------|----------------------------|-------------------|
| | September 30, 2015 | December 31, 2014 | September 30, 2015 | December 31, 2014 |
| | (in millions) | | | |
| Derivatives designated as hedging instruments | | | | |
| Interest rate contracts | \$ 15.7 | \$ 8.8 | \$ 162.2 | \$ 193.9 |
| Foreign exchange contracts | 105.0 | 80.0 | 146.5 | 69.1 |
| Total derivatives designated as hedging instruments | \$ 120.7 | \$ 88.8 | \$ 308.7 | \$ 263.0 |
| Derivatives not designated as hedging instruments | | | | |
| Interest rate contracts | \$ 597.8 | \$ 508.7 | \$ 314.1 | \$ 321.4 |
| Foreign exchange contracts | 17.2 | 20.8 | 63.8 | 40.1 |
| Equity contracts | 72.5 | 30.2 | 91.7 | 131.7 |
| Credit contracts | 13.1 | 13.3 | 38.7 | 35.6 |
| Other contracts | | | 446.9 | 415.5 |
| Total derivatives not designated as hedging instruments | 700.6 | 573.0 | 955.2 | 944.3 |
| Total derivative instruments | \$ 821.3 | \$ 661.8 | \$ 1,263.9 | \$ 1,207.3 |

(1) The fair value of derivative assets is reported with other investments on the consolidated statements of financial position.

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of \$210.3 million and \$176.4 million as of September 30, 2015 and December 31, 2014, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

When we sell credit protection, we are exposed to the underlying credit risk similar to purchasing a fixed maturity security instrument. The majority of our credit derivative contracts sold reference a single name or reference security (referred to as single name credit default swaps). The remainder of our credit derivatives reference either a basket or index of securities. These instruments are either referenced in an over-the-counter credit derivative transaction, or embedded within an investment structure that has been fully consolidated into our financial

statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by \$0.0 million as of September 30, 2015 and \$10.0 million as of December 31, 2014. These purchased credit derivative transactions had a net asset (liability) fair value of \$0.0 million as of September 30, 2015 and \$(0.1) million as of December 31, 2014. In certain circumstances, our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

We purchased an investment structure with embedded credit features that is fully consolidated into our financial statements. This consolidation results in recognition of the underlying credit derivatives and collateral within the structure, typically high quality fixed maturities that are owned by a special purpose vehicle. These credit derivatives reference several names in a basket structure. In the event of default, the collateral within the structure would typically be liquidated to pay the claims of the credit derivative counterparty.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

The following tables show our credit default swap protection sold by types of contract, types of referenced/underlying asset class and external agency rating for the underlying reference security. The maximum future payments are undiscounted and have not been reduced by the effect of any offsetting transactions, collateral or recourse features described above.

| | September 30, 2015 | | | |
|--|--------------------|---------------|-------------------------------|--|
| | Notional amount | Fair value | Maximum future payments | Weighted average expected life (in years) |
| | | (in millions) | | |
| Single name credit default swaps | | | | |
| Corporate debt | | | | |
| AAA | \$ 30.0 | \$ 0.8 | \$ 30.0 | 3.5 |
| AA | 74.0 | 1.2 | 74.0 | 2.5 |
| A | 204.5 | 2.9 | 204.5 | 2.4 |
| BBB | 340.0 | (1.3) | 340.0 | 3.2 |
| BB | 10.0 | (2.1) | 10.0 | 4.2 |
| Government/municipalities | | | | |
| AA | 30.0 | 0.6 | 30.0 | 3.6 |
| Sovereign | | | | |
| AA | 10.0 | (0.1) | 10.0 | 4.0 |
| BBB | 40.0 | (1.1) | 40.0 | 4.0 |
| Total single name credit default swaps | 738.5 | 0.9 | 738.5 | 3.0 |
| Basket and index credit default swaps | | | | |
| Corporate debt | | | | |
| Near default (1) | 100.4 | (22.5) | 100.4 | 1.5 |
| Government/municipalities | | | | |
| AA | 30.0 | (1.2) | 30.0 | 2.0 |
| Structured finance | | | | |
| AAA | 13.8 | 0.1 | 13.8 | 0.9 |
| Total basket and index credit default swaps | 144.2 | (23.6) | 144.2 | 1.5 |
| Total credit default swap protection sold | \$ 882.7 | \$ (22.7) | \$ 882.7 | 2.8 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | December 31, 2014 | | | |
|---|--------------------|---------------|-------------------------------|--|
| | Notional amount | Fair value | Maximum future payments | Weighted average expected life (in years) |
| | (in millions) | | | |
| Single name credit default swaps | | | | |
| Corporate debt | | | | |
| AAA | \$ 30.0 | \$ 1.0 | \$ 30.0 | 4.2 |
| AA | 79.0 | 1.6 | 79.0 | 3.3 |
| A | 254.5 | 3.3 | 254.5 | 2.8 |
| BBB | 345.0 | 1.2 | 345.0 | 3.6 |
| BB | 10.0 | 0.9 | 10.0 | 5.0 |
| Government/municipalities | | | | |
| AA | 30.0 | 0.6 | 30.0 | 4.3 |
| Sovereign | | | | |
| AA | 10.0 | 0.1 | 10.0 | 4.7 |
| BBB | 40.0 | (0.1) | 40.0 | 4.7 |
| Total single name credit default swaps | 798.5 | 8.6 | 798.5 | 3.5 |
| Basket and index credit default swaps | | | | |
| Corporate debt | | | | |
| Near default (1) | 100.4 | (19.1) | 100.4 | 2.2 |
| Government/municipalities | | | | |
| AA | 30.0 | (1.8) | 30.0 | 2.7 |
| Structured finance | | | | |
| BBB | 16.9 | 0.1 | 16.9 | 3.5 |
| Total basket and index credit default swaps | 147.3 | (20.8) | 147.3 | 2.5 |
| Total credit default swap protection sold | \$ 945.8 | \$ (12.2) | \$ 945.8 | 3.3 |

(1) Includes \$78.0 million as of both September 30, 2015 and December 31, 2014, notional of derivatives in consolidated collateralized private investment vehicle VIEs where the credit risk is borne by third party investors.

We also have invested in fixed maturities classified as trading that contain credit default swaps. These securities are subject to the credit risk of the issuer, normally a special purpose vehicle, which consists of the underlying credit default swaps and high quality fixed maturities that serve as collateral. A default event occurs if the cumulative losses exceed a specified attachment point, which is typically not the first loss of the portfolio. If a default event occurs that exceeds the specified attachment point, our investment may not be fully returned. We would have no future potential payments under these investments. The following tables show, by the types of referenced/underlying asset class and external rating, our fixed maturities with embedded credit derivatives.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

September 30, 2015

| | Amortized cost | Carrying value (in millions) | Weighted average expected life (in years) |
|--|-------------------|------------------------------------|--|
| Corporate debt | | | |
| A | \$ 24.4 | \$ 24.4 | 1.3 |
| Total corporate debt | 24.4 | 24.4 | 1.3 |
| Structured finance | | | |
| A | 62.1 | 62.1 | 1.1 |
| BB | 5.8 | 5.8 | 1.6 |
| CCC | 8.4 | 8.4 | 4.8 |
| Total structured finance | 76.3 | 76.3 | 1.5 |
| Total fixed maturities with credit derivatives | \$ 100.7 | \$ 100.7 | 1.5 |

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | | December 31, 2014 | | |
|--|---------------------------|--------------------------|---|--|
| | Amortized cost | | Carrying value (in millions) | Weighted average expected life (in years) |
| Corporate debt | | | | |
| A | \$ 24.1 | \$ | 24.1 | 2.0 |
| Total corporate debt | 24.1 | | 24.1 | 2.0 |
| Structured finance | | | | |
| A | 56.1 | | 56.1 | 1.5 |
| BB | 5.8 | | 5.8 | 2.7 |
| CCC | 9.5 | | 9.5 | 4.7 |
| Total structured finance | 71.4 | | 71.4 | 2.1 |
| Total fixed maturities with credit derivatives | \$ 95.5 | \$ | 95.5 | 2.0 |

Fair Value Hedges

We use fixed-to-floating rate interest rate swaps to more closely align the interest rate characteristics of certain assets and liabilities. In general, these swaps are used in asset and liability management to modify duration, which is a measure of sensitivity to interest rate changes.

We enter into currency exchange swap agreements to convert certain foreign denominated assets and liabilities into U.S. dollar floating-rate denominated instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in fair value hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

Hedge effectiveness testing for fair value relationships is performed utilizing a regression analysis approach for both prospective and retrospective evaluations. This regression analysis will consider multiple data points for the assessment that the hedge continues to be highly effective in achieving offsetting changes in fair value. In certain periods, the comparison of the change in value of the derivative and the change in the value of the hedged item may not be offsetting at a specific period in time due to small movements in value. However, any amounts recorded as fair value hedges have shown to be highly effective in achieving offsetting changes in fair value both for present and future periods.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The following table shows the effect of derivatives in fair value hedging relationships and the related hedged items on the consolidated statements of operations. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

| Derivatives in fair value hedging relationships | Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, (1) | | Hedged items in fair value hedging relationships | Amount of gain (loss) recognized in net income on related hedged item for the three months ended September 30, (1) | |
|---|--|---------|--|--|-----------|
| | 2015 | 2014 | | 2015 | 2014 |
| | (in millions) | | | (in millions) | |
| Interest rate contracts | \$ (7.0) | \$ 18.5 | Fixed maturities, available-for-sale | \$ 6.7 | \$ (18.3) |
| Interest rate contracts | 2.4 | (2.4) | Investment-type insurance contracts | (2.4) | 2.4 |
| Foreign exchange contracts | | 3.0 | Fixed maturities, available-for-sale | | (3.1) |
| Total | \$ (4.6) | \$ 19.1 | Total | \$ 4.3 | \$ (19.0) |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| Derivatives in fair value hedging relationships | Amount of gain recognized in net income on derivatives for the nine months ended September 30, (1) | | Hedged items in fair value hedging relationships | Amount of loss recognized in net income on related hedged item for the for the nine months ended September 30, (1) | |
|---|---|---------|---|--|-----------|
| | 2015 | 2014 | | 2015 | 2014 |
| | (in millions) | | | (in millions) | |
| Interest rate contracts | \$ 11.1 | \$ 27.2 | Fixed maturities, available-for-sale | \$ (11.0) | \$ (28.4) |
| Interest rate contracts | 3.9 | 0.2 | Investment-type insurance contracts | (3.8) | (0.1) |
| Foreign exchange contracts | 3.8 | 3.8 | Fixed maturities, available-for-sale | (3.8) | (3.8) |
| Foreign exchange contracts | | 0.2 | Investment-type insurance contracts | | (0.2) |
| Total | \$ 18.8 | \$ 31.4 | Total | \$ (18.6) | \$ (32.5) |

(1) The gain (loss) on both derivatives and hedged items in fair value relationships is reported in net realized capital gains (losses) on the consolidated statements of operations. The net amount represents the ineffective portion of our fair value hedges.

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships.

| Hedged item | Amount of gain (loss) for the three months ended September 30, | | (in millions) | Amount of gain (loss) for the nine months ended September 30, | |
|--|--|-----------|---------------|---|--------|
| | 2015 | 2014 | | 2015 | 2014 |
| Fixed maturities, available-for-sale (1) | \$ (17.6) | \$ (22.2) | \$ | (56.9) | (71.5) |
| Investment-type insurance contracts (2) | 0.9 | 1.0 | \$ | 2.8 | 3.4 |

(1) Reported in net investment income on the consolidated statements of operations.

(2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

Cash Flow Hedges

We utilize floating-to-fixed rate interest rate swaps to eliminate the variability in cash flows of recognized financial assets and liabilities and forecasted transactions.

We enter into currency exchange swap agreements to convert both principal and interest payments of certain foreign denominated assets and liabilities into U.S. dollar denominated fixed-rate instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in cash flow hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

The maximum length of time we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 4.7 years. At September 30, 2015, we had \$53.1 million of net gains reported in AOCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from AOCI into net income. We reclassified \$0.0 million and \$0.0 million from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring during the nine months ended September 30, 2015 and 2014, respectively.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

| | | (in millions) | | | | (in millions) | |
|----------------------------|--------------------------------------|---------------|-------|----|------|--|--------|
| Interest rate contracts | Fixed maturities, available-for-sale | \$ | 12.6 | \$ | 8.8 | Net investment income | \$ 4.4 |
| Interest rate contracts | Investment-type insurance contracts | | 1.1 | | 0.2 | Benefits, claims and settlement expenses | \$ 3.5 |
| Interest rate contracts | Debt | | | | | Operating expense | (2.1) |
| Foreign exchange contracts | Fixed maturities, available-for-sale | | 11.4 | | 44.6 | Net realized capital gains | 2.0 |
| Foreign exchange contracts | Investment-type insurance contracts | | (0.5) | | 1.3 | Benefits, claims and settlement expenses | 0.2 |
| Total | | \$ | 24.6 | \$ | 54.9 | Total | \$ 4.3 |

| Derivatives in cash flow hedging relationships | Related hedged item | Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the nine months ended September 30, | | Location of gain (loss) reclassified from AOCI into net income (effective portion) | Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the nine months ended September 30, | |
|--|---|---|---------|---|---|----------|
| | | 2015 | 2014 | | 2015 | 2014 |
| | | (in millions) | | | (in millions) | |
| Interest rate contracts | Fixed maturities, available-for-sale | \$ 23.7 | \$ 10.8 | Net investment income | \$ 12.3 | \$ 10.1 |
| Interest rate contracts | Investment-type insurance contracts | 3.4 | 2.6 | Benefits, claims and settlement expenses | | |
| Interest rate contracts | Debt | | | Operating expense | (6.1) | (5.5) |
| Foreign exchange contracts | Fixed maturities, available-for-sale | 24.9 | 44.4 | Net realized capital gains (losses) | 15.9 | (10.9) |
| Foreign exchange contracts | Investment-type insurance contracts | (1.7) | 9.8 | Benefits, claims and settlement expenses | | |
| Total | | \$ 50.3 | \$ 67.6 | Total | \$ 22.1 | \$ (6.3) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships.

| Hedged item | Amount of gain (loss) for the three months ended September 30, | | Amount of gain (loss) for the nine months ended September 30, | |
|--|---|--------|--|--------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Fixed maturities, available-for-sale (1) | \$ 1.5 | \$ 1.1 | \$ 4.6 | \$ 3.9 |
| Investment-type insurance contracts (2) | (4.8) | (2.6) | (13.5) | (8.4) |

-
- (1) Reported in net investment income on the consolidated statements of operations.
- (2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net gain (loss) resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.0 million and \$0.1 million for the three months ended September 30, 2015 and 2014, respectively. The net gain (loss) resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.1 million and \$0.0 million for the nine months ended September 30, 2015 and 2014, respectively.

We expect to reclassify net losses of \$(1.3) million from AOCI into net income in the next 12 months, which includes both net deferred gains on discontinued hedges and net losses on periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

Net Investment Hedges

We may take measures to hedge our net equity investments in our foreign operations from currency risk. This is accomplished with the use of currency forwards.

Gains and losses associated with net investment hedges are recorded in AOCI and will be released into earnings if our investment in the foreign operation is sold or substantially liquidated.

The following table shows the effect of derivatives in net investment hedging relationships on the consolidated statements of financial position. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

| Derivatives in net investment hedging relationships | Amount of gain recognized in AOCI on derivatives (effective portion) for the three months ended September 30, | | | Amount of gain recognized in AOCI on derivatives (effective portion) for the nine months ended September 30, | | |
|---|---|-----|------|--|-----|------|
| | 2015 | | 2014 | 2015 | | 2014 |
| | (in millions) | | | | | |
| Foreign exchange contracts | \$ | 1.7 | \$ | \$ | 1.7 | \$ |
| Total | \$ | 1.7 | \$ | \$ | 1.7 | \$ |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

We did not have any ineffectiveness and did not reclassify any gains or losses from AOCI into net income related to our net investment hedges for the three and nine months ended September 30, 2015 and 2014.

Derivatives Not Designated as Hedging Instruments

Our use of futures, certain swaptions and swaps, collars, options and forwards are effective from an economic standpoint, but they have not been designated as hedges for financial reporting purposes. As such, periodic changes in the market value of these instruments, which includes mark-to-market gains and losses as well as periodic and final settlements, primarily flow directly into net realized capital gains (losses) on the consolidated statements of operations.

The following table shows the effect of derivatives not designated as hedging instruments, including fair value changes of embedded derivatives that have been bifurcated from the host contract, on the consolidated statements of operations.

| Derivatives not designated as hedging instruments | Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, | | Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, | |
|---|--|-----------|---|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Interest rate contracts | \$ 150.8 | \$ 38.3 | \$ 84.7 | \$ 134.7 |
| Foreign exchange contracts | (27.0) | (43.7) | (39.2) | (56.6) |
| Equity contracts | 39.7 | 37.7 | 7.5 | 0.1 |
| Credit contracts | (11.0) | (21.7) | 2.4 | (10.8) |
| Other contracts | (97.9) | (62.0) | (39.0) | (108.5) |
| Total | \$ 54.6 | \$ (51.4) | \$ 16.4 | \$ (41.1) |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****5. Long-Term Debt**

The components of long-term debt were as follows:

| | September 30, 2015 | December 31, 2014 |
|--|--------------------|-------------------|
| | (in millions) | |
| 1.85% notes payable, due 2017 | \$ 299.9 | \$ 299.8 |
| 8.875% notes payable, due 2019 | 350.0 | 350.0 |
| 3.3% notes payable, due 2022 | 299.2 | 299.1 |
| 3.125% notes payable, due 2023 | 299.7 | 299.6 |
| 3.4% notes payable, due in 2025 | 398.8 | |
| 6.05% notes payable, due 2036 | 601.6 | 601.6 |
| 4.625% notes payable, due 2042 | 299.5 | 299.5 |
| 4.35% notes payable, due 2043 | 299.3 | 299.3 |
| 4.7% notes payable, due 2055 | 400.0 | |
| Non-recourse mortgages and notes payable | 38.1 | 82.3 |
| Total long-term debt | \$ 3,286.1 | \$ 2,531.2 |

The amounts included above are net of the discount and premium associated with issuing these notes, which are being amortized to expense over the respective terms using the interest method.

On May 7, 2015, we issued \$400.0 million of senior notes. The notes bear interest at 3.4% and will mature in 2025. Interest on the notes is payable semi-annually on May 15 and November 15 each year, beginning on November 15, 2015. In addition, on May 7, 2015, we issued \$400.0 million of junior subordinated notes, which are subordinated to all our senior debt. The notes are callable in 2020 and have a maturity date in 2055. The notes initially bear a fixed rate of interest at 4.7% and convert to a floating rate at the date the notes become callable. Interest on the notes is payable semi-annually on May 15 and November 15 each year. After the call date the notes will bear interest at 3-month LIBOR plus 3.044%, reset quarterly and payable in arrears in February, May, August, and November each year. We have the right to defer interest payments on the junior subordinated notes for up to 5 years without resulting in a default, during which time interest will be compounded. The proceeds from these notes were used to redeem our series A and series B preferred stock with the remainder available for general corporate purposes.

6. Income Taxes

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The effective income tax rate for the three months ended September 30, 2015, was lower than the U.S. corporate income tax rate of 35% (U.S. statutory rate) primarily due to income tax deductions allowed for corporate dividends received and the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income.

The effective income tax rate for the three months ended September 30, 2014, was higher than the U.S. statutory rate primarily due to an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile, partially offset by income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income and lower tax rates of foreign jurisdictions.

The effective income tax rate for the nine months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, a change in deferred tax balances related to the merger of two of our Chilean legal entities and the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income, partially offset by the negative impact of a court ruling on some uncertain tax positions.

The effective income tax rate for the nine months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income and tax credits, partially offset by an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

We are a U.S. shareholder in various foreign entities classified as controlled foreign corporations (CFCs) for U.S. tax purposes. U.S. shareholders of CFCs are generally required to take into account as gross income in the U.S. certain passive income earned by the CFCs (Subpart F income) even if the income is not currently distributed. Temporary exceptions (the active financing and look through exceptions) were applicable for tax years beginning before January 1, 2015 to avoid the current recognition of Subpart F income derived in either the active conduct of a banking, financing, insurance or similar business or for certain payments between related corporations in different foreign jurisdictions. The U.S. Congress and the President have yet to enact extenders legislation as of September 30, 2015. Therefore, current tax expense has increased by an immaterial amount associated with the U.S. recognition of Subpart F income from our foreign operations. We will reverse any tax expense subject to the active financing and look through exceptions during the fourth quarter, assuming the legislation is enacted in 2015 retroactive to January 1, 2015.

The U.S. Court of Federal Claims denied cross-motions for partial summary judgment on February 4, 2015, and ordered a trial on the previously taxed income issue in the case of Principal Life Insurance Company and Subsidiaries (Principal Life) v. the United States. Previously, in the same case, the court had ruled against Principal Life's tax treatment of transactions involving the purchase and sale of principal-only certificates. These recent events caused re-evaluation of all our pending uncertain tax positions. The overall re-evaluation resulted in a \$30.3 million reduction in net income in the first quarter of 2015. We do not believe there is a reasonable possibility the total amount of uncertain tax benefits will significantly increase or decrease in the next twelve months.

Unrecognized Tax Benefits

A summary of the changes in unrecognized tax benefits follows:

| | For the nine months ended September 30, 2015 | For the year ended December 31, 2014 |
|--|---|---|
| | (in millions) | |
| Balance at beginning of period | \$ 172.4 | \$ 108.9 |
| Additions based on tax positions related to the current year | 11.0 | 12.9 |
| Additions for tax positions of prior years | 46.7 | 62.5 |
| Reductions for tax positions related to the current year | (7.1) | (8.4) |
| Reductions for tax positions of prior years | (3.5) | (0.2) |
| Settlements | | (3.3) |
| Balance at end of period (1) | \$ 219.5 | \$ 172.4 |

(1) Of this amount, \$81.0 million, if recognized, would reduce the 2015 effective income tax rate. We recognize interest and penalties related to uncertain tax positions in operating expenses.

As of September 30, 2015 and December 31, 2014, we had recognized \$137.4 million and \$100.4 million of accumulated pre-tax interest and penalties related to unrecognized tax benefits, respectively.

7. Employee and Agent Benefits

Components of Net Periodic Benefit Cost

| | Pension benefits | | | Other postretirement benefits | | |
|---------------------------------------|--|--------|----|--|------|--------|
| | For the three months ended September 30, | | | For the three months ended September 30, | | |
| | 2015 | 2014 | | 2015 | 2014 | |
| | (in millions) | | | | | |
| Service cost | \$ | 15.8 | \$ | 13.5 | \$ | 0.5 |
| Interest cost | | 30.0 | | 29.2 | | 1.6 |
| Expected return on plan assets | | (40.2) | | (33.0) | | (8.5) |
| Amortization of prior service benefit | | (0.5) | | (1.0) | | (4.6) |
| Recognized net actuarial (gain) loss | | 25.7 | | 12.5 | | (0.3) |
| Net periodic benefit cost (income) | \$ | 30.8 | \$ | 21.2 | \$ | (11.3) |
| | | | | | \$ | (12.1) |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | Pension benefits | | Other postretirement benefits | |
|---------------------------------------|----------------------------------|-------------|--------------------------------------|-------------|
| | For the nine months ended | | For the nine months ended | |
| | September 30, | | September 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Service cost | \$ 47.4 | \$ 40.5 | \$ 1.5 | \$ 1.1 |
| Interest cost | 90.2 | 87.8 | 4.9 | 5.0 |
| Expected return on plan assets | (120.5) | (99.0) | (25.5) | (24.5) |
| Amortization of prior service benefit | (1.4) | (3.4) | (13.8) | (15.2) |
| Recognized net actuarial (gain) loss | 76.8 | 37.8 | (0.7) | (2.7) |
| Net periodic benefit cost (income) | \$ 92.5 | \$ 63.7 | \$ (33.6) | \$ (36.3) |

Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act (ERISA) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2015 will be zero so we will not be required to fund our qualified pension plan during 2015. However, it is possible that we may fund the qualified and nonqualified pension plans in 2015 for a combined total of up to \$150.0 million. During the three and nine months ended September 30, 2015, we contributed \$25.2 million and \$67.8 million to these plans, respectively.

8. Contingencies, Guarantees and Indemnifications**Litigation and Regulatory Contingencies**

We are regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services; individual life insurance, specialty benefits insurance and our investment activities. Some of the lawsuits may be class actions, or purport to be, and some may include claims for unspecified or substantial punitive and treble damages.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

We may discuss such litigation in one of three ways. We accrue a charge to income and disclose legal matters for which the chance of loss is probable and for which the amount of loss can be reasonably estimated. We may disclose contingencies for which the chance of loss is reasonably possible and provide an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. Finally, we may voluntarily disclose loss contingencies for which the chance of loss is remote in order to provide information concerning matters that potentially expose us to possible losses.

In addition, regulatory bodies such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor and other regulatory agencies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers. We receive requests from regulators and other governmental authorities relating to industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On March 18, 2014, McCaffree Financial Corp. Employee Retirement Program (McCaffree) filed a putative class action lawsuit in the United States District Court for the Southern District of Iowa against Principal Life. The complaint alleged, among other things, breach of duty of loyalty, breach of duty of prudence and prohibited transactions under ERISA. McCaffree seeks a nationwide class action on behalf of all participants and beneficiaries of defined contribution retirement plans that invested in any Principal Separate Account in the last six years. McCaffree seeks disgorgement of all fees it alleges Principal Life improperly retained in addition to other general claims for relief. Principal Life filed a motion to dismiss the case and on December 11, 2014, the court granted the motion. McCaffree filed a notice of appeal on December 22, 2014. Principal Life will continue to aggressively defend the case.

On August 29, 2013, American Chemicals & Equipment, Inc. 401(k) Retirement Plan (ACE) filed a lawsuit in the United States District Court for the Northern District of Alabama against Principal Management Corporation and Principal Global Investors, LLC (the ACE Defendants). The lawsuit alleges the ACE Defendants breached their fiduciary duty under Section 36(b) of the Investment Company Act by charging excessive fees on certain of the LifeTime series target date

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

funds. On January 24, 2014, the court granted the motion filed by the ACE Defendants to transfer the case to the Southern District of Iowa. The case is set for trial on April 11, 2016. The ACE Defendants continue to aggressively defend the lawsuit.

In 2008, Principal Life received approximately \$440.0 million in connection with the termination of certain structured transactions and the resulting prepayment of Principal Life's investment in those transactions. The transactions involved Lehman Brothers Special Financing Inc. and Lehman Brothers Holdings Inc. (collectively, Lehman) in various capacities. Subsequent to Lehman's 2008 bankruptcy filing, its bankruptcy estate initiated several lawsuits seeking to recover from numerous sources significant amounts to which it claims entitlement under various theories. We are one of a large group of defendants to this action, and believe that we have meritorious defenses to Lehman's claims and intend to aggressively defend against them. The estate's claim against Principal Life, including interest through November 2014 (which we also dispute), was approximately \$550.0 million.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any such matter will have a material adverse effect on our business or financial position. As of September 30, 2015, there were no estimated losses accrued related to the legal matters discussed above because we believe the loss from these matters is not probable and cannot be reasonably estimated.

We believe all of the litigation contingencies discussed above involve a chance of loss that is either remote or reasonably possible. Unless otherwise noted, all of these matters involve unspecified claim amounts, in which the respective plaintiffs seek an indeterminate amount of damages. To the extent such matters present a reasonably possible chance of loss, we are generally not able to estimate the possible loss or range of loss associated therewith.

The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts that we could not estimate at September 30, 2015.

Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to former subsidiaries and joint ventures. These agreements generally expire through 2019. The maximum exposure under these agreements as of September 30, 2015, was approximately \$205.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. While the likelihood is remote, such outcomes could materially affect net income in a particular quarter or annual period.

We manage mandatory privatized social security funds in Chile. By regulation, we have a required minimum guarantee on the funds' relative return. Because the guarantee has no limitation with respect to duration or amount, the maximum exposure of the guarantee in the future is indeterminable.

We are also subject to various other indemnification obligations issued in conjunction with divestitures, acquisitions and financing transactions whose terms range in duration and often are not explicitly defined. Certain portions of these indemnifications may be capped, while other portions are not subject to such limitations; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. At inception, the fair value of such indemnifications was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe that performance under these indemnifications would not result in a material adverse effect on our business or financial position. While the likelihood is remote, performance under these indemnifications could materially affect net income in a particular quarter or annual period.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****9. Stockholders' Equity****Reconciliation of Outstanding Shares**

| | Series A preferred stock | Series B preferred stock (in millions) | Common stock |
|--|-------------------------------------|---|-------------------------|
| Outstanding shares at January 1, 2014 | 3.0 | 10.0 | 295.2 |
| Shares issued | | | 3.1 |
| Treasury stock acquired | | | (4.7) |
| Outstanding shares at September 30, 2014 | 3.0 | 10.0 | 293.6 |
| Outstanding shares at January 1, 2015 | 3.0 | 10.0 | 293.9 |
| Shares issued | | | 3.3 |
| Treasury stock acquired | | | (3.7) |
| Preferred stock redemption | (3.0) | (10.0) | |
| Outstanding shares at September 30, 2015 | | | 293.5 |

On June 30, 2015 we redeemed our 3.0 million shares of series A preferred stock for \$250.0 million and our 10.0 million shares of series B preferred stock for \$300.0 million. At redemption, we recognized \$8.2 million excess redemption value over carrying value of the preferred shares redeemed as an adjustment to determine net income available to common stockholders.

In February 2013, our Board of Directors authorized a share repurchase program of up to \$150.0 million of our outstanding common stock, which was completed in March 2014. In February 2014, our Board of Directors authorized a share repurchase program of up to \$200.0 million of our outstanding common stock, which was completed in March 2015. In February 2015, our Board of Directors authorized a share repurchase program of up to \$150.0 million of our outstanding common stock. Shares repurchased under these programs are accounted for as treasury stock, carried at cost and reflected as a reduction to stockholders' equity.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Other Comprehensive Income (Loss)**

| | For the three months ended September 30, 2015 | | | For the nine months ended September 30, 2015 | | |
|--|--|---------|------------|---|----------|------------|
| | Pre-Tax | Tax | After-Tax | Pre-Tax | Tax | After-Tax |
| | (in millions) | | | | | |
| Net unrealized losses on available-for-sale securities during the period | \$ (191.9) | \$ 66.4 | \$ (125.5) | \$ (999.0) | \$ 340.7 | \$ (658.3) |
| Reclassification adjustment for (gains) losses included in net income (1) | 6.8 | (2.5) | 4.3 | (1.7) | 0.5 | (1.2) |
| Adjustments for assumed changes in amortization patterns | 35.7 | (12.5) | 23.2 | 118.1 | (41.3) | 76.8 |
| Adjustments for assumed changes in policyholder liabilities | 190.5 | (64.2) | 126.3 | 547.8 | (186.1) | 361.7 |
| Net unrealized gains (losses) on available-for-sale securities | 41.1 | (12.8) | 28.3 | (334.8) | 113.8 | (221.0) |
| Noncredit component of impairment losses on fixed maturities, available-for-sale during the period | 1.1 | (0.3) | 0.8 | 28.0 | (9.7) | 18.3 |
| Adjustments for assumed changes in amortization patterns | | | | (1.3) | 0.5 | (0.8) |
| Adjustments for assumed changes in policyholder liabilities | 0.3 | (0.1) | 0.2 | 0.5 | (0.1) | 0.4 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale (2) | 1.4 | (0.4) | 1.0 | 27.2 | (9.3) | 17.9 |
| Net unrealized gains on derivative instruments during the period | 21.7 | (7.6) | 14.1 | 50.1 | (17.5) | 32.6 |
| Reclassification adjustment for gains included in net income (3) | (4.3) | 1.3 | (3.0) | (22.1) | 7.3 | (14.8) |
| Adjustments for assumed changes in amortization patterns | 6.0 | (2.1) | 3.9 | 18.5 | (6.5) | 12.0 |
| Adjustments for assumed changes in policyholder liabilities | (7.2) | 2.5 | (4.7) | (12.0) | 4.2 | (7.8) |
| Net unrealized gains on derivative instruments | 16.2 | (5.9) | 10.3 | 34.5 | (12.5) | 22.0 |
| Foreign currency translation adjustment | (306.5) | 43.3 | (263.2) | (512.6) | 74.3 | (438.3) |
| Amortization of prior service cost and actuarial loss included in net periodic benefit cost (4) | 20.3 | (8.4) | 11.9 | 60.9 | (25.0) | 35.9 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | |
|--|------------|---------|------------|------------|----------|------------|
| Net unrecognized postretirement benefit obligation | 20.3 | (8.4) | 11.9 | 60.9 | (25.0) | 35.9 |
| Other comprehensive loss | \$ (227.5) | \$ 15.8 | \$ (211.7) | \$ (724.8) | \$ 141.3 | \$ (583.5) |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the three months ended September 30, 2014 | | | For the nine months ended September 30, 2014 | | |
|--|--|----------|------------|---|------------|-----------|
| | Pre-Tax | Tax | After-Tax | Pre-Tax | Tax | After-Tax |
| | (in millions) | | | | | |
| Net unrealized gains (losses) on available-for-sale securities during the period | \$ (301.8) | \$ 103.8 | \$ (198.0) | \$ 1,009.9 | \$ (340.7) | \$ 669.2 |
| Reclassification adjustment for (gains) losses included in net income (1) | 4.3 | (1.4) | 2.9 | (57.4) | 18.8 | (38.6) |
| Adjustments for assumed changes in amortization patterns | 28.2 | (9.8) | 18.4 | (71.0) | 24.9 | (46.1) |
| Adjustments for assumed changes in policyholder liabilities | 149.8 | (47.0) | 102.8 | (434.7) | 146.8 | (287.9) |
| Net unrealized gains (losses) on available-for-sale securities | (119.5) | 45.6 | (73.9) | 446.8 | (150.2) | 296.6 |
| Noncredit component of impairment losses on fixed maturities, available-for-sale during the period | 14.7 | (5.0) | 9.7 | 82.6 | (29.3) | 53.3 |
| Adjustments for assumed changes in amortization patterns | 3.1 | (1.2) | 1.9 | (5.3) | 1.9 | (3.4) |
| Adjustments for assumed changes in policyholder liabilities | (0.9) | 0.3 | (0.6) | (1.5) | 0.5 | (1.0) |
| Noncredit component of impairment losses on fixed maturities, available-for-sale (2) | 16.9 | (5.9) | 11.0 | 75.8 | (26.9) | 48.9 |
| Net unrealized gains on derivative instruments during the period | 48.4 | (17.0) | 31.4 | 67.7 | (23.8) | 43.9 |
| Reclassification adjustment for (gains) losses included in net income (3) | (1.8) | 0.6 | (1.2) | 6.3 | (2.4) | 3.9 |
| Adjustments for assumed changes in amortization patterns | (8.4) | 2.9 | (5.5) | (8.9) | 3.1 | (5.8) |
| Adjustments for assumed changes in policyholder liabilities | 6.9 | (2.4) | 4.5 | 0.4 | (0.1) | 0.3 |
| Net unrealized gains on derivative instruments | 45.1 | (15.9) | 29.2 | 65.5 | (23.2) | 42.3 |
| Foreign currency translation adjustment | (210.3) | 14.5 | (195.8) | (231.2) | 22.8 | (208.4) |
| Amortization of prior service cost and actuarial loss included in net periodic benefit cost (4) | 5.5 | (1.9) | 3.6 | 16.5 | (5.8) | 10.7 |
| Net unrecognized postretirement benefit obligation | 5.5 | (1.9) | 3.6 | 16.5 | (5.8) | 10.7 |
| Other comprehensive income (loss) | \$ (262.3) | \$ 36.4 | \$ (225.9) | \$ 373.4 | \$ (183.3) | \$ 190.1 |

-
- (1) Pre-tax reclassification adjustments relating to available-for-sale securities are reported in net realized capital gains (losses) on the consolidated statements of operations.
- (2) Represents the net impact of (1) unrealized gains resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold and (2) unrealized losses resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI.
- (3) See Note 4, Derivative Financial Instruments Cash Flow Hedges, for further details.
- (4) Pre-tax amortization of prior service cost and actuarial loss included in net periodic benefit cost, which is comprised of amortization of prior service cost (benefit) and recognized net actuarial (gain) loss, is reported in operating expenses on the consolidated statements of operations. See Note 7, Employee and Agent Benefits Components of Net Periodic Benefit Cost, for further details.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Accumulated Other Comprehensive Income (Loss)**

| | Net unrealized gains on available-for-sale securities | Noncredit component of impairment losses on fixed maturities available-for-sale | Net unrealized gains (losses) on derivative instruments (in millions) | Foreign currency translation adjustment | Unrecognized postretirement benefit obligation | Accumulated other comprehensive income (loss) |
|--|--|---|---|--|---|--|
| Balances at January 1, 2014 | \$ 878.1 | \$ (167.0) | \$ (10.5) | \$ (361.5) | \$ (155.9) | \$ 183.2 |
| Other comprehensive income during the period, net of adjustments | 335.2 | | 38.4 | (201.6) | | 172.0 |
| Amounts reclassified from AOCI | (38.6) | 48.9 | 3.9 | | 10.7 | 24.9 |
| Other comprehensive income | 296.6 | 48.9 | 42.3 | (201.6) | 10.7 | 196.9 |
| Balances at September 30, 2014 | \$ 1,174.7 | \$ (118.1) | \$ 31.8 | \$ (563.1) | \$ (145.2) | \$ 380.1 |
| Balances at January 1, 2015 | \$ 1,202.8 | \$ (105.1) | \$ 50.6 | \$ (686.8) | \$ (411.1) | \$ 50.4 |
| Other comprehensive loss during the period, net of adjustments | (219.8) | | 36.8 | (419.3) | | (602.3) |
| Amounts reclassified from AOCI | (1.2) | 17.9 | (14.8) | | 35.9 | 37.8 |
| Other comprehensive loss | (221.0) | 17.9 | 22.0 | (419.3) | 35.9 | (564.5) |
| Purchase of subsidiary shares from noncontrolling interest | | | | (10.3) | | (10.3) |
| Balances at September 30, 2015 | \$ 981.8 | \$ (87.2) | \$ 72.6 | \$ (1,116.4) | \$ (375.2) | \$ (524.4) |

Noncontrolling Interest

Interests held by unaffiliated parties in consolidated entities are reflected in noncontrolling interest, which represents the noncontrolling partners share of the underlying net assets of our consolidated subsidiaries. Noncontrolling interest that is not redeemable is reported in the equity section of the consolidated statements of financial position.

The noncontrolling interest holders in certain of our consolidated entities maintain an equity interest that is redeemable at the option of the holder, which may be exercised on varying dates. Since redemption of the noncontrolling interest is outside of our control, this interest is presented on the consolidated statements of financial position line item titled Redeemable noncontrolling interest. If the interest were to be redeemed, we would be required to purchase such interest at a redemption value based on fair value or a formula that management intended to reasonably approximate fair value based on a fixed multiple of earnings over a measurement period. As such, the carrying value of the redeemable noncontrolling interest is compared to the redemption value at each reporting period. Any adjustments to the carrying amount of the redeemable noncontrolling interest for changes in redemption value prior to exercise of the redemption option are determined after the attribution of net income or loss of the subsidiary and are recognized in the redemption value as they occur. Adjustments to the carrying value of redeemable noncontrolling interest result in adjustments to additional paid-in capital and/or retained earnings. Adjustments are recorded in retained earnings to the extent the redemption value of the redeemable noncontrolling interest exceeds its fair value and will impact the numerator in our earnings per share calculations. All other adjustments to the redeemable noncontrolling interest are recorded in additional paid-in capital.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

Following is a reconciliation of the changes in the redeemable noncontrolling interest (in millions):

| | | |
|---|-----------|--------------|
| Balance at January 1, 2014 | \$ | 247.2 |
| Net income attributable to redeemable noncontrolling interest | | 8.3 |
| Contributions from redeemable noncontrolling interest | | 0.1 |
| Distributions to redeemable noncontrolling interest | | (14.4) |
| Purchase of subsidiary shares from redeemable noncontrolling interest (1) | | (216.8) |
| Change in redemption value of redeemable noncontrolling interest | | 33.2 |
| Foreign currency translation adjustment | | (1.5) |
| Balance at September 30, 2014 | \$ | 56.1 |
| Balance at January 1, 2015 | \$ | 58.0 |
| Net income attributable to redeemable noncontrolling interest | | 1.5 |
| Contributions from redeemable noncontrolling interest | | 49.3 |
| Distributions to redeemable noncontrolling interest | | (10.7) |
| Purchase of subsidiary shares from redeemable noncontrolling interest | | (6.0) |
| Change in redemption value of redeemable noncontrolling interest | | 3.6 |
| Foreign currency translation adjustment | | (17.7) |
| Balance at September 30, 2015 | \$ | 78.0 |

(1) During the third quarter of 2014, we increased our ownership stake in Columbus Circle Investors.

10. Fair Value Measurements

We use fair value measurements to record fair value of certain assets and liabilities and to estimate fair value of financial instruments not recorded at fair value but required to be disclosed at fair value. Certain financial instruments, particularly policyholder liabilities other than investment-type insurance contracts, are excluded from these fair value disclosure requirements.

Valuation Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair

value into three levels. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety considering factors specific to the asset or liability.

- **Level 1** Fair values are based on unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities primarily include exchange traded equity securities, mutual funds and U.S. Treasury bonds.
- **Level 2** Fair values are based on inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. Our Level 2 assets and liabilities primarily include fixed maturities (including public and private bonds), equity securities, derivatives and other investments for which public quotations are not available but that are priced by third party pricing services or internal models using substantially all observable inputs. Our level 2 assets also include commercial mortgage loan investments of consolidated VIEs for which the fair value option was elected.
- **Level 3** Fair values are based on at least one significant unobservable input for the asset or liability. Our Level 3 assets and liabilities include certain assets and liabilities priced using broker quotes or other valuation methods that utilize at least one significant unobservable input. These include fixed maturities, private equity securities, real estate and commercial mortgage loan investments of our separate accounts, obligations of consolidated VIEs for which the fair value option was elected, complex derivatives, embedded derivatives and equity method real estate investments for which the fair value option was elected.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Determination of Fair Value

The following discussion describes the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis or disclosed at fair value. The techniques utilized in estimating the fair values of financial instruments are reliant on the assumptions used. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

Fair value estimates are made based on available market information and judgments about the financial instrument at a specific point in time. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. Beginning in 2015 a measurement alternative is used for consolidated collateralized financing entities (CCFEs) utilizing the more observable of the fair value of the financial assets or the financial liabilities for both the financial assets and financial liabilities. We did not make any other significant changes to our valuation processes during 2015.

Fixed Maturities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred securities. When available, the fair value of fixed maturities is based on quoted prices of identical assets in active markets. These are reflected in Level 1 and primarily include U.S. Treasury bonds and actively traded redeemable corporate preferred securities.

When quoted prices of identical assets in active markets are not available, our first priority is to obtain prices from third party pricing vendors. We have regular interaction with these vendors to ensure we understand their pricing methodologies and to confirm they are utilizing observable market information. Their methodologies vary by asset class and include inputs such as estimated cash flows, benchmark yields, reported trades, broker quotes, credit quality, industry events and economic events. Fixed maturities with validated prices from pricing services, which includes the majority of our public fixed maturities in all asset classes, are generally reflected in Level 2. Also included in Level 2 are corporate bonds where quoted market prices are not available, for which an internal model using substantially all observable inputs or a matrix pricing valuation approach is used. In the matrix approach, securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each

pricing category may actually be impacted by company specific factors.

If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to the asset class, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available and where at least one significant unobservable input is utilized, which are reflected in Level 3 and can include fixed maturities across all asset classes. As of September 30, 2015, less than 1% of our fixed maturities were valued using internal pricing models, which were classified as Level 3 assets accordingly.

The primary inputs, by asset class, for valuations of the majority of our Level 2 investments from third party pricing vendors or our internal pricing valuation approach are described below.

U.S. Government and Agencies/Non-U.S. Governments. Inputs include recently executed market transactions, interest rate yield curves, maturity dates, market price quotations and credit spreads relating to similar instruments.

States and Political Subdivisions. Inputs include Municipal Securities Rulemaking Board reported trades, U.S. Treasury and other benchmark curves, material event notices, new issue data and obligor credit ratings.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Corporate. Inputs include recently executed transactions, market price quotations, benchmark yields, issuer spreads and observations of equity and credit default swap curves related to the issuer. For private placement corporate securities valued through the matrix valuation approach inputs include the current Treasury curve and risk spreads based on sector, rating and average life of the issuance.

RMBS, CMBS, Collateralized Debt Obligations and Other Debt Obligations. Inputs include cash flows, priority of the tranche in the capital structure, expected time to maturity for the specific tranche, reinvestment period remaining and performance of the underlying collateral including prepayments, defaults, deferrals, loss severity of defaulted collateral and, for RMBS, prepayment speed assumptions. Other inputs include market indices and recently executed market transactions.

Equity Securities

Equity securities include mutual funds, common stock, nonredeemable preferred stock and regulatory required investments. Fair values of equity securities are determined using quoted prices in active markets for identical assets when available, which are reflected in Level 1. When quoted prices are not available, we may utilize internal valuation methodologies appropriate for the specific asset that use observable inputs such as underlying share prices or the net asset value (NAV), which are reflected in Level 2. Fair values might also be determined using broker quotes or through the use of internal models or analysis that incorporate significant assumptions deemed appropriate given the circumstances and consistent with what other market participants would use when pricing such securities, which are reflected in Level 3.

Derivatives

The fair values of exchange-traded derivatives are determined through quoted market prices, which are reflected in Level 1. Exchange-traded derivatives include futures that are settled daily such that their fair value is not reflected in the consolidated statements of financial position. The fair values of derivative instruments cleared through centralized clearinghouses are determined through market prices published by the clearinghouses, which are reflected in Level 2. The clearinghouses may utilize the overnight indexed swap (OIS) curve in their valuation. The fair values of bilateral OTC derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The majority of our bilateral OTC derivatives are valued with models that use market observable inputs, which are reflected in Level 2. Significant inputs include contractual terms, interest rates, currency exchange rates, credit spread curves, equity prices and volatilities. These valuation models consider projected discounted cash flows, relevant swap curves and appropriate implied volatilities. Certain bilateral OTC derivatives utilize unobservable market data, primarily independent broker quotes that are nonbinding quotes based on models that do not

reflect the result of market transactions, which are reflected in Level 3.

Our non-cleared derivative contracts are generally documented under ISDA Master Agreements, which provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Collateral arrangements are bilateral and based on current ratings of each entity. We utilize the LIBOR interest rate curve to value our positions, which includes a credit spread. This credit spread incorporates an appropriate level of nonperformance risk into our valuations given the current ratings of our counterparties, as well as the collateral agreements in place. Counterparty credit risk is routinely monitored to ensure our adjustment for non-performance risk is appropriate. Our centrally cleared derivative contracts are conducted with regulated centralized clearinghouses, which provide for daily exchange of cash collateral equal to the difference in the daily market values of those contracts that eliminates the non-performance risk on these trades.

Interest Rate Contracts. For non-cleared contracts we use discounted cash flow valuation techniques to determine the fair value of interest rate swaps using observable swap curves as the inputs. These are reflected in Level 2. For centrally cleared contracts we use published prices from clearinghouses. These are reflected in Level 2. In addition, we have a limited number of complex inflation-linked interest rate swaps, interest rate collars and swaptions that are valued using broker quotes. These are reflected in Level 3.

Foreign Exchange Contracts. We use discounted cash flow valuation techniques that utilize observable swap curves and exchange rates as the inputs to determine the fair value of foreign currency swaps. These are reflected in Level 2. Currency forwards are valued using observable market inputs, including forward currency exchange rates. These are reflected in Level 2. In addition, we have a limited number of non-standard currency swaps that are valued using broker quotes. These are reflected within Level 3.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Equity Contracts. We use an option pricing model using observable implied volatilities, dividend yields, index prices and swap curves as the inputs to determine the fair value of equity options. These are reflected in Level 2.

Credit Contracts. We use either the ISDA Credit Default Swap Standard discounted cash flow model that utilizes observable default probabilities and recovery rates as inputs or broker prices to determine the fair value of credit default swaps. These are reflected in Level 3. In addition, we have a limited number of total return swaps that are valued based on the observable quoted price of underlying equity indices. These are reflected in Level 2.

Other Investments

Other investments reported at fair value include seed money investments, other investment funds, commercial mortgage loans of consolidated VIEs and equity method real estate investments for which the fair value option was elected.

The fair value of seed money and other investment funds is determined using the NAV of the fund. The NAV of the fund represents the price at which we feel we would be able to initiate a transaction. Seed money investments in mutual funds for which the NAV represents a quoted price in an active market for identical assets are reflected in Level 1. Seed money investments in mutual funds that do not have a quoted price in an active market and other investment funds, which are relatively illiquid due to restrictions on sale, are reflected in Level 2.

Commercial mortgage loans of consolidated VIEs valued using the measurement alternative for CCFEs are reflected in Level 2. These investments are based on the more observable fair value of the liabilities of the consolidated VIEs.

Prior to 2015, commercial mortgage loans of consolidated VIEs for which the fair value option was elected were reflected in Level 3. The fair value of the commercial mortgage loans was computed utilizing a discount rate based on the current market. The market discount rate was then adjusted based on various factors that differentiate it from our pool of loans. Equity method real estate investments for which the fair value option was elected are reflected in Level 3. The equity method real estate investments consist of underlying real estate and debt. The real estate fair value is estimated using a discounted cash flow valuation model that utilizes public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. The debt fair value is estimated using a discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements.

Cash and Cash Equivalents

Certain cash equivalents are reported at fair value on a recurring basis and include money market instruments and other short-term investments with maturities of less than three months. Fair values of these cash equivalents may be determined using public quotations, when available, which are reflected in Level 1. When public quotations are not available, because of the highly liquid nature of these assets, carrying amounts may be used to approximate fair values, which are reflected in Level 2.

Separate Account Assets

Separate account assets include equity securities, debt securities and derivative instruments, for which fair values are determined as previously described, and are reflected in Level 1, Level 2 and Level 3. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of the loans. The market clearing spreads vary based on mortgage type, weighted average life, rating and liquidity. These are reflected in Level 3. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize various public real estate market data inputs. In addition, each property is appraised annually by an independent appraiser. The real estate included in separate account assets is recorded net of related mortgage encumbrances for which the fair value is estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. The real estate within the separate accounts is reflected in Level 3.

Investment-Type Insurance Contracts

Certain annuity contracts and other investment-type insurance contracts include embedded derivatives that have been bifurcated from the host contract and that are measured at fair value on a recurring basis, which are reflected in Level 3. The key assumptions for calculating the fair value of the embedded derivative liabilities are market assumptions (such as equity market returns, interest rate levels, market volatility and correlations) and policyholder behavior assumptions (such as

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

lapse, mortality, utilization and withdrawal patterns). Risk margins are included in the policyholder behavior assumptions. The assumptions are based on a combination of historical data and actuarial judgment. The embedded derivative liabilities are valued using stochastic models that incorporate a spread reflecting our own creditworthiness.

The assumption for our own non-performance risk for investment-type insurance contracts and any embedded derivatives bifurcated from certain annuity and investment-type insurance contracts is based on the current market credit spreads for debt-like instruments that we have issued and are available in the market.

Other Liabilities

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities that are valued based on prices obtained from third party pricing vendors as utilized and described in our discussion of how fair value is determined for fixed maturities, which are reflected in Level 2.

Additionally, obligations of consolidated VIEs for which the fair value option was elected are included in other liabilities. The VIEs' obligations are valued either based on prices obtained from third party pricing vendors which are reflected in Level 2, or internal pricing models, which are reflected in Level 3.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis are summarized below.

| Assets/ (liabilities) measured at fair value | September 30, 2015 | | |
|---|----------------------------|---------|---------|
| | Fair value hierarchy level | | |
| | Level 1 | Level 2 | Level 3 |
| | (in millions) | | |

| Assets | | | | | |
|---|----|------------------|----|-----------------|---------------------------------------|
| Fixed maturities, available-for-sale: | | | | | |
| U.S. government and agencies | \$ | 1,543.6 | \$ | 895.7 | \$ 647.9 \$ |
| Non-U.S. governments | | 787.7 | | 2.8 | 736.0 48.9 |
| States and political subdivisions | | 4,455.7 | | | 4,455.7 |
| Corporate | | 31,278.7 | | 38.6 | 31,003.3 236.8 |
| Residential mortgage-backed securities | | 2,680.2 | | | 2,680.2 |
| Commercial mortgage-backed securities | | 3,861.2 | | | 3,845.9 15.3 |
| Collateralized debt obligations | | 633.0 | | | 569.8 63.2 |
| Other debt obligations | | 4,540.5 | | | 4,527.0 13.5 |
| Total fixed maturities, available-for-sale | | 49,780.6 | | 937.1 | 48,465.8 377.7 |
| Fixed maturities, trading | | 710.2 | | 101.7 | 469.5 139.0 |
| Equity securities, available-for-sale | | 465.3 | | 105.8 | 355.4 4.1 |
| Equity securities, trading | | 869.1 | | 101.8 | 767.3 |
| Derivative assets (1) | | 821.3 | | | 768.8 52.5 |
| Other investments (2) | | 425.4 | | 177.8 | 216.1 31.5 |
| Cash equivalents (3) | | 1,153.6 | | | 1,153.6 |
| Sub-total excluding separate account assets | | 54,225.5 | | 1,424.2 | 52,196.5 604.8 |
| | | | | | |
| Separate account assets | | 134,045.8 | | 69,860.6 | 57,449.1 6,736.1 |
| Total assets | \$ | 188,271.3 | \$ | 71,284.8 | \$ 109,645.6 \$ 7,340.9 |
| | | | | | |
| Liabilities | | | | | |
| Investment-type insurance contracts (4) | \$ | (210.3) | \$ | | \$ (210.3) |
| Derivative liabilities (1) | | (816.9) | | | (771.2) (45.7) |
| Other liabilities (4) | | (301.4) | | | (236.7) (64.7) |
| Total liabilities | \$ | (1,328.6) | \$ | | \$ (1,007.9) \$ (320.7) |
| | | | | | |
| Net assets | \$ | 186,942.7 | \$ | 71,284.8 | \$ 108,637.7 \$ 7,020.2 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| December 31, 2014 | | | | | |
|---|----------------------------|-------------|--------------|---------|---------|
| Assets/ (liabilities) measured at fair value | Fair value hierarchy level | | | | |
| | Level 1 | Level 2 | | Level 3 | |
| | (in millions) | | | | |
| Assets | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| U.S. government and agencies | \$ 1,121.8 | \$ 720.5 | \$ 401.3 | \$ | |
| Non-U.S. governments | 891.1 | | 852.4 | | 38.7 |
| States and political subdivisions | 4,204.0 | | 4,204.0 | | |
| Corporate | 31,535.0 | 40.3 | 31,249.1 | | 245.6 |
| Residential mortgage-backed securities | 2,822.9 | | 2,822.9 | | |
| Commercial mortgage-backed securities | 3,975.5 | | 3,975.5 | | |
| Collateralized debt obligations | 504.1 | | 439.9 | | 64.2 |
| Other debt obligations | 4,616.4 | | 4,552.7 | | 63.7 |
| Total fixed maturities, available-for-sale | 49,670.8 | 760.8 | 48,497.8 | | 412.2 |
| Fixed maturities, trading | 604.6 | | 464.9 | | 139.7 |
| Equity securities, available-for-sale | 123.0 | 64.2 | 54.7 | | 4.1 |
| Equity securities, trading | 840.2 | 105.9 | 734.3 | | |
| Derivative assets (1) | 661.8 | | 608.1 | | 53.7 |
| Other investments (2) | 478.9 | 3.3 | 348.4 | | 127.2 |
| Cash equivalents (3) | 1,041.7 | | 1,041.7 | | |
| Sub-total excluding separate account assets | 53,421.0 | 934.2 | 51,749.9 | | 736.9 |
| Separate account assets | 140,072.8 | 73,363.4 | 60,818.0 | | 5,891.4 |
| Total assets | \$ 193,493.8 | \$ 74,297.6 | \$ 112,567.9 | \$ | 6,628.3 |
| Liabilities | | | | | |
| Investment-type insurance contracts (4) | \$ (176.4) | \$ | \$ | \$ | (176.4) |
| Derivative liabilities (1) | (791.8) | | (756.3) | | (35.5) |
| Other liabilities (4) | (310.1) | | (243.8) | | (66.3) |
| Total liabilities | \$ (1,278.3) | \$ | \$ (1,000.1) | \$ | (278.2) |
| Net assets | \$ 192,215.5 | \$ 74,297.6 | \$ 111,567.8 | \$ | 6,350.1 |

(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities. Refer to Note 4, Derivative Financial Instruments, for further information on fair value by class of derivative instruments. Our derivatives are primarily Level 2, with the exception of certain credit default swaps and other swaps that are Level 3.

(2) Primarily includes seed money investments, other investment funds, commercial mortgage loans of consolidated VIEs and equity method investments reported at fair value.

- (3) Includes money market instruments and short-term investments with a maturity date of three months or less when purchased.
- (4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported. Other liabilities also include obligations of consolidated VIEs reported at fair value.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Changes in Level 3 Fair Value Measurements**

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) are summarized as follows:

| | For the three months ended September 30, 2015 | | | | | | | |
|---|--|---|---|--|------------------------------|--------------------------------|--|---|
| | Beginning asset/ (liability) balance as of June 30, 2015 | Total realized/unrealized gains (losses) | | Net purchases, sales, issuances and settlements (4) (in millions) | Transfers into Level 3 | Transfers out of Level 3 | Ending asset/ (liability) balance as of September 30, 2015 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
| | | Included in net income (1) | Included in other comprehensive income | | | | | |
| Assets | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | \$ 45.6 | \$ (0.1) | \$ 0.3 | \$ 3.1 | \$ | \$ | \$ 48.9 | \$ (0.1) |
| Corporate | 227.0 | (0.1) | (2.4) | 3.4 | 15.0 | (6.1) | 236.8 | (0.1) |
| Commercial mortgage-backed securities | | | 0.1 | 15.2 | | | 15.3 | |
| Collateralized debt obligations | 63.3 | 0.1 | | (0.2) | | | 63.2 | |
| Other debt obligations | 41.4 | | 0.9 | 5.2 | | (34.0) | 13.5 | |
| Total fixed maturities, available-for-sale | 377.3 | (0.1) | (1.1) | 26.7 | 15.0 | (40.1) | 377.7 | (0.2) |
| Fixed maturities, trading | 139.8 | (0.8) | | | | | 139.0 | (0.8) |
| Equity securities, available-for-sale | 4.1 | | | | | | 4.1 | |
| Derivative assets | 45.1 | 7.4 | | | | | 52.5 | 7.4 |
| Other investments | 29.7 | 0.5 | | 1.3 | | | 31.5 | 0.5 |
| Separate account assets (2) | 6,406.0 | 344.4 | | (14.3) | 0.1 | (0.1) | 6,736.1 | 267.5 |
| Liabilities | | | | | | | | |
| Investment-type insurance contracts | (117.0) | (98.1) | | 4.8 | | | (210.3) | (98.9) |
| Derivative liabilities | (37.0) | (9.1) | 0.4 | | | | (45.7) | (9.5) |
| Other liabilities (3) | (67.5) | 2.8 | | | | | (64.7) | 2.8 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the three months ended September 30, 2014 | | | | | | Ending asset/ (liability) balance as of September 30, 2014 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
|---|--|---|---|---|------------------------------|--------------------------------|--|---|
| | Beginning asset/ (liability) balance as of June 30, 2014 | Total realized/unrealized gains (losses) | | Net purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | | |
| | | Included in net income (1) | Included in other comprehensive income | (in millions) | | | | |
| Assets | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | \$ 39.6 | \$ | \$ (0.2) | \$ 1.9 | \$ | \$ | \$ 41.3 | \$ |
| States and political subdivisions | 1.7 | | | | | | 1.7 | |
| Corporate | 170.0 | (1.4) | (2.8) | 40.7 | 15.7 | | 222.2 | (1.4) |
| Commercial mortgage-backed securities | 6.7 | (1.0) | 0.2 | 0.2 | 0.7 | (1.4) | 5.4 | (0.9) |
| Collateralized debt obligations | 68.5 | | 0.1 | 9.5 | | (16.5) | 61.6 | |
| Other debt obligations | 47.1 | | | (1.4) | | | 45.7 | |
| Total fixed maturities, available-for-sale | 333.6 | (2.4) | (2.7) | 50.9 | 16.4 | (17.9) | 377.9 | (2.3) |
| Fixed maturities, trading | 159.6 | 3.7 | | (24.0) | | | 139.3 | 0.2 |
| Equity securities, available-for-sale | 17.5 | (0.3) | 0.2 | | | | 17.4 | (0.3) |
| Derivative assets | 62.3 | (14.4) | | 9.8 | | | 57.7 | (14.3) |
| Other investments | 134.6 | 3.8 | | (14.1) | | | 124.3 | 3.8 |
| Separate account assets (2) | 5,533.6 | 167.0 | (0.3) | 79.0 | 2.3 | (4.2) | 5,777.4 | 163.7 |
| Liabilities | | | | | | | | |
| Investment-type insurance contracts | (37.6) | (62.8) | | 6.3 | | | (94.1) | (56.1) |
| Derivative liabilities | (24.7) | (13.3) | (0.6) | 0.8 | | | (37.8) | (14.5) |
| Other liabilities (3) | (79.9) | 9.9 | | 9.0 | | | (61.0) | 9.8 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the nine months ended September 30, 2015 | | | | | | Ending asset/ (liability) balance as of September 30, 2015 | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
|---|--|---|---|---|------------------------------|--------------------------------|---|---|
| | Beginning asset/ (liability) balance as of December 31, 2014 | Total realized/unrealized gains (losses) | | Net purchases, sales, issuances and settlements (4) | Transfers into Level 3 | Transfers out of Level 3 | | |
| | | Included in net income (1) | Included in other comprehensive income | (in millions) | | | | |
| Assets | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | \$ 38.7 | \$ (0.2) | \$ 0.4 | \$ 10.0 | \$ | \$ | \$ 48.9 | \$ (0.2) |
| Corporate | 245.6 | (0.2) | (3.3) | 27.1 | 41.2 | (73.6) | 236.8 | (0.2) |
| Commercial mortgage-backed securities | | | 0.1 | 15.2 | | | 15.3 | |
| Collateralized debt obligations | 64.2 | 0.1 | (0.1) | (1.0) | | | 63.2 | |
| Other debt obligations | 63.7 | | 0.8 | 7.3 | | (58.3) | 13.5 | |
| Total fixed maturities, available-for-sale | 412.2 | (0.3) | (2.1) | 58.6 | 41.2 | (131.9) | 377.7 | (0.4) |
| Fixed maturities, trading | 139.7 | (0.6) | | (0.1) | | | 139.0 | (0.7) |
| Equity securities, available-for-sale | 4.1 | | | | | | 4.1 | |
| Derivative assets | 53.7 | (3.6) | | 2.4 | | | 52.5 | (3.4) |
| Other investments | 127.2 | 4.5 | | (65.2) | | (35.0) | 31.5 | 4.5 |
| Separate account assets (2) | 5,891.4 | 799.3 | | 45.4 | 0.2 | (0.2) | 6,736.1 | 705.2 |
| Liabilities | | | | | | | | |
| Investment-type insurance contracts | (176.4) | (40.5) | | 6.6 | | | (210.3) | (43.8) |
| Derivative liabilities | (35.5) | (12.0) | 1.6 | 0.2 | | | (45.7) | (12.6) |
| Other liabilities (3) | (66.3) | 1.6 | | | | | (64.7) | 1.5 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the nine months ended September 30, 2014 | | | | | | | Changes in unrealized gains (losses) included in net income relating to positions still held (1) |
|---|--|---|-------------------------|--|-----------------|-------------------|---|---|
| | Beginning | Total realized/unrealized gains (losses) | | Net | | Ending | | |
| | asset/ (liability) balance as of | Included in net | Included in other | purchases, sales, issuances and | Transfers | Transfers | asset/ (liability) balance as of | |
| | December 31, 2013 | income (1) | comprehensive income | settlements (4) (in millions) | into Level 3 | out of Level 3 | September 30, 2014 | |
| Assets | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Non-U.S. governments | \$ 47.5 | \$ (0.1) | \$ (0.2) | \$ (5.9) | \$ | \$ | \$ 41.3 | \$ (0.1) |
| States and political subdivisions | 1.8 | | | (0.1) | | | 1.7 | |
| Corporate | 164.0 | (1.6) | (1.7) | 21.0 | 46.6 | (6.1) | 222.2 | (1.5) |
| Commercial mortgage-backed securities | 1.6 | (1.6) | 1.3 | (0.2) | 6.8 | (2.5) | 5.4 | (1.5) |
| Collateralized debt obligations | 37.8 | | 1.4 | 46.4 | | (24.0) | 61.6 | |
| Other debt obligations | 84.1 | | 1.1 | (9.8) | | (29.7) | 45.7 | |
| Total fixed maturities, available-for-sale | 336.8 | (3.3) | 1.9 | 51.4 | 53.4 | (62.3) | 377.9 | (3.1) |
| Fixed maturities, trading | 169.9 | 9.5 | | (40.1) | | | 139.3 | 0.8 |
| Equity securities, available-for-sale | 16.9 | (0.3) | 0.6 | | 0.2 | | 17.4 | (0.3) |
| Derivative assets | 74.2 | (26.4) | | 9.9 | | | 57.7 | (26.4) |
| Other investments | 142.9 | 6.6 | | (25.2) | | | 124.3 | 6.6 |
| Separate account assets (2) | 5,265.2 | 358.4 | (0.2) | 161.3 | 4.4 | (11.7) | 5,777.4 | 359.9 |
| Liabilities | | | | | | | | |
| Investment-type insurance contracts | (6.9) | (109.9) | | 22.7 | | | (94.1) | (109.9) |
| Derivative liabilities | (39.6) | 0.5 | 0.7 | 0.6 | | | (37.8) | (3.7) |
| Other liabilities (3) | (73.9) | 3.9 | | 9.0 | | | (61.0) | 4.5 |

(1) Both realized gains (losses) and mark-to-market unrealized gains (losses) are generally reported in net realized capital gains (losses) within the consolidated statements of operations. Realized and unrealized gains (losses) on certain fixed maturities, trading and certain derivatives used in relation to certain trading portfolios are reported in net investment income within the consolidated statements of operations.

(2) Gains and losses for separate account assets do not impact net income as the change in value of separate account assets is offset by a change in value of separate account liabilities. Foreign currency translation adjustments related to the Principal International segment separate account assets are recorded in AOCI and are offset by foreign currency translation adjustments of the corresponding separate account liabilities.

(3) Certain embedded derivatives reported in other liabilities are part of a cash flow hedge, with the effective portion of the unrealized gains (losses) recorded in AOCI.

(4) Gross purchases, sales, issuances and settlements were:

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****For the three months ended September 30, 2015**

| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
|--|------------------|--------------|------------------------------------|--------------------|--|
| Assets | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | \$ 3.4 | \$ | \$ | \$ (0.3) | \$ 3.1 |
| Corporate | 5.5 | | | (2.1) | 3.4 |
| Commercial mortgage-backed securities | 15.2 | | | | 15.2 |
| Collateralized debt obligations | | | | (0.2) | (0.2) |
| Other debt obligations | 6.4 | | | (1.2) | 5.2 |
| Total fixed maturities, available-for-sale | 30.5 | | | (3.8) | 26.7 |
| Other investments | 1.3 | | | | 1.3 |
| Separate account assets (5) | 69.6 | (29.7) | (54.7) | 0.5 | (14.3) |
| Liabilities | | | | | |
| Investment-type insurance contracts | | | 3.7 | 1.1 | 4.8 |

For the three months ended September 30, 2014

| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
|--|------------------|--------------|------------------------------------|--------------------|--|
| Assets | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | \$ 2.2 | \$ | \$ | \$ (0.3) | \$ 1.9 |
| Corporate | 46.5 | (5.5) | | (0.3) | 40.7 |
| Commercial mortgage-backed securities | | | | 0.2 | 0.2 |
| Collateralized debt obligations | 9.7 | | | (0.2) | 9.5 |
| Other debt obligations | | | | (1.4) | (1.4) |
| Total fixed maturities, available-for-sale | 58.4 | (5.5) | | (2.0) | 50.9 |
| Fixed maturities, trading | | (10.0) | | (14.0) | (24.0) |
| Derivative assets | 9.8 | | | | 9.8 |
| Other investments | | | | (14.1) | (14.1) |
| Separate account assets (5) | 228.5 | (127.3) | (196.5) | 174.3 | 79.0 |
| Liabilities | | | | | |
| Investment-type insurance contracts | | | 4.2 | 2.1 | 6.3 |
| Derivative liabilities | (0.6) | 1.4 | | | 0.8 |
| Other liabilities | | 9.0 | | | 9.0 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****For the nine months ended September 30, 2015**

| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
|--|------------------|--------------|------------------------------------|--------------------|--|
| Assets | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | \$ 10.9 | \$ | \$ | \$ (0.9) | \$ 10.0 |
| Corporate | 47.1 | (5.7) | | (14.3) | 27.1 |
| Commercial mortgage-backed securities | 15.2 | | | | 15.2 |
| Collateralized debt obligations | | | | (1.0) | (1.0) |
| Other debt obligations | 16.5 | | | (9.2) | 7.3 |
| Total fixed maturities, available-for-sale | 89.7 | (5.7) | | (25.4) | 58.6 |
| Fixed maturities, trading | | (0.2) | | 0.1 | (0.1) |
| Derivative assets | 2.5 | (0.1) | | | 2.4 |
| Other investments | 2.5 | (67.7) | | | (65.2) |
| Separate account assets (5) | 430.6 | (189.1) | (200.5) | 4.4 | 45.4 |
| Liabilities | | | | | |
| Investment-type insurance contracts | | | 1.4 | 5.2 | 6.6 |
| Derivative liabilities | | 0.2 | | | 0.2 |

For the nine months ended September 30, 2014

| | Purchases | Sales | Issuances (in millions) | Settlements | Net purchases, sales, issuances and settlements |
|--|------------------|--------------|------------------------------------|--------------------|--|
| Assets | | | | | |
| Fixed maturities, available-for-sale: | | | | | |
| Non-U.S. governments | \$ 5.8 | \$ (10.8) | \$ | \$ (0.9) | \$ (5.9) |
| States and political subdivisions | | | | (0.1) | (0.1) |
| Corporate | 64.5 | (39.2) | | (4.3) | 21.0 |
| Commercial mortgage-backed securities | | | | (0.2) | (0.2) |
| Collateralized debt obligations | 61.3 | | | (14.9) | 46.4 |
| Other debt obligations | | | | (9.8) | (9.8) |
| Total fixed maturities, available-for-sale | 131.6 | (50.0) | | (30.2) | 51.4 |
| Fixed maturities, trading | | (10.0) | | (30.1) | (40.1) |
| Derivative assets | 9.9 | | | | 9.9 |
| Other investments | 0.2 | | | (25.4) | (25.2) |
| Separate account assets (5) | 467.2 | (257.5) | (290.1) | 241.7 | 161.3 |
| Liabilities | | | | | |
| Investment-type insurance contracts | | | 18.7 | 4.0 | 22.7 |
| Derivative liabilities | (0.8) | 1.4 | | | 0.6 |
| Other liabilities | | 9.0 | | | 9.0 |

(5) Issuances and settlements include amounts related to mortgage encumbrances associated with real estate in our separate accounts.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Transfers**

Transfers of assets and liabilities measured at fair value on a recurring basis between fair value hierarchy levels are summarized below.

| | For the three months ended September 30, 2015 | | | | | |
|---|---|---|---|---|---|---|
| | Transfers out of Level 1 into Level 2 | Transfers out of Level 1 into Level 3 | Transfers out of Level 2 into Level 1 | Transfers out of Level 2 into Level 3 | Transfers out of Level 3 into Level 1 | Transfers out of Level 3 into Level 2 |
| | (in millions) | | | | | |
| Assets | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Corporate | \$ | \$ | \$ | \$ 15.0 | \$ | \$ 6.1 |
| Other debt obligations | | | | | | 34.0 |
| Total fixed maturities, available-for-sale | | | | 15.0 | | 40.1 |
| Other investments | | | 141.4 | | | |
| Separate account assets | 24.6 | | 1.2 | 0.1 | | 0.1 |

| | For the three months ended September 30, 2014 | | | | | |
|---|---|---|---|---|---|---|
| | Transfers out of Level 1 into Level 2 | Transfers out of Level 1 into Level 3 | Transfers out of Level 2 into Level 1 | Transfers out of Level 2 into Level 3 | Transfers out of Level 3 into Level 1 | Transfers out of Level 3 into Level 2 |
| | (in millions) | | | | | |
| Assets | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Corporate | \$ | \$ | \$ | \$ 15.7 | \$ | \$ |
| Commercial mortgage-backed securities | | | | 0.7 | | 1.4 |
| Collateralized debt obligations | | | | | | 16.5 |
| Total fixed maturities, available-for-sale | | | | 16.4 | | 17.9 |
| Separate account assets | 2.1 | | 17.5 | 2.3 | | 4.2 |

| For the nine months September 30, 2015 | | | | | |
|--|---------------|---------------|---------------|---------------|---------------|
| Transfers out | Transfers out | Transfers out | Transfers out | Transfers out | Transfers out |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | of Level 1 into Level 2 | of Level 1 into Level 3 | of Level 2 into Level 1 | of Level 2 into Level 3 | of Level 3 into Level 1 | of Level 3 into Level 2 |
|---|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|----------------------------|
| (in millions) | | | | | | |
| Assets | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | |
| Corporate | \$ | \$ | \$ | \$ | 41.2 | \$ 73.6 |
| Other debt obligations | | | | | | 58.3 |
| Total fixed maturities, available-for-sale | | | | 41.2 | | 131.9 |
| Other investments | | | 141.4 | | | 35.0 |
| Separate account assets | 26.6 | | 8.0 | 0.2 | | 0.2 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| | For the nine months September 30, 2014 | | | | | | | |
|---|---|---|---|---|---|---|----|------|
| | Transfers out of Level 1 into Level 2 | Transfers out of Level 1 into Level 3 | Transfers out of Level 2 into Level 1 | Transfers out of Level 2 into Level 3 | Transfers out of Level 3 into Level 1 | Transfers out of Level 3 into Level 2 | | |
| | (in millions) | | | | | | | |
| Assets | | | | | | | | |
| Fixed maturities, available-for-sale: | | | | | | | | |
| Corporate | \$ | \$ | \$ | \$ | 46.6 | \$ | \$ | 6.1 |
| Commercial mortgage-backed securities | | | | | 6.8 | | | 2.5 |
| Collateralized debt obligations | | | | | | | | 24.0 |
| Other debt obligations | | | | | | | | 29.7 |
| Total fixed maturities, available-for-sale | | | | | 53.4 | | | 62.3 |
| Equity securities, available-for-sale | | | | | 0.2 | | | |
| Separate account assets | 17.5 | | 71.3 | 4.4 | | | | 11.7 |

Transfers between fair value hierarchy levels are recognized at the beginning of the reporting period.

Assets transferred from Level 2 into Level 1 for the three and nine months ended September 30, 2015, primarily included assets valued using a NAV with a quoted price in an active market for identical assets as a result of additional analysis to clarify the source of the quoted price.

Assets transferred into Level 3 during the three and nine months ended September 30, 2015 and 2014, primarily included those assets for which we are now unable to obtain pricing from a recognized third party pricing vendor as well as assets that were previously priced using a matrix valuation approach that may no longer be relevant when applied to asset-specific situations.

Assets transferred out of Level 3 during the three and nine months ended September 30, 2015 and 2014, included those for which we are now able to obtain pricing from a recognized third party pricing vendor or from internal models using substantially all market observable information. In addition, for the nine months ended September 30, 2015, assets transferred out of Level 3 included assets valued using the measurement alternative for CCFEs for which the corresponding liabilities have the more observable fair value and are reflected in Level 2.

Quantitative Information about Level 3 Fair Value Measurements

The following table provides quantitative information about the significant unobservable inputs used for recurring fair value measurements categorized within Level 3, excluding assets and liabilities for which significant quantitative unobservable inputs are not developed internally, which primarily consists of those valued using broker quotes or the measurement alternative for CCFEs. Refer to Assets and liabilities measured at fair value on a recurring basis for a complete valuation hierarchy summary.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)**

| As of September 30, 2015 | | | | | |
|--|---|--|--|------------------------------------|---------------------|
| | Assets / (liabilities) measured at fair value (in millions) | Valuation technique(s) | Unobservable input description | Input/range of inputs | Weighted average |
| Assets | | | | | |
| Non-U.S. governments | \$ 9.4 | Discounted cash flow | Discount rate (1) Illiquidity premium | 1.7% 50 basis points ("bps") | 1.7% 50bps |
| Corporate | 42.0 | Discounted cash flow | Discount rate (1) Comparability adjustment | 1.6%-7.6% 0bps-14bps | 4.8% 3bps |
| Commercial mortgage-backed securities | 15.3 | Discounted cash flow | Discount rate (1) | 3.7%-4.9% | 4.3% |
| Collateralized debt obligations | 3.1 | Discounted cash flow | Discount rate (1) | 12.1% | 12.1% |
| | | | Probability of default | 100.0% | 100.0% |
| | | | Potential loss severity | 67.0% | 67.0% |
| Other debt obligations | 7.8 | Discounted cash flow | Discount rate (1) Illiquidity premium | 5.0% 750bps | 5.0% 750bps |
| Fixed maturities, trading | 14.2 | Discounted cash flow | Discount rate (1) Illiquidity premium | 2.1%-16.0% 200bps-800bps | 6.4% 430bps |
| Other investments | 31.5 | Discounted cash flow - equity method real estate investments | Discount rate (1) | 7.9% | 7.9% |
| | | | Terminal capitalization rate | 6.8% | 6.8% |
| | | | Average market rent growth rate | 3.3% | 3.3% |
| | | Discounted cash flow - equity method real estate investments - debt | Loan to value | 54.9% | 54.9% |
| | | | Credit spread rate | 2.3% | 2.3% |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****As of September 30, 2015**

| As of September 30, 2015 | | | | | |
|--|--|--|---------------------------------------|---------------------|------|
| Assets / (liabilities) measured at fair value | Valuation technique(s) | Unobservable input description | Input/range of inputs | Weighted average | |
| Separate account assets | 6,616.4 | Discounted cash flow - mortgage loans | Discount rate (1) | 1.1%-7.1% | 3.3% |
| | | | Illiquidity premium | 0bps-60bps | 7bps |
| | Credit spread rate | | 85bps-665bps | 226bps | |
| | Discounted cash flow - real estate | Discount rate (1) | 5.6%-38.1% | 7.3% | |
| | | Terminal capitalization rate | 4.3%-9.5% | 6.2% | |
| | | Average market rent growth rate | 0%-4.4% | 3.1% | |
| | Discounted cash flow - real estate debt | Loan to value | 15.3%-65.2% | 45.8% | |
| | | Credit spread rate | 1.6%-4.3% | 2.3% | |
| Liabilities | | | | | |
| Investment-type insurance contracts | (210.3) | Discounted cash flow | Long duration interest rate | 2.4%-2.5% | (3) |
| | | | Long-term equity market volatility | 14.9%-44.9% | |
| | | | Non-performance risk | 0.5%-1.9% | |
| | | | Utilization rate | See note(4) | |
| | | | Lapse rate | 0.5%-14.1% | |
| | | | Mortality rate | See note(5) | |
| | | | | | |

December 31, 2014

| December 31, 2011 | | | | | |
|----------------------|--|---------------------------|--|--------------------------|---------------------|
| | Assets / (liabilities) measured at fair value | Valuation technique(s) | Unobservable input description | Input/range of inputs | Weighted average |
| | | | | | |
| Assets | | | | | |
| | | | | | |
| Non-U.S. governments | \$ 10.3 | Discounted cash flow | Discount rate (1) Illiquidity premium | 2.2% 50 bps | 2.2% 50bps |
| | | | | | |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****December 31, 2014**

| | Assets / (liabilities) measured at fair value | Valuation technique(s) | Unobservable input description | Input/range of inputs | Weighted average |
|---------------------------------|--|-----------------------------------|---|----------------------------------|-----------------------------|
| Collateralized debt obligations | 12.7 | Discounted cash flow | Discount rate (1) | 2.7%-17.1% | 6.1% |
| | | | Probability of default | 0%-100% | 23.5% |
| | | | Potential loss severity | 0%-70.0% | 16.4% |
| Other debt obligations | 49.3 | Discounted cash flow | Discount rate (1) | 1.4%-5.0% | 2.3% |
| Fixed maturities, trading | 15.2 | Discounted cash flow | Discount rate (1) | 1.8%-126.9% | 3.5% |
| | | | Illiquidity premium | 200bps-1,400bps | 460bps |
| | 100.4 | See note (2) | | | |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****December 31, 2014**

| | Assets / (liabilities) measured at fair value | Valuation technique(s) | Unobservable input description | Input/range of inputs | Weighted average |
|--|--|--|---------------------------------------|--------------------------|---------------------|
| Separate account assets | 5,857.4 | Discounted cash flow - mortgage loans | Discount rate (1) | 1.1%-6.9% | 3.2% |
| | | | Illiquidity premium | 0bps-60bps | 7bps |
| | | | Credit spread rate | 70bps-632bps | 221bps |
| | | Discounted cash flow - real estate | Discount rate (1) | 6.0%-24.6% | 7.4% |
| | | | Terminal capitalization rate | 4.5%-9.5% | 6.4% |
| | | | Average market rent growth rate | 1.3%-4.4% | 3.0% |
| | | Discounted cash flow - real estate debt | Loan to value | 6.8%-64.1% | 46.5% |
| | | | Credit spread rate | 2.1%-4.8% | 3.4% |
| Liabilities | | | | | |
| Investment-type insurance contracts | (176.4) | Discounted cash flow | Long duration interest rate | 2.6%-2.7%(3) | |
| | | | Long-term equity market volatility | 14.9%-39.5% | |
| | | | Non-performance risk | 0.1%-1.4% | |
| | | | Utilization rate | See note(4) | |
| | | | Lapse rate | 0.5%-14.1% | |
| | | | Mortality rate | See note(5) | |
| Derivative liabilities | (19.3) | See note (2) | | | |
| Other liabilities | (66.3) | See note (2) | | | |

(1) Represents market comparable interest rate or an index adjusted rate used as the base rate in the discounted cash flow analysis prior to any credit spread, illiquidity or other adjustments, where applicable.

(2) Prior to 2015, the assets and liabilities fair values relate to a consolidated collateralized private investment vehicle that is a VIE. Fixed maturities, trading represents the underlying collateral of the investment structure and consists of high-grade fixed maturity investments, which are over-collateralized based on outstanding notes priced at par. The derivative liability represents credit default swaps that are valued using a correlation model to the credit default swap (CDS) Index (CDX) and inputs to the valuation are based on observable market data such as the end of period swap curve, CDS constituents of the index and spread levels of the index, as well as CDX tranche spreads. The value of the obligations, which are due at maturity or termination of the trust, reflect the third parties' interest in the investment structure.

- (3) Represents the range of rate curves used in the valuation analysis that we have determined market participants would use when pricing the instrument. Derived from interpolation between various observable swap rates.
- (4) This input factor is the number of contractholders taking withdrawals as well as the amount and timing of the withdrawals and a range does not provide a meaningful presentation.
- (5) This input is based on an appropriate industry mortality table and a range does not provide a meaningful presentation.

Market comparable discount rates are used as the base rate in the discounted cash flows used to determine the fair value of certain assets. Increases or decreases in the credit spreads on the comparable assets could cause the fair value of the assets to significantly decrease or increase, respectively. Additionally, we may adjust the base discount rate or the modeled

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

price by applying an illiquidity premium given the highly structured nature of certain assets. Increases or decreases in this illiquidity premium could cause significant decreases or increases, respectively, in the fair value of the asset.

Embedded derivatives can be either assets or liabilities within the investment-type insurance contracts line item, depending on certain inputs at the reporting date. Increases to an asset or decreases to a liability are described as increases to fair value. Increases or decreases in market volatilities could cause significant decreases or increases, respectively, in the fair value of embedded derivatives in investment-type insurance contracts. Long duration interest rates are used as the mean return when projecting the growth in the value of associated account value and impact the discount rate used in the discounted future cash flows valuation. The amount of claims will increase if account value is not sufficient to cover guaranteed withdrawals. Increases or decreases in risk free rates could cause the fair value of the embedded derivative to significantly increase or decrease, respectively. Increases or decreases in our own credit risks, which impact the rates used to discount future cash flows, could significantly increase or decrease, respectively, the fair value of the embedded derivative. All of these changes in fair value would impact net income.

Decreases or increases in the mortality rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. Decreases or increases in the overall lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The lapse rate assumption varies dynamically based on the relationship of the guarantee and associated account value. A stronger or weaker dynamic lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The utilization rate assumption includes how many contractholders will take withdrawals, when they will take them and how much of their benefit they will take. Increases or decreases in the assumption of the number of contractholders taking withdrawals could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take withdrawals earlier or later could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take more or less of their benefit could cause the fair value of the embedded derivative to decrease or increase, respectively.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis. During the nine months ended September 30, 2015, certain mortgage loans had been marked to fair value of \$13.9 million. The net impact of write-downs of loans reclassified to held-for-sale, impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$1.5 million and \$3.3 million for the three and nine months ended September 30, 2015, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During our annual testing process for impairment of goodwill and other intangible assets in the third quarter of 2015, identified intangibles that originated from the acquisition of our mutual fund company in Brazil were deemed to be impaired, and were marked to fair value of zero. These impairments were driven by the current macroeconomic and market conditions in Brazil, including higher discount rates and change in the mix of business. The fair value calculation for intangibles is a Level 3 fair value measurement, as the fair value is determined by calculating the present value of future cash flows that are expected to emerge from the identified intangibles. The net impact of impairments of identified intangibles resulted in a loss of \$23.0 million that was recorded in operating expenses.

During the nine months ended September 30, 2014, certain mortgage loans had been marked to fair value of \$63.8 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$9.7 million and \$9.1 million for the three and nine months ended September 30, 2014, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs. The ranges of inputs used in the fair value measurements for the mortgage loans marked to fair value during the nine months ended September 30, 2014, were:

Discount rate = 8.8% - 11.0%

Terminal capitalization rate = 7.3% - 9.0%

Average market rent growth = 2.5% - 10.9%

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

Fair Value Option

We elected fair value accounting for certain assets and liabilities of consolidated VIEs for which it was not practicable for us to determine the carrying value. The fair value option was elected for commercial mortgage loans reported with other investments and obligations reported with other liabilities in the consolidated statements of financial position. The changes in fair value of these items are reported in net realized capital gains (losses) on the consolidated statements of operations.

The fair value and aggregate contractual principal amounts of commercial mortgage loans for which the fair value option has been elected were \$25.1 million and \$23.6 million as of September 30, 2015, and \$35.0 million and \$32.4 million as of December 31, 2014, respectively. The change in fair value of the loans resulted in a \$1.0 million and \$(0.2) million pre-tax gain (loss) for the three months ended September 30, 2015 and 2014, respectively, and a \$1.1 million and \$0.8 million pre-tax loss for the nine months ended September 30, 2015 and 2014, respectively, none of which related to instrument-specific credit risk. None of these loans were more than 90 days past due or in nonaccrual status. Interest income on these commercial mortgage loans is included in net investment income on the consolidated statements of operations and is recorded based on the effective interest rates as determined at the closing of the loan. Interest income recorded on these commercial mortgage loans was \$0.7 million and \$3.2 million for the three months ended September 30, 2015 and 2014, respectively, and \$2.2 million and \$5.4 million for the nine months ended September 30, 2015 and 2014, respectively.

The fair value and aggregate unpaid principal amounts of obligations for which the fair value option has been elected were \$64.7 million and \$124.0 million as of September 30, 2015, and \$71.0 million and \$132.8 million as of December 31, 2014, respectively. For the three months ended September 30, 2015 and 2014, the change in fair value of the obligations resulted in a pre-tax gain of \$1.5 million and \$10.4 million, which includes a pre-tax gain of \$2.8 million and \$8.9 million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. For the nine months ended September 30, 2015 and 2014, the change in fair value of the obligations resulted in a pre-tax gain of \$1.3 million and \$4.7 million, which includes a pre-tax gain of \$1.5 million and \$2.9 million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. Interest expense recorded on these obligations is included in operating expenses on the consolidated statements of operations and was \$0.4 million and \$2.7 million for the three months ended September 30, 2015 and 2014, respectively, and \$0.8 million and \$3.8 million for the nine months ended September 30, 2015 and 2014, respectively.

We invest in real estate ventures for the purpose of earning investment returns and for capital appreciation. We elected the fair value option for certain ventures that are subject to the equity method of accounting because the nature of the investments are to add value to the properties and generate income from the operations of the properties. Other equity method real estate investments are not fair valued because the investments mainly generate income from the operations of the underlying properties. These investments are reported with other investments in the consolidated statements of financial position. The changes in fair value are reported in net investment income on the consolidated statements of operations. The fair value of the equity method investments for which the fair value option has been elected was \$31.5 million and \$92.2 million as of September 30, 2015 and December 31, 2014, respectively. The decrease from December 31, 2014, is due to a real estate disposal during the first quarter of 2015. The change in fair value of the investments resulted in a \$0.5 million and \$4.0 million pre-tax gain for the three months ended September 30, 2015 and 2014, respectively, and \$4.5 million and \$7.6 million pre-tax gain for the nine months ended September 30, 2015

and 2014, respectively.

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Financial Instruments Not Reported at Fair Value**

The carrying value and estimated fair value of financial instruments not recorded at fair value on a recurring basis but required to be disclosed at fair value were as follows:

| September 30, 2015 | | | | | |
|-------------------------------------|-----------------|-------------|--------------------------|---------------------------------------|-------------|
| | Carrying amount | Fair value | Level 1 (in millions) | Fair value hierarchy level Level 2 | Level 3 |
| Assets (liabilities) | | | | | |
| Mortgage loans | \$ 12,232.1 | \$ 12,752.8 | \$ | \$ | \$ 12,752.8 |
| Policy loans | 822.8 | 1,049.0 | | | 1,049.0 |
| Other investments | 238.2 | 251.2 | | 170.8 | 80.4 |
| Cash and cash equivalents | 1,360.6 | 1,360.6 | 1,360.6 | | |
| Investment-type insurance contracts | (28,483.4) | (28,281.9) | | (4,733.5) | (23,548.4) |
| Short-term debt | (221.6) | (221.6) | | (221.6) | |
| Long-term debt | (3,286.1) | (3,431.0) | | (3,392.7) | (38.2) |
| Separate account liabilities | (122,714.6) | (121,486.1) | | | (121,486.1) |
| Bank deposits | (2,004.6) | (2,008.7) | (1,388.3) | (620.4) | |
| Cash collateral payable | (267.5) | (267.5) | (267.5) | | |

| December 31, 2014 | | | | | |
|-------------------------------------|-----------------|-------------|--------------------------|---------------------------------------|-------------|
| | Carrying amount | Fair value | Level 1 (in millions) | Fair value hierarchy level Level 2 | Level 3 |
| Assets (liabilities) | | | | | |
| Mortgage loans | \$ 11,811.6 | \$ 12,350.2 | \$ | \$ | \$ 12,350.2 |
| Policy loans | 829.2 | 1,083.2 | | | 1,083.2 |
| Other investments | 211.2 | 211.6 | | 183.7 | 27.9 |
| Cash and cash equivalents | 822.2 | 822.2 | 822.2 | | |
| Investment-type insurance contracts | (28,256.3) | (28,322.7) | | (5,455.4) | (22,867.3) |
| Short-term debt | (28.0) | (28.0) | | (28.0) | |
| Long-term debt | (2,531.2) | (2,786.1) | | (2,703.8) | (82.3) |
| Separate account liabilities | (128,480.5) | (127,131.0) | | | (127,131.0) |
| Bank deposits | (1,979.7) | (1,985.5) | (1,343.8) | (641.7) | |
| Cash collateral payable | (148.3) | (148.3) | (148.3) | | |

Mortgage Loans

Fair values of commercial and residential mortgage loans are primarily determined by discounting the expected cash flows at current treasury rates plus an applicable risk spread, which reflects credit quality and maturity of the loans. The risk spread is based on market clearing levels for loans with comparable credit quality, maturities and risk. The fair value of mortgage loans may also be based on the fair value of the underlying real estate collateral less cost to sell, which is estimated using appraised values. These are reflected in Level 3.

Policy Loans

Fair values of policy loans are estimated by discounting expected cash flows using a risk-free rate based on the Treasury curve. The expected cash flows reflect an estimate of timing of the repayment of the loans. These are reflected in Level 3.

Other Investments

The fair value of commercial loans and certain consumer loans included in other investments is calculated by discounting expected cash flows through the estimated maturity date using market interest rates that reflect the credit and interest rate risk inherent in the loans. The estimate of term to maturity is based on historical experience, adjusted as required, for current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

value estimate. These are reflected in Level 3. The fair value of certain tax credit investments are estimated by discounting expected future tax benefits using estimated investment return rates. These are reflected in Level 3. The carrying value of the remaining investments reported in this line item approximate their fair value. These are reflected in Level 2.

Cash and Cash Equivalents

Certain cash equivalents not reported at fair value include short-term investments with maturities of less than three months for which public quotations are not available to use in determining fair value. Because of the highly liquid nature of these assets, carrying amounts are used to approximate fair value, which are reflected in Level 2. The carrying amounts of the remaining cash and cash equivalents that are not reported at fair value on a recurring basis approximate their fair value, which are reflected in Level 1 given the nature of cash.

Investment-Type Insurance Contracts

The fair values of our reserves and liabilities for investment-type insurance contracts are determined via a third party pricing vendor or using discounted cash flow analyses when we are unable to find a price from third party pricing vendors. Third party pricing on various outstanding medium-term notes and funding agreements is based on observable inputs such as benchmark yields and spreads based on reported trades for our medium-term notes and funding agreement issuances. These are reflected in Level 2. The discounted cash flow analyses for the remaining contracts is based on current interest rates, including non-performance risk, being offered for similar contracts with maturities consistent with those remaining for the investment-type contracts being valued. These are reflected in Level 3. Investment-type insurance contracts include insurance, annuity and other policy contracts that do not involve significant mortality or morbidity risk and are only a portion of the policyholder liabilities appearing in the consolidated statements of financial position. Insurance contracts include insurance, annuity and other policy contracts that do involve significant mortality or morbidity risk. The fair values for our insurance contracts, other than investment-type contracts, are not required to be disclosed.

Short-Term Debt

The carrying amount of short-term debt approximates its fair value because of the relatively short time between origination of the debt instrument and its maturity, which is reflected in Level 2.

Long-Term Debt

Long-term debt primarily includes senior note issuances for which the fair values are determined using inputs that are observable in the market or that can be derived from or corroborated with observable market data. These are reflected in Level 2. Additionally, our long-term debt includes non-recourse mortgages and notes payable that are primarily financings for real estate developments for which the fair values are estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. These are reflected in Level 3.

Separate Account Liabilities

Fair values of separate account liabilities, excluding insurance-related elements, are estimated based on market assumptions around what a potential acquirer would pay for the associated block of business, including both the separate account assets and liabilities. As the applicable separate account assets are already reflected at fair value, any adjustment to the fair value of the block is an assumed adjustment to the separate account liabilities. To compute fair value, the separate account liabilities are originally set to equal separate account assets because these are pass-through contracts. The separate account liabilities are reduced by the amount of future fees expected to be collected that are intended to offset upfront acquisition costs already incurred that a potential acquirer would not have to pay. The estimated future fees are adjusted by an adverse deviation discount and the amount is then discounted at a risk-free rate as measured by the yield on Treasury securities at maturities aligned with the estimated timing of fee collection. These are reflected in Level 3.

Bank Deposits

The fair value of deposits of our Principal Bank subsidiary with no stated maturity is equal to the amount payable on demand (i.e., their carrying amounts). These are reflected in Level 1. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount is estimated using the rates currently offered for deposits of similar remaining maturities. These are reflected in Level 2.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

Cash Collateral Payable

The carrying amount of the payable associated with our obligation to return the cash collateral received under derivative credit support annex (collateral) agreements approximates its fair value, which is reflected in Level 1.

11. Segment Information

We provide financial products and services through the following segments: Retirement and Investor Services, Principal Global Investors, Principal International and U.S. Insurance Solutions. In addition, we have a Corporate segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

The Retirement and Investor Services segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals.

The Principal Global Investors segment provides asset management services to our asset accumulation business, our insurance operations, the Corporate segment and third party clients.

The Principal International segment has operations in Brazil, Chile, China, Hong Kong Special Administrative Region, India, Mexico and Southeast Asia. We focus on countries with large middle classes, favorable demographics and growing long-term savings, ideally with defined contribution markets. We entered these countries through acquisitions, start-up operations and joint ventures.

The U.S. Insurance Solutions segment provides individual life insurance and specialty benefits insurance, which consists of group dental and vision insurance, individual and group disability insurance, group life insurance and non-medical fee-for-service claims administration, throughout the United States.

The Corporate segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate segment primarily reflect our financing activities (including interest expense and preferred stock dividends), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items. Results of our exited group medical insurance business are reported in this segment.

As described in Note 1, Nature of Operations and Significant Accounting Policies, planned changes to our organizational structure will be reflected in our December 31, 2015, Form 10-K.

Management uses segment operating earnings in goal setting, as a basis for determining employee compensation and in evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income for net realized capital gains (losses), as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized capital gains (losses), as adjusted, are net of income taxes, related changes in the amortization pattern of DAC and related actuarial balances, recognition of deferred front-end fee revenues for sales charges on retirement and life insurance products and services, amortization of hedge accounting book value adjustments for certain discontinued hedges, net realized capital gains and losses distributed, noncontrolling interest capital gains and losses, certain adjustments related to seed money and certain market value adjustments to fee revenues. Net realized capital gains (losses), as adjusted, exclude periodic settlements and accruals on derivative instruments not designated as hedging instruments and exclude certain market value adjustments of embedded derivatives and realized capital gains (losses) associated with our exited group medical insurance business. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on derivatives not designated as hedging instruments), including their impact on recognition of front-end fee revenues, certain market value adjustments to fee revenues and amortization of hedge accounting book value adjustments for certain discontinued hedges, certain adjustments related to seed money and revenue from our exited group medical insurance business. Segment operating revenues include operating revenues from real estate properties that qualify for discontinued operations. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

The accounting policies of the segments are consistent with the accounting policies for the consolidated financial statements, with the exception of income tax allocation. The Corporate segment functions to absorb the risk inherent in interpreting and applying tax law. The segments are allocated tax adjustments consistent with the positions we took on tax returns. The Corporate segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

The following tables summarize select financial information by segment and reconcile segment totals to those reported in the consolidated financial statements:

| | September 30, 2015 | December 31, 2014 |
|----------------------------------|--------------------|-------------------|
| | (in millions) | |
| Assets: | | |
| Retirement and Investor Services | \$ 137,404.4 | \$ 138,549.4 |
| Principal Global Investors | 1,149.9 | 1,175.1 |
| Principal International | 50,458.0 | 53,531.8 |
| U.S. Insurance Solutions | 22,180.7 | 21,554.5 |
| Corporate | 4,172.4 | 4,276.2 |
| Total consolidated assets | \$ 215,365.4 | \$ 219,087.0 |

| | For the three months ended September 30, | 2014 | For the nine months ended September 30, | 2014 |
|---|---|------------|--|------------|
| | 2015 | | 2015 | |
| | (in millions) | | (in millions) | |
| Operating revenues by segment: | | | | |
| Retirement and Investor Services | \$ 1,957.5 | \$ 1,324.7 | \$ 5,385.5 | \$ 3,851.0 |
| Principal Global Investors | 182.8 | 173.6 | 557.8 | 517.9 |
| Principal International | 311.2 | 294.5 | 862.4 | 952.2 |
| U.S. Insurance Solutions | 853.2 | 821.0 | 2,572.7 | 2,436.8 |
| Corporate | (69.0) | (61.1) | (191.3) | (163.3) |
| Total segment operating revenues | 3,235.7 | 2,552.7 | 9,187.1 | 7,594.6 |
| Net realized capital gains (losses), net of related revenue adjustments | 4.8 | (68.2) | (90.9) | (25.0) |
| Other income on a tax indemnification | | | 60.2 | |
| Exited group medical insurance business | 0.4 | (0.2) | 1.0 | |
| Total revenues per consolidated statements of operations | \$ 3,240.9 | \$ 2,484.3 | \$ 9,157.4 | \$ 7,569.6 |
| Operating earnings (loss) by segment, net of related income taxes: | | | | |
| Retirement and Investor Services | \$ 163.3 | \$ 204.3 | \$ 590.9 | \$ 632.9 |
| Principal Global Investors | 30.4 | 25.3 | 92.6 | 79.6 |
| Principal International | 45.8 | 73.8 | 165.0 | 205.1 |
| U.S. Insurance Solutions | 114.5 | 83.3 | 228.4 | 175.7 |
| Corporate | (37.0) | (33.0) | (109.6) | (99.4) |
| Total segment operating earnings, net of related income taxes | 317.0 | 353.7 | 967.3 | 993.9 |
| Net realized capital losses, as adjusted (1) | (16.5) | (55.2) | (86.2) | (47.3) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | |
|---|----------|----------|----------|----------|
| Other after-tax adjustments (2) | (0.1) | (57.8) | 74.6 | (105.9) |
| Net income available to common stockholders per consolidated statements of operations | \$ 300.4 | \$ 240.7 | \$ 955.7 | \$ 840.7 |

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

(1) Net realized capital gains (losses), as adjusted, is derived as follows:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|-----------|--|-----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Net realized capital gains (losses): | | | | |
| Net realized capital gains (losses) | \$ 38.4 | \$ (46.4) | \$ (10.0) | \$ 41.0 |
| Certain derivative and hedging-related adjustments | (34.2) | (21.9) | (80.3) | (66.4) |
| Certain market value adjustments to fee revenues | | | (1.1) | |
| Certain adjustments related to seed money | 0.5 | | 0.5 | |
| Recognition of front-end fee (revenue) expense | 0.1 | 0.1 | | 0.4 |
| Net realized capital gains (losses), net of related revenue adjustments | 4.8 | (68.2) | (90.9) | (25.0) |
| Amortization of deferred acquisition costs and other actuarial balances | (28.6) | (3.6) | (28.4) | (26.8) |
| Capital (gains) losses distributed | 12.9 | (8.8) | 14.8 | (18.1) |
| Certain market value adjustments of embedded derivatives | (1.1) | 5.7 | (2.0) | 6.0 |
| Net realized capital losses associated with exited group medical insurance business | 0.1 | | 0.1 | |
| Noncontrolling interest capital gains | (3.7) | (0.1) | (5.7) | (0.2) |
| Income tax effect | (0.9) | 19.8 | 25.9 | 16.8 |
| Net realized capital losses, as adjusted | \$ (16.5) | \$ (55.2) | \$ (86.2) | \$ (47.3) |

(2) For the three months ended September 30, 2015, other after-tax adjustments included the negative effect of losses associated with our exited group medical insurance business that did not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended September 30, 2014, other after-tax adjustments included the negative effect of an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile (\$58.1 million) and the positive effect of gains associated with our exited group medical insurance business that did not qualify for discontinued operations accounting treatment under U.S. GAAP (\$0.3 million).

For the nine months ended September 30, 2015, other after-tax adjustments included the positive effect of a change in deferred tax balances related to the merger of two of our Chilean legal entities (\$105.2 million) and the negative effect of: (1) the impact of a court ruling on some uncertain tax positions (\$30.3 million) and (2) losses associated with our exited group medical insurance business that did not qualify for discontinued operations accounting treatment under U.S. GAAP (\$0.3 million).

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

For the nine months ended September 30, 2014, other after-tax adjustments included the negative effect of: (a) an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile (\$58.1 million); (b) the impact of a court ruling on some uncertain tax positions (\$47.5 million) and (c) losses associated with our exited group medical insurance business that did not qualify for discontinued operations accounting treatment under U.S. GAAP (\$0.3 million).

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

The following table summarizes operating revenues for our products and services:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|------------|--|------------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions) | | | |
| Retirement and Investor Services: | | | | |
| Full service accumulation | \$ 383.0 | \$ 392.1 | \$ 1,153.8 | \$ 1,170.0 |
| Principal Funds | 231.8 | 219.7 | 699.9 | 638.2 |
| Individual annuities | 476.7 | 335.6 | 1,524.0 | 1,082.9 |
| Bank and trust services | 19.9 | 21.9 | 64.2 | 63.7 |
| Eliminations | (36.9) | (38.8) | (115.0) | (116.3) |
| Total Accumulation | 1,074.5 | 930.5 | 3,326.9 | 2,838.5 |
| Investment only | 63.8 | 73.4 | 199.9 | 234.5 |
| Full service payout | 819.2 | 320.8 | 1,858.7 | 778.0 |
| Total Guaranteed | 883.0 | 394.2 | 2,058.6 | 1,012.5 |
| Total Retirement and Investor Services | 1,957.5 | 1,324.7 | 5,385.5 | 3,851.0 |
| Principal Global Investors (1) | 182.8 | 173.6 | 557.8 | 517.9 |
| Principal International | 311.2 | 294.5 | 862.4 | 952.2 |
| U.S. Insurance Solutions: | | | | |
| Individual life insurance | 389.6 | 382.7 | 1,178.2 | 1,148.5 |
| Specialty benefits insurance | 463.6 | 438.3 | 1,394.6 | 1,288.4 |
| Eliminations | | | (0.1) | (0.1) |
| Total U.S. Insurance Solutions | 853.2 | 821.0 | 2,572.7 | 2,436.8 |
| Corporate | (69.0) | (61.1) | (191.3) | (163.3) |
| Total operating revenues | \$ 3,235.7 | \$ 2,552.7 | \$ 9,187.1 | \$ 7,594.6 |
| Total operating revenues | \$ 3,235.7 | \$ 2,552.7 | \$ 9,187.1 | \$ 7,594.6 |
| Net realized capital gains (losses), net of related revenue adjustments | 4.8 | (68.2) | (90.9) | (25.0) |
| Other income on a tax indemnification | | | 60.2 | |
| Exited group medical insurance business | 0.4 | (0.2) | 1.0 | |
| Total revenues per consolidated statements of operations | \$ 3,240.9 | \$ 2,484.3 | \$ 9,157.4 | \$ 7,569.6 |

(1) Reflects inter-segment revenues of \$76.1 million and \$71.0 million for the three months ended September 30, 2015 and 2014, respectively, and \$237.7 million and \$214.4 million for the nine months ended September 30, 2015 and 2014, respectively.

12. Stock-Based Compensation Plans

As of September 30, 2015, we have the 2014 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2014 Directors Stock Plan, the Long-Term Performance Plan, the Amended and Restated 2010 Stock Incentive Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

and the Directors Stock Plan (Stock Based Compensation Plans). As of May 20, 2014, no new grants will be made under the Amended and Restated 2010 Stock Incentive Plan or the 2005 Directors Stock Plan. No grants have been made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan since at least 2005. Under the terms of the 2014 Stock Incentive Plan, grants may be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units or other stock-based awards. The 2014 Directors Stock Plan provides for the grant of nonqualified stock options, restricted stock, restricted stock units or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock or performance units under any plans.

As of September 30, 2015, the maximum number of new shares of common stock that were available for grant under the 2014 Stock Incentive Plan and the 2014 Directors Stock Plan was 12.0 million.

[Table of Contents](#)

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

For awards with graded vesting, we use an accelerated expense attribution method. The compensation cost that was charged against income for stock-based awards granted under the Stock-Based Compensation Plans was as follows:

| | | For the nine months ended September 30, 2015 | (in millions) | For the nine months ended September 30, 2014 |
|---------------------------------|----|---|---------------|---|
| Compensation cost | \$ | 52.5 | \$ | 50.3 |
| Related income tax benefit | | 17.0 | | 16.4 |
| Capitalized as part of an asset | | 1.7 | | 1.9 |

Nonqualified Stock Options

Nonqualified stock options were granted to certain employees under the 2014 Stock Incentive Plan. Total options granted were 0.6 million for the nine months ended September 30, 2015. The fair value of stock options is estimated using the Black-Scholes option pricing model. The following is a summary of the assumptions used in this model for the stock options granted during the period:

| | For the nine months ended September 30, 2015 |
|--|---|
| Expected volatility | 52.2% |
| Expected term (in years) | 6.5 |
| Risk-free interest rate | 1.8% |
| Expected dividend yield | 2.81% |
| Weighted average estimated fair value per common share | \$ 20.43 |

As of September 30, 2015, we had \$5.5 million of total unrecognized compensation cost related to nonvested stock options. The cost is expected to be recognized over a weighted-average service period of approximately 1.4 years.

Performance Share Awards

Performance share awards were granted to certain employees under the 2014 Stock Incentive Plan. Total performance share awards granted were 0.3 million for the nine months ended September 30, 2015. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance results to be determined at the end of the performance period. The actual number of common shares to be awarded at the end of each performance period will range between 0% and 150% of the initial target

awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was \$51.33 per common share.

As of September 30, 2015, we had \$9.6 million of total unrecognized compensation cost related to nonvested performance share awards granted. The cost is expected to be recognized over a weighted-average service period of approximately 1.6 years.

Restricted Stock Units

Restricted stock units were issued to certain employees and agents pursuant to the 2014 Stock Incentive Plan and non-employee directors pursuant to the 2015 Directors Stock Plan. Total restricted stock units granted were 0.9 million for the nine months ended September 30, 2015. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was \$51.35 per common share.

As of September 30, 2015, we had \$54.6 million of total unrecognized compensation cost related to nonvested restricted stock unit awards granted. The cost is expected to be recognized over a weighted-average period of approximately 1.8 years.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

Employee Stock Purchase Plan

Under the Employee Stock Purchase Plan, employees purchased 0.3 million shares for the nine months ended September 30, 2015. The weighted average fair value of the discount on the stock purchased was \$7.69 per share.

As of September 30, 2015, a total of 4.4 million of new shares are available to be made issuable by us for this plan.

13. Earnings Per Common Share

The computations of the basic and diluted per share amounts were as follows:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|---|---|----------|--|----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in millions, except per share data) | | | |
| Net income | \$ 300.9 | \$ 252.8 | \$ 994.9 | \$ 896.1 |
| Subtract: | | | | |
| Net income attributable to noncontrolling interest | 0.5 | 3.9 | 14.5 | 30.7 |
| Preferred stock dividends | | 8.2 | 16.5 | 24.7 |
| Excess of redemption value over carrying value of preferred shares redeemed | | | 8.2 | |
| Adjustments to redemption amounts of redeemable noncontrolling interests | | 10.3 | | 19.7 |
| Total | \$ 300.4 | \$ 230.4 | \$ 955.7 | \$ 821.0 |
| Weighted-average shares outstanding: | | | | |
| Basic | 295.0 | 294.2 | 295.0 | 294.9 |
| Dilutive effects: | | | | |
| Stock options | 1.6 | 1.8 | 1.6 | 1.7 |
| Restricted stock units | 1.6 | 1.8 | 1.6 | 1.7 |
| Performance share awards | 0.3 | 0.4 | 0.3 | 0.4 |
| Diluted | 298.5 | 298.2 | 298.5 | 298.7 |
| Net income per common share: | | | | |
| Basic | \$ 1.02 | \$ 0.78 | \$ 3.24 | \$ 2.78 |
| Diluted | \$ 1.01 | \$ 0.77 | \$ 3.20 | \$ 2.75 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

The calculation of diluted earnings per share for the three and nine months ended September 30, 2015 and 2014, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

14. Condensed Consolidating Financial Information

Principal Life has established special purpose entities to issue secured medium-term notes. Under the program, the payment obligations of principal and interest on the notes are secured by funding agreements issued by Principal Life. Principal Life's payment obligations on the funding agreements are fully and unconditionally guaranteed by PFG. All of the outstanding stock of Principal Life is indirectly owned by PFG and PFG is the only guarantor of the payment obligations of the funding agreements.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) Principal Life, (iii) Principal Financial Services, Inc. (PFS) and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2015 and December 31, 2014, and for the nine months ended September 30, 2015 and 2014.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in all direct subsidiaries of PFG, (ii) Principal Life's interest in all direct subsidiaries of Principal Life and (iii) PFS's interest in Principal Life even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent's investment and earnings. All intercompany balances and transactions, including elimination of the parent's investment in subsidiaries, between PFG, Principal Life and PFS and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

Condensed Consolidating Statements of Financial Position

September 30, 2015

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---------------------------------------|--|--|--|---------------|---|
| Assets | | | | | |
| Fixed maturities, available-for-sale | \$ | \$ 43,723.9 | \$ 6,433.3 | \$ (376.6) | \$ 49,780.6 |
| Fixed maturities, trading | | 358.7 | 351.5 | | 710.2 |
| Equity securities, available-for-sale | | 101.5 | 363.8 | | 465.3 |
| Equity securities, trading | | 0.3 | 868.8 | | 869.1 |
| Mortgage loans | | 11,527.0 | 1,174.3 | (469.2) | 12,232.1 |
| Real estate | | 6.4 | 1,408.6 | | 1,415.0 |
| Policy loans | | 792.7 | 30.1 | | 822.8 |
| Investment in unconsolidated entities | 12,494.0 | 2,701.4 | 5,957.4 | (20,562.4) | 590.4 |
| Other investments | 9.7 | 3,827.7 | 1,573.9 | (2,731.3) | 2,680.0 |
| Cash and cash equivalents | 578.1 | 928.6 | 1,420.0 | (412.5) | 2,514.2 |
| Accrued investment income | | 500.3 | 68.2 | (1.7) | 566.8 |
| Premiums due and other receivables | | 1,455.3 | 2,390.3 | (2,444.0) | 1,401.6 |
| Deferred acquisition costs | | 2,925.9 | 219.1 | | 3,145.0 |
| Property and equipment | | 530.6 | 81.0 | | 611.6 |
| Goodwill | | 54.3 | 950.9 | | 1,005.2 |
| Other intangibles | | 24.9 | 1,374.0 | | 1,398.9 |
| Separate account assets | | 92,088.8 | 41,957.0 | | 134,045.8 |
| Other assets | 452.7 | 913.8 | 3,093.7 | (3,349.4) | 1,110.8 |
| Total assets | \$ 13,534.5 | \$ 162,462.1 | \$ 69,715.9 | \$ (30,347.1) | \$ 215,365.4 |
| Liabilities | | | | | |
| Contractholder funds | \$ | \$ 32,593.0 | \$ 2,838.1 | \$ (315.9) | \$ 35,115.2 |
| Future policy benefits and claims | | 21,564.0 | 4,461.2 | (503.5) | 25,521.7 |
| Other policyholder funds | | 737.9 | 82.6 | (1.0) | 819.5 |
| Short-term debt | | | 221.6 | | 221.6 |
| Long-term debt | 3,247.9 | | 489.9 | (451.7) | 3,286.1 |
| Income taxes currently payable | | 10.1 | 117.2 | (110.6) | 16.7 |
| Deferred income taxes | | 465.9 | 1,030.2 | (617.3) | 878.8 |
| Separate account liabilities | | 92,088.8 | 41,957.0 | | 134,045.8 |
| Other liabilities | 666.3 | 6,480.9 | 5,958.8 | (7,409.8) | 5,696.2 |
| Total liabilities | 3,914.2 | 153,940.6 | 57,156.6 | (9,409.8) | 205,601.6 |
| Redeemable noncontrolling interest | | | 78.0 | | 78.0 |
| Stockholders' equity | | | | | |
| Common stock | 4.7 | 2.5 | | (2.5) | 4.7 |
| Additional paid-in capital | 9,524.2 | 5,322.2 | 8,984.8 | (14,307.0) | 9,524.2 |
| Retained earnings | 6,734.7 | 2,289.7 | 3,504.1 | (5,793.8) | 6,734.7 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|-----------|--------------|-------------|---------------|--------------|
| Accumulated other comprehensive income (loss) | (524.4) | 907.1 | (77.8) | (829.3) | (524.4) |
| Treasury stock, at cost | (6,118.9) | | | | (6,118.9) |
| Total stockholders' equity attributable to PFG | 9,620.3 | 8,521.5 | 12,411.1 | (20,932.6) | 9,620.3 |
| Noncontrolling interest | | | 70.2 | (4.7) | 65.5 |
| Total stockholders' equity | 9,620.3 | 8,521.5 | 12,481.3 | (20,937.3) | 9,685.8 |
| Total liabilities and stockholders' equity \$ | 13,534.5 | \$ 162,462.1 | \$ 69,715.9 | \$ (30,347.1) | \$ 215,365.4 |

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

Condensed Consolidating Statements of Financial Position

December 31, 2014

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---------------------------------------|--|--|--|---------------|---|
| Assets | | | | | |
| Fixed maturities, available-for-sale | \$ | \$ 43,649.7 | \$ 6,411.6 | \$ (390.5) | \$ 49,670.8 |
| Fixed maturities, trading | | 298.5 | 306.1 | | 604.6 |
| Equity securities, available-for-sale | | 108.9 | 14.1 | | 123.0 |
| Equity securities, trading | | 0.3 | 839.9 | | 840.2 |
| Mortgage loans | | 10,972.6 | 1,188.6 | (349.6) | 11,811.6 |
| Real estate | | 7.0 | 1,337.6 | | 1,344.6 |
| Policy loans | | 799.0 | 30.2 | | 829.2 |
| Investment in unconsolidated entities | 12,446.5 | 2,787.9 | 5,745.7 | (20,164.3) | 815.8 |
| Other investments | 9.5 | 3,416.7 | 1,578.5 | (2,610.7) | 2,394.0 |
| Cash and cash equivalents | 412.4 | 602.7 | 1,253.6 | (404.8) | 1,863.9 |
| Accrued investment income | | 449.2 | 58.1 | (1.4) | 505.9 |
| Premiums due and other receivables | | 1,237.4 | 2,165.6 | (2,190.0) | 1,213.0 |
| Deferred acquisition costs | | 2,754.6 | 238.4 | | 2,993.0 |
| Property and equipment | | 505.8 | 84.4 | | 590.2 |
| Goodwill | | 54.3 | 953.1 | | 1,007.4 |
| Other intangibles | | 25.7 | 1,297.8 | | 1,323.5 |
| Separate account assets | | 94,328.4 | 45,744.4 | | 140,072.8 |
| Other assets | 450.7 | 873.2 | 2,768.6 | (3,009.0) | 1,083.5 |
| Total assets | \$ 13,319.1 | \$ 162,871.9 | \$ 72,016.3 | \$ (29,120.3) | \$ 219,087.0 |
| Liabilities | | | | | |
| Contractholder funds | \$ | \$ 33,428.3 | \$ 1,607.5 | \$ (309.1) | \$ 34,726.7 |
| Future policy benefits and claims | | 19,768.1 | 4,718.2 | (449.7) | 24,036.6 |
| Other policyholder funds | | 742.8 | 70.4 | (0.5) | 812.7 |
| Short-term debt | | | 28.0 | | 28.0 |
| Long-term debt | 2,448.9 | | 417.5 | (335.2) | 2,531.2 |
| Income taxes currently payable | | | 83.1 | (71.6) | 11.5 |
| Deferred income taxes | | 629.9 | 1,022.5 | (617.1) | 1,035.3 |
| Separate account liabilities | | 94,328.4 | 45,744.4 | | 140,072.8 |
| Other liabilities | 686.2 | 5,793.0 | 5,845.5 | (6,782.5) | 5,542.2 |
| Total liabilities | 3,135.1 | 154,690.5 | 59,537.1 | (8,565.7) | 208,797.0 |
| Redeemable noncontrolling interest | | | 58.0 | | 58.0 |
| Stockholders' equity | | | | | |
| Series A preferred stock | | | | | |
| Series B preferred stock | 0.1 | | | | 0.1 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|-----------|--------------|-------------|---------------|--------------|
| Common stock | 4.6 | 2.5 | | (2.5) | 4.6 |
| Additional paid-in capital | 9,945.5 | 5,275.0 | 8,964.2 | (14,239.2) | 9,945.5 |
| Retained earnings | 6,114.1 | 1,817.2 | 2,858.6 | (4,675.8) | 6,114.1 |
| Accumulated other comprehensive income | 50.4 | 1,086.7 | 545.9 | (1,632.6) | 50.4 |
| Treasury stock, at cost | (5,930.7) | | | | (5,930.7) |
| Total stockholders' equity attributable to PFG | 10,184.0 | 8,181.4 | 12,368.7 | (20,550.1) | 10,184.0 |
| Noncontrolling interest | | | 52.5 | (4.5) | 48.0 |
| Total stockholders' equity | 10,184.0 | 8,181.4 | 12,421.2 | (20,554.6) | 10,232.0 |
| Total liabilities and stockholders' equity \$ | 13,319.1 | \$ 162,871.9 | \$ 72,016.3 | \$ (29,120.3) | \$ 219,087.0 |

Table of Contents

Principal Financial Group, Inc.
Notes to Consolidated Financial Statements
September 30, 2015
(Unaudited)

Condensed Consolidating Statements of Operations

For the nine months ended September 30, 2015

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|--|--------------|---|
| Revenues | | | | | |
| Premiums and other considerations | \$ | \$ 3,885.3 | \$ 270.6 | \$ | \$ 4,155.9 |
| Fees and other revenues | | 1,522.0 | 1,523.9 | (301.7) | 2,744.2 |
| Net investment income | 1.3 | 1,606.8 | 1,212.0 | (552.8) | 2,267.3 |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | | 50.4 | (39.3) | | 11.1 |
| Net other-than-temporary impairment recoveries on available-for-sale securities | | 6.9 | | | 6.9 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | | (27.9) | (0.1) | | (28.0) |
| Net impairment losses on available-for-sale securities | | (21.0) | (0.1) | | (21.1) |
| Net realized capital gains (losses) | | 29.4 | (39.4) | | (10.0) |
| Total revenues | 1.3 | 7,043.5 | 2,967.1 | (854.5) | 9,157.4 |
| Expenses | | | | | |
| Benefits, claims and settlement expenses | | 4,685.3 | 483.8 | (8.6) | 5,160.5 |
| Dividends to policyholders | | 123.5 | | | 123.5 |
| Operating expenses | 128.5 | 1,658.7 | 1,216.9 | (252.5) | 2,751.6 |
| Total expenses | 128.5 | 6,467.5 | 1,700.7 | (261.1) | 8,035.6 |
| Income (loss) before income taxes | (127.2) | 576.0 | 1,266.4 | (593.4) | 1,121.8 |
| Income taxes (benefits) | (52.5) | 106.0 | 74.4 | (1.0) | 126.9 |
| Equity in the net income (loss) of subsidiaries | 1,055.1 | 262.6 | (127.5) | (1,190.2) | |
| Net income | 980.4 | 732.6 | 1,064.5 | (1,782.6) | 994.9 |
| Net income attributable to noncontrolling interest | | | 14.5 | | 14.5 |
| Net income attributable to PFG | 980.4 | 732.6 | 1,050.0 | (1,782.6) | 980.4 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Excess of redemption value over carrying value of preferred shares redeemed | 8.2 | | | | 8.2 |
| Net income available to common stockholders | \$ 955.7 | \$ 732.6 | \$ 1,050.0 | \$ (1,782.6) | \$ 955.7 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | |
|--------------------------|----|---------|----|---------|----|---------|----|-----------|----|---------|
| Net income | \$ | 980.4 | \$ | 732.6 | \$ | 1,064.5 | \$ | (1,782.6) | \$ | 994.9 |
| Other comprehensive loss | | (633.8) | | (181.1) | | (606.7) | | 838.1 | | (583.5) |
| Comprehensive income | \$ | 346.6 | \$ | 551.5 | \$ | 457.8 | \$ | (944.5) | \$ | 411.4 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Operations****For the nine months ended September 30, 2014**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|---|---------------------|---|
| Revenues | | | | | |
| Premiums and other considerations | \$ | \$ | 2,200.5 | \$ | \$ 2,514.8 |
| Fees and other revenues | | | 1,407.5 | | 2,569.7 |
| Net investment income | 0.4 | 1,719.4 | 1,260.1 | (535.8) | 2,444.1 |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | | 674.1 | (569.1) | | 105.0 |
| Net other-than-temporary impairment (losses) recoveries on available-for-sale securities | | 27.7 | (9.2) | | 18.5 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income | | (84.5) | 2.0 | | (82.5) |
| Net impairment losses on available-for-sale securities | | (56.8) | (7.2) | | (64.0) |
| Net realized capital gains (losses) | | 617.3 | (576.3) | | 41.0 |
| Total revenues | 0.4 | 5,944.7 | 2,449.6 | (825.1) | 7,569.6 |
| Expenses | | | | | |
| Benefits, claims and settlement expenses | | 3,083.8 | 534.5 | (8.6) | 3,609.7 |
| Dividends to policyholders | | 134.5 | | | 134.5 |
| Operating expenses | 106.8 | 1,624.3 | 1,156.4 | (239.8) | 2,647.7 |
| Total expenses | 106.8 | 4,842.6 | 1,690.9 | (248.4) | 6,391.9 |
| Income (loss) before income taxes | (106.4) | 1,102.1 | 758.7 | (576.7) | 1,177.7 |
| Income taxes (benefits) | (42.7) | 260.6 | 65.3 | (1.6) | 281.6 |
| Equity in the net income (loss) of subsidiaries | 929.1 | (125.0) | 266.4 | (1,070.5) | |
| Net income | 865.4 | 716.5 | 959.8 | (1,645.6) | 896.1 |
| Net income attributable to noncontrolling interest | | | 30.7 | | 30.7 |
| Net income attributable to PFG | 865.4 | 716.5 | 929.1 | (1,645.6) | 865.4 |
| Preferred stock dividends | 24.7 | | | | 24.7 |
| Net income available to common stockholders | \$ 840.7 | \$ 716.5 | \$ 929.1 | \$ (1,645.6) | \$ 840.7 |
| Net income | \$ 865.4 | \$ 716.5 | \$ 959.8 | \$ (1,645.6) | \$ 896.1 |
| Other comprehensive income | 129.6 | 334.8 | 275.7 | (550.0) | 190.1 |
| Comprehensive income | \$ 995.0 | \$ 1,051.3 | \$ 1,235.5 | \$ (2,195.6) | \$ 1,086.2 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Cash Flows****For the nine months ended September 30, 2015**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|--|--|---|---------------------|---|
| Operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$ (40.4) | \$ 3,038.3 | \$ 316.7 | \$ 8.4 | \$ 3,323.0 |
| Investing activities | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | (6,241.4) | (811.3) | 0.1 | (7,052.6) |
| Sales | | 834.3 | 576.5 | | 1,410.8 |
| Maturities | | 4,436.6 | 583.9 | | 5,020.5 |
| Mortgage loans acquired or originated | | (1,573.8) | (246.5) | 162.3 | (1,658.0) |
| Mortgage loans sold or repaid | | 1,011.2 | 205.1 | (41.0) | 1,175.3 |
| Real estate acquired | | (0.3) | (255.5) | | (255.8) |
| Net purchases of property and equipment | | (77.7) | (18.6) | | (96.3) |
| Purchases of interests in subsidiaries, net of cash acquired | | | (293.7) | | (293.7) |
| Dividends and returns of capital received from (contributed to) unconsolidated entities | 425.5 | (1.5) | 225.6 | (649.6) | |
| Net change in other investments | 1.5 | 169.7 | (167.1) | (21.1) | (17.0) |
| Net cash provided by (used in) investing activities | 427.0 | (1,442.9) | (201.6) | (549.3) | (1,766.8) |
| Financing activities | | | | | |
| Issuance of common stock | 71.5 | | | | 71.5 |
| Acquisition of treasury stock | (188.2) | | | | (188.2) |
| Proceeds from financing element derivatives | | 0.2 | | | 0.2 |
| Payments for financing element derivatives | | (60.9) | | | (60.9) |
| Excess tax benefits from share-based payment arrangements | 0.7 | 5.5 | 9.0 | | 15.2 |
| Purchase of subsidiary shares from noncontrolling interest | | | (23.1) | 0.6 | (22.5) |
| Sale of subsidiary shares to noncontrolling interest | | | 0.6 | (0.6) | |
| Dividends to common stockholders | (330.2) | | | | (330.2) |
| Dividends to preferred stockholders | (16.5) | | | | (16.5) |
| Preferred stock redemption | (550.0) | | | | (550.0) |
| Issuance of long-term debt | 791.8 | | 167.2 | (158.6) | 800.4 |
| Principal repayments of long-term debt | | | (94.8) | 42.2 | (52.6) |
| Net proceeds from short-term borrowings | | | 197.2 | | 197.2 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|---|----------|-----------|------------|------------|-----------|
| Dividends and capital paid to parent | | (225.6) | (424.0) | 649.6 | |
| Investment contract deposits | | 3,988.0 | 202.3 | | 4,190.3 |
| Investment contract withdrawals | | (4,966.3) | (8.0) | | (4,974.3) |
| Net increase in banking operation deposits | | | 24.9 | | 24.9 |
| Other | | (10.4) | | | (10.4) |
| Net cash provided by (used in) financing activities | (220.9) | (1,269.5) | 51.3 | 533.2 | (905.9) |
| Net increase in cash and cash equivalents | 165.7 | 325.9 | 166.4 | (7.7) | 650.3 |
| Cash and cash equivalents at beginning of period | 412.4 | 602.7 | 1,253.6 | (404.8) | 1,863.9 |
| Cash and cash equivalents at end of period | \$ 578.1 | \$ 928.6 | \$ 1,420.0 | \$ (412.5) | 2,514.2 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Cash Flows****For the nine months ended September 30, 2014**

| | Principal Financial Group, Inc. Parent Only | Principal Life Insurance Company Only | Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|---|---------------------|---|
| Operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$ (42.3) | \$ 1,729.9 | \$ 504.6 | \$ 5.4 | \$ 2,197.6 |
| Investing activities | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | (5,902.2) | (705.1) | 11.3 | (6,596.0) |
| Sales | | 1,559.7 | 311.8 | | 1,871.5 |
| Maturities | | 4,149.4 | 349.9 | | 4,499.3 |
| Mortgage loans acquired or originated | | (1,620.6) | (118.1) | 124.5 | (1,614.2) |
| Mortgage loans sold or repaid | | 1,291.5 | 137.6 | (109.3) | 1,319.8 |
| Real estate acquired | | (0.6) | (246.2) | | (246.8) |
| Net purchases of property and equipment | | (90.3) | (27.2) | | (117.5) |
| Dividends and returns of capital received from unconsolidated entities | 517.5 | 263.5 | 467.5 | (1,248.5) | |
| Net change in other investments | (2.0) | (83.6) | 34.9 | 107.3 | 56.6 |
| Net cash provided by (used in) investing activities | 515.5 | (433.2) | 205.1 | (1,114.7) | (827.3) |
| Financing activities | | | | | |
| Issuance of common stock | 69.6 | (0.2) | 0.2 | | 69.6 |
| Acquisition of treasury stock | (222.5) | | | | (222.5) |
| Proceeds from financing element derivatives | | 14.9 | | | 14.9 |
| Payments for financing element derivatives | | (41.5) | | | (41.5) |
| Excess tax benefits from share-based payment arrangements | 0.3 | 3.7 | 4.6 | | 8.6 |
| Purchase of subsidiary shares from noncontrolling interest | | | (222.7) | 0.3 | (222.4) |
| Sale of subsidiary shares to noncontrolling interest | | | 0.3 | (0.3) | |
| Dividends to common stockholders | (276.7) | | | | (276.7) |
| Dividends to preferred stockholders | (24.7) | | | | (24.7) |
| Issuance of long-term debt | | | 138.9 | (102.4) | 36.5 |
| Principal repayments of long-term debt | | (100.0) | (87.4) | 87.1 | (100.3) |
| Net repayments of short-term borrowings | | | (20.5) | | (20.5) |
| Dividends and capital paid to parent | | (467.5) | (781.0) | 1,248.5 | |
| Investment contract deposits | | 3,978.2 | 206.1 | | 4,184.3 |
| Investment contract withdrawals | | (5,857.3) | (7.0) | | (5,864.3) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|----------|-----------|----------|----------|------------|
| Net decrease in banking operation deposits | | | (2.3) | | (2.3) |
| Other | | (10.1) | 0.1 | | (10.0) |
| Net cash used in financing activities | (454.0) | (2,479.8) | (770.7) | 1,233.2 | (2,471.3) |
| Net increase (decrease) in cash and cash equivalents | 19.2 | (1,183.1) | (61.0) | 123.9 | (1,101.0) |
| Cash and cash equivalents at beginning of period | 131.5 | 1,332.2 | 894.5 | 13.6 | 2,371.8 |
| Cash and cash equivalents at end of period | \$ 150.7 | \$ 149.1 | \$ 833.5 | \$ 137.5 | \$ 1,270.8 |

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

September 30, 2015

(Unaudited)

On May 7, 2014, our shelf registration statement was filed with the SEC and became effective replacing the shelf registration that had been in effect since May 2011. Under our current shelf registration, we have the ability to issue in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) PFS, (iii) Principal Life and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2015 and December 31, 2014, and for the nine months ended September 30, 2015 and 2014.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in all direct subsidiaries of PFG and (ii) PFS's interest in Principal Life and all other subsidiaries, where applicable, even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent's investment and earnings. All intercompany balances and transactions, including elimination of the parent's investment in subsidiaries, between PFG, PFS and Principal Life and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Financial Position****September 30, 2015**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---------------------------------------|--|--|---|---------------|---|
| Assets | | | | | |
| Fixed maturities, available-for-sale | \$ | \$ | \$ 49,780.6 | \$ | \$ 49,780.6 |
| Fixed maturities, trading | | | 710.2 | | 710.2 |
| Equity securities, available-for-sale | | | 465.3 | | 465.3 |
| Equity securities, trading | | 4.2 | 864.9 | | 869.1 |
| Mortgage loans | | | 12,232.1 | | 12,232.1 |
| Real estate | | | 1,415.0 | | 1,415.0 |
| Policy loans | | | 822.8 | | 822.8 |
| Investment in unconsolidated entities | 12,494.0 | 12,498.9 | 546.2 | (24,948.7) | 590.4 |
| Other investments | 9.7 | 176.3 | 2,494.0 | | 2,680.0 |
| Cash and cash equivalents | 578.1 | 577.2 | 2,450.0 | (1,091.1) | 2,514.2 |
| Accrued investment income | | 0.1 | 566.7 | | 566.8 |
| Premiums due and other receivables | | 13.1 | 1,544.5 | (156.0) | 1,401.6 |
| Deferred acquisition costs | | | 3,145.0 | | 3,145.0 |
| Property and equipment | | | 611.6 | | 611.6 |
| Goodwill | | | 1,005.2 | | 1,005.2 |
| Other intangibles | | | 1,398.9 | | 1,398.9 |
| Separate account assets | | | 134,045.8 | | 134,045.8 |
| Other assets | 452.7 | 232.1 | 1,091.8 | (665.8) | 1,110.8 |
| Total assets | \$ 13,534.5 | \$ 13,501.9 | \$ 215,190.6 | \$ (26,861.6) | \$ 215,365.4 |
| Liabilities | | | | | |
| Contractholder funds | \$ | \$ | \$ 35,115.2 | \$ | \$ 35,115.2 |
| Future policy benefits and claims | | | 25,521.7 | | 25,521.7 |
| Other policyholder funds | | | 819.5 | | 819.5 |
| Short-term debt | | | 367.4 | (145.8) | 221.6 |
| Long-term debt | 3,247.9 | 156.0 | 38.2 | (156.0) | 3,286.1 |
| Income taxes currently payable | | | 83.3 | (66.6) | 16.7 |
| Deferred income taxes | | 1.0 | 1,471.5 | (593.7) | 878.8 |
| Separate account liabilities | | | 134,045.8 | | 134,045.8 |
| Other liabilities | 666.3 | 933.8 | 5,002.7 | (906.6) | 5,696.2 |
| Total liabilities | 3,914.2 | 1,090.8 | 202,465.3 | (1,868.7) | 205,601.6 |
| Redeemable noncontrolling interest | | | 78.0 | | 78.0 |
| Stockholders' equity | | | | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|-------------|-------------|--------------|---------------|--------------|
| Common stock | 4.7 | | 17.8 | (17.8) | 4.7 |
| Additional paid-in capital | 9,524.2 | 8,984.8 | 9,847.5 | (18,832.3) | 9,524.2 |
| Retained earnings | 6,734.7 | 3,504.1 | 2,930.6 | (6,434.7) | 6,734.7 |
| Accumulated other comprehensive loss | (524.4) | (77.8) | (212.1) | 289.9 | (524.4) |
| Treasury stock, at cost | (6,118.9) | | (2.0) | 2.0 | (6,118.9) |
| Total stockholders' equity attributable to PFG | 9,620.3 | 12,411.1 | 12,581.8 | (24,992.9) | 9,620.3 |
| Noncontrolling interest | | | 65.5 | | 65.5 |
| Total stockholders' equity | 9,620.3 | 12,411.1 | 12,647.3 | (24,992.9) | 9,685.8 |
| Total liabilities and stockholders' equity | \$ 13,534.5 | \$ 13,501.9 | \$ 215,190.6 | \$ (26,861.6) | \$ 215,365.4 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Financial Position****December 31, 2014**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---------------------------------------|--|--|---|----------------------|---|
| Assets | | | | | |
| Fixed maturities, available-for-sale | \$ | \$ | \$ 49,670.8 | \$ | \$ 49,670.8 |
| Fixed maturities, trading | | | 604.6 | | 604.6 |
| Equity securities, available-for-sale | | | 123.0 | | 123.0 |
| Equity securities, trading | | | 840.2 | | 840.2 |
| Mortgage loans | | | 11,811.6 | | 11,811.6 |
| Real estate | | | 1,344.6 | | 1,344.6 |
| Policy loans | | | 829.2 | | 829.2 |
| Investment in unconsolidated entities | 12,446.5 | 12,042.5 | 781.9 | (24,455.1) | 815.8 |
| Other investments | 9.5 | 128.2 | 2,256.3 | | 2,394.0 |
| Cash and cash equivalents | 412.4 | 907.2 | 1,598.0 | (1,053.7) | 1,863.9 |
| Accrued investment income | | | 505.9 | | 505.9 |
| Premiums due and other receivables | | 0.3 | 1,211.8 | 0.9 | 1,213.0 |
| Deferred acquisition costs | | | 2,993.0 | | 2,993.0 |
| Property and equipment | | | 590.2 | | 590.2 |
| Goodwill | | | 1,007.4 | | 1,007.4 |
| Other intangibles | | | 1,323.5 | | 1,323.5 |
| Separate account assets | | | 140,072.8 | | 140,072.8 |
| Other assets | 450.7 | 167.6 | 1,117.7 | (652.5) | 1,083.5 |
| Total assets | \$ 13,319.1 | \$ 13,245.8 | \$ 218,682.5 | \$ (26,160.4) | \$ 219,087.0 |
| Liabilities | | | | | |
| Contractholder funds | \$ | \$ | \$ 34,726.7 | \$ | \$ 34,726.7 |
| Future policy benefits and claims | | | 24,036.6 | | 24,036.6 |
| Other policyholder funds | | | 812.7 | | 812.7 |
| Short-term debt | | | 182.5 | (154.5) | 28.0 |
| Long-term debt | 2,448.9 | | 82.3 | | 2,531.2 |
| Income taxes currently payable | | 4.3 | 54.1 | (46.9) | 11.5 |
| Deferred income taxes | | | 1,626.1 | (590.8) | 1,035.3 |
| Separate account liabilities | | | 140,072.8 | | 140,072.8 |
| Other liabilities | 686.2 | 872.8 | 4,862.4 | (879.2) | 5,542.2 |
| Total liabilities | 3,135.1 | 877.1 | 206,456.2 | (1,671.4) | 208,797.0 |
| Redeemable noncontrolling interest | | | 58.0 | | 58.0 |
| Stockholders' equity | | | | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|-------------|-------------|--------------|---------------|--------------|
| Series A preferred stock | | | | | |
| Series B preferred stock | 0.1 | | | | 0.1 |
| Common stock | 4.6 | | 17.8 | (17.8) | 4.6 |
| Additional paid-in capital | 9,945.5 | 8,964.2 | 9,341.0 | (18,305.2) | 9,945.5 |
| Retained earnings | 6,114.1 | 2,858.6 | 2,283.2 | (5,141.8) | 6,114.1 |
| Accumulated other comprehensive income | 50.4 | 545.9 | 480.3 | (1,026.2) | 50.4 |
| Treasury stock, at cost | (5,930.7) | | (2.0) | 2.0 | (5,930.7) |
| Total stockholders' equity attributable to PFG | 10,184.0 | 12,368.7 | 12,120.3 | (24,489.0) | 10,184.0 |
| Noncontrolling interest | | | 48.0 | | 48.0 |
| Total stockholders' equity | 10,184.0 | 12,368.7 | 12,168.3 | (24,489.0) | 10,232.0 |
| Total liabilities and stockholders' equity | \$ 13,319.1 | \$ 13,245.8 | \$ 218,682.5 | \$ (26,160.4) | \$ 219,087.0 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Operations****For the nine months ended September 30, 2015**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|---|--|--|---|--------------|---|
| Revenues | | | | | |
| Premiums and other considerations | \$ | \$ | \$ 4,155.9 | \$ | \$ 4,155.9 |
| Fees and other revenues | | 0.2 | 2,744.7 | (0.7) | 2,744.2 |
| Net investment income | 1.3 | | 2,258.6 | 7.4 | 2,267.3 |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | | (4.1) | 16.8 | (1.6) | 11.1 |
| Net other-than-temporary impairment recoveries on available-for-sale securities | | | 6.9 | | 6.9 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | | | (28.0) | | (28.0) |
| Net impairment losses on available-for-sale securities | | | (21.1) | | (21.1) |
| Net realized capital losses | | (4.1) | (4.3) | (1.6) | (10.0) |
| Total revenues | 1.3 | (3.9) | 9,154.9 | 5.1 | 9,157.4 |
| Expenses | | | | | |
| Benefits, claims and settlement expenses | | | 5,160.5 | | 5,160.5 |
| Dividends to policyholders | | | 123.5 | | 123.5 |
| Operating expenses | 128.5 | 9.3 | 2,613.8 | | 2,751.6 |
| Total expenses | 128.5 | 9.3 | 7,897.8 | | 8,035.6 |
| Income (loss) before income taxes | (127.2) | (13.2) | 1,257.1 | 5.1 | 1,121.8 |
| Income taxes (benefits) | (52.5) | 0.2 | 179.2 | | 126.9 |
| Equity in the net income of subsidiaries | 1,055.1 | 1,063.4 | | (2,118.5) | |
| Net income | 980.4 | 1,050.0 | 1,077.9 | (2,113.4) | 994.9 |
| Net income attributable to noncontrolling interest | | | 14.5 | | 14.5 |
| Net income attributable to PFG | 980.4 | 1,050.0 | 1,063.4 | (2,113.4) | 980.4 |
| Preferred stock dividends | 16.5 | | | | 16.5 |
| Excess of redemption value over carrying value of preferred shares redeemed | 8.2 | | | | 8.2 |
| Net income available to common stockholders | \$ 955.7 | \$ 1,050.0 | \$ 1,063.4 | \$ (2,113.4) | \$ 955.7 |
| Net income | \$ 980.4 | \$ 1,050.0 | \$ 1,077.9 | \$ (2,113.4) | \$ 994.9 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | |
|--------------------------|----|---------|----|---------|----|---------|----|---------|----|---------|
| Other comprehensive loss | | (633.8) | | (621.7) | | (700.7) | | 1,372.7 | | (583.5) |
| Comprehensive income | \$ | 346.6 | \$ | 428.3 | \$ | 377.2 | \$ | (740.7) | \$ | 411.4 |

[Table of Contents](#)**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Operations****For the nine months ended September 30, 2014**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|---|---------------------|---|
| Revenues | | | | | |
| Premiums and other considerations | \$ | \$ | \$ 2,514.8 | \$ | \$ 2,514.8 |
| Fees and other revenues | | 0.3 | 2,569.4 | | 2,569.7 |
| Net investment income | 0.4 | 0.5 | 2,443.2 | | 2,444.1 |
| Net realized capital gains, excluding impairment losses on available-for-sale securities | | | 105.0 | | 105.0 |
| Net other-than-temporary impairment recoveries on available-for-sale securities | | | 18.5 | | 18.5 |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | | | (82.5) | | (82.5) |
| Net impairment losses on available-for-sale securities | | | (64.0) | | (64.0) |
| Net realized capital gains | | | 41.0 | | 41.0 |
| Total revenues | 0.4 | 0.8 | 7,568.4 | | 7,569.6 |
| Expenses | | | | | |
| Benefits, claims and settlement expenses | | | 3,609.7 | | 3,609.7 |
| Dividends to policyholders | | | 134.5 | | 134.5 |
| Operating expenses | 106.8 | 3.1 | 2,537.8 | | 2,647.7 |
| Total expenses | 106.8 | 3.1 | 6,282.0 | | 6,391.9 |
| Income (loss) before income taxes | (106.4) | (2.3) | 1,286.4 | | 1,177.7 |
| Income taxes (benefits) | (42.7) | (3.2) | 327.5 | | 281.6 |
| Equity in the net income of subsidiaries | 929.1 | 928.2 | | (1,857.3) | |
| Net income | 865.4 | 929.1 | 958.9 | (1,857.3) | 896.1 |
| Net income attributable to noncontrolling interest | | | 30.7 | | 30.7 |
| Net income attributable to PFG | 865.4 | 929.1 | 928.2 | (1,857.3) | 865.4 |
| Preferred stock dividends | 24.7 | | | | 24.7 |
| Net income available to common stockholders | \$ 840.7 | \$ 929.1 | \$ 928.2 | \$ (1,857.3) | \$ 840.7 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | |
|----------------------------|----|-------|----|---------|----|---------|----|-----------|----|---------|
| Net income | \$ | 865.4 | \$ | 929.1 | \$ | 958.9 | \$ | (1,857.3) | \$ | 896.1 |
| Other comprehensive income | | 129.6 | | 183.5 | | 163.9 | | (286.9) | | 190.1 |
| Comprehensive income | \$ | 995.0 | \$ | 1,112.6 | \$ | 1,122.8 | \$ | (2,144.2) | \$ | 1,086.2 |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Cash Flows****For the nine months ended September 30, 2015**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|---|---------------------|---|
| Operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$ (40.4) | \$ 185.2 | \$ 3,462.8 | \$ (284.6) | \$ 3,323.0 |
| Investing activities | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | | (7,052.6) | | (7,052.6) |
| Sales | | | 1,410.8 | | 1,410.8 |
| Maturities | | | 5,020.5 | | 5,020.5 |
| Mortgage loans acquired or originated | | | (1,658.0) | | (1,658.0) |
| Mortgage loans sold or repaid | | | 1,175.3 | | 1,175.3 |
| Real estate acquired | | | (255.8) | | (255.8) |
| Net purchases of property and equipment | | | (96.3) | | (96.3) |
| Purchases of interests in subsidiaries, net of cash acquired | | | (293.7) | | (293.7) |
| Dividends and returns of capital received from unconsolidated entities | 425.5 | 212.7 | | (638.2) | |
| Net change in other investments | 1.5 | (458.4) | 45.5 | 394.4 | (17.0) |
| Net cash provided by (used in) investing activities | 427.0 | (245.7) | (1,704.3) | (243.8) | (1,766.8) |
| Financing activities | | | | | |
| Issuance of common stock | 71.5 | | | | 71.5 |
| Acquisition of treasury stock | (188.2) | | | | (188.2) |
| Proceeds from financing element derivatives | | | 0.2 | | 0.2 |
| Payments for financing element derivatives | | | (60.9) | | (60.9) |
| Excess tax benefits from share-based payment arrangements | 0.7 | | 14.5 | | 15.2 |
| Purchase of subsidiary shares from noncontrolling interest | | | (22.5) | | (22.5) |
| Dividends to common stockholders | (330.2) | | | | (330.2) |
| Dividends to preferred stockholders | (16.5) | | | | (16.5) |
| Preferred stock redemption | (550.0) | | | | (550.0) |
| Issuance of long-term debt | 791.8 | 156.0 | 50.9 | (198.3) | 800.4 |
| Principal repayments of long-term debt | | | (94.9) | 42.3 | (52.6) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | |
|--|----------|----------|------------|--------------|------------|-----------|
| Net proceeds from short-term borrowings | | | | 188.4 | 8.8 | 197.2 |
| Dividends and capital paid to parent | (425.5) | | | (212.7) | 638.2 | |
| Investment contract deposits | | | | 4,190.3 | | 4,190.3 |
| Investment contract withdrawals | | | | (4,974.3) | | (4,974.3) |
| Net increase in banking operation deposits | | | | 24.9 | | 24.9 |
| Other | | | | (10.4) | | (10.4) |
| Net cash used in financing activities | (220.9) | (269.5) | | (906.5) | 491.0 | (905.9) |
| Net increase (decrease) in cash and cash equivalents | 165.7 | (330.0) | | 852.0 | (37.4) | 650.3 |
| Cash and cash equivalents at beginning of period | 412.4 | 907.2 | | 1,598.0 | (1,053.7) | 1,863.9 |
| Cash and cash equivalents at end of period | \$ 578.1 | \$ 577.2 | \$ 2,450.0 | \$ (1,091.1) | \$ 2,514.2 | |

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2015****(Unaudited)****Condensed Consolidating Statements of Cash Flows****For the nine months ended September 30, 2014**

| | Principal Financial Group, Inc. Parent Only | Principal Financial Services, Inc. Only | Principal Life Insurance Company and Other Subsidiaries Combined (in millions) | Eliminations | Principal Financial Group, Inc. Consolidated |
|--|--|--|---|---------------------|---|
| Operating activities | | | | | |
| Net cash provided by (used in) operating activities | \$ (42.3) | \$ (373.5) | \$ 2,335.4 | \$ 278.0 | \$ 2,197.6 |
| Investing activities | | | | | |
| Available-for-sale securities: | | | | | |
| Purchases | | | (6,596.0) | | (6,596.0) |
| Sales | | | 1,871.5 | | 1,871.5 |
| Maturities | | | 4,499.3 | | 4,499.3 |
| Mortgage loans acquired or originated | | | (1,614.2) | | (1,614.2) |
| Mortgage loans sold or repaid | | | 1,319.8 | | 1,319.8 |
| Real estate acquired | | | (246.8) | | (246.8) |
| Net purchases of property and equipment | | | (117.5) | | (117.5) |
| Dividends and returns of capital received from unconsolidated entities | 517.5 | 714.0 | | (1,231.5) | |
| Net change in other investments | (2.0) | (98.7) | 185.2 | (27.9) | 56.6 |
| Net cash provided by (used in) investing activities | 515.5 | 615.3 | (698.7) | (1,259.4) | (827.3) |
| Financing activities | | | | | |
| Issuance of common stock | 69.6 | | | | 69.6 |
| Acquisition of treasury stock | (222.5) | | | | (222.5) |
| Proceeds from financing element derivatives | | | 14.9 | | 14.9 |
| Payments for financing element derivatives | | | (41.5) | | (41.5) |
| Excess tax benefits from share-based payment arrangements | 0.3 | | 8.3 | | 8.6 |
| Purchase of subsidiary shares from noncontrolling interest | | | (222.4) | | (222.4) |
| Dividends to common stockholders | (276.7) | | | | (276.7) |
| Dividends to preferred stockholders | (24.7) | | | | (24.7) |
| Issuance of long-term debt | | | 36.5 | | 36.5 |
| Principal repayments of long-term debt | | | (100.3) | | (100.3) |
| Net repayments of short-term borrowings | | | (113.5) | 93.0 | (20.5) |
| Dividends and capital paid to parent | | (517.5) | (714.0) | 1,231.5 | |
| Investment contract deposits | | | 4,184.3 | | 4,184.3 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | |
|--|----------|----------|------------|------------|------------|
| Investment contract withdrawals | | | (5,864.3) | | (5,864.3) |
| Net decrease in banking operation deposits | | | (2.3) | | (2.3) |
| Other | | | (10.0) | | (10.0) |
| Net cash used in financing activities | (454.0) | (517.5) | (2,824.3) | 1,324.5 | (2,471.3) |
| Net increase (decrease) in cash and cash equivalents | 19.2 | (275.7) | (1,187.6) | 343.1 | (1,101.0) |
| Cash and cash equivalents at beginning of period | 131.5 | 688.7 | 2,384.0 | (832.4) | 2,371.8 |
| Cash and cash equivalents at end of period | \$ 150.7 | \$ 413.0 | \$ 1,196.4 | \$ (489.3) | \$ 1,270.8 |

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of September 30, 2015, compared with December 31, 2014, and our consolidated results of operations for the three and nine months ended September 30, 2015 and 2014, prepared in conformity with U.S. GAAP. The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2014, filed with the SEC and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

Forward-Looking Information

Our narrative analysis below contains forward-looking statements intended to enhance the reader's ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as anticipate, believe, plan, estimate, expect, intend, similar expressions. Forward-looking statements are made based upon management's current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties including, but not limited to, the following: (1) adverse capital and credit market conditions may significantly affect our ability to meet liquidity needs, as well as our access to capital and cost of capital; (2) conditions in the global capital markets and the economy generally may materially and adversely affect our business and results of operations; (3) continued volatility or declines in the equity, bond or real estate markets could reduce our assets under management (AUM) and may result in investors withdrawing from the markets or decreasing their rates of investment, all of which could reduce our revenues and net income; (4) changes in interest rates or credit spreads or a sustained low interest rate environment may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period-to-period; (5) our investment portfolio is subject to several risks that may diminish the value of our invested assets and the investment returns credited to customers, which could reduce our sales, revenues, AUM and net income; (6) our valuation of investments and the determinations of the amount of the allowances and impairments taken on our investments may include methodologies, estimations and assumptions which are subject to differing interpretations and, if changed, could materially adversely affect our results of operations or financial condition; (7) any impairments of or valuation allowances against our deferred tax assets could adversely affect our results of operations and financial condition; (8) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (9) the pattern of amortizing our DAC and other actuarial balances on our universal life-type insurance contracts, participating life insurance policies and certain investment contracts may change, impacting both the level of the DAC and other actuarial balances and the timing of our net income; (10) we may not be able to protect our intellectual property and may be subject to infringement claims; (11) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life; (12) changes in laws or regulations may reduce our profitability; (13) changes in accounting standards may reduce the transparency of our reported profitability and financial condition; (14) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (15) from time to time we may become subject to tax audits, tax litigation or similar proceedings, and as a result we may owe additional taxes, interest and penalties in amounts that may be material; (16) applicable laws and our certificate of incorporation and by-laws may discourage takeovers and business combinations that some stockholders might consider in their best interests; (17) competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability; (18) a downgrade in our financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors, impact existing liabilities and increase our cost of capital, any of which could adversely affect our profitability and financial condition; (19) guarantees within certain of our products that protect policyholders may

decrease our earnings or increase the volatility of our results of operations or financial position under U.S. GAAP if our hedging or risk management strategies prove ineffective or insufficient; (20) if we are unable to attract and retain qualified employees and sales representatives and develop new distribution sources, our results of operations, financial condition and sales of our products may be adversely impacted; (21) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (22) we may need to fund deficiencies in our Closed Block assets; (23) a pandemic, terrorist attack, military action or other catastrophic event could adversely affect our net income; (24) our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and financial condition; (25) we face risk arising from acquisition of businesses; (26) a computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our profitability; (27) loss of key vendor relationships or failure of a vendor to protect information of our customers or employees could adversely affect our business or result in losses; and (28) our financial results may be adversely impacted by global climate changes.

Table of Contents

Overview

We provide financial products and services through the following reportable segments:

- Retirement and Investor Services is organized into the Accumulation business, which includes full service accumulation, Principal Funds (our mutual fund business), individual annuities and bank and trust services; and the Guaranteed business, which includes investment only and full service payout. We offer a comprehensive portfolio of asset accumulation products and services for retirement savings and investment:
- To businesses of all sizes with a concentration on small and medium sized businesses, we offer products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, nonqualified executive benefit plans and ESOP consulting services. For more basic investment needs, we offer SIMPLE IRA and payroll deduction plans;
- To large institutional clients, we also offer investment-only products, including guaranteed investment contracts (GICs) and funding agreements and
- To employees of businesses and other individuals, we offer the ability to accumulate savings for retirement and other purposes through mutual funds, individual annuities and bank products.
- Principal Global Investors, which consists of our asset management operations, manages assets for sophisticated investors around the world, using a multi-boutique strategy that enables the segment to provide an expanded range of diverse investment capabilities including equity, fixed income, real estate investments and other alternative investments. Principal Global Investors also has experience in asset allocation, stable value management and other structured investment strategies.
- Principal International, which offers retirement products and services, annuities, mutual funds, institutional asset management and life insurance accumulation products through operations in Brazil, Chile, China, Hong Kong Special Administrative Region, India, Mexico and Southeast Asia.
- U.S. Insurance Solutions, which provides individual life insurance and specialty benefits insurance in the U.S. Our individual life insurance products include universal and variable universal life insurance and traditional life insurance. Our specialty benefits products include group dental and vision insurance, individual and group disability insurance, group life insurance and non-medical fee-for-service claims administration.
- Corporate, which manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate segment primarily reflect our financing activities (including interest expense and preferred stock dividends), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

In February 2015 we announced planned changes to our organizational structure to better align businesses, distribution teams and product offerings for future growth. We plan to implement these changes during 2015 and will report our consolidated financial statements under the new structure in our December 31, 2015 10-K. The changes are not expected to have a material impact on our consolidated financial statements.

Transactions Affecting Comparability of Results of Operations

Acquisitions

We entered into acquisition agreements for the following businesses.

AXA MPF and ORSO Pension Business. On September 1, 2015, we finalized the purchase of AXA's MPF and ORSO pension business in Hong Kong for \$335.5 million. As part of the transaction, we entered into an exclusive 15-year distribution agreement with AXA to provide co-branded pension products through AXA's extensive agency network in Hong Kong. We more than doubled the AUM in our Hong Kong pension business to \$5.9 billion. AXA's MPF and ORSO pension business is consolidated within our Principal International segment.

Columbus Circle Investors. On September 30, 2014, we acquired an additional 24.65% interest in Columbus Circle Investors from the minority shareholder partners and contracted to purchase the remaining interest from the minority shareholder partners in two installments. On April 28, 2015, we purchased an additional 2.5% interest. We now own 97.5% of Columbus Circle Investors and are expected to purchase the remaining 2.5% from the minority shareholder partners in April 2016. Columbus Circle Investors is consolidated within our Principal Global Investors segment.

Table of Contents*Other*

Actuarial Assumption Updates. We periodically review and update actuarial assumptions that are inputs to the models for DAC and other actuarial balances and make model refinements as necessary. During the third quarter of 2015, assumption updates and model refinements were made resulting in an unlocking of DAC and other actuarial balances that increased total company net income by \$26.2 million for both the three and nine months ended September 30, 2015. The net positive segment operating earnings impact was \$31.2 million, which was comprised of \$49.9 million for our U.S. Insurance Solutions segment and \$(18.7) million for our Retirement and Investor Services segment, for both the three and nine months ended September 30, 2015.

During the third quarter of 2014, assumption updates and model refinements were made resulting in an unlocking of DAC and other actuarial balances that increased total company net income by \$45.3 million for both the three and nine months ended September 30, 2014. The net positive segment operating earnings impact was \$40.7 million, which was comprised of \$39.0 million for our U.S. Insurance Solutions segment and \$1.7 million for our Retirement and Investor Services segment, for both the three and nine months ended September 30, 2014.

The individual life insurance actuarial assumption updates and model refinements had the most significant impact and affected several line items within the income statement. The following table presents the impact on the individual life insurance income statement line items for the three and nine months ended September 30, 2015 and 2014.

| | For the three and nine months ended September 30, | | |
|--|--|---------------|---------|
| | 2015 | (in millions) | 2014 |
| Operating earnings | \$ | 42.0 | \$ 39.0 |
| Fee revenues | | (3.0) | 3.1 |
| Benefits, claims and settlement expenses | | (43.5) | (131.6) |
| Operating expenses | | (24.1) | 74.7 |

Chilean Legal Entity Merger. In January 2015, we received regulatory approval and executed upon the merger of two of our Chilean legal entities. As a result of the merger, we recognized a \$105.2 million benefit in net income available to common stockholders in first quarter 2015 to reflect a change in deferred tax balances related to the merged entity.

Fluctuations in Foreign Currency to U.S. Dollar Exchange Rates

Fluctuations in foreign currency to U.S. dollar exchange rates for countries in which we have operations can affect reported financial results. In years when foreign currencies weaken against the U.S. dollar, translating foreign currencies into U.S. dollars results in fewer U.S. dollars to be reported. When foreign currencies strengthen, translating foreign currencies into U.S. dollars results in more U.S. dollars to be reported.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Foreign currency exchange rate fluctuations create variances in our financial statement line items but have not had a material impact on our consolidated financial results. Principal International segment operating earnings were negatively impacted \$10.5 million and \$33.2 million for the three and nine months ended September 30, 2015, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

Stock-Based Compensation Plans

For information related to our Stock-Based Compensation Plans, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 12, Stock-Based Compensation Plans.

Employee and Agent Benefits Expense

The 2015 annual defined benefit pension expense for substantially all of our employees and certain agents is expected to be \$123.3 million pre-tax, which is a \$38.3 million increase from the 2014 pre-tax pension expense of \$85.0 million. This increase is due to a decrease in the discount rate from 4.90% for 2014 to 4.00% for 2015 and a change in the mortality assumption. Offsetting these increases were a better than expected asset return in 2014 and an increase in the expected long-term return on plan assets to 7.20% for 2015 from 6.75% used in 2014. Pre-tax pension expense of \$30.8 million and \$92.5 million was reflected in the determination of net income for the three and nine months ended September 30, 2015, respectively.

Table of Contents

The 2015 annual other postemployment benefit (OPEB) plan expense (income) for employees and certain agents is expected to be \$(44.7) million pre-tax, which is a \$3.6 million decrease from the 2014 pre-tax OPEB income of \$(48.3) million. The weighted average expected long-term return on plan assets used to develop the expense (income) in 2015 was 5.36% which was based on weighted average expected long-term asset returns for the medical, life and long-term care plan. The discount rate used to develop the 2015 expense (income) decreased to 4.00%, down from 4.90% used in 2014. The mortality table was changed for the calculation of the OPEB liabilities as well, but it had little impact. Pre-tax expense (income) of \$(11.3) million and \$(33.6) million was reflected in the determination of net income for the three and nine months ended September 30, 2015, respectively.

Recent Accounting Changes

For recent accounting changes, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies under the caption, Recent Accounting Pronouncements.

Results of Operations

The following table presents summary consolidated financial information for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|--|----------|------------------------|---|------------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Revenues: | | | | | | |
| Premiums and other considerations | \$ 1,557.1 | \$ 875.8 | \$ 681.3 | \$ 4,155.9 | \$ 2,514.8 | \$ 1,641.1 |
| Fees and other revenues | 891.9 | 884.5 | 7.4 | 2,744.2 | 2,569.7 | 174.5 |
| Net investment income | 753.5 | 770.4 | (16.9) | 2,267.3 | 2,444.1 | (176.8) |
| Net realized capital gains (losses), excluding impairment losses on available-for-sale securities | 46.0 | (24.5) | 70.5 | 11.1 | 105.0 | (93.9) |
| Net other-than-temporary impairment (losses) recoveries on available-for-sale securities | (6.5) | (7.3) | 0.8 | 6.9 | 18.5 | (11.6) |
| Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income | (1.1) | (14.6) | 13.5 | (28.0) | (82.5) | 54.5 |
| Net impairment losses on available-for-sale securities | (7.6) | (21.9) | 14.3 | (21.1) | (64.0) | 42.9 |
| Net realized capital gains (losses) | 38.4 | (46.4) | 84.8 | (10.0) | 41.0 | (51.0) |
| Total revenues | 3,240.9 | 2,484.3 | 756.6 | 9,157.4 | 7,569.6 | 1,587.8 |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses | 1,869.6 | 1,113.8 | 755.8 | 5,160.5 | 3,609.7 | 1,550.8 |
| Dividends to policyholders | 40.7 | 44.2 | (3.5) | 123.5 | 134.5 | (11.0) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | |
|---|-----------------|----------|---------|-----------------|----------|----------|
| Operating expenses | 961.4 | 932.5 | 28.9 | 2,751.6 | 2,647.7 | 103.9 |
| Total expenses | 2,871.7 | 2,090.5 | 781.2 | 8,035.6 | 6,391.9 | 1,643.7 |
| Income before income taxes | 369.2 | 393.8 | (24.6) | 1,121.8 | 1,177.7 | (55.9) |
| Income taxes | 68.3 | 141.0 | (72.7) | 126.9 | 281.6 | (154.7) |
| Net income | 300.9 | 252.8 | 48.1 | 994.9 | 896.1 | 98.8 |
| Net income attributable to noncontrolling interest | 0.5 | 3.9 | (3.4) | 14.5 | 30.7 | (16.2) |
| Net income attributable to Principal Financial Group, Inc. | 300.4 | 248.9 | 51.5 | 980.4 | 865.4 | 115.0 |
| Preferred stock dividends | | 8.2 | (8.2) | 16.5 | 24.7 | (8.2) |
| Excess of redemption value over carrying value of preferred shares redeemed | | | | 8.2 | | 8.2 |
| Net income available to common stockholders | \$ 300.4 | \$ 240.7 | \$ 59.7 | \$ 955.7 | \$ 840.7 | \$ 115.0 |

Table of Contents

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Net Income Available to Common Stockholders

Net income available to common stockholders increased primarily due to the 2014 increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile.

Total Revenues

Premiums increased \$633.0 million for the Retirement and Investor Services segment primarily due to higher sales of single premium group and individual annuities with life contingencies. The single premium group product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore premiums tend to vary from period to period.

Total Expenses

Benefits, claims and settlement expenses increased \$642.1 million for the Retirement and Investor Services segment primarily due to an increase in change in reserves resulting from higher sales of single premium group and individual annuities with life contingencies.

Operating expenses increased \$94.4 million for the Retirement and Investor Services segment primarily due to unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015 and an increase in DAC amortization resulting from a sharp equity market decline and a decrease in interest rates. Operating expenses increased \$23.2 million for the Principal International segment primarily due to intangible asset impairments in our mutual fund company in Brazil in third quarter 2015 partially offset by the weakening of the Chilean and Mexican pesos against the U.S. dollar. Operating expenses decreased \$78.0 million for the U.S. Insurance Solutions segment due to a more favorable unlocking associated with assumption updates and model refinements in 2015 than in 2014, which was partially offset by higher expenses related to growth in the business. Operating expenses decreased \$14.7 million for the Corporate segment primarily due to a decline in amounts credited to employee accounts in a nonqualified defined contribution pension plan, which was offset by a corresponding reduction in net realized capital gains related to the assets backing this nonqualified plan.

Income Taxes

The effective income tax rates were 18% and 36% for the three months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the three months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received and the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income. The effective income tax rate for the three months ended September 30, 2014, was higher than the U.S. statutory rate

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

primarily due to an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile, partially offset by income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income and lower tax rates of foreign jurisdictions. The effective income tax rate decreased to 18% from 36% for the three months ended September 30, 2015 and 2014, respectively, primarily due to the 2014 increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Net Income Available to Common Stockholders

Net income available to common stockholders increased primarily due to a change in deferred tax balances related to the merger of two of our Chilean legal entities, partially offset by net realized capital losses in 2015 as compared to net realized capital gains in 2014 primarily due to decreased gains on sales of real estate investments and joint venture real estate and a write-off of unamortized book value on corporate owned real estate in 2015.

Total Revenues

Premiums increased \$1,526.2 million for the Retirement and Investor Services segment primarily due to higher sales of single premium group and individual annuities with life contingencies. The single premium group product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore premiums tend to vary from period to period.

Table of Contents

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain invested assets and our decision to sell invested assets. We had net realized capital losses in 2015 as compared to net realized capital gains in 2014 primarily due to decreased gains on sales of real estate investments and joint venture real estate and a write-off of unamortized book value on corporate owned real estate in 2015. This was partially offset by gains versus losses attributable to derivatives not designated as hedging instruments. For additional information, see Investments Investment Results.

Total Expenses

Benefits, claims and settlement expenses increased \$1,492.9 million for the Retirement and Investor Services segment primarily due to an increase in change in reserves resulting from higher sales of single premium group and individual annuities with life contingencies.

Operating expenses increased \$142.5 million for the Retirement and Investor Services segment primarily due to an increase in staff related costs including pension and other postretirement benefits, unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015 and an increase in sub-advisory fee costs and non-deferrable distribution costs stemming from an increase in average account values, which resulted from growth in the business and positive equity market performance in prior periods. In addition, operating expenses decreased \$51.9 million for the Corporate segment primarily due to a decline in amounts credited to employee accounts in a nonqualified defined contribution pension plan, which was offset by a corresponding reduction in net realized capital gains related to the assets backing this nonqualified plan and lower expenses associated with court rulings on some uncertain tax positions.

Income Taxes

The effective income tax rates were 11% and 24% for the nine months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the nine months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, a change in deferred tax balances related to the merger of two of our Chilean legal entities and the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income, partially offset by the negative impact of a court ruling on some uncertain tax positions. The effective income tax rate for the nine months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments reflected in net investment income and tax credits, partially offset by an increase in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile. The effective income tax rate decreased to 11% from 24% for the nine months ended September 30, 2015 and 2014, respectively, primarily due to a change in deferred tax balances related to the merger of two of our Chilean legal entities, a change in net deferred tax liabilities resulting from the third quarter 2014 enactment of tax legislation in Chile not replicated in 2015, partially offset by the negative impact of a court ruling on some uncertain tax positions.

Results of Operations by Segment

For results of operations by segment see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 11, Segment Information.

Retirement and Investor Services Segment

Retirement and Investor Services Segment Summary Financial Data

Net revenue is a key metric used to understand Retirement and Investor Services (RIS) earnings growth. Net revenue is defined as operating revenues less benefits, claims and settlement expenses less dividends to policyholders. Net revenue from our Accumulation products is primarily fee based and is impacted by changes in the equity markets. Net revenue from our Guaranteed products is driven by our ability to earn an investment spread. Accumulation net revenue has grown due to improvement in the equity markets as well as growth in the block of business. Guaranteed net revenue has decreased due to a decline in variable investment income.

Table of Contents

The following table presents the RIS net revenue for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|---|----------|---|--|------------|------------------------|
| | 2015 | 2014 | Increase (decrease) (in millions) | 2015 | 2014 | Increase (decrease) |
| Net revenue: | | | | | | |
| Accumulation | \$ 650.2 | \$ 642.9 | \$ 7.3 | \$ 1,981.6 | \$ 1,908.4 | \$ 73.2 |
| Guaranteed | 37.7 | 43.7 | (6.0) | 129.0 | 151.2 | (22.2) |
| Total Retirement and Investor Services | \$ 687.9 | \$ 686.6 | \$ 1.3 | \$ 2,110.6 | \$ 2,059.6 | \$ 51.0 |

The following table presents certain summary financial data relating to the RIS segment for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|---|----------|---|--|----------|------------------------|
| | 2015 | 2014 | Increase (decrease) (in millions) | 2015 | 2014 | Increase (decrease) |
| Operating revenues: | | | | | | |
| Premiums and other considerations | \$ 976.1 | \$ 343.1 | \$ 633.0 | \$ 2,429.1 | \$ 902.9 | \$ 1,526.2 |
| Fees and other revenues | 531.4 | 519.3 | 12.1 | 1,604.1 | 1,509.6 | 94.5 |
| Net investment income | 450.0 | 462.3 | (12.3) | 1,352.3 | 1,438.5 | (86.2) |
| Total operating revenues | 1,957.5 | 1,324.7 | 632.8 | 5,385.5 | 3,851.0 | 1,534.5 |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses, including dividends to policyholders | 1,269.6 | 638.1 | 631.5 | 3,274.9 | 1,791.4 | 1,483.5 |
| Operating expenses | 504.4 | 431.5 | 72.9 | 1,412.3 | 1,273.8 | 138.5 |
| Total expenses | 1,774.0 | 1,069.6 | 704.4 | 4,687.2 | 3,065.2 | 1,622.0 |
| Operating earnings before income taxes | 183.5 | 255.1 | (71.6) | 698.3 | 785.8 | (87.5) |
| Income taxes | 20.2 | 50.8 | (30.6) | 107.4 | 152.9 | (45.5) |
| Operating earnings | \$ 163.3 | \$ 204.3 | \$ (41.0) | \$ 590.9 | \$ 632.9 | \$ (42.0) |

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Operating Earnings

Operating earnings decreased \$36.9 million in our Accumulation business primarily due to unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015.

Net Revenue

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net revenue increased \$7.3 million in our Accumulation business primarily due to higher fees stemming from an increase in average account values, which resulted from growth in the business, and to a lesser extent, positive equity market performance in prior periods. Net revenue decreased \$6.0 million in our Guaranteed business primarily due to a decrease in variable investment income resulting from a decline in loan prepayment activity and associated fees.

Operating Expenses

Operating expenses increased \$72.7 million in our Accumulation business primarily due to unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015 and an increase in DAC amortization resulting from a sharp equity market decline and a decrease in interest rates.

Income Taxes

The effective income tax rates for the segment were 11% and 20% for the three months ended September 30, 2015 and 2014, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received. The effective tax rate decreased to 11% from 20% for the three months ended September 30, 2015 and 2014, respectively, primarily due to a decrease in operating earnings before income taxes with no proportionate decrease in permanent tax adjustments.

Table of Contents

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Operating Earnings

Operating earnings decreased \$27.1 million in our Accumulation business primarily due to unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015, which was partially offset by higher fees stemming from an increase in average account values resulting from growth in the business. Operating earnings decreased \$14.9 million in our Guaranteed business primarily due to a decrease in variable investment income resulting from a decline in loan prepayment activity and associated fees.

Net Revenue

Net revenue increased \$73.2 million in our Accumulation business primarily due to higher fees stemming from an increase in average account values, which resulted from growth in the business. Net revenue decreased \$22.2 million in our Guaranteed business primarily due to a decrease in variable investment income resulting from a decline in loan prepayment activity and associated fees.

Operating Expenses

Operating expenses increased \$137.3 million in our Accumulation business primarily due to an increase in staff related costs including pension and other postretirement benefits, unfavorable DAC unlocking associated with the review and update of our actuarial assumptions in 2015 and an increase in sub-advisory fee costs stemming from an increase in average account values, which resulted from growth in the business and positive equity market performance in prior periods.

Income Taxes

The effective income tax rates for the segment were 15% and 19% for the nine months ended September 30, 2015 and 2014, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received. The effective tax rate decreased to 15% from 19% for the nine months ended September 30, 2015 and 2014, respectively, primarily due to an increase in income tax deductions for corporate dividends received.

Principal Global Investors Segment

Principal Global Investors Segment Summary Financial Data

AUM is a key indicator of earnings growth for the Principal Global Investors segment, as AUM is the base by which we generate revenues. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects equity, fixed income, real estate and other alternative investment market performance. The percentage growth in revenues of the segment will generally track with the percentage growth in AUM. This trend may vary due to changes in business and/or product mix.

The following table presents the AUM rollforward for assets managed by Principal Global Investors for the periods indicated:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|----------------------------|--|----------|---|----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in billions) | | | |
| AUM, beginning of period | \$ 328.4 | \$ 307.3 | \$ 314.0 | \$ 292.1 |
| Net cash flow | 2.9 | 0.3 | 12.4 | 1.9 |
| Investment performance (1) | (8.1) | (1.3) | (3.0) | 12.8 |
| Operations acquired (2) | 1.9 | | 1.9 | |
| Other | (0.8) | 0.7 | (1.0) | 0.2 |
| AUM, end of period | \$ 324.3 | \$ 307.0 | \$ 324.3 | \$ 307.0 |

(1) Variations in investment performance are primarily the result of fluctuations in market performance over time.

(2) Reflects assets managed by Principal Global Investors resulting from the acquisition of AXA's MPF and ORSO pension business in September 2015.

Table of Contents

The following table presents certain summary financial data relating to the Principal Global Investors segment for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|--|----------|------------------------|---|----------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Fees and other revenues | \$ 183.8 | \$ 173.3 | \$ 10.5 | \$ 556.5 | \$ 515.0 | \$ 41.5 |
| Net investment income(loss) | (1.0) | 0.3 | (1.3) | 1.3 | 2.9 | (1.6) |
| Total operating revenues | 182.8 | 173.6 | 9.2 | 557.8 | 517.9 | 39.9 |
| Expenses: | | | | | | |
| Total expenses | 134.8 | 129.7 | 5.1 | 408.9 | 382.4 | 26.5 |
| Operating earnings before income taxes and noncontrolling interest | 48.0 | 43.9 | 4.1 | 148.9 | 135.5 | 13.4 |
| Income taxes | 16.3 | 14.6 | 1.7 | 52.9 | 44.5 | 8.4 |
| Operating earnings attributable to noncontrolling interest | 1.3 | 4.0 | (2.7) | 3.4 | 11.4 | (8.0) |
| Operating earnings | \$ 30.4 | \$ 25.3 | \$ 5.1 | \$ 92.6 | \$ 79.6 | \$ 13.0 |

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Operating Earnings

Operating earnings increased primarily due to higher fee revenues, which were the result of an increase in average AUM, and our increased ownership in Columbus Circle Investors. These increases were partially offset by related expense growth to support our business.

Income Taxes

The effective income tax rates for the segment were 34% and 33% for the three months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the three months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to a foreign permanent tax adjustment partially offset by a valuation allowance on certain foreign deferred tax assets. The effective income tax rate for the three months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to the inclusion of income attributable to noncontrolling interest in operating earnings before income taxes with no corresponding change in income taxes reported by us as the controlling interest.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Operating Earnings

Operating earnings increased primarily due to higher fee revenues, which were the result of an increase in average AUM, higher performance fees realized in our real estate business and our increased ownership in Columbus Circle Investors. These increases were partially offset by related expense growth to support our business.

Income Taxes

The effective income tax rates for the segment were 36% and 33% for the nine months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the nine months ended September 30, 2015, was higher than the U.S. statutory rate primarily due to a valuation allowance on certain foreign deferred tax assets partially offset by the inclusion of income attributable to noncontrolling interest in operating earnings before income taxes with no corresponding change in income taxes reported by us as the controlling interest. The effective income tax rate for the nine months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to the inclusion of income attributable to noncontrolling interest in operating earnings before income taxes with no corresponding change in income taxes reported by us as the controlling interest. The effective income tax rate increased to 36% from 33% for the nine months ended September 30, 2015 and 2014, respectively, primarily due to our increased ownership in Columbus Circle Investors lessening the impact of operating earnings attributable to noncontrolling interest.

Table of Contents**Principal International Segment*****Principal International Segment Summary Financial Data***

AUM is generally a key indicator of earnings growth for the segment, as AUM is the base by which we can generate local currency profits. The Cuprum business in Chile differs in that the majority of fees are collected with each deposit by the mandatory retirement customers, based on a capped salary level, as opposed to asset levels. Net customer cash flow and market performance are the two main drivers of local currency AUM growth. Net customer cash flow reflects our ability to attract and retain client deposits. Market performance reflects the investment returns on our underlying AUM. Our financial results are also impacted by fluctuations of the foreign currency to U.S. dollar exchange rates for the countries in which we have business. AUM of our foreign subsidiaries is translated into U.S. dollar equivalents at the end of the reporting period using the spot foreign exchange rates. Revenue and expenses for our foreign subsidiaries are translated into U.S. dollar equivalents at the average foreign exchange rates for the reporting period.

The following table presents the Principal International segment AUM rollforward for the periods indicated:

| | For the three months ended September 30, | | For the nine months ended September 30, | |
|----------------------------|--|----------|---|----------|
| | 2015 | 2014 | 2015 | 2014 |
| | (in billions) | | | |
| AUM, beginning of period | \$ 117.5 | \$ 118.8 | \$ 114.6 | \$ 104.5 |
| Net cash flow (1) | 1.6 | 2.5 | 7.5 | 8.8 |
| Investment performance (2) | 0.3 | 3.9 | 5.2 | 10.0 |
| Operations acquired (3) | 3.1 | | 4.0 | |
| Effect of exchange rates | (16.3) | (8.6) | (26.9) | (6.9) |
| Other (4) | | (0.5) | 1.8 | (0.3) |
| AUM, end of period | \$ 106.2 | \$ 116.1 | \$ 106.2 | \$ 116.1 |

(1) Positive net cash flows are primarily due to continued strong distribution results.

(2) Variations in investment performance are primarily the result of fluctuations in market performance over time.

(3) Reflects the acquisition of AXA's MPF and ORSO pension business in September 2015 and Finansia Asset Management Limited in January 2015.

(4) Reflects \$1.9 billion transfer of CIMB-Principal Islamic Asset Management Sdn. Bhd from Principal Global Investors in April 2015.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net revenue is a key metric used to understand the earnings growth for the Principal International segment. The following table presents the net revenue of the Principal International segment for the periods indicated.

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|-------------|--|----------|---|---|----------|------------------------|
| | 2015 | 2014 | Increase (decrease) (in millions) | 2015 | 2014 | Increase (decrease) |
| Net revenue | \$ 146.3 | \$ 179.4 | \$ (33.1) | \$ 445.8 | \$ 499.0 | \$ (53.2) |

For the three months ended September 30, 2015 compared to September 30, 2014, net revenue decreased primarily due to the weakening of Latin American currencies against the U.S. dollar and unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company. These were partially offset by higher earnings in our equity method investment in Brazil. For the nine months ended September 30, 2015 compared to September 30, 2014, net revenue decreased primarily due to unfavorable market changes on our regulatory required investment in the pension funds in Chile and the weakening of Latin American currencies against the U.S. dollar. These were partially offset by higher earnings in our equity method investment in Brazil.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Table of Contents

The following table presents certain summary financial data of the Principal International segment for the periods indicated.

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|--|---------|------------------------|---|----------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Premiums and other considerations | \$ 74.7 | \$ 47.9 | \$ 26.8 | \$ 191.4 | \$ 181.4 | \$ 10.0 |
| Fees and other revenues | 98.0 | 113.5 | (15.5) | 300.2 | 323.5 | (23.3) |
| Net investment income | 138.5 | 133.1 | 5.4 | 370.8 | 447.3 | (76.5) |
| Total operating revenues | 311.2 | 294.5 | 16.7 | 862.4 | 952.2 | (89.8) |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses | 164.9 | 115.1 | 49.8 | 416.6 | 453.2 | (36.6) |
| Operating expenses | 114.0 | 91.1 | 22.9 | 287.8 | 262.3 | 25.5 |
| Total expenses | 278.9 | 206.2 | 72.7 | 704.4 | 715.5 | (11.1) |
| Operating earnings before income taxes and noncontrolling interest | 32.3 | 88.3 | (56.0) | 158.0 | 236.7 | (78.7) |
| Income taxes (benefits) | (9.1) | 14.1 | (23.2) | (3.2) | 29.3 | (32.5) |
| Operating earnings (losses) attributable to noncontrolling interest | (4.4) | 0.4 | (4.8) | (3.8) | 2.3 | (6.1) |
| Operating earnings | \$ 45.8 | \$ 73.8 | \$ (28.0) | \$ 165.0 | \$ 205.1 | \$ (40.1) |

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Operating Earnings

Operating earnings decreased primarily due to the weakening of Latin American currencies against the U.S. dollar, unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company, and intangible asset impairments in our mutual fund company in Brazil in third quarter 2015. These decreases were partially offset by higher earnings in our equity method investments in Brazil and China.

Operating Revenues

Premiums increased primarily due to higher sales of single premium annuities with life contingencies in Chile partially offset by the weakening of the Chilean peso against the U.S. dollar.

Fees and other revenues decreased primarily due to the weakening of the Chilean and Mexican pesos against the U.S. dollar.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net investment income increased primarily in Chile due to higher inflation-based investment returns on average invested assets and cash as a result of higher inflation partially offset by unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company and the weakening of the Chilean peso against the U.S. dollar.

Total Expenses

Benefits, claims and settlement expenses increased primarily in Chile due to an increase in the change in reserves related to higher inflation-based interest crediting rates to customers and higher sales of single premium annuities with life contingencies. These were partially offset by the weakening of the Chilean peso against the U.S. dollar.

Operating expenses increased primarily due to intangible asset impairments in our mutual fund company in Brazil in third quarter 2015 partially offset by the weakening of the Chilean and Mexican pesos against the U.S. dollar.

Income Taxes

The effective income tax rates for the segment were -28% and 16% for the three months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the three months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to the effect of the presentation of taxes on our share of earnings generated from our equity method investments reflected in net investment income and foreign permanent tax adjustments related to inflation. The effective income

Table of Contents

tax rate for the three months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to lower tax rates of foreign jurisdictions and the effect of the presentation of taxes on our share of earnings generated from our equity method investments reflected in net investment income. The effective tax rate decreased to -28% from 16% for the three months ended September 30, 2015 and 2014, respectively, primarily due to a decrease in operating earnings before income taxes with no proportionate decrease in permanent tax adjustments.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Operating Earnings

Operating earnings decreased primarily due to the weakening of Latin American currencies against the U.S. dollar, unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company, and intangible asset impairments in our mutual fund company in Brazil in third quarter 2015. These decreases were partially offset by higher earnings in our equity method investments in Brazil and China.

Operating Revenues

Premiums increased primarily due to higher sales of single premium annuities with life contingencies in Chile partially offset by the weakening of the Chilean peso against the U.S. dollar.

Fees and other revenues decreased primarily due to the weakening of Latin American currencies against the U.S. dollar. This decrease was partially offset by higher fees resulting from higher mandatory deposits in Chile and higher average AUM in Chile and Hong Kong.

Net investment income decreased primarily due to the weakening of the Chilean peso and Brazilian real against the U.S. dollar and unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company. These were partially offset by higher earnings in our equity method investment in Brazil.

Total Expenses

Benefits, claims and settlement expenses decreased primarily due to the weakening of the Chilean peso against the U.S. dollar partially offset by an increase in the change in reserves related to higher sales of single premium annuities with life contingencies in Chile.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Operating expenses increased primarily due to intangible asset impairments in our mutual fund company in Brazil in third quarter 2015 and overall growth of the business partially offset by the weakening of Latin American currencies against the U.S. dollar.

Income Taxes

The effective income tax rates for the segment were -2% and 12% for the nine months ended September 30, 2015 and 2014, respectively. The effective income tax rate for the nine months ended September 30, 2015, was lower than the U.S. statutory rate primarily due to the effect of the presentation of taxes on our share of earnings generated from our equity method investments reflected in net investment income, foreign permanent tax adjustments related to inflation and lower tax rates of foreign jurisdictions. The effective income tax rate for the nine months ended September 30, 2014, was lower than the U.S. statutory rate primarily due to lower tax rates of foreign jurisdictions and the effect of the presentation of taxes on our share of earnings generated from our equity method investments reflected in net investment income. The effective tax rate decreased to -2% from 12% for the nine months ended September 30, 2015 and 2014, respectively, primarily due to a decrease in operating earnings before income taxes with no proportionate decrease in permanent tax adjustments.

U.S. Insurance Solutions Segment

Several key drivers impact earnings growth in the U.S. Insurance Solutions segment. The ability of our distribution channels to generate new sales and retain existing business drives growth in our premium and fees. Our earnings growth also depends on our ability to price our products at a level that enables us to earn a margin over the cost of providing benefits and the expense of acquiring and administering those products. Factors impacting pricing decisions include competitive conditions, economic trends, persistency, our ability to assess and manage trends in mortality and morbidity and our ability to manage operating expenses.

Table of Contents*U.S. Insurance Solutions Insurance Trends*

Premium and fees are a key metric for growth in the U.S. Insurance Solutions segment. We receive premiums on our traditional life insurance products as well as on our specialty benefits insurance products. Fees are generated from our universal life and variable universal life insurance products as well as our specialty benefits fee-for-service products.

Premium and fees are influenced by economic, industry and regulatory trends. Due to the declining interest rate environment in recent years, we have intentionally increased sales of non-interest sensitive traditional products in our individual life insurance business. Premium and fees in our specialty benefits insurance business have increased due to improved sales and retention, as well as recovery in underlying salaries and membership growth in existing group contracts.

The following table presents the U.S. Insurance Solutions segment premium and fees for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|------------------------------|--|----------|------------------------|---|----------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Premium and fees: | | | | | | |
| Individual life insurance | \$ 239.2 | \$ 235.2 | \$ 4.0 | \$ 727.0 | \$ 701.4 | \$ 25.6 |
| Specialty benefits insurance | 429.6 | 405.1 | 24.5 | 1,293.4 | 1,185.1 | 108.3 |

U.S. Insurance Solutions Segment Summary Financial Data

The following table presents certain summary financial data relating to the U.S. Insurance Solutions segment for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|--|--|----------|------------------------|---|------------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Premiums and other considerations | \$ 506.2 | \$ 485.5 | \$ 20.7 | \$ 1,535.3 | \$ 1,431.6 | \$ 103.7 |
| Fees and other revenues (1) | 162.6 | 154.8 | 7.8 | 485.0 | 454.8 | 30.2 |
| Net investment income | 184.4 | 180.7 | 3.7 | 552.4 | 550.4 | 2.0 |
| Total operating revenues | 853.2 | 821.0 | 32.2 | 2,572.7 | 2,436.8 | 135.9 |
| Expenses: | | | | | | |
| Benefits, claims and settlement expenses | | | | | | |
| (1) | 432.0 | 366.6 | 65.4 | 1,455.8 | 1,360.4 | 95.4 |
| Dividends to policyholders | 40.6 | 43.9 | (3.3) | 123.5 | 133.6 | (10.1) |
| Operating expenses (1) | 207.7 | 285.4 | (77.7) | 650.5 | 681.8 | (31.3) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | |
|--|-----------------|----------------|----------------|-----------------|-----------------|----------------|
| Total expenses | 680.3 | 695.9 | (15.6) | 2,229.8 | 2,175.8 | 54.0 |
| Operating earnings before income taxes | 172.9 | 125.1 | 47.8 | 342.9 | 261.0 | 81.9 |
| Income taxes | 58.4 | 41.8 | 16.6 | 114.5 | 85.3 | 29.2 |
| Operating earnings (1) | \$ 114.5 | \$ 83.3 | \$ 31.2 | \$ 228.4 | \$ 175.7 | \$ 52.7 |

(1) For further details related to the impact associated with actuarial assumption updates and model refinements for the three and nine months ended September 30, 2015 and 2014, see Transactions Affecting Comparability of Results of Operations Actuarial Assumption Updates.

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Operating Earnings

Operating earnings increased \$20.7 million in our individual life insurance business due to improved mortality and a more favorable impact from assumption updates and model refinements in 2015 than in 2014. Operating earnings increased \$10.5 million in our specialty benefits insurance business due to a favorable impact from assumption updates and model refinements, growth in the business and favorable claim experience.

Table of Contents

Operating Revenues

Premium and fees increased \$24.5 million in our specialty benefits insurance business primarily due to growth in the business, partially offset by an unfavorable impact from assumption updates and model refinements.

Total Expenses

Benefits, claims and settlement expenses increased \$67.5 million in our individual life insurance business primarily due to a less favorable impact from unlocking associated with assumption updates and model refinements in 2015 than in 2014, partially offset by improved mortality.

Operating expenses decreased \$88.3 million in our individual life insurance business primarily due to a more favorable impact from unlocking associated with assumption updates and model refinements in 2015 than in 2014, which was partially offset by higher expenses related to growth in the business.

Income Taxes

The effective income tax rates for the segment were 34% and 33% for the three months ended September 30, 2015 and 2014, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Operating Earnings

Operating earnings increased \$35.2 million in our individual life insurance business primarily due to improved mortality and a more favorable impact from unlocking associated with assumption updates and model refinements in 2015 than in 2014. Operating earnings increased \$17.5 million in our specialty benefits insurance business primarily due to a favorable impact from assumption updates and model refinements, the recovery of reinsurance premiums, favorable claim experience and growth in the business, partially offset by higher staff related costs, including pension and other postretirement benefits.

Operating Revenues

Premium and fees increased \$108.3 million in our specialty benefits insurance business primarily due to growth in the business and the recovery of reinsurance premiums, partially offset by an unfavorable impact from assumption updates and model refinements.

Total Expenses

Benefits, claims and settlement expenses increased \$64.7 million in our individual life insurance business primarily due to a less favorable impact from unlocking associated with assumption updates and model refinements in 2015 than in 2014, which was partially offset by improved mortality. Benefits, claims and settlement expenses increased \$30.7 million in our specialty benefits insurance business primarily due to growth in the business, which was partially offset by a favorable impact from assumption updates and model refinements and favorable claim experience.

Operating expenses decreased \$78.3 million in our individual life insurance business primarily due to a more favorable impact from unlocking associated with assumption updates and model refinements in 2015 than in 2014, which was partially offset by higher expenses related to growth in the business. Operating expenses increased \$47.0 million in our specialty benefits insurance business primarily due growth in the business, higher staff related costs, including pension and other postretirement benefits and reimbursement of a reinsurance expense allowance.

Income Taxes

The effective income tax rate for the segment was 33% for both the nine months ended September 30, 2015 and 2014. The effective income tax rate was lower than the U.S. statutory rate primarily due to interest exclusion from taxable income and income tax deductions allowed for corporate dividends received.

Table of Contents**Corporate Segment***Corporate Segment Summary Financial Data*

The following table presents certain summary financial data relating to the Corporate segment for the periods indicated:

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|--|-----------|------------------------|---|------------|------------------------|
| | 2015 | 2014 | Increase (decrease) | 2015 | 2014 | Increase (decrease) |
| | (in millions) | | | | | |
| Operating revenues: | | | | | | |
| Total operating revenues | \$ (69.0) | \$ (61.1) | \$ (7.9) | \$ (191.3) | \$ (163.3) | \$ (28.0) |
| Expenses: | | | | | | |
| Total expenses | (13.6) | (16.7) | 3.1 | (56.8) | (48.4) | (8.4) |
| Operating loss before income taxes, preferred stock dividends and noncontrolling interest | (55.4) | (44.4) | (11.0) | (134.5) | (114.9) | (19.6) |
| Income tax benefits | (18.3) | (20.1) | 1.8 | (56.6) | (58.1) | 1.5 |
| Operating earnings (loss) attributable to noncontrolling interest | (0.1) | 0.5 | (0.6) | 7.0 | 17.9 | (10.9) |
| Preferred stock dividends | | 8.2 | (8.2) | 16.5 | 24.7 | (8.2) |
| Excess of redemption value over carrying value of preferred shares redeemed | | | | 8.2 | | 8.2 |
| Operating loss | \$ (37.0) | \$ (33.0) | \$ (4.0) | \$ (109.6) | \$ (99.4) | \$ (10.2) |

*Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014***Operating Loss**

The operating loss increased primarily due to the one-time costs associated with the acquisition of AXA's MPF and ORSO pension business in the third quarter of 2015.

*Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014***Operating Loss**

The operating loss increased primarily due to the write-off of prior issuance costs associated with redemption of preferred stock in the second quarter of 2015.

Liquidity and Capital Resources

Liquidity and capital resources represent the overall strength of a company and its ability to generate strong cash flows, borrow funds at a competitive rate and raise new capital to meet operating and growth needs. Our legal entity structure has an impact on our ability to meet cash flow needs as an organization. Following is a simplified organizational structure.

Table of Contents*Liquidity*

Our liquidity requirements have been and will continue to be met by funds from consolidated operations as well as the issuance of commercial paper, common stock, debt or other capital securities and borrowings from credit facilities. We believe that cash flows from these sources are sufficient to satisfy the current liquidity requirements of our operations, including reasonably foreseeable contingencies.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term payment obligations. We will continue our prudent capital management practice of regularly exploring options available to us to maximize capital flexibility, including accessing the capital markets and careful attention to and management of expenses.

We perform rigorous liquidity stress testing to ensure our asset portfolio includes sufficient high quality liquid assets that could be utilized to bolster our liquidity position under increasingly stressed market conditions. These assets could be utilized as collateral for secured borrowing transactions with various third parties or by selling the securities in the open market if needed.

We also manage liquidity risk by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times. For example, as of September 30, 2015, approximately \$7.9 billion, or 99%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. Our individual annuity liabilities also contain surrender charges and other provisions limiting early surrenders.

The following table summarizes the withdrawal characteristics of our domestic general account investment-type insurance contracts as of September 30, 2015.

| | Contractholder funds (in millions) | Percentage |
|---|---------------------------------------|------------|
| Not subject to discretionary withdrawal | \$ 8,916.5 | 32.2% |
| Subject to discretionary withdrawal with adjustments: | | |
| Specified surrender charges | 6,336.0 | 22.9 |
| Market value adjustments | 5,346.0 | 19.3 |
| Subject to discretionary withdrawal without adjustments | 7,085.1 | 25.6 |
| Total domestic investment-type insurance contracts | \$ 27,683.7 | 100.0% |

Universal life insurance and certain traditional life insurance policies are also subject to discretionary withdrawals by policyholders. However, life insurance policies tend to be less susceptible to withdrawal than our investment-type insurance contracts because policyholders may be subject to a new underwriting process in order to obtain a new life insurance policy. In addition, our life insurance liabilities include surrender charges to discourage early surrenders.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

As of September 30, 2015 and December 31, 2014, we had short-term credit facilities with various financial institutions in an aggregate amount of \$1,005.0 million for both periods. As of September 30, 2015 and December 31, 2014, we had \$221.6 million and \$28.0 million, respectively, of outstanding borrowings, with no assets pledged as support as of September 30, 2015. During the first quarter of 2015, we extended or renewed \$900.0 million of our revolving credit facilities. The facilities and their new maturity dates include a \$400.0 million 5-year facility with PFG, PFS and Principal Life as co-borrowers that matures March 2020; a \$300.0 million 364-day facility with Principal Life as borrower that matures March 2016; and a \$200.0 million 3-year credit facility with PFG, PFS, Principal Life and Principal Financial Services V (UK) LTD as co-borrowers, maturing March 2020. The revolving credit facilities are committed and provide 100% back-stop support for our commercial paper program. The \$300.0 million and the \$400.0 million facilities are supported by sixteen banks and the \$200.0 million facility is supported by fifteen banks, most of which have other relationships with us. In addition to the revolving credit facilities, Principal International Chile has the capacity to access up to \$60.0 million in unsecured lines of credit offered by Chilean financial institutions and Principal Life has a \$45.0 million unsecured line of credit. Due to the financial strength and the strong relationships we have with these providers, we are comfortable there is a very low risk the financial institutions would be unable or unwilling to fund these facilities.

The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc. The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and raise capital to meet operating and growth needs. The declaration and payment of common stock dividends by us is subject to the discretion of our Board of Directors and will depend on our overall financial condition, results of operations, capital levels, cash requirements, future prospects, receipt of dividends from Principal Life (as

Table of Contents

described below), risk management considerations and other factors deemed relevant by the Board. There are no significant restrictions that limit the payment of dividends by PFG, except those generally applicable to corporations incorporated in Delaware. Dividends from Principal Life, our primary subsidiary, are limited by Iowa law.

Under Iowa law, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa (the Commissioner) to pay stockholder dividends or make any other distribution if such distributions would exceed certain statutory limitations. Iowa law gives the Commissioner discretion to disapprove requests for distributions in excess of these limits. Extraordinary dividends include those made within the preceding twelve months that exceed the greater of (i) 10% of Principal Life's statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year. Based on December 31, 2014, statutory results, the dividend limitation for Principal Life is approximately \$615.2 million in 2015.

Total stockholder dividends paid by Principal Life to its parent as of September 30, 2015, were \$244.4 million, all of which were extraordinary and approved by the Commissioner. As of September 30, 2015, we had \$797.0 million of cash and liquid assets held in our holding companies and other subsidiaries which is available for corporate purposes.

Operations. Our primary consolidated cash flow sources are premiums from insurance products, pension and annuity deposits, asset management fee revenues, administrative services fee revenues, income from investments and proceeds from the sales or maturity of investments. Cash outflows consist primarily of payment of benefits to policyholders and beneficiaries, income and other taxes, current operating expenses, payment of dividends to policyholders, payments in connection with investments acquired, payments made to acquire subsidiaries, payments relating to policy and contract surrenders, withdrawals, policy loans, interest payments and repayment of short-term debt and long-term debt. Our investment strategies are generally intended to provide adequate funds to pay benefits without forced sales of investments. For a discussion of our investment objectives, strategies and a discussion of duration matching, see Investments as well as Item 3. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk.

Cash Flows. Activity, as reported in our consolidated statements of cash flows, provides relevant information regarding our sources and uses of cash. The following discussion of our operating, investing and financing portions of the cash flows excludes cash flows attributable to the separate accounts.

Net cash provided by operating activities was \$3,323.0 million and \$2,197.6 million for the nine months ended September 30, 2015 and 2014, respectively. Our insurance business typically generates positive cash flows from operating activities, as premiums collected from our insurance products and income received from our investments exceed acquisition costs, benefits paid, redemptions and operating expenses. These positive cash flows are then invested to support the obligations of our insurance and investment products and required capital supporting these products. Our cash flows from operating activities are affected by the timing of premiums, fees and investment income received and benefits and expenses paid. The increase in cash provided by operating activities in 2015 compared to 2014 is primarily due to growth in the business including higher sales of single premium group annuities and individual annuities with life contingencies. Cash provided by operating activities also includes fluctuations in receivables and payables associated with the timing of settlements.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net cash used in investing activities was \$1,766.8 million and \$827.3 million for the nine months ended September 30, 2015 and 2014, respectively. The increase in cash used in investing activities in 2015 compared to 2014 is primarily the result of higher net purchases of fixed maturity securities in 2015 compared to 2014 and the acquisition of AXA's MPF and ORSO pension business in Hong Kong in 2015.

Net cash used in financing activities was \$905.9 million and \$2,471.3 million for the nine months ended September 30, 2015 and 2014, respectively. The decrease in cash used in financing activities is the result of the issuance of long-term debt in 2015 and decreased net withdrawals of investment contracts. The proceeds of the debt issuance were primarily used for the redemption of preferred stock in 2015.

Shelf Registration. On May 7, 2014, our shelf registration statement was filed with the SEC and became effective, replacing the shelf registration that had been in effect since May 2011. Under our current shelf registration, we have the ability to issue in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration.

Table of Contents

Short-Term Debt. The components of short-term debt were as follows:

| | September 30, 2015 | (in millions) | December 31, 2014 |
|--------------------------------|--------------------|---------------|-------------------|
| Short-term credit facilities | \$ | 197.4 | \$ |
| Other recourse short-term debt | | 24.2 | 28.0 |
| Total short-term debt | \$ | 221.6 | \$ 28.0 |

The short-term credit facilities are used for general corporate purposes and borrowings outstanding can fluctuate as part of working capital management.

Long-Term Debt. On May 7, 2015, we issued \$400.0 million of senior notes and \$400.0 million of junior subordinated notes, which are subordinated to all our senior debt. For additional long-term debt information regarding these debt issuances and all outstanding long-term debt, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 5, Long-Term Debt.

Stockholders' Equity. On June 30, 2015, we redeemed our 3.0 million shares of series A preferred stock for \$250.0 million and our 10.0 million shares of series B preferred stock for \$300.0 million. The following table summarizes our return of capital to common stockholders.

| | For the nine months ended September 30, 2015 | (in millions) | For the year ended December 31, 2014 |
|--|---|---------------|---|
| Dividends to stockholders | \$ | 330.2 | \$ 376.6 |
| Repurchase of common stock | | 188.2 | 222.7 |
| Total cash returned to common stockholders | \$ | 518.4 | \$ 599.3 |

For additional stockholders' equity information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Stockholders' Equity.

Capitalization

The following table summarizes our capital structure:

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | September 30, 2015 | December 31, 2014 |
|---------------------------------------|--------------------|-------------------|
| | (\$ in millions) | |
| Debt: | | |
| Short-term debt | \$ 221.6 | \$ 28.0 |
| Long-term debt | 3,286.1 | 2,531.2 |
| Total debt | 3,507.7 | 2,559.2 |
| Equity excluding AOCI | 10,144.7 | 10,133.6 |
| Total capitalization excluding AOCI | \$ 13,652.4 | \$ 12,692.8 |
| Debt to equity excluding AOCI | 35% | 25% |
| Debt to capitalization excluding AOCI | 26% | 20% |

Contractual Obligations and Contractual Commitments

As of September 30, 2015, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2014.

Off-Balance Sheet Arrangements

Variable Interest Entities. We have relationships with various types of special purpose entities and other entities where we have a variable interest as described in Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 2, Variable Interest Entities.

Table of Contents

Guarantees and Indemnifications. As of September 30, 2015, there have been no significant changes to guarantees and indemnifications since December 31, 2014. For guarantee and indemnification information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Contingencies, Guarantees and Indemnifications under the caption, Guarantees and Indemnifications.

Financial Strength Rating and Credit Ratings

Our ratings are influenced by the relative ratings of our peers/competitors as well as many other factors including our operating and financial performance, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), risk exposures, operating leverage, ratings and other factors.

In April 2015, Standard & Poor's (S&P) affirmed PFG's credit ratings and the financial strength ratings of Principal Life and Principal National Life Insurance Company at A+. The outlook remains stable for all ratings. Principal Life's enterprise risk management rating was affirmed as Strong. The rating affirmation reflects S&P's view that we are a leading competitor in the U.S. small to midsize 401K market, with strong asset management and insurance solution capabilities which is supported by respected brand, diversified and sophisticated product portfolio, strong distribution relationships and increasing global reach. Further, S&P cites our favorable earnings, well diversified investment portfolio and strong financial flexibility, with proven access to capital markets and credit facilities.

In April 2015, Fitch affirmed PFG's credit ratings and the financial strength ratings of Principal Life and Principal National Life Insurance Company at AA-. The outlook remains stable for all ratings. Fitch noted our strong capitalization and stable, balanced operating profitability. Fitch also cited the contribution of Cuprum to overall profitability, higher fee-based revenue from growing account values and gradually declining financial leverage.

In January 2015, A.M. Best completed its annual review, and affirmed the ratings of PFG and its subsidiaries. Principal Life's financial strength rating was affirmed at A+. The outlook remains stable for all ratings. Principal Life's ratings reflect our diversified revenue sources, consistent operating earnings and solid balance sheet. The ratings also reflect our position as a leading provider of defined contribution plans, defined benefit plans, plan termination annuities and nonqualified plans in the United States.

All four of the rating agencies maintain a stable outlook on the U.S. life insurance sector. The rating agencies acknowledge that interest rates have remained at historically low levels for a longer than expected time. However, the agencies have also cited that the U.S. life insurance industry has maintained strong risk-adjusted capital, generated steady U.S. GAAP and statutory earnings, improved balance sheet fundamentals and enhanced risk focused decision making. Continued low rates will pressure interest margins and reserve adequacy, but the agencies believe that will not have a material impact and is manageable over the near term.

The following table summarizes our significant financial strength and debt ratings from the major independent rating organizations. The debt ratings shown are indicative ratings. Outstanding issuances are rated the same as indicative ratings unless otherwise noted. Actual ratings can differ from indicative ratings based on contractual terms.

| | A.M. Best | Fitch | Standard & Poor's | Moody's |
|--|-----------|-------|-------------------|---------|
| Principal Financial Group | | | | |
| Senior Unsecured Debt (1) | a- | | BBB+ | Baa2 |
| Junior Subordinated Debt (1) (2) | bbb+ | | BBB | Baa3 |
| Principal Financial Services | | | | |
| Senior Unsecured Debt | a- | | BBB+ | Baa1 |
| Commercial Paper | AMB-1 | | A-2 | P-2 |
| Principal Life Insurance Company | | | | |
| Insurer Financial Strength | A+ | AA- | A+ | A1 |
| Issuer Credit Rating | aa- | | | |
| Commercial Paper | AMB-1+ | | A-1+ | P-1 |
| Enterprise Risk Management Rating | | | Strong | |
| Principal National Life Insurance Company | | | | |
| Insurer Financial Strength | A+ | AA- | A+ | A1 |

(1) Principal Financial Group's senior debt issuance has been rated Baa1 by Moody's.

(2) Principal Financial Group's junior subordinated debt issuance has been rated BBB- by S&P, and Baa2 by Moody's.

Table of Contents

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The fair value hierarchy gives the highest priority (Level 1) to quoted prices in active markets for identical assets or liabilities and gives the lowest priority (Level 3) to unobservable inputs. An asset or liability's classification within the fair value hierarchy is based on the lowest level of significant input to its valuation. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Fair Value Measurements for further details, including a reconciliation of changes in Level 3 fair value measurements.

As of September 30, 2015, 38% of our net assets (liabilities) were Level 1, 58% were Level 2 and 4% were Level 3. Excluding separate account assets as of September 30, 2015, 3% of our net assets (liabilities) were Level 1, 96% were Level 2 and 1% were Level 3.

As of December 31, 2014, 39% of our net assets (liabilities) were Level 1, 58% were Level 2 and 3% were Level 3. Excluding separate account assets as of December 31, 2014, 2% of our net assets (liabilities) were Level 1, 97% were Level 2 and 1% were Level 3.

Changes in Level 3 Fair Value Measurements

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of September 30, 2015, were \$7,020.2 million as compared to \$6,350.1 million as of December 31, 2014. The increase was primarily related to gains on other invested assets and real estate included in our separate account assets.

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of September 30, 2014, were \$6,301.1 million as compared to \$5,885.5 million as of December 31, 2013. The increase was primarily related to gains on other invested assets and real estate included in our separate account assets.

Investments

We had total consolidated assets as of September 30, 2015, of \$215,365.4 million, of which \$69,565.5 million were invested assets. The rest of our total consolidated assets are comprised primarily of separate account assets for which we do not bear investment risk. Because we generally do not bear any investment risk on assets held in separate accounts, the discussion and financial information below does not include such assets.

Overall Composition of Invested Assets

Invested assets as of September 30, 2015, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of invested assets are fixed maturities and commercial mortgage loans. The remainder is invested in other investments, residential mortgage loans, real estate and equity securities. In addition, policy loans are included in our invested assets.

Table of Contents

| | September 30, 2015 | | December 31, 2014 | |
|---------------------------------|--------------------|------------|-------------------|------------|
| | Carrying amount | % of total | Carrying amount | % of total |
| | (\$ in millions) | | | |
| Fixed maturities: | | | | |
| Public | \$ 34,961.6 | 50% | \$ 34,863.2 | 51% |
| Private | 15,529.2 | 22 | 15,412.2 | 23 |
| Equity securities | 1,334.4 | 2 | 963.2 | 1 |
| Mortgage loans: | | | | |
| Commercial | 11,149.3 | 16 | 10,696.9 | 15 |
| Residential | 1,082.8 | 2 | 1,114.7 | 2 |
| Real estate held for sale | 158.6 | | 174.0 | |
| Real estate held for investment | 1,256.4 | 2 | 1,170.6 | 2 |
| Policy loans | 822.8 | 1 | 829.2 | 1 |
| Other investments | 3,270.4 | 5 | 3,209.8 | 5 |
| Total invested assets | 69,565.5 | 100% | 68,433.8 | 100% |
| Cash and cash equivalents | 2,514.2 | | 1,863.9 | |
| Total invested assets and cash | \$ 72,079.7 | | \$ 70,297.7 | |

Investment Results*Net Investment Income*

The following table presents the yield and investment income, excluding net realized capital gains and losses, for our invested assets for the periods indicated. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period. The yields for available-for-sale fixed maturities and available-for-sale equity securities are calculated using amortized cost and cost, respectively. All other yields are calculated using carrying amounts.

| | For the three months ended September 30, | | | | | | For the nine months ended September 30, | | | | | |
|----------------------------------|--|----------|---------------------|----------|--------|-----------|---|------------|-------|------------|---------------------|------------|
| | 2015 | 2014 | Increase (decrease) | | 2015 | 2014 | Increase (decrease) | | 2015 | 2014 | Increase (decrease) | |
| | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount | Yield | Amount |
| | (\$ in millions) | | | | | | | | | | | |
| Fixed maturities | 4.5% | \$ 541.9 | 4.6% | \$ 548.6 | (0.1)% | \$ (6.7) | 4.5% | \$ 1,604.7 | 4.8% | \$ 1,719.3 | (0.3)% | \$ (114.6) |
| Equity securities | 1.0 | 3.1 | 11.3 | 26.3 | (10.3) | (23.2) | 3.7 | 31.7 | 9.6 | 63.5 | (5.9) | (31.8) |
| Mortgage loans commercial | 4.4 | 120.6 | 5.1 | 134.2 | (0.7) | (13.6) | 4.5 | 371.9 | 5.2 | 411.9 | (0.7) | (40.0) |
| Mortgage loans residential | 7.1 | 19.3 | 5.6 | 16.8 | 1.5 | 2.5 | 6.2 | 51.5 | 7.1 | 64.7 | (0.9) | (13.2) |
| Real estate | 6.0 | 21.6 | 4.7 | 15.5 | 1.3 | 6.1 | 7.8 | 80.5 | 9.5 | 93.6 | (1.7) | (13.1) |
| Policy loans | 5.6 | 11.5 | 5.9 | 12.3 | (0.3) | (0.8) | 5.6 | 35.0 | 5.8 | 37.0 | (0.2) | (2.0) |
| Cash and cash equivalents | 0.4 | 2.4 | 0.4 | 1.6 | | 0.8 | 0.4 | 6.2 | 0.4 | 4.9 | | 1.3 |
| Other investments | 6.3 | 51.8 | 4.5 | 34.0 | 1.8 | 17.8 | 5.9 | 143.1 | 4.8 | 106.4 | 1.1 | 36.7 |
| Total before investment expenses | 4.5 | 772.2 | 4.7 | 789.3 | (0.2) | (17.1) | 4.5 | 2,324.6 | 5.0 | 2,501.3 | (0.5) | (176.7) |
| Investment expenses | (0.1) | (18.7) | (0.1) | (18.9) | | 0.2 | (0.1) | (57.3) | (0.1) | (57.2) | | (0.1) |
| Net investment income | 4.4% | \$ 753.5 | 4.6% | \$ 770.4 | (0.2)% | \$ (16.9) | 4.4% | \$ 2,267.3 | 4.9% | \$ 2,444.1 | (0.5)% | \$ (176.8) |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Net investment income decreased primarily due to lower investment yields and prepayments on our invested assets and cash in our U.S. Operations, partially offset by higher inflation-based investment returns on average invested assets and cash as a result of higher inflation in Chile.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Net investment income decreased primarily due to lower investment yields and prepayments on our invested assets and cash in our U.S. Operations. In addition, net investment income decreased due to the weakening of the Chilean peso and Brazilian real against the U.S. dollar and unfavorable market changes on our regulatory required investment in the pension funds of our Chilean pension company.

Table of Contents**Net Realized Capital Gains (Losses)**

The following table presents the contributors to net realized capital gains and losses for our invested assets for the periods indicated.

| | For the three months ended September 30, | | | For the nine months ended September 30, | | |
|---|--|-----------|---|---|-----------|------------------------|
| | 2015 | 2014 | Increase (decrease) (in millions) | 2015 | 2014 | Increase (decrease) |
| Fixed maturities, available-for-sale credit impairments (1) | \$ (7.6) | \$ (21.6) | \$ 14.0 | \$ (21.1) | \$ (68.6) | \$ 47.5 |
| Commercial mortgages credit impairments | (2.0) | (1.3) | (0.7) | (3.1) | 0.9 | (4.0) |
| Other credit impairments | 0.7 | (11.0) | 11.7 | 2.0 | (5.9) | 7.9 |
| Fixed maturities, available-for-sale and trading noncredit | (1.9) | 12.5 | (14.4) | 3.4 | 55.3 | (51.9) |
| Derivatives and related hedge activities | 55.8 | (26.6) | 82.4 | 24.2 | (18.6) | 42.8 |
| Other gains (losses) | (6.6) | 1.6 | (8.2) | (15.4) | 77.9 | (93.3) |
| Net realized capital gains (losses) | \$ 38.4 | \$ (46.4) | \$ 84.8 | \$ (10.0) | \$ 41.0 | \$ (51.0) |

(1) Includes credit impairments as well as losses on sales of fixed maturities to reduce credit risk, net of realized credit recoveries on the sale of previously impaired securities. Credit gains on sales, excluding associated foreign currency fluctuations that are included in derivatives and related hedging activities, were a net gain of \$0.0 million and \$0.1 million for the three months ended September 30, 2015 and 2014, and \$0.3 million and \$0.9 million for the nine months ended September 30, 2015 and 2014, respectively.

Three Months Ended September 30, 2015 Compared to Three Months Ended September 30, 2014

Derivatives and related hedge activities had net gains in 2015 as compared to losses in 2014 due to increased gains on the GMWB embedded derivatives, including changes in the spread reflecting our own creditworthiness, and related hedging instruments and increased gains on interest rate swap derivatives not designated as hedging instruments due to changes in interest rates.

Nine Months Ended September 30, 2015 Compared to Nine Months Ended September 30, 2014

Net realized capital losses on fixed maturities, available-for-sale credit impairments decreased primarily due to decreased losses on structured fixed maturities as a result of improved market conditions. This was partially offset by losses versus gains on corporate fixed maturities.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Net realized capital gains on fixed maturities, available-for-sale and trading noncredit decreased primarily due to losses versus gains on trading securities related to changes in interest rates and credit spreads and a gain from the sale of a long dated structured security in 2014.

Derivatives and related hedge activities had net gains in 2015 as compared to losses in 2014 due primarily to increased gains on interest rate swap derivatives not designated as hedging instruments due to changes in interest rates.

Other gains (losses) reflected losses in 2015 as compared to gains in 2014 primarily due to decreased gains on sales of real estate investments and joint venture real estate and a write-off of unamortized book value on corporate owned real estate in 2015.

U.S. Investment Operations

Of our invested assets, \$63,147.5 million were held by our U.S. operations as of September 30, 2015. Our U.S. invested assets are managed primarily by our Principal Global Investors segment. Our primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters. We seek to protect policyholders' benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing the credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification. We are exposed to two primary sources of investment risk:

Table of Contents

- credit risk, relating to the uncertainty associated with the continued ability of an obligor to make timely payments of principal and interest and
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves.

Our ability to manage credit risk is essential to our business and our profitability. We devote considerable resources to the credit analysis of each new investment. We manage credit risk through industry, issuer and asset class diversification. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing all investment policies and approving or authorizing all investments, except the Executive Committee of the Board must approve any investment transaction exceeding \$500.0 million. As of September 30, 2015, eleven members served on the Investment Committee, one of whom is a member of our Board of Directors. The remaining members were senior management members representing various areas of our company.

We purchase credit default swaps to hedge certain credit exposures in our investment portfolio and total return swaps and futures to hedge a portion of our investment portfolio from credit losses. We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of \$213.2 million and \$288.7 million, total return swaps of \$90.0 million and \$90.0 million, and futures of \$15.6 million and \$10.5 million as of September 30, 2015 and December 31, 2014, respectively. We sell credit default swaps to offer credit protection to investors when entering into synthetic replicating transactions. When selling credit protection, if there is an event of default by the referenced name, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security. For further information on credit derivatives sold, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Derivative Financial Instruments under the caption, Credit Derivatives Sold.

We also seek to manage call or prepayment risk arising from changes in interest rates. We assess and price for call or prepayment risks in all of our investments and monitor these risks in accordance with asset/liability management policies.

The amortized cost and weighted average yield, calculated using amortized cost, of non-structured fixed maturity securities that will be callable at the option of the issuer, excluding securities with a make-whole provision, were \$1,435.9 million and 3.9%, respectively, as of September 30, 2015 and \$1,119.1 million and 4.3%, respectively, as of December 31, 2014. In addition, the amortized cost and weighted average yield of residential mortgage-backed pass-through securities, residential collateralized mortgage obligations, and asset-backed securities - home equity with material prepayment risk were \$4,323.9 million and 3.3%, respectively, as of September 30, 2015 and \$4,319.0 million and 3.3%, respectively, as of December 31, 2014.

Our Fixed Income Securities Committee, consisting of fixed income securities senior management members, approves the credit rating for the fixed maturities we purchase. Teams of security analysts, organized by industry, analyze and monitor these investments. In addition, we have teams who specialize in RMBS, CMBS, ABS, municipals and below investment grade securities. Our analysts monitor issuers held in the portfolio on a continuous basis with a formal review documented annually or more frequently if material events affect the issuer. The analysis includes both fundamental and technical factors. The fundamental analysis encompasses both quantitative and qualitative analysis of the issuer. The qualitative analysis includes an assessment of both accounting and management aggressiveness of the issuer. In addition, technical indicators such as stock price volatility and credit default swap levels are monitored.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Our Fixed Income Securities Committee also reviews private transactions on a continuous basis to assess the quality ratings of our privately placed investments. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

- material changes in the issuer's revenues or margins;
- significant management or organizational changes;
- significant changes regarding the issuer's industry;
- debt service coverage or cash flow ratios that fall below industry-specific thresholds;
- violation of financial covenants and
- other business factors that relate to the issuer.

Our use of derivatives exposes us to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- obtaining approval of all new counterparties by the Investment Committee;
- establishing exposure limits that take into account non-derivative exposure we have with the counterparty as well as derivative exposure;

Table of Contents

- performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;
- diversifying our risk across numerous approved counterparties;
- implementing credit support annex (collateral) agreements (CSAs) for over-the-counter derivative transactions or similar agreements with a majority of our counterparties to further limit counterparty exposures, which provide for netting of exposures;
- limiting exposure to A credit or better for over-the-counter derivative counterparties without CSAs;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;
- daily monitoring of counterparty credit ratings, exposures and associated collateral levels and
- trading mandatorily cleared contracts through centralized clearinghouses.

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments under the caption, Balance Sheet Offsetting.

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage loan portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying security, conduct a comprehensive market analysis and compare against industry lending practices. We use a proprietary risk rating model to evaluate all new and substantially all existing loans within the portfolio. The proprietary risk model is designed to stress projected cash flows under simulated economic and market downturns. Our lending guidelines are typically 75% or less loan-to-value ratio and a debt service coverage ratio of at least 1.2 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The following table presents loan-to-value and debt service coverage ratios for our brick and mortar commercial mortgages, excluding Principal Global Investors segment mortgages:

| | Weighted average loan-to-value ratio | | Debt service coverage ratio | |
|---------------------------|--------------------------------------|-------------------|-----------------------------|-------------------|
| | September 30, 2015 | December 31, 2014 | September 30, 2015 | December 31, 2014 |
| New mortgages | 48% | 51% | 3.3X | 2.6X |
| Entire mortgage portfolio | 46% | 48% | 2.8X | 2.6X |

Our investment decisions and objectives are a function of the underlying risks and product profiles of each primary business operation. In addition, we diversify our product portfolio offerings to include products that contain features that will protect us against fluctuations in interest rates. Those features include adjustable crediting rates, policy surrender charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk.

Overall Composition of U.S. Invested Assets

As shown in the following table, the major categories of U.S. invested assets are fixed maturities and commercial mortgage loans. The remainder is invested in other investments, real estate, residential mortgage loans and equity securities. In addition, policy loans are included in our invested assets. The following discussion analyzes the composition of U.S. invested assets, but excludes invested assets of the separate accounts.

Table of Contents

| | September 30, 2015 | | December 31, 2014 | |
|---------------------------------|--------------------|------------|-------------------|------------|
| | Carrying amount | % of total | Carrying amount | % of total |
| | (\$ in millions) | | | |
| Fixed maturities: | | | | |
| Public | \$ 31,508.9 | 50% | \$ 31,618.0 | 51% |
| Private | 15,526.7 | 25 | 15,410.1 | 25 |
| Equity securities | 302.5 | | 300.5 | |
| Mortgage loans: | | | | |
| Commercial | 11,085.7 | 18 | 10,657.2 | 17 |
| Residential | 566.0 | 1 | 507.2 | 1 |
| Real estate held for sale | 155.4 | | 171.8 | |
| Real estate held for investment | 1,254.7 | 2 | 1,168.6 | 2 |
| Policy loans | 802.3 | 1 | 806.5 | 1 |
| Other investments | 1,945.3 | 3 | 1,688.0 | 3 |
| Total invested assets | 63,147.5 | 100% | 62,327.9 | 100% |
| Cash and cash equivalents | 2,090.2 | | 1,762.5 | |
| Total invested assets and cash | \$ 65,237.7 | | \$ 64,090.4 | |

Fixed Maturities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred securities. Included in the privately placed category as of September 30, 2015 and December 31, 2014, were \$10.5 billion and \$10.3 billion, respectively, of securities subject to certain holding periods and resale restrictions pursuant to Rule 144A of the Securities Act of 1933.

Fixed maturities were diversified by category of issuer, as shown in the following table for the periods indicated.

| | September 30, 2015 | | December 31, 2014 | |
|---|--------------------|------------------|-------------------|------------------|
| | Carrying amount | Percent of total | Carrying amount | Percent of total |
| | (\$ in millions) | | | |
| U.S. government and agencies | \$ 1,492.4 | 3% | \$ 1,121.8 | 2% |
| States and political subdivisions | 4,553.5 | 10 | 4,329.4 | 9 |
| Non-U.S. governments | 398.0 | 1 | 446.6 | 1 |
| Corporate - public | 16,537.5 | 35 | 16,834.6 | 37 |
| Corporate - private | 12,215.1 | 26 | 12,262.9 | 26 |
| Residential mortgage-backed pass-through securities | 2,694.1 | 6 | 2,839.6 | 6 |
| Commercial mortgage-backed securities | 3,870.8 | 8 | 3,977.0 | 8 |
| Residential collateralized mortgage obligations | 1,471.6 | 3 | 1,306.2 | 3 |
| Asset-backed securities | 3,802.6 | 8 | 3,910.0 | 8 |
| Total fixed maturities | \$ 47,035.6 | 100% | \$ 47,028.1 | 100% |

We believe it is desirable to hold residential mortgage-backed pass-through securities due to their credit quality and liquidity as well as portfolio diversification characteristics. Our portfolio is comprised of Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation pass-through securities. In addition, our residential collateralized mortgage obligation portfolio offers structural features that allow cash flows to be matched to our liabilities.

CMBS provide varying levels of credit protection, diversification and reduced event risk depending on the securities owned and composition of the loan pool. CMBS are predominantly comprised of large pool securitizations that are diverse by property type, borrower and geographic dispersion. The risks to any CMBS deal are determined by the credit quality of the underlying loans and how those loans perform over time. Another key risk is the vintage of the underlying loans and the state of the markets during a particular vintage. In the CMBS market, there is a material difference in the outlook for the performance of loans originated in 2004 and earlier relative to loans originated in 2005 through 2008. For loans originated prior to 2005, underwriting assumptions were more conservative regarding required debt service coverage and loan-to-value ratios. For the 2005 through 2008 vintages, real estate values peaked and the underwriting expectations were that values would continue to increase, which makes those loan values more sensitive to market declines. The 2009 through 2015 vintages represent a return to debt service coverage ratios and loan-to-value ratios that more closely resemble loans originated prior to 2005.

Table of Contents

We purchase ABS to diversify the overall credit risks of the fixed maturities portfolio and to provide attractive returns. The principal risks in holding ABS are structural and credit risks. Structural risks include the security's priority in the issuer's capital structure, the adequacy of and ability to realize proceeds from the collateral and the potential for prepayments. Credit risks involve collateral and issuer/servicer risk where collateral and servicer performance may deteriorate. Our ABS portfolio is diversified both by type of asset and by issuer. We actively monitor holdings of ABS to recognize adverse changes in the risk profile of each security. Prepayments in the ABS portfolio are, in general, insensitive to changes in interest rates or are insulated from such changes by call protection features. In the event that we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we hold a diverse class of securities, which limits our exposure to any one security.

The international exposure held in our U.S. operation's fixed maturities portfolio was 23% of total fixed maturities as of September 30, 2015 and 25% as of December 31, 2014. It is comprised of corporate and foreign government fixed maturities. The following table presents the carrying amount of our international exposure for our U.S. operation's fixed maturities portfolio for the periods indicated.

| | September 30, 2015 | (in millions) | December 31, 2014 |
|------------------------------|--------------------|---------------|-------------------|
| European Union, excluding UK | \$ 3,419.4 | | \$ 3,717.9 |
| United Kingdom | 2,357.8 | | 2,467.5 |
| Asia-Pacific | 1,470.4 | | 1,564.8 |
| Australia/New Zealand | 1,177.1 | | 1,285.6 |
| Latin America | 910.5 | | 989.9 |
| Europe, non-European Union | 800.6 | | 855.6 |
| Middle East and Africa | 311.3 | | 365.3 |
| Other (1) | 299.2 | | 276.7 |
| Total | \$ 10,746.3 | | \$ 11,523.3 |

(1) Includes exposure from 2 countries and various supranational organizations as of September 30, 2015, and 1 country and various supranational organizations as of December 31, 2014.

International fixed maturities exposure is determined by the country of domicile of the parent entity of an individual asset. All international fixed maturities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturities investments and we are within those internal limits. Exposure to Canada is not included in our international exposure. As of September 30, 2015 and December 31, 2014, our investments in Canada totaled \$1,355.6 million and \$1,478.3 million, respectively.

Fixed Maturities Credit Concentrations. One aspect of managing credit risk is through industry, issuer and asset class diversification. Our credit concentrations are managed to established limits. The following table presents our top ten exposures as of September 30, 2015.

Amortized cost

(in millions)

| | | |
|-----------------------------|----|---------|
| General Electric Company | \$ | 196.4 |
| Berkshire Hathaway Inc. | | 188.8 |
| AT&T Inc. | | 188.4 |
| People's Republic of China | | 173.5 |
| Verizon Communications Inc. | | 155.5 |
| Wells Fargo & Company | | 155.2 |
| Mars, Incorporated | | 146.3 |
| Duke Energy Corporation | | 136.7 |
| MetLife, Inc. | | 127.5 |
| PG&E Corporation | | 127.3 |
| Total top ten exposures | \$ | 1,595.6 |

Table of Contents

Fixed Maturities Valuation and Credit Quality. Valuation techniques for the fixed maturities portfolio vary by security type and the availability of market data. The use of different pricing techniques and their assumptions could produce different financial results. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Fair Value Measurements for further details regarding our pricing methodology. Once prices are determined, they are reviewed by pricing analysts for reasonableness based on asset class and observable market data. Investment analysts who are familiar with specific securities review prices for reasonableness through direct interaction with external sources, review of recent trade activity or use of internal models. All fixed maturities placed on the watch list are periodically analyzed by investment analysts or analysts that focus on troubled securities (Workout Group). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative and unobservable inputs.

The Securities Valuation Office (SVO) of the NAIC monitors the bond investments of insurers for regulatory capital and reporting purposes and, when required, assigns securities to one of six investment categories. For certain bonds, the NAIC designations closely mirror the Nationally Recognized Statistical Rating Organizations (NRSRO) credit ratings. For most corporate bonds, NAIC designations 1 and 2 include bonds considered investment grade by such rating organizations. Bonds are considered investment grade when rated Baa3 or higher by Moody's, or BBB- or higher by S&P. NAIC designations 3 through 6 are referred to as below investment grade. Bonds are considered below investment grade when rated Ba1 or lower by Moody's, or BB+ or lower by S&P.

However, for loan-backed and structured securities, as defined by the NAIC, the NAIC rating is not always equivalent to an NRSRO rating as described below. For non-agency RMBS, PIMCO Advisors models and assigns the NAIC ratings. For CMBS, Blackrock Solutions undertakes the modeling and assignment of those NAIC ratings. Other loan-backed and structured securities may be subject to an intrinsic price matrix as provided by the NAIC. This may result in a final designation being higher or lower than the NRSRO credit rating.

The following table presents our total fixed maturities by NAIC designation and the equivalent ratings of the NRSROs as of the periods indicated as well as the percentage, based on fair value, that each designation comprises.

| NAIC Rating | Rating Agency Equivalent | September 30, 2015 | | | December 31, 2014 | | |
|----------------|--------------------------|--------------------|--------------------|--|-------------------|--------------------|----------------------------------|
| | | Amortized cost | Carrying amount | Percent of carrying amount (\$ in millions) | Amortized cost | Carrying amount | Percent of carrying amount |
| 1 | AAA/AA/A | \$ 28,950.2 | \$ 30,335.2 | 64% | \$ 28,364.4 | \$ 30,140.6 | 64% |
| 2 | BBB | 12,592.8 | 13,088.9 | 28 | 12,291.8 | 13,184.7 | 28 |
| 3 | BB | 2,895.2 | 2,826.6 | 7 | 2,902.0 | 2,879.3 | 6 |
| 4 | B | 642.5 | 583.7 | 1 | 659.1 | 637.3 | 2 |
| 5 | CCC and lower | 150.9 | 124.5 | | 147.8 | 120.0 | |
| 6 | In or near default | 87.8 | 76.7 | | 74.7 | 66.2 | |
| | Total fixed maturities | \$ 45,319.4 | \$ 47,035.6 | 100% | \$ 44,439.8 | \$ 47,028.1 | 100% |

Fixed maturities include 73 securities with an amortized cost of \$713.1 million, gross gains of \$5.5 million, gross losses of \$9.3 million and a carrying amount of \$709.3 million as of September 30, 2015, that are still pending a review and assignment of a rating by the SVO. Due to the timing of when fixed maturities are purchased, legal documents are filed and the review by the SVO is completed, there will always be securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent rating is assigned based on our fixed income analyst's assessment.

Commercial Mortgage-Backed Securities. As of September 30, 2015, based on amortized cost, 60% of our CMBS portfolio had ratings of A or higher and 48% was issued prior to 2005 and after 2008.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Table of Contents

The following tables present our exposure by credit quality, based on the lowest NRSRO designation, and year of issuance (vintage) for our CMBS portfolio as of the periods indicated.

| | September 30, 2015 | | | | | | | | | | | |
|-----------|--------------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & | | | | | | | | | | | | |
| Prior | \$ 12.3 | \$ 13.2 | \$ 4.1 | \$ 4.3 | \$ 4.3 | \$ 4.8 | \$ 29.3 | \$ 33.1 | \$ 34.9 | \$ 38.7 | \$ 84.9 | \$ 94.1 |
| 2004 | 15.2 | 15.6 | 30.4 | 30.9 | 23.3 | 24.9 | 14.2 | 15.1 | 22.2 | 22.2 | 105.3 | 108.7 |
| 2005 | 24.2 | 24.5 | 2.0 | 2.1 | 18.6 | 19.2 | 51.8 | 51.9 | 109.6 | 103.4 | 206.2 | 201.1 |
| 2006 | 70.7 | 70.7 | 44.5 | 44.8 | 95.6 | 96.9 | 159.3 | 160.9 | 116.4 | 105.7 | 486.5 | 479.0 |
| 2007 | 31.7 | 32.0 | 110.9 | 117.2 | 156.3 | 165.5 | 223.7 | 232.1 | 621.7 | 630.6 | 1,144.3 | 1,177.4 |
| 2008 | 10.7 | 11.4 | 34.0 | 35.4 | | | 43.7 | 44.8 | 54.9 | 59.0 | 143.3 | 150.6 |
| 2009 | 64.1 | 65.6 | 42.3 | 43.7 | 24.0 | 24.5 | | | | | 130.4 | 133.8 |
| 2010 | 60.9 | 62.8 | 30.9 | 32.2 | | | | | | | 91.8 | 95.0 |
| 2011 | 64.2 | 63.8 | 125.2 | 127.4 | 2.2 | 2.2 | | | 0.7 | 0.8 | 192.3 | 194.2 |
| 2012 | 210.8 | 212.8 | 139.4 | 142.0 | 7.8 | 7.7 | 1.2 | 1.2 | | | 359.2 | 363.7 |
| 2013 | 234.6 | 232.8 | 85.1 | 85.3 | | | 19.3 | 19.4 | 10.3 | 10.3 | 349.3 | 347.8 |
| 2014 | 192.7 | 193.0 | 60.3 | 60.4 | 5.3 | 5.3 | 3.0 | 3.0 | | | 261.3 | 261.7 |
| 2015 | 116.4 | 116.5 | 136.5 | 136.5 | 9.9 | 9.9 | 0.8 | 0.8 | | | 263.6 | 263.7 |
| Total (1) | \$ 1,108.5 | \$ 1,114.7 | \$ 845.6 | \$ 862.2 | \$ 347.3 | \$ 360.9 | \$ 546.3 | \$ 562.3 | \$ 970.7 | \$ 970.7 | \$ 3,818.4 | \$ 3,870.8 |

(1) The CMBS portfolio included agency CMBS with a \$389.2 million amortized cost and a \$394.8 million carrying amount.

| | December 31, 2014 | | | | | | | | | | | |
|-----------|-------------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|----------------|-----------------|
| | AAA | | AA | | A | | BBB | | BB+ and Below | | Total | |
| | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount | Amortized cost | Carrying amount |
| | (in millions) | | | | | | | | | | | |
| 2003 & | | | | | | | | | | | | |
| Prior | \$ 14.4 | \$ 15.1 | \$ 9.8 | \$ 10.5 | \$ 4.8 | \$ 5.2 | \$ 28.7 | \$ 33.5 | \$ 39.8 | \$ 43.6 | \$ 97.5 | \$ 107.9 |
| 2004 | 2.8 | 3.3 | 39.1 | 39.8 | 31.6 | 33.4 | 25.8 | 27.3 | 29.9 | 30.3 | 129.2 | 134.1 |
| 2005 | 205.5 | 208.3 | 63.3 | 64.7 | 28.7 | 29.6 | 85.2 | 86.4 | 139.0 | 125.2 | 521.7 | 514.2 |
| 2006 | 80.1 | 82.2 | 45.2 | 46.2 | 85.8 | 88.6 | 150.9 | 155.1 | 126.9 | 115.7 | 488.9 | 487.8 |
| 2007 | 41.0 | 42.4 | 102.3 | 111.2 | 156.0 | 169.7 | 213.8 | 226.8 | 665.9 | 670.5 | 1,179.0 | 1,220.6 |
| 2008 | 22.0 | 23.3 | 26.7 | 29.1 | | | 44.6 | 45.5 | 55.5 | 61.2 | 148.8 | 159.1 |
| 2009 | 70.2 | 73.0 | 45.6 | 47.4 | 18.4 | 19.2 | | | | | 134.2 | 139.6 |
| 2010 | 64.7 | 68.4 | 41.3 | 42.7 | | | | | | | 106.0 | 111.1 |
| 2011 | 76.5 | 77.0 | 136.8 | 139.0 | 2.2 | 2.2 | | | | | 215.5 | 218.2 |
| 2012 | 214.8 | 218.3 | 143.3 | 145.4 | 3.5 | 3.5 | | | | | 361.6 | 367.2 |
| 2013 | 201.4 | 200.7 | 72.8 | 73.0 | | | 15.6 | 15.7 | 10.3 | 10.4 | 300.1 | 299.8 |
| 2014 | 168.1 | 169.5 | 44.8 | 44.9 | 3.0 | 3.0 | | | | | 215.9 | 217.4 |
| Total (1) | \$ 1,161.5 | \$ 1,181.5 | \$ 771.0 | \$ 793.9 | \$ 334.0 | \$ 354.4 | \$ 564.6 | \$ 590.3 | \$ 1,067.3 | \$ 1,056.9 | \$ 3,898.4 | \$ 3,977.0 |

(1) The CMBS portfolio included agency CMBS with a \$415.5 million amortized cost and a \$420.4 million carrying amount.

Fixed Maturities Watch List. We monitor any decline in the credit quality of fixed maturities through the designation of problem securities, potential problem securities and restructured securities. We define problem securities in our fixed

maturity portfolio as securities: (i) with principal and/or interest payments in default or where default is perceived to be imminent in the near term, or (ii) issued by a company that went into bankruptcy subsequent to the acquisition of such securities. We define potential problem securities in our fixed maturity portfolio as securities included on an internal watch list for which management has concerns as to the ability of the issuer to comply with the present debt payment terms and which may result in the security becoming a problem or being restructured. The decision whether to classify a performing fixed maturity security as a potential problem involves significant subjective judgments by our management as to the likely future industry conditions and developments with respect to the issuer. We define restructured securities in our fixed maturity portfolio as securities where a concession has been granted to the borrower related to the borrower's financial difficulties that would not have otherwise been considered. We determine that restructures should occur in those instances where greater economic value will be realized under the new terms than through liquidation or other disposition and may involve a change in contractual cash flows. If the present

Table of Contents

value of the restructured cash flows is less than the current cost of the asset being restructured, a realized capital loss is recorded in net income and a new cost basis is established.

The following table presents the total carrying amount of our fixed maturities portfolio, as well as its problem, potential problem and restructured fixed maturities for the periods indicated.

| | September 30, 2015 | December 31, 2014 |
|---|--------------------|-------------------|
| | (\$ in millions) | |
| Total fixed maturities (public and private) | \$ 47,035.6 | \$ 47,028.1 |
| Problem fixed maturities (1) | \$ 252.8 | \$ 297.0 |
| Potential problem fixed maturities | 132.2 | 161.3 |
| Total problem, potential problem and restructured fixed maturities | \$ 385.0 | \$ 458.3 |
| Total problem, potential problem and restructured fixed maturities as a percent of total fixed maturities | 0.82% | 0.97% |

(1) The problem fixed maturities carrying amount is net of other-than-temporary impairment losses.

Fixed Maturities Impairments. We have a process in place to identify securities that could potentially have a credit impairment that is other than temporary. This process involves monitoring market events that could impact issuers credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Each reporting period, a group of individuals including the Chief Investment Officer, our Portfolio Managers, members of our Workout Group and representatives from Investment Accounting review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. The analysis focuses on each issuer's ability to service its debts in a timely fashion. Formal documentation of the analysis and our decision is prepared and approved by management.

We consider relevant facts and circumstances in evaluating whether a credit or interest-rate related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; (4) for structured securities, the adequacy of the expected cash flows and (5) our intent to sell the security or whether it is more likely than not we will be required to sell the security before recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine that a security is deemed to be other than temporarily impaired, an impairment loss is recognized. For additional details, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments.

We would not consider a security with unrealized losses to be other than temporarily impaired when it is not our intent to sell the security, it is not more likely than not that we would be required to sell the security before recovery of the amortized cost, which may be maturity, and we

expect to recover the amortized cost basis. However, we do sell securities under certain circumstances, such as when we have evidence of a change in the issuer's creditworthiness, when we anticipate poor relative future performance of securities, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities. Sales generate both gains and losses.

There are a number of significant risks and uncertainties inherent in the process of monitoring credit impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer's ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to not sell the security prior to recovery of its amortized cost. Any of these situations could result in a charge to net income in a future period.

The net realized loss relating to other-than-temporary credit impairments and credit related sales of fixed maturities was \$7.6 million and \$21.7 million for the three months ended September 30, 2015 and 2014, respectively and \$21.2 million and \$66.7 million for the nine months ended September 30, 2015 and 2014, respectively.

Table of Contents*Fixed Maturities Available-for-Sale*

The following tables present our fixed maturities available-for-sale by industry category and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in AOCI, as of the periods indicated.

| | | | | | | | | | |
|---|-----------------------|----|----------|----|---------|----|-------|----|----------|
| Finance | Banking | \$ | 3,779.1 | \$ | 117.0 | \$ | 114.3 | \$ | 3,781.8 |
| Finance | Brokerage | | 235.2 | | 18.3 | | 0.9 | | 252.6 |
| Finance | Finance Companies | | 261.6 | | 6.8 | | 0.6 | | 267.8 |
| Finance | Financial Other | | 475.6 | | 54.7 | | 0.4 | | 529.9 |
| Finance | Insurance | | 2,215.0 | | 221.4 | | 7.7 | | 2,428.7 |
| Finance | REITS | | 880.9 | | 36.0 | | 5.0 | | 911.9 |
| Industrial | Basic Industry | | 1,396.5 | | 48.0 | | 55.5 | | 1,389.0 |
| Industrial | Capital Goods | | 1,650.9 | | 123.0 | | 9.2 | | 1,764.7 |
| Industrial | Communications | | 2,234.7 | | 193.5 | | 18.1 | | 2,410.1 |
| Industrial | Consumer Cyclical | | 1,405.2 | | 61.2 | | 9.3 | | 1,457.1 |
| Industrial | Consumer Non-Cyclical | | 3,165.1 | | 167.0 | | 10.8 | | 3,321.3 |
| Industrial | Energy | | 2,849.7 | | 142.9 | | 133.2 | | 2,859.4 |
| Industrial | Other | | 318.1 | | 15.8 | | 0.3 | | 333.6 |
| Industrial | Technology | | 1,099.3 | | 33.3 | | 2.3 | | 1,130.3 |
| Industrial | Transportation | | 1,056.8 | | 46.1 | | 15.8 | | 1,087.1 |
| Utility | Electric | | 2,734.5 | | 201.5 | | 14.0 | | 2,922.0 |
| Utility | Natural Gas | | 254.1 | | 13.3 | | 1.2 | | 266.2 |
| Utility | Other | | 261.3 | | 17.0 | | | | 278.3 |
| Government guaranteed | | | 1,105.1 | | 107.9 | | 15.3 | | 1,197.7 |
| Total corporate securities | | | 27,378.7 | | 1,624.7 | | 413.9 | | 28,589.5 |
| Residential mortgage-backed pass-through securities | | | 2,559.6 | | 111.9 | | 5.0 | | 2,666.5 |
| Commercial mortgage-backed securities | | | 3,774.3 | | 103.0 | | 50.6 | | 3,826.7 |
| Residential collateralized mortgage obligations | | | 1,386.3 | | 27.3 | | 4.1 | | 1,409.5 |
| Asset-backed securities | Home equity (1) | | 288.3 | | 15.8 | | 10.3 | | 293.8 |
| Asset-backed securities | All other | | 2,824.8 | | 17.7 | | 5.3 | | 2,837.2 |
| Collateralized debt obligations | Credit | | 52.2 | | | | 18.8 | | 33.4 |
| Collateralized debt obligations | CMBS | | 3.2 | | 0.1 | | | | 3.3 |
| Collateralized debt obligations | Loans | | 600.5 | | 1.1 | | 5.3 | | 596.3 |
| Total mortgage-backed and other asset-backed securities | | | 11,489.2 | | 276.9 | | 99.4 | | 11,666.7 |
| U.S. government and agencies | | | 1,354.3 | | 39.6 | | 3.2 | | 1,390.7 |
| States and political subdivisions | | | 4,245.0 | | 231.4 | | 20.7 | | 4,455.7 |
| Non-U.S. governments | | | 317.2 | | 82.1 | | 1.3 | | 398.0 |
| Total fixed maturities, available-for-sale | | \$ | 44,784.4 | \$ | 2,254.7 | \$ | 538.5 | \$ | 46,500.6 |

(1) This exposure is all related to sub-prime mortgage loans.

Table of Contents

| | | December 31, 2014 | | | |
|---|-----------------------|-------------------|------------------------------|-------------------------------|--------------------|
| | | Amortized cost | Gross unrealized gains | Gross unrealized losses | Carrying amount |
| | | (in millions) | | | |
| Finance | Banking | \$ 3,734.8 | \$ 148.0 | \$ 92.4 | \$ 3,790.4 |
| Finance | Brokerage | 282.3 | 22.0 | | 304.3 |
| Finance | Finance Companies | 210.0 | 7.7 | 0.5 | 217.2 |
| Finance | Financial Other | 403.8 | 55.8 | 0.2 | 459.4 |
| Finance | Insurance | 2,218.5 | 277.1 | 2.0 | 2,493.6 |
| Finance | REITS | 816.8 | 47.1 | 2.3 | 861.6 |
| Industrial | Basic Industry | 1,527.2 | 82.7 | 12.4 | 1,597.5 |
| Industrial | Capital Goods | 1,543.1 | 144.4 | 2.5 | 1,685.0 |
| Industrial | Communications | 2,302.0 | 268.8 | 9.9 | 2,560.9 |
| Industrial | Consumer Cyclical | 1,332.2 | 78.4 | 3.1 | 1,407.5 |
| Industrial | Consumer Non-Cyclical | 3,045.4 | 213.9 | 3.6 | 3,255.7 |
| Industrial | Energy | 2,853.1 | 238.7 | 39.4 | 3,052.4 |
| Industrial | Other | 386.0 | 23.1 | 0.2 | 408.9 |
| Industrial | Technology | 1,061.9 | 40.8 | 2.0 | 1,100.7 |
| Industrial | Transportation | 924.8 | 66.8 | 2.2 | 989.4 |
| Utility | Electric | 2,627.2 | 266.1 | 5.3 | 2,888.0 |
| Utility | Natural Gas | 243.2 | 19.9 | 0.1 | 263.0 |
| Utility | Other | 253.0 | 19.6 | | 272.6 |
| Government guaranteed | | 1,226.0 | 130.3 | 10.3 | 1,346.0 |
| Total corporate securities | | 26,991.3 | 2,151.2 | 188.4 | 28,954.1 |
| Residential mortgage-backed pass-through securities | | 2,687.0 | 124.5 | 6.3 | 2,805.2 |
| Commercial mortgage-backed securities | | 3,896.9 | 141.5 | 62.9 | 3,975.5 |
| Residential collateralized mortgage obligations | | 1,229.5 | 25.6 | 5.0 | 1,250.1 |
| Asset-backed securities Home equity (1) | | 312.0 | 14.6 | 15.1 | 311.5 |
| Asset-backed securities All other | | 3,041.9 | 17.3 | 4.4 | 3,054.8 |
| Collateralized debt obligations Credit | | 52.4 | | 18.0 | 34.4 |
| Collateralized debt obligations CMBS | | 3.2 | 0.1 | | 3.3 |
| Collateralized debt obligations Loans | | 465.6 | 3.4 | 2.6 | 466.4 |
| Total mortgage-backed and other asset-backed securities | | 11,688.5 | 327.0 | 114.3 | 11,901.2 |
| U.S. government and agencies | | 1,085.6 | 39.1 | 2.9 | 1,121.8 |
| States and political subdivisions | | 3,916.8 | 291.3 | 4.1 | 4,204.0 |
| Non-U.S. governments | | 357.2 | 90.8 | 1.4 | 446.6 |
| Total fixed maturities, available-for-sale | | \$ 44,039.4 | \$ 2,899.4 | \$ 311.1 | \$ 46,627.7 |

(1) This exposure is all related to sub-prime mortgage loans.

Of the \$538.5 million in gross unrealized losses as of September 30, 2015, \$2.1 million in losses were attributed to securities scheduled to mature in one year or less, \$75.1 million attributed to securities scheduled to mature between one to five years, \$132.3 million attributed to securities scheduled to mature between five to ten years, \$229.6 million attributed to securities scheduled to mature after ten years and \$99.4 million related to mortgage-backed and other ABS that are not classified by maturity year. As of September 30, 2015, we were in a \$1,716.2 million net unrealized gain position as compared to a \$2,588.3 million net unrealized gain position as of December 31, 2014. The \$872.1 million decrease in net unrealized gains for the nine months ended September 30, 2015, can primarily be attributed to widening of credit spreads.

Fixed Maturities Available-for-Sale Unrealized Losses. We believe that our long-term fixed maturities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of cash flow.

We invest in privately placed fixed maturities to enhance the overall value of the portfolio, increase diversification and obtain higher yields than are possible with comparable quality public market securities. Generally, private placements provide broader access to management information, strengthened negotiated protective covenants, call protection features and, where

Table of Contents

applicable, a higher level of collateral. They are, however, generally not freely tradable because of restrictions imposed by federal and state securities laws and illiquid trading markets.

The following table presents our fixed maturities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses, including the other-than-temporary impairment losses reported in OCI, as of the periods indicated.

| | Amortized cost | September 30, 2015 Gross unrealized gains | Gross unrealized losses | Carrying amount | Amortized cost | December 31, 2014 Gross unrealized gains | Gross unrealized losses | Carrying amount |
|---|-------------------|--|-------------------------------|--------------------|-------------------|---|-------------------------------|--------------------|
| | (in millions) | | | | | | | |
| Investment grade: | | | | | | | | |
| Public | \$ 28,118.1 | \$ 1,562.6 | \$ 211.4 | \$ 29,469.3 | \$ 27,534.4 | \$ 2,049.3 | \$ 103.6 | \$ 29,480.1 |
| Private | 12,967.8 | 621.4 | 91.5 | 13,497.7 | 12,785.6 | 763.6 | 40.2 | 13,509.0 |
| Below investment grade: | | | | | | | | |
| Public | 1,785.7 | 22.3 | 128.3 | 1,679.7 | 1,931.3 | 37.4 | 90.0 | 1,878.7 |
| Private | 1,912.8 | 48.4 | 107.3 | 1,853.9 | 1,788.1 | 49.1 | 77.3 | 1,759.9 |
| Total fixed maturities, available-for-sale | \$ 44,784.4 | \$ 2,254.7 | \$ 538.5 | \$ 46,500.6 | \$ 44,039.4 | \$ 2,899.4 | \$ 311.1 | \$ 46,627.7 |

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

| | Public | | September 30, 2015 Private | | Total | |
|--|--------------------|-------------------------------|-------------------------------|-------------------------------|--------------------|-------------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |
| Three months or less | \$ 1,366.0 | \$ 18.9 | \$ 1,028.2 | \$ 25.6 | \$ 2,394.2 | \$ 44.5 |
| Greater than three to six months | 2,131.1 | 66.0 | 1,047.8 | 29.2 | 3,178.9 | 95.2 |
| Greater than six to nine months | 548.0 | 13.8 | 214.3 | 5.2 | 762.3 | 19.0 |
| Greater than nine to twelve months | 220.8 | 19.9 | 120.1 | 6.0 | 340.9 | 25.9 |
| Greater than twelve to twenty-four months | 115.7 | 8.0 | 176.8 | 3.5 | 292.5 | 11.5 |
| Greater than twenty-four to thirty-six months | 373.1 | 10.7 | 196.6 | 9.2 | 569.7 | 19.9 |
| Greater than thirty-six months | 353.0 | 74.1 | 144.1 | 12.8 | 497.1 | 86.9 |
| Total fixed maturities, available-for-sale | \$ 5,107.7 | \$ 211.4 | \$ 2,927.9 | \$ 91.5 | \$ 8,035.6 | \$ 302.9 |

| | Public | | December 31, 2014 Private | | Total | |
|--|--------------------|-------------------------------|------------------------------|-------------------------------|--------------------|-------------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| | (in millions) | | | | | |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | | | |
|---|----|---------|----|-------|----|---------|----|------|----|---------|----|-------|
| Three months or less | \$ | 1,753.2 | \$ | 18.6 | \$ | 969.0 | \$ | 6.8 | \$ | 2,722.2 | \$ | 25.4 |
| Greater than three to six months | | 200.9 | | 4.1 | | 375.7 | | 4.4 | | 576.6 | | 8.5 |
| Greater than six to nine months | | 111.4 | | 1.1 | | 142.3 | | 3.0 | | 253.7 | | 4.1 |
| Greater than nine to twelve months | | 7.5 | | 0.2 | | 60.0 | | 0.3 | | 67.5 | | 0.5 |
| Greater than twelve to twenty-four months | | 1,046.0 | | 20.2 | | 408.6 | | 11.9 | | 1,454.6 | | 32.1 |
| Greater than twenty-four to thirty-six months | | 96.8 | | 2.6 | | 21.6 | | 0.3 | | 118.4 | | 2.9 |
| Greater than thirty-six months | | 436.4 | | 56.8 | | 186.3 | | 13.5 | | 622.7 | | 70.3 |
| Total fixed maturities, available-for-sale | \$ | 3,652.2 | \$ | 103.6 | \$ | 2,163.5 | \$ | 40.2 | \$ | 5,815.7 | \$ | 143.8 |

Table of Contents

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on below investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

| | Public | | September 30, 2015 Private | | Total | |
|---|-----------------|-------------------------|----------------------------------|-------------------------|-----------------|-------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount (in millions) | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| Three months or less | \$ 410.7 | \$ 10.8 | \$ 379.1 | \$ 7.4 | \$ 789.8 | \$ 18.2 |
| Greater than three to six months | 150.8 | 11.8 | 257.7 | 12.4 | 408.5 | 24.2 |
| Greater than six to nine months | 38.0 | 3.1 | 46.0 | 1.8 | 84.0 | 4.9 |
| Greater than nine to twelve months | 125.9 | 41.4 | 64.1 | 12.9 | 190.0 | 54.3 |
| Greater than twelve to twenty-four months | 49.0 | 8.8 | 174.2 | 34.7 | 223.2 | 43.5 |
| Greater than twenty-four to thirty-six months | 14.0 | 3.3 | 65.3 | 1.9 | 79.3 | 5.2 |
| Greater than thirty-six months | 189.1 | 49.1 | 115.6 | 36.2 | 304.7 | 85.3 |
| Total fixed maturities, available-for-sale | \$ 977.5 | \$ 128.3 | \$ 1,102.0 | \$ 107.3 | \$ 2,079.5 | \$ 235.6 |

| | Public | | December 31, 2014 Private | | Total | |
|---|-----------------|-------------------------|----------------------------------|-------------------------|-----------------|-------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount (in millions) | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| Three months or less | \$ 478.0 | \$ 14.8 | \$ 298.1 | \$ 8.3 | \$ 776.1 | \$ 23.1 |
| Greater than three to six months | 111.8 | 4.1 | 274.1 | 15.9 | 385.9 | 20.0 |
| Greater than six to nine months | 8.2 | 0.8 | 52.4 | 0.7 | 60.6 | 1.5 |
| Greater than nine to twelve months | | | 94.8 | 2.8 | 94.8 | 2.8 |
| Greater than twelve to twenty-four months | 21.2 | 0.8 | 66.7 | 8.1 | 87.9 | 8.9 |
| Greater than twenty-four to thirty-six months | 0.5 | | 0.4 | 0.4 | 0.9 | 0.4 |
| Greater than thirty-six months | 280.6 | 69.5 | 151.7 | 41.1 | 432.3 | 110.6 |
| Total fixed maturities, available-for-sale | \$ 900.3 | \$ 90.0 | \$ 938.2 | \$ 77.3 | \$ 1,838.5 | \$ 167.3 |

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in OCI, on fixed maturities available-for-sale where the estimated fair value had declined and remained below amortized cost by 20% or more as of the periods indicated.

| | Problem, potential problem and restructured | | September 30, 2015 All other fixed maturity securities | | Total | |
|----------------------------------|--|-------------------------|--|-------------------------|-----------------|-------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount (in millions) | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| Three months or less | \$ 10.0 | \$ 11.0 | \$ 176.5 | \$ 61.7 | \$ 186.5 | \$ 72.7 |
| Greater than three to six months | 7.6 | 12.0 | 37.4 | 28.7 | 45.0 | 40.7 |

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

| | | | | | | | | | | | | |
|--|------|------|------|------|-------|-------|------|-------|-------|-------|------|-------|
| Greater than six to nine months | | | | | 52.8 | | 20.1 | | 52.8 | | 20.1 | |
| Greater than nine to twelve months | | | | | 80.9 | | 37.2 | | 80.9 | | 37.2 | |
| Greater than twelve months | 29.7 | | 17.4 | | 163.2 | | 71.0 | | 192.9 | | 88.4 | |
| Total fixed maturities, available-for-sale | \$ | 47.3 | \$ | 40.4 | \$ | 510.8 | \$ | 218.7 | \$ | 558.1 | \$ | 259.1 |

Table of Contents

| | Problem, potential problem and restructured | | December 31, 2014 All other fixed maturity securities | | Total | |
|--|--|-------------------------------|---|-------------------------------|--------------------|-------------------------------|
| | Carrying amount | Gross unrealized losses | Carrying amount (in millions) | Gross unrealized losses | Carrying amount | Gross unrealized losses |
| Three months or less | \$ | \$ | \$ 107.4 | \$ 32.4 | \$ 107.4 | \$ 32.4 |
| Greater than three to six months | | | 1.5 | 1.0 | 1.5 | 1.0 |
| Greater than six to nine months | 7.6 | 5.2 | 0.5 | 0.2 | 8.1 | 5.4 |
| Greater than nine to twelve months | | | | 0.2 | | 0.2 |
| Greater than twelve months | 46.3 | 31.4 | 189.1 | 68.8 | 235.4 | 100.2 |
| Total fixed maturities, available-for-sale | \$ 53.9 | \$ 36.6 | \$ 298.5 | \$ 102.6 | \$ 352.4 | \$ 139.2 |

Mortgage Loans

Mortgage loans consist of commercial mortgage loans on real estate and residential mortgage loans. The carrying amount of our commercial mortgage loan portfolio was \$11,085.7 million and \$10,657.2 million as of September 30, 2015 and December 31, 2014, respectively. The carrying amount of our residential mortgage loan portfolio was \$566.0 million and \$507.2 million as of September 30, 2015 and December 31, 2014, respectively.

Commercial Mortgage Loans. We generally report commercial mortgage loans on real estate at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances.

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

- providing strong risk-adjusted relative value in comparison to other investment alternatives;
- enhancing total returns and
- providing strategic portfolio diversification.

As a result, we have focused on constructing a high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages originated with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of well anchored retail properties, office properties, general-purpose industrial properties and apartments.

Our commercial mortgage loan portfolio is diversified by geography and specific collateral property type. Commercial mortgage lending in the state of California accounted for 18% and 19% of our commercial mortgage loan portfolio before valuation allowance as of September 30, 2015 and December 31, 2014, respectively. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building's design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses, by building and geographic fault lines, the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

The typical borrower in our commercial loan portfolio is a single purpose entity or single asset entity. As of September 30, 2015 and December 31, 2014, the total number of commercial mortgage loans outstanding was 892 and 911, of which 61% and 63% were for loans with principal balances less than \$10.0 million, respectively. The average loan size of our commercial mortgage portfolio was \$12.4 million and \$11.7 million as of September 30, 2015 and December 31, 2014, respectively.

Commercial Mortgage Loan Credit Monitoring. For further details on monitoring and management of our commercial mortgage loan portfolio, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Credit Monitoring.

We categorize loans that are 60 days or more delinquent, loans in process of foreclosure and loans with borrowers or credit tenants in bankruptcy that are delinquent as problem loans. Valuation allowances or charge-offs have been recognized on most problem loans. We categorize loans that are delinquent less than 60 days where the default is expected to be cured and

Table of Contents

loans with borrowers or credit tenants in bankruptcy that are current as potential problem loans. The decision whether to classify a loan delinquent less than 60 days as a potential problem involves significant subjective judgments by management as to the likely future economic conditions and developments with respect to the borrower. We categorize loans for which the original note rate has been reduced below market and loans for which the principal has been reduced as restructured loans. We also consider loans that are refinanced more than one year beyond the original maturity or call date at below market rates as restructured.

The following table presents the carrying amounts of problem, potential problem and restructured commercial mortgages relative to the carrying amount of all commercial mortgages for the periods indicated.

| | September 30, 2015 | December 31, 2014 |
|---|--------------------|-------------------|
| | (\$ in millions) | |
| Total commercial mortgages | \$ 11,085.7 | \$ 10,657.2 |
| Problem commercial mortgages (1) | \$ 28.2 | \$ 4.5 |
| Potential problem commercial mortgages | 16.2 | 28.3 |
| Restructured problem commercial mortgages | | 2.7 |
| Total problem, potential problem and restructured commercial mortgages | \$ 44.4 | \$ 35.5 |
| Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages | 0.40% | 0.33% |

(1) Includes \$0.0 million of commercial mortgage loans in foreclosure as of both September 30, 2015 and December 31, 2014.

Commercial Mortgage Loan Valuation Allowance. The valuation allowance for commercial mortgage loans includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. For further details on the commercial mortgage loan valuation allowance, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Valuation Allowance.

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

| | For the nine months ended September 30, 2015 | For the year ended December 31, 2014 |
|------------------------------|---|---|
| | (\$ in millions) | |
| Balance, beginning of period | \$ 26.9 | \$ 28.7 |
| Provision | 3.5 | (0.9) |
| Charge-offs | | (0.9) |
| Recoveries | 0.1 | |
| Balance, end of period | \$ 30.5 | \$ 26.9 |

Valuation allowance as % of carrying value before reserves

0.27%

0.25%

Residential Mortgage Loans. The residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$234.1 million and \$283.4 million and first lien mortgages with an amortized cost of \$357.6 million and \$252.9 million as of September 30, 2015 and December 31, 2014, respectively. The home equity loans are generally second lien mortgages made up of closed-end loans and lines of credit. Non-performing residential mortgage loans, which are defined as loans 90 days or greater delinquent plus non-accrual loans, totaled \$17.0 million and \$20.4 million as of September 30, 2015 and December 31, 2014, respectively.

We establish the residential mortgage loan valuation allowance at levels considered adequate to absorb estimated probable losses within the portfolio based on management's evaluation of the size and current risk characteristics of the portfolio. Such evaluation considers numerous factors, including, but not limited to net charge-off trends, loss forecasts, collateral values, geographic location, borrower credit scores, delinquency rates, industry condition and economic trends. The changes in the valuation allowance are reported in net realized capital gains (losses) on our consolidated statements of operations.

Table of Contents

Our residential mortgage loan portfolio, and in particular our home equity loan portfolio, experienced an increase in loss severity from sustained elevated levels of unemployment along with continued depressed collateral values beginning in 2010. While these factors continue to drive charge-offs, loss rates overall have stabilized and the portfolio balance continues to decline. The following table represents our residential mortgage loan valuation allowance for the periods indicated.

| | For the nine months ended September 30, 2015 | | For the year ended December 31, 2014 |
|--|---|----|---|
| | (\$ in millions) | | |
| Balance, beginning of period | \$ 29.1 | \$ | 40.3 |
| Provision | 1.5 | | 7.9 |
| Charge-offs | (7.5) | | (22.7) |
| Recoveries | 2.6 | | 3.6 |
| Balance, end of period | \$ 25.7 | \$ | 29.1 |
| Valuation allowance as % of carrying value before reserves | 4.3% | | 5.4% |

Real Estate

Real estate consists primarily of commercial equity real estate. As of September 30, 2015 and December 31, 2014, the carrying amount of our equity real estate investment was \$1,410.1 million, or 2%, and \$1,340.4 million, or 2%, of U.S. invested assets, respectively. Our commercial equity real estate is held in the form of wholly owned real estate, real estate acquired upon foreclosure of commercial mortgage loans and majority owned interests in real estate joint ventures.

Equity real estate is categorized as either real estate held for investment or real estate held for sale. Real estate held for investment totaled \$1,254.7 million and \$1,168.6 million as of September 30, 2015 and December 31, 2014, respectively. The carrying value of real estate held for investment is generally adjusted for impairments whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized capital losses in our consolidated results of operations. Impairment adjustments recorded for the year ended December 31, 2014 were \$6.2 million. No such impairment adjustments were recorded for the nine months ended September 30, 2015.

The carrying amount of real estate held for sale was \$155.4 million and \$171.8 million as of September 30, 2015 and December 31, 2014, respectively. Once we identify a real estate property to be sold and commence a plan for marketing the property, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs. No valuation allowance was established during the nine months ended September 30, 2015, or the year ended December 31, 2014.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Edgar Filing: PRINCIPAL FINANCIAL GROUP INC - Form 10-Q

Equity real estate is distributed across geographic regions of the country. As of September 30, 2015, our equity real estate portfolio was concentrated in the Pacific (37%), South Atlantic (20%), and West South Central (19%) regions of the United States. By property type, there is a concentration in office that represented approximately 47% of the equity real estate portfolio as of September 30, 2015.

Other Investments

Our other investments totaled \$1,945.3 million as of September 30, 2015, compared to \$1,688.0 million as of December 31, 2014. Derivative assets accounted for \$813.9 million and \$651.5 million in other investments as of September 30, 2015 and December 31, 2014, respectively. The remaining invested assets are primarily related to equity method investments, which include real estate properties owned jointly with venture partners and operated by the partners, and seed money.

Table of Contents**International Investment Operations**

Of our invested assets, \$6,418.0 million were held by our Principal International segment as of September 30, 2015. The assets are primarily managed by the local Principal International affiliate. Due to the regulatory constraints in each country, each company maintains its own investment policies. As shown in the following table, the major category of international invested assets is fixed maturities. The following table excludes invested assets of the separate accounts.

| | September 30, 2015 | | December 31, 2014 | |
|--|--------------------|---------------------|--------------------|---------------------|
| | Carrying amount | Percent of total | Carrying amount | Percent of total |
| | (\$ in millions) | | | |
| Fixed maturities: | | | | |
| Public | \$ 3,452.7 | 54% | \$ 3,245.2 | 53% |
| Private | 2.5 | | 2.1 | |
| Equity securities | 1,031.9 | 16 | 662.7 | 11 |
| Mortgage loans: | | | | |
| Commercial | 63.6 | 1 | 39.7 | 1 |
| Residential | 516.8 | 8 | 607.5 | 10 |
| Real estate held for sale | 3.2 | | 2.2 | |
| Real estate held for investment | 1.7 | | 2.0 | |
| Policy loans | 20.5 | | 22.7 | |
| Other investments: | | | | |
| Direct financing leases | 771.3 | 12 | 790.8 | 13 |
| Investment in equity method subsidiaries | 458.8 | 7 | 614.7 | 10 |
| Derivative assets and other short-term investments | 95.0 | 2 | 116.3 | 2 |
| Total invested assets | 6,418.0 | 100% | 6,105.9 | 100% |
| Cash and cash equivalents | 424.0 | | 101.4 | |
| Total invested assets and cash | \$ 6,842.0 | | \$ 6,207.3 | |

Regulations in certain locations require investment in the funds we manage. These regulatory required investments are classified as equity securities, trading within our consolidated statements of financial position, with all mark-to-market changes reflected in net investment income. Our investment is primarily dictated by client activity and all investment performance is retained by us.

Item 3. Quantitative and Qualitative Disclosures About Market Risk**Market Risk Exposures and Risk Management**

Market risk is the risk we will incur losses due to adverse fluctuations in market rates and prices. Our primary market risk exposures are to interest rates, equity markets and foreign currency exchange rates. The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges by using the following approaches:

- rebalance our existing asset or liability portfolios;
- control the risk structure of newly acquired assets and liabilities or
- use derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

Interest Rate Risk

Interest rate risk is the risk we will incur economic losses due to adverse changes in interest rates. We are exposed to interest rate risk from several sources:

- Due to the inherent difficulty in obtaining assets that mature or have their rate reset at the exact same time as the liabilities they support, assets may have to be reinvested or sold in the future to meet the liability cash flows in unknown interest rate environments.
- There may be timing differences between when new liabilities are priced and when assets are purchased or procured that can cause fluctuations in profitability if interest rates move materially in the interim.
- Prepayment options embedded within asset and liability contracts can alter the cash flow profiles from what was

Table of Contents

originally expected.

- The spreads between the investment income we earn and the interest we credit to customers who own products with guaranteed minimum interest rates may decrease (or potentially become negative) during periods of sustained low interest rates.
- During periods of sustained low interest rates, the interest rates that we earn on our assets may be lower than the rates assumed in pricing our insurance products, thereby reducing our profitability. If interest rates remain low over a sustained period of time, this may result in increases in our reserves and/or unlocking of our DAC asset and other actuarial balances.
- During periods of rising interest rates, policy surrenders, withdrawals, and requests for policy loans may increase as customers seek to achieve higher returns. This may result in unlocking of our DAC and other actuarial balances. We may be required to sell assets to raise the cash necessary to respond to such surrenders, withdrawals and loans, thereby realizing capital losses on the assets sold. In addition, the value of fixed income assets we manage may decline in periods of rising interest rates, resulting in lower fee revenue that we may collect.
- For our long-term borrowings, we are exposed to interest rate risk at the time of maturity or early redemption, when we may be required to refinance our obligations.
- We are exposed to interest rate risk based upon the discount rate assumption used for purposes of valuing our pension and other postretirement benefit obligations.

An increase in market interest rates may cause the fair value of our financial assets to decline. The reduction in the fair value of our financial assets would be partly offset by a corresponding reduction in the fair value of our financial liabilities. The following tables show the net estimated potential loss in fair value at a total company level from a hypothetical 100 basis point immediate, parallel increase in interest rates as of September 30, 2015, and December 31, 2014. Our selection of a 100 basis point immediate, parallel increase in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While these fair value measurements provide a representation of interest rate sensitivity, they are based on our portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing portfolio transactions in response to new business, management's assessment of changing market conditions and available investment opportunities.

| Notional | September 30, 2015 | | |
|---|---------------------------------|---|--|
| | Asset (liability) fair value | Hypothetical fair value after +100 basis point parallel yield curve shift (in millions) | Hypothetical changes in fair value |
| Financial assets with interest rate risk: | | | |
| Fixed maturities, available-for-sale | \$ 49,780.6 | \$ 47,400.0 | \$ (2,380.6) |
| Fixed maturities, trading | 710.2 | 685.4 | (24.8) |
| Mortgage loans | 12,752.8 | 12,210.4 | (542.4) |
| Policy loans | 1,049.0 | 952.5 | (96.5) |
| Equity securities, available-for-sale | 315.8 | 302.6 | (13.2) |
| Equity securities, trading | 402.6 | 386.3 | (16.3) |
| Other investments | 52.1 | 54.9 | 2.8 |

Financial liabilities with interest rate risk:

| | | | |
|-------------------------------------|------------|------------|-------|
| Investment-type insurance contracts | (28,492.2) | (27,655.2) | 837.0 |
| Long-term debt | (3,431.0) | (3,163.6) | 267.4 |
| Bank deposits | (2,008.7) | (1,999.6) | 9.1 |

Derivatives with interest rate risk:

| | | | | |
|-----------------------|-------------|--------|---------|---------|
| Interest rate swaps | \$ 21,931.0 | 97.9 | (273.9) | (371.8) |
| Currency swaps | 1,831.6 | (78.3) | (85.3) | (7.0) |
| Equity options | 3,558.2 | (19.4) | (87.2) | (67.8) |
| Interest rate options | 4,900.0 | 39.3 | 31.7 | (7.6) |
| Swaptions | 159.0 | | 0.3 | 0.3 |
| Interest rate futures | 173.5 | (1.5) | 9.0 | 10.5 |

Net estimated potential loss in fair value \$ (2,400.9)

Table of Contents

| Notional | December 31, 2014 | | |
|--|---------------------------------|---|--|
| | Asset (liability) fair value | Hypothetical fair value after +100 basis point parallel yield curve shift (in millions) | Hypothetical changes in fair value |
| Financial assets with interest rate risk: | | | |
| Fixed maturities, available-for-sale | \$ 49,670.8 | \$ 47,225.5 | \$ (2,445.3) |
| Fixed maturities, trading | 604.6 | 583.8 | (20.8) |
| Mortgage loans | 12,350.2 | 11,811.9 | (538.3) |
| Policy loans | 1,083.2 | 981.6 | (101.6) |
| Equity securities, trading | 648.5 | 626.6 | (21.9) |
| Other investments | 121.2 | 127.3 | 6.1 |
| Financial liabilities with interest rate risk: | | | |
| Investment-type insurance contracts | (28,499.1) | (27,699.2) | 799.9 |
| Long-term debt | (2,786.1) | (2,539.6) | 246.5 |
| Bank deposits | (1,985.5) | (1,976.5) | 9.0 |
| Derivatives with interest rate risk: | | | |
| Interest rate swaps | \$ 19,182.6 | (38.1) | (208.3) |
| Currency swaps | 1,975.5 | (0.9) | (6.4) |
| Equity options | 3,293.4 | (101.4) | (153.9) |
| Interest rate options | 4,900.0 | 40.3 | 43.8 |
| Swaptions | 260.0 | 0.6 | 0.6 |
| Interest rate futures | 147.5 | 0.3 | 8.3 |
| Net estimated potential loss in fair value | | | \$ (2,282.5) |

The tables include only the portion of assets and liabilities that are interest rate sensitive. Separate account assets and liabilities, which are interest rate sensitive, are not included in the tables, as any interest rate risk is borne by the holder of the separate account. The fair value sensitivities of our U.S. operations' foreign financial assets and liabilities have been netted within the currency swaps line item due to fully hedging the foreign exposure.

The tables above do not include approximately \$32,762.7 million of liabilities relating to insurance contracts involving significant mortality or morbidity risk as of September 30, 2015 and \$31,143.2 million as of December 31, 2014, which are not considered financial liabilities. We believe the interest rate sensitivities of these insurance liabilities would economically serve as a partial offset to the net interest rate risk of the financial assets and liabilities that are set forth in these tables.

Our net estimated potential loss in fair value as of September 30, 2015, increased \$118.4 million from December 31, 2014, primarily due to an increase in the interest rate sensitivity of our derivatives with interest rate risk.

Table of Contents

The following table provides detail on the differences between the interest rates being credited to contractholders as of September 30, 2015, and the respective guaranteed minimum interest rates (GMIRs), broken down by GMIR level within the Retirement and Investor Services and U.S. Insurance Solutions segments.

| | Account values (1) | | | | | | Total |
|----------------------------------|--------------------|---------------------------|--------------------------------------|------------------------------|-----------------------------|-------------|-------|
| | At GMIR | Up to 0.50% above GMIR | Excess of crediting rates over GMIR: | | 2.01% or more above GMIR | | |
| | | | 0.51% to 1.00% above GMIR | 1.01% to 2.00% above GMIR | | | |
| (\$ in millions) | | | | | | | |
| Guaranteed minimum interest rate | | | | | | | |
| Retirement and Investor Services | | | | | | | |
| Up to 1.00% | \$ 528.8 | \$ 1,617.9 | \$ 3,870.7 | \$ 536.5 | \$ 51.3 | \$ 6,605.2 | |
| 1.01% - 2.00% | 444.3 | 0.7 | 9.0 | 26.3 | | 480.3 | |
| 2.01% - 3.00% | 7,228.1 | 843.4 | 4.3 | 28.0 | | 8,103.8 | |
| 3.01% - 4.00% | 232.1 | | | | | 232.1 | |
| Subtotal | 8,433.3 | 2,462.0 | 3,884.0 | 590.8 | 51.3 | 15,421.4 | |
| U.S. Insurance Solutions | | | | | | | |
| Up to 1.00% | | | 31.5 | | 24.6 | 56.1 | |
| 1.01% - 2.00% | 292.0 | | 159.3 | 134.6 | 34.3 | 620.2 | |
| 2.01% - 3.00% | 1,879.9 | 1,016.6 | 228.7 | 80.6 | 0.1 | 3,205.9 | |
| 3.01% - 4.00% | 1,437.2 | 60.9 | 12.1 | 35.0 | 4.5 | 1,549.7 | |
| 4.01% - 5.00% | 192.2 | 64.6 | 59.3 | 13.4 | | 329.5 | |
| Subtotal | 3,801.3 | 1,142.1 | 490.9 | 263.6 | 63.5 | 5,761.4 | |
| Total | \$ 12,234.6 | \$ 3,604.1 | \$ 4,374.9 | \$ 854.4 | \$ 114.8 | \$ 21,182.8 | |
| Percentage of total | 57.8% | 17.0% | 20.7% | 4.0% | 0.5% | 100.0% | |

(1) Includes only the account values, net of policy loans, for products with GMIRs and discretionary crediting rates.

During periods of low or declining interest rates, our margin of investment income above our interest credited to our liabilities (investment margins) may be negatively impacted. Assuming a hypothetical scenario where market interest rates immediately fall by 25 basis points from their September 30, 2015, levels and then remain unchanged thereafter, we estimate that the impact of such an environment could reduce our investment margins for our domestic business by approximately \$1.4 million and \$4.5 million pre-tax during the twelve months ending September 30, 2016 and 2017, respectively, compared to a scenario where market interest rates remain unchanged from their September 30, 2015, levels. This hypothetical scenario reflects only the impact related to the approximately \$21.2 billion of in-force contracts with guaranteed minimum interest rates shown above, and does not reflect potential impacts on our DAC asset and other actuarial balances. In determining the potential impact, we have reflected the impact of potential changes in crediting rates to policyholders, limited by any restrictions on our ability to adjust crediting rates due to guaranteed minimum interest rates. Our estimates of future margins include the impact of expected premium payments, lapses, and withdrawals on existing policies, but they do not include the impact of new sales. Our selection of a 25 basis point immediate, parallel decrease in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 25 basis point immediate, parallel decrease does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events.

We manage interest rate risk through the use of an integrated risk management framework that helps us identify, assess, monitor, report and manage our risks within established limits and risk tolerances. Our internal risk committees monitor and discuss our risk profile and identify necessary actions to mitigate impacts from interest rate risk.

We also limit our exposure to interest rate risk through our business mix and strategy. We have intentionally limited our exposure to specific products where investment margins are critical to the product's profitability, and we continue to emphasize the sale of products that generate revenues in the form of fees for service or premiums for insurance coverage and expose us to minimal interest rate risk.

One of the measures we use to quantify our exposure to interest rate risk is duration, which is a measure of the sensitivity of the fair value of assets and liabilities to changes in interest rates. Differences in durations between assets and liabilities are measured and kept within acceptable tolerances. Derivatives are also commonly used to mitigate interest rate risk due to cash flow mismatches and timing differences. Prepayment risk is controlled by limiting our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer. We also require additional yield on these investments to compensate for the risk the issuer will exercise such option. Prepayment risk is also controlled by limiting the sales of

Table of Contents

liabilities with features such as puts or other options that can be exercised against the company at inopportune times. We manage the interest rate risk associated with our long-term borrowings by monitoring the interest rate environment and evaluating refinancing opportunities as maturity dates approach.

See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Valuation and Impairment of Fixed Income Investments in our Annual Report on Form 10-K for the year ended December 31, 2014, for additional discussion of the impact interest rate increases would have on fixed maturities, available-for-sale.

The plan fiduciaries use a Dynamic Asset Allocation strategy for our qualified defined benefit pension plan, which strategically allocates an increasing portion of the assets of the pension plan to fixed income securities as the funding status improves. The intended purpose of using the Dynamic Asset Allocation strategy is that the expected change in the value of the plan assets and the change in pension benefit obligation due to market movements are more likely to have more correlation versus a static allocation of assets between categories. For more information see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Benefit Plans and Item 8. Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 7, Employee and Agent Benefits in our Annual Report on Form 10-K for the year ended December 31, 2014.

Use of Derivatives to Manage Interest Rate Risk. We use or have previously used various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, interest rate collars, swaptions and futures. We use interest rate swaps and futures contracts to hedge changes in interest rates subsequent to the issuance of an insurance liability, such as a guaranteed investment contract, but prior to the purchase of a supporting asset, or during periods of holding assets in anticipation of near term liability sales. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities. They can be used to change the sensitivity to the interest rate of specific assets and liabilities as well as an entire portfolio. We use interest rate collars to manage interest rate risk related to GMIR liabilities in our individual annuities contracts and lapse risk associated with higher interest rates. We purchase swaptions to offset or modify existing exposures.

Foreign Currency Risk

Foreign currency risk is the risk we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements issued to nonqualified institutional investors in the international market, foreign currency-denominated fixed maturity and equity securities, and our international operations, including potential acquisition and divestiture activity.

We estimate that as of September 30, 2015, a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we are exposed would result in no material change to the net fair value of our foreign currency denominated instruments identified above because we effectively hedge foreign currency denominated instruments to minimize exchange rate impacts, which is consistent with our estimate as of December 31, 2014. However, fluctuations in foreign currency exchange rates do affect the translation of operating earnings and equity of our international operations into our consolidated financial statements.

For our Principal International segment, we estimate that a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we were exposed would have resulted in a \$305.7 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of September 30, 2015, as compared to an estimated \$302.6 million, or 10%, reduction as of December 31, 2014. We estimate that a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a \$4.6 million, or 10%, reduction in the operating earnings of our international operations for the three months ended September 30, 2015, as compared to an estimated \$6.5 million, or 9%, reduction for the three months ended September 30, 2014. In addition, we estimate that a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a \$18.6 million, or 11%, reduction in the operating earnings of our international operations for the nine months ended September 30, 2015, as compared to an estimated \$21.1 million, or 10%, reduction for the nine months ended September 30, 2014.

The selection of a 10% immediate unfavorable change in all currency exchange rates should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. These exposures will change as a result of a change in the size and mix of our foreign operations.

Use of Derivatives to Manage Foreign Currency Risk. The foreign currency risk on funding agreements and fixed maturities in our U.S. operations is mitigated by using currency swaps that swap the foreign currency interest and principal

Table of Contents

payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities was \$1,190.5 million as of both September 30, 2015 and December 31, 2014. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturities was \$492.7 million and \$644.5 million as of September 30, 2015 and December 31, 2014, respectively. The notional amount of our currency forwards hedging foreign-denominated equity securities was \$14.9 million and \$17.9 million as of September 30, 2015 and December 31, 2014, respectively.

With regard to our international operations, in order to enhance the diversification of our investment portfolios we may invest in bonds denominated in a currency that is different than the currency of our liabilities. We use foreign exchange derivatives to economically hedge the currency mismatch. Our Principal International operations had currency swaps with a notional amount of \$148.4 million and \$140.5 million as of September 30, 2015 and December 31, 2014, respectively. Principal International also utilized currency forwards with a notional amount of \$948.1 million and \$252.8 million as of September 30, 2015 and December 31, 2014, respectively.

There are times when we use derivatives to manage the foreign currency risk associated with a business combination. There were no hedges of business combinations outstanding at September 30, 2015 or December 31, 2014. Additionally, from time to time we take measures to hedge certain net equity investments in our foreign subsidiaries from currency risks. We used currency forwards during 2015 to hedge certain net investments in foreign operations. Currency forwards were not used for hedging any net investments in foreign operations during 2014.

Equity Risk

Equity risk is the risk we will incur economic losses due to adverse fluctuations in common stock prices. As of September 30, 2015 and December 31, 2014, the fair value of our equity securities was \$1,334.4 million and \$963.2 million, respectively. As of September 30, 2015, we estimate that a 10% decline in the value of the equity securities would result in a decline in fair value of the equity securities of \$133.4 million, as compared to a decline in fair value of the equity securities of \$96.3 million as of December 31, 2014.

We are also exposed to the risk that asset-based fees decrease as a result of declines in assets under management due to changes in investment prices and the risk that asset management fees calculated by reference to performance could be lower. The risk of decreased asset-based and asset management fees could also impact our estimates of total gross profits used as a basis for amortizing deferred acquisition costs and other actuarial balances. We estimate that an immediate 10% decline in the S&P index, followed by a 2% per quarter increase would reduce our annual operating earnings by approximately 4% to 6%. For further discussion, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Deferred Acquisition Costs and Other Actuarial Balances in our Annual Report on Form 10-K for the year ended December 31, 2014.

The selection of a 10% unfavorable change in the equity markets should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. Our exposure will change as a result of changes in our mix of business.

We also have equity risk associated with (1) fixed deferred annuity and universal life contracts that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a GMWB rider that allows the customer to make withdrawals of a specified annual amount, either for a fixed number of years or for the lifetime of the customer, even if the account value is reduced to zero; (3) variable annuity contracts that have a guaranteed minimum death benefit (GMDB) that allows the death benefit to be paid, even if the account value has

fallen below the GMDB amount and (4) investment-type insurance contracts in which the return is subject to minimum contractual guarantees. We are also subject to equity risk based upon the assets that support our employee benefit plans. For further discussion of equity risk associated with these plans, see Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Benefit Plans in our Annual Report on Form 10-K for the year ended December 31, 2014.

Use of Derivatives to Manage Equity Risk. We economically hedge the fixed deferred annuity and universal life products, where the interest credited is linked to an external equity index, by purchasing options that match the product's profile or selling options to offset existing exposures. We economically hedged the GMWB exposure, which includes interest rate risk and equity risk, using futures, options and interest rate swaps with notional amounts of \$736.9 million, \$3,229.2 million, and \$3,986.4 million, respectively, as of September 30, 2015, and notional amounts of \$645.6 million, \$2,969.2 million, and \$3,790.4 million, respectively, as of December 31, 2014. The fair value of both the GMWB embedded derivative and associated hedging instruments are sensitive to financial market conditions and the variance related to the change in fair value of these items for a given period is largely dependent on market conditions at the end of the period.

Table of Contents

Item 4. Controls and Procedures

Changes in Internal Control Over Financial Reporting

There was no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Disclosure Controls and Procedures

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chairman, Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chairman, Larry D. Zimpleman, our Chief Executive Officer, Daniel J. Houston, and our Chief Financial Officer, Terrance J. Lillis, have reviewed and evaluated our disclosure controls and procedures as of September 30, 2015, and have concluded that our disclosure controls and procedures are effective.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Part I, Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Contingencies, Guarantees and Indemnifications under the caption, Litigation and Regulatory Contingencies and in Part I, Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 6, Income Taxes which are incorporated here by this reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, consideration should be given to the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2014. If any of those factors were to occur, they could materially

adversely affect our business, financial condition or future results, and could cause actual results to differ materially from those expressed in forward-looking statements in this report. There have been no material changes with respect to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Table of Contents**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table presents the amount of our common share purchase activity for the periods indicated.

Issuer Purchases of Equity Securities

| Period | Total number of shares purchased (1) | Average price paid per share | Total number of shares purchased as part of publicly announced programs | Maximum dollar value of shares that may yet be purchased under the programs (in millions) (2) |
|--|--|------------------------------------|---|--|
| January 1, 2015 – January 31, 2015 | 315 | \$ 51.81 | | \$ 50.0 |
| February 1, 2015 – February 28, 2015 | 842 | \$ 46.93 | | \$ 200.0 |
| March 1, 2015 – March 31, 2015 | 1,478,105 | \$ 50.96 | 983,863 | \$ 150.0 |
| April 1, 2015 – April 30, 2015 | 573 | \$ 51.20 | | \$ 150.0 |
| May 1, 2015 – May 31, 2015 | 1,653 | \$ 51.67 | | \$ 150.0 |
| June 1, 2015 – June 30, 2015 | 534 | \$ 52.88 | | \$ 150.0 |
| July 1, 2015 – July 31, 2015 | 528,054 | \$ 52.26 | 528,054 | \$ 122.4 |
| August 1, 2015 – August 31, 2015 | 575,110 | \$ 55.16 | 575,110 | \$ 90.7 |
| September 1, 2015 – September 30, 2015 | 1,098,465 | \$ 48.50 | 1,098,465 | \$ 37.4 |
| Total | 3,683,651 | | 3,185,492 | |

(1) Includes the number of shares of common stock utilized to execute certain stock incentive awards and shares purchased as part of publicly announced programs.

(2) In February 2014, our Board of Directors authorized a repurchase program of up to \$200.0 million of our outstanding common stock, which was completed in March 2015. In February 2015, our Board of Directors authorized a repurchase program of up to \$150.0 million of our outstanding common stock, of which \$37.4 million was outstanding as of September 30, 2015. In October 2015, our Board of Directors authorized an additional repurchase program of up to \$150.0 million of our outstanding common stock.

Table of Contents

Item 6. Exhibits

| Exhibit Number | Description |
|-----------------------|---|
| 12 | Statement Regarding Computation of Ratio of Earnings to Fixed Charges |
| 31.1 | Certification of Larry D. Zimpleman |
| 31.2 | Certification of Daniel J. Houston |
| 31.3 | Certification of Terrance J. Lillis |
| 32.1 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman |
| 32.2 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Daniel J. Houston |
| 32.3 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis |
| 101 | The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2015 formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Unaudited Consolidated Financial Statements. |

Table of Contents

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PRINCIPAL FINANCIAL GROUP, INC.

Dated: October 28, 2015

By

/s/ Terrance J. Lillis
Terrance J. Lillis
Executive Vice President and Chief Financial Officer

Duly Authorized Officer, Principal Financial Officer,
and
Chief Accounting Officer

Table of Contents

Exhibit Index

| Exhibit Number | Description |
|-----------------------|---|
| 12 | Statement Regarding Computation of Ratio of Earnings to Fixed Charges |
| 31.1 | Certification of Larry D. Zimpleman |
| 31.2 | Certification of Daniel J. Houston |
| 31.3 | Certification of Terrance J. Lillis |
| 32.1 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman |
| 32.2 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Daniel J. Houston |
| 32.3 | Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis |
| 101 | The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the period ended September 30, 2015 formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders' Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Unaudited Consolidated Financial Statements. |