

PRINCIPAL FINANCIAL GROUP INC  
Form 10-Q  
October 30, 2013  
[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, 2013

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 23, 2013, was 294,370,290.



Table of Contents

**PRINCIPAL FINANCIAL GROUP, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>Part I - FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements</u>	3
<u>Consolidated Statements of Financial Position at September 30, 2013 (Unaudited) and December 31, 2012</u>	3
<u>Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2013 and 2012</u>	4
<u>Unaudited Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012</u>	5
<u>Unaudited Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2013 and 2012</u>	6
<u>Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012</u>	7
<u>Notes to Unaudited Consolidated Financial Statements - September 30, 2013</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>	129
<u>Item 4.</u>	
<u>Controls and Procedures</u>	135
<u>Part II - OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	136
<u>Item 1A.</u>	
<u>Risk Factors</u>	136
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	137
<u>Item 6.</u>	
<u>Exhibits</u>	138
<u>Signature</u>	139

Table of Contents**PART I FINANCIAL INFORMATION****Item 1. Financial Statements****Principal Financial Group, Inc.****Consolidated Statements of Financial Position**

	September 30, 2013 (Unaudited)	December 31, 2012 (As adjusted)
	(in millions)	
<b>Assets</b>		
Fixed maturities, available-for-sale (2013 and 2012 include \$243.3 million and \$194.6 million related to consolidated variable interest entities)	\$ 48,914.9	\$ 50,939.3
Fixed maturities, trading (2013 and 2012 both include \$110.4 million related to consolidated variable interest entities)	572.9	626.7
Equity securities, available-for-sale	114.0	136.5
Equity securities, trading	666.2	252.8
Mortgage loans	11,868.1	11,519.7
Real estate	1,278.6	1,180.3
Policy loans	859.6	864.9
Other investments (2013 and 2012 include \$72.6 million and \$80.3 million related to consolidated variable interest entities and \$140.5 million and \$113.9 million measured at fair value under the fair value option)	2,994.0	3,291.1
Total investments	67,268.3	68,811.3
Cash and cash equivalents	1,707.1	4,177.2
Accrued investment income	571.2	584.4
Premiums due and other receivables	1,160.7	1,084.4
Deferred acquisition costs	3,007.6	2,590.0
Property and equipment	479.1	464.2
Goodwill	1,127.5	543.4
Other intangibles	1,497.4	914.7
Separate account assets (2013 includes \$31,999.2 million related to consolidated variable interest entities)	123,800.5	81,653.8
Other assets	1,068.0	1,006.8
Total assets	\$ 201,687.4	\$ 161,830.2
<b>Liabilities</b>		
Contractholder funds	\$ 36,402.7	\$ 37,786.5
Future policy benefits and claims	22,324.2	22,436.2
Other policyholder funds	753.6	716.4
Short-term debt	175.5	40.8
Long-term debt	2,593.3	2,671.3
Income taxes currently payable	7.9	15.3
Deferred income taxes	634.6	600.0
Separate account liabilities (2013 includes \$31,999.2 million related to consolidated variable interest entities)	123,800.5	81,653.8
Other liabilities (2013 and 2012 include \$320.6 million and \$302.9 million related to consolidated variable interest entities, of which \$102.2 million and \$85.0 million are measured at fair value under the fair value option)	5,387.2	6,146.1

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

Total liabilities	192,079.5	152,066.4
Redeemable noncontrolling interest	234.5	60.4
<b>Stockholders' equity</b>		
Series A preferred stock, par value \$.01 per share with liquidation preference of \$100 per share 3.0 million shares authorized, issued and outstanding in 2013 and 2012		
Series B preferred stock, par value \$.01 per share with liquidation preference of \$25 per share 10.0 million shares authorized, issued and outstanding in 2013 and 2012	0.1	0.1
Common stock, par value \$.01 per share 2,500.0 million shares authorized, 458.0 million and 453.5 million shares issued, and 293.9 million and 293.8 million shares outstanding in 2013 and 2012	4.6	4.5
Additional paid-in capital	9,749.3	9,730.9
Retained earnings	5,249.9	4,862.0
Accumulated other comprehensive income (loss)	(17.7)	640.3
Treasury stock, at cost (164.1 million and 159.7 million shares in 2013 and 2012)	(5,707.8)	(5,554.4)
Total stockholders' equity attributable to Principal Financial Group, Inc.	9,278.4	9,683.4
Noncontrolling interest	95.0	20.0
Total stockholders' equity	9,373.4	9,703.4
Total liabilities and stockholders' equity	\$ 201,687.4	\$ 161,830.2

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,	
	2013	2012	2013	2012
	(in millions, except per share data)			
<b>Revenues</b>				
Premiums and other considerations	\$ 703.0	\$ 1,158.2	\$ 2,134.9	\$ 2,519.3
Fees and other revenues	803.0	675.0	2,340.4	1,909.1
Net investment income	784.5	783.8	2,323.5	2,409.6
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	(29.7)	122.1	(109.5)	176.4
Total other-than-temporary impairment losses on available-for-sale securities	(11.9)	(43.6)	(81.2)	(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income	(9.3)	9.2	8.8	31.2
Net impairment losses on available-for-sale securities	(21.2)	(34.4)	(72.4)	(95.2)
Net realized capital gains (losses)	(50.9)	87.7	(181.9)	81.2
Total revenues	2,239.6	2,704.7	6,616.9	6,919.2
<b>Expenses</b>				
Benefits, claims and settlement expenses	1,096.2	1,647.0	3,286.4	3,969.5
Dividends to policyholders	48.5	49.7	144.3	149.5
Operating expenses	774.6	816.4	2,372.1	2,101.1
Total expenses	1,919.3	2,513.1	5,802.8	6,220.1
Income before income taxes	320.3	191.6	814.1	699.1
Income taxes (benefits)	61.2	(7.2)	128.4	100.4
Net income	259.1	198.8	685.7	598.7
Net income attributable to noncontrolling interest	5.2	3.4	14.7	15.3
Net income attributable to Principal Financial Group, Inc.	253.9	195.4	671.0	583.4
Preferred stock dividends	8.2	8.2	24.7	24.7
Net income available to common stockholders	\$ 245.7	\$ 187.2	\$ 646.3	\$ 558.7
<b>Earnings per common share</b>				
Basic earnings per common share	\$ 0.83	\$ 0.64	\$ 2.20	\$ 1.87
Diluted earnings per common share	\$ 0.82	\$ 0.63	\$ 2.17	\$ 1.85

*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,	
	2013	2012	2013	2012
	(in millions)			
Net income	\$ 259.1	\$ 198.8	\$ 685.7	\$ 598.7
Other comprehensive income (loss), net:				
Net unrealized gains (losses) on available-for-sale securities	29.3	296.0	(523.7)	558.0
Noncredit component of impairment losses on fixed maturities, available-for-sale	(2.5)	(4.0)	(13.1)	(14.8)
Net unrealized gains (losses) on derivative instruments	(25.1)	(18.2)	(3.4)	27.2
Foreign currency translation adjustment	(33.5)	45.4	(169.5)	21.5
Net unrecognized postretirement benefit obligation	13.8	8.7	41.4	26.2
Other comprehensive income (loss)	(18.0)	327.9	(668.3)	618.1
Comprehensive income	241.1	526.7	17.4	1,216.8
Comprehensive income attributable to noncontrolling interest	4.4	4.2	4.4	16.3
Comprehensive income attributable to Principal Financial Group, Inc.	\$ 236.7	\$ 522.5	\$ 13.0	\$ 1,200.5

*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)	Treasury stock	Noncontrolling interest	Total stockholders equity
	(in millions)								
<b>Balances at January 1, 2012 (as adjusted)</b>	\$	\$ 0.1	\$ 4.5	\$ 9,634.7	\$ 4,323.4	\$ 271.4	\$ (5,281.7)	\$ 353.8	\$ 9,306.2
Common stock issued				24.7					24.7
Stock-based compensation and additional related tax benefits				52.8	(2.7)				50.1
Treasury stock acquired, common							(272.7)		(272.7)
Dividends to common stockholders					(169.6)				(169.6)
Dividends to preferred stockholders					(24.7)				(24.7)
Distributions to noncontrolling interest								(8.1)	(8.1)
Contributions from noncontrolling interest								12.1	12.1
Deconsolidation of certain variable interest entities								(353.2)	(353.2)
Net income (excludes \$1.6 million attributable to redeemable noncontrolling interest)					583.4			13.7	597.1
Other comprehensive income (excludes \$0.9 million attributable to redeemable noncontrolling interest)						617.1		0.1	617.2
<b>Balances at September 30, 2012</b>	\$	\$ 0.1	\$ 4.5	\$ 9,712.2	\$ 4,709.8	\$ 888.5	\$ (5,554.4)	\$ 18.4	\$ 9,779.1
<b>Balances at January 1, 2013</b>	\$	\$ 0.1	\$ 4.5	\$ 9,730.9	\$ 4,862.0	\$ 640.3	\$ (5,554.4)	\$ 20.0	\$ 9,703.4
Common stock issued			0.1	80.1					80.2
Stock-based compensation and additional related tax benefits				54.7	(3.4)				51.3
Treasury stock acquired, common							(153.4)		(153.4)
Dividends to common stockholders					(211.7)				(211.7)
Dividends to preferred stockholders					(24.7)				(24.7)
Contributions from noncontrolling interest								115.7	115.7
Purchase of subsidiary shares from noncontrolling interest				1.8				(53.2)	(51.4)

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

Sale of subsidiary shares to noncontrolling interest		11.5		20.3	31.8												
Adjustments to redemption amount of redeemable noncontrolling interest		(129.7)	(43.3)	(6.5)	(179.5)												
Net income (excludes \$9.0 million attributable to redeemable noncontrolling interest)			671.0	5.7	676.7												
Other comprehensive loss (excludes \$(3.3) million attributable to redeemable noncontrolling interest)				(658.0)	(7.0)	(665.0)											
<b>Balances at September 30, 2013</b>	\$	\$	0.1	\$	4.6	\$	9,749.3	\$	5,249.9	\$	(17.7)	\$	(5,707.8)	\$	95.0	\$	9,373.4

See accompanying notes.

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

	For the nine months ended September 30,	
	2013	2012
	(in millions)	
<b>Operating activities</b>		
Net income	\$ 685.7	\$ 598.7
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred acquisition costs	136.0	27.6
Additions to deferred acquisition costs	(338.5)	(298.9)
Accrued investment income	13.2	0.8
Net cash flows for trading securities	(40.5)	135.3
Premiums due and other receivables	(43.8)	65.7
Contractholder and policyholder liabilities and dividends	993.0	1,578.8
Current and deferred income taxes (benefits)	175.6	(29.6)
Net realized capital (gains) losses	181.9	(81.2)
Depreciation and amortization expense	114.5	99.1
Mortgage loans held for sale, acquired or originated		(48.2)
Mortgage loans held for sale, sold or repaid, net of gain	0.2	90.1
Real estate acquired through operating activities	(81.5)	(25.5)
Real estate sold through operating activities	12.2	4.1
Stock-based compensation	51.7	50.2
Other	(461.8)	206.7
Net adjustments	712.2	1,775.0
Net cash provided by operating activities	1,397.9	2,373.7
<b>Investing activities</b>		
Available-for-sale securities:		
Purchases	(7,012.3)	(6,467.5)
Sales	1,626.7	946.5
Maturities	5,783.2	4,702.7
Mortgage loans acquired or originated	(2,020.0)	(1,811.8)
Mortgage loans sold or repaid	1,570.8	1,166.7
Real estate acquired	(59.0)	(114.8)
Net purchases of property and equipment	(22.7)	(35.6)
Purchase of interests in subsidiaries, net of cash acquired	(1,268.3)	(62.5)
Net change in other investments	(31.2)	(42.9)
Net cash used in investing activities	(1,432.8)	(1,719.2)
<b>Financing activities</b>		
Issuance of common stock	80.2	24.7
Acquisition of treasury stock	(153.4)	(272.7)
Proceeds from financing element derivatives	46.7	51.6
Payments for financing element derivatives	(36.9)	(38.3)
Excess tax benefits from share-based payment arrangements	8.6	9.8
Purchase of subsidiary shares from noncontrolling interest	(51.7)	
Sale of subsidiary shares to noncontrolling interest	32.1	
Dividends to common stockholders	(211.7)	(169.6)
Dividends to preferred stockholders	(24.7)	(16.5)
Issuance of long-term debt	24.1	602.9
Principal repayments of long-term debt	(212.2)	(2.1)

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

Net proceeds from (repayments of) short-term borrowings	<b>131.6</b>	(81.0)
Investment contract deposits	<b>5,270.2</b>	4,798.7
Investment contract withdrawals	<b>(7,055.6)</b>	(6,126.0)
Net increase (decrease) in banking operation deposits	<b>(276.2)</b>	14.9
Other	<b>(6.3)</b>	(5.8)
Net cash used in financing activities	<b>(2,435.2)</b>	(1,209.4)
Net decrease in cash and cash equivalents	<b>(2,470.1)</b>	(554.9)
Cash and cash equivalents at beginning of period	<b>4,177.2</b>	2,833.9
Cash and cash equivalents at end of period	<b>\$ 1,707.1</b>	<b>\$ 2,279.0</b>

*See accompanying notes.*

Table of Contents

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**September 30, 2013**

**(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, 2013, are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2012, included in our Form 10-K for the year ended December 31, 2012, filed with the United States Securities and Exchange Commission ( SEC ). The accompanying consolidated statement of financial position as of December 31, 2012, 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.

**Revisions of Previously Issued Financial Statements**

In conjunction with our first quarter 2013 acquisition of AFP Cuprum S.A. ( Cuprum ) in Chile, we re-evaluated the accounting treatment for similar products offered in other foreign jurisdictions, including the AFORE retirement accumulation business in Mexico. As a result of this re-evaluation, we have concluded that the AFORE product, which was previously accounted for under Accounting Standards Codification 944, *Financial Services - Insurance*, should be accounted for as a long-term service contract, consistent with the accounting requirements for our recently acquired retirement accumulation business in Chile. The revision to the accounting treatment for the AFORE product in Mexico resulted in the following changes:

- (a) Fewer acquisition costs are capitalized. Specifically, we expense as incurred salary and related costs associated with the successful efforts of our proprietary sales force and sales support staff. All direct and incremental costs such as commissions will continue to be deferred.
- (b) Deferred costs are amortized on a straight line basis over the expected contract life rather than based on estimated gross profits. The amortization method change also impacts purchased customer intangible assets.

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

We have revised our prior period consolidated financial statements accordingly. These revisions, inclusive of any other potential adjustments, are not material in any prior period based on an analysis of quantitative and qualitative factors in accordance with SEC Staff Accounting Bulletins 99 and 108, and, as a result, amendment of previously filed periodic reports is not required. Rather, these revisions will be made the next time we file the prior period consolidated financial statements. See our March 31, 2013, Form 10-Q filed with the SEC on May 1, 2013, for historical impacts of this revision.

### **Recent Accounting Pronouncements**

In July 2013, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that requires the liability related to certain unrecognized benefits to be offset against a deferred tax asset from operating loss carryforwards. This guidance will be effective for us beginning January 1, 2014, and is not expected to have a material impact on our consolidated financial statements.

In June 2013, the FASB issued authoritative guidance that formalizes the definition of an investment company. This guidance will be effective for us beginning January 1, 2014, and is not expected to have a material impact on our consolidated financial statements.

In March 2013, the FASB issued authoritative guidance that clarifies how the cumulative translation adjustment ( CTA ) related to a parent s investment in a foreign entity should be released when certain transactions related to the foreign entity occur. This guidance will be effective prospectively for us beginning January 1, 2014, and is not expected to have a material impact on our consolidated financial statements.

In February 2013, the FASB issued authoritative guidance that requires entities to disclose additional information about items reclassified out of accumulated other comprehensive income ( AOCI ). Entities are required to disclose information regarding changes in AOCI balances by component and significant items reclassified out of AOCI by component either on the face of the income statement or as a separate footnote to the financial statements. This guidance was effective for us beginning January 1, 2013,

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

and did not have a material impact on our consolidated financial statements. This guidance did not impact the requirements for reporting of comprehensive income under FASB guidance issued in June 2011, which changed the presentation of comprehensive income in the financial statements. The guidance eliminated the presentation options contained in previous guidance and instead required entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements that show the components of net income and other comprehensive income ( OCI ), including adjustments for items that are reclassified from OCI to net income. The guidance did not change the items that must be reported in OCI or when an item of OCI must be reclassified to net income. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. See Note 9, Stockholders Equity, for further details.

In January 2013 and December 2011, the FASB issued authoritative guidance related to balance sheet offsetting. The 2011 guidance requires disclosures about assets and liabilities that are offset or have the potential to be offset. These disclosures are intended to address differences in the asset and liability offsetting requirements under U.S. GAAP and International Financial Reporting Standards. The 2013 guidance clarified that the disclosure requirements would apply to derivative instruments, including bifurcated embedded derivatives, repurchase and reverse repurchase agreements and securities borrowing and securities lending arrangements that are either offset on the balance sheet or subject to an enforceable master netting arrangement or similar agreement. Both pieces of guidance were effective for us beginning January 1, 2013, with retrospective application required and did not have a material impact on our consolidated financial statements. See Note 4, Investments, for further details.

In July 2012, the FASB issued authoritative guidance that amends how indefinite-lived intangible assets are tested for impairment. The amendments provide an option to perform a qualitative assessment to determine whether it is necessary to perform the annual fair value calculation impairment test. This new guidance is effective for our 2013 indefinite-lived intangible asset impairment testing and is not expected to have a material impact on our consolidated financial statements.

In December 2011, the FASB issued authoritative guidance that requires a reporting entity to follow the real estate sales guidance when the reporting entity ceases to have a controlling financial interest in a subsidiary that is in-substance real estate as a result of a default on the subsidiary's nonrecourse debt. This guidance was effective for us on January 1, 2013, and did not have a material impact on our consolidated financial statements.

In September 2011, the FASB issued authoritative guidance that amends how goodwill is tested for impairment. The amendments provide an option to perform a qualitative assessment to determine whether it is necessary to perform the annual two-step quantitative goodwill impairment test. This guidance was effective for our 2012 goodwill impairment test and did not have a material impact on our consolidated financial statements.

In May 2011, the FASB issued authoritative guidance that clarifies and changes fair value measurement and disclosure requirements. This guidance expands existing disclosure requirements for fair value measurements and makes other amendments but does not require additional fair value measurements. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. See Note 10, Fair Value Measurements, for further details.

In April 2011, the FASB issued authoritative guidance that modifies the criteria for determining when repurchase agreements would be accounted for as secured borrowings as opposed to sales. The guidance was effective for us on January 1, 2012, for new transfers and modifications to existing transactions 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. Separate account assets and separate account liabilities include certain non-domestic 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.



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

At September 30, 2013 and December 31, 2012, the separate account assets include a separate account valued at \$201.1 million and \$148.3 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.

**2. Acquisition**

On February 4, 2013, we completed the purchase of Cuprum, a premier pension manager in Chile that will grow our ability to offer customers in Chile unmatched pension savings and retirement solutions. Our acquisition agreement required Empresas Penta S.A. and Inversiones Banpenta Limitada to sell their 63% ownership in Cuprum pursuant to a public tender offer that also included the remaining 37% of publicly traded shares. As a result of the public tender offer, we initially acquired a 91.55% ownership stake in Cuprum for a purchase price of \$1.3 billion. Cuprum is consolidated within the Principal International segment on a one-month lag.

A summary of the fair values of the net assets acquired as of February 4, 2013, based upon current valuation estimates, is as follows (in millions):

<b>Assets</b>	
Equity securities, available-for-sale	\$ 3.2
Equity securities, trading	340.5
Real estate	1.9
Other investments	24.2
Cash and cash equivalents	3.5
Premiums due and other receivables	1.4
Property and equipment	19.6
Goodwill	633.3
Other intangibles	671.3
Separate account assets	33,919.4
Other assets	27.3
<b>Total assets</b>	<b>35,645.6</b>
<b>Liabilities</b>	
Short-term debt	5.0
Long-term debt	114.6
Separate account liabilities	33,919.4
Other liabilities	229.5
<b>Total liabilities</b>	<b>34,268.5</b>
Noncontrolling interest	113.6

Net assets acquired	\$	<b>1,263.5</b>
---------------------	----	----------------

Of the acquired intangible assets, \$633.3 million was assigned to goodwill and is not subject to amortization. The goodwill is largely related to future sales anticipated from our internal workforce and entity-specific revenue synergies that will be generated by combining Cuprum with our existing businesses.

Of the remaining acquired intangible assets, \$185.2 million was assigned to trade name, which is not subject to amortization, and \$486.1 million was assigned to customer relationships, which is subject to amortization over a 15-year useful life.

See Note 3, Variable Interest Entities, for further information on Cuprum's separate account assets and liabilities.

The following (unaudited) pro forma consolidated results of operations have been prepared to show the impact of the acquisition of Cuprum as if the acquisition had occurred January 1, 2013, for the three and nine months ended September 30, 2013, and on January 1, 2012, for the three and nine months ended September 30, 2012. This supplemental pro forma information has been prepared for comparative purposes and is not necessarily indicative of the results of operations that actually would have been achieved had the acquisition been consummated as of that time, nor is it intended to be a projection of future results.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the three months ended, September 30,		For the nine months ended, September 30,	
	2013	2012	2013	2012
	(in millions, except per share data)			
Total revenues	\$ 2,239.6	\$ 2,756.8	\$ 6,666.9	\$ 7,073.6
Net income	259.1	224.1	706.4	679.8
Basic earnings per common share	0.83	0.76	2.40	2.28
Diluted earnings per common share	0.82	0.75	2.37	2.26

The (unaudited) total revenues and net income of Cuprum included in the consolidated statement of operations from the acquisition date to the period ended September 30, 2013, were as follows:

	For the three months ended, September 30, 2013	For the nine months ended, September 30, 2013
	(in millions)	
Total revenues	\$ 44.1	\$ 120.8
Net income	17.3	52.7

### 3. 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. On an ongoing basis, we assess whether we are the primary beneficiary of VIEs we have relationships with.

#### 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 Vehicle*

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*

In September 2000, 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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

out rights of the special servicer.

**Mandatory Retirement Savings**

As a result of our first quarter 2013 acquisition of Cuprum, we hold an equity interest in mandatory privatized social security funds in which we provide asset management services. We determined that the mandatory privatized social security funds, which include contributors 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.

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 vehicle	CMBS (in millions)	Mandatory retirement savings	Total
<b>September 30, 2013</b>					
Fixed maturities, available-for-sale	\$ 243.3	\$	\$	\$	\$ 243.3
Fixed maturities, trading		110.4			110.4
Other investments			72.6		72.6
Accrued investment income	0.4		0.4		0.8
Separate account assets				31,999.2	31,999.2
Total assets	\$ 243.7	\$ 110.4	\$ 73.0	\$ 31,999.2	\$ 32,426.3
Deferred income taxes	\$ 1.5	\$	\$	\$	\$ 1.5
Separate account liabilities				31,999.2	31,999.2
Other liabilities (1)	190.3	94.9	35.4		320.6
Total liabilities	\$ 191.8	\$ 94.9	\$ 35.4	\$ 31,999.2	\$ 32,321.3
<b>December 31, 2012</b>					
Fixed maturities, available-for-sale	\$ 194.6	\$	\$	\$	\$ 194.6
Fixed maturities, trading		110.4			110.4
Other investments			80.3		80.3
Accrued investment income	0.5		0.6		1.1

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

Total assets	\$	195.1	\$	110.4	\$	80.9	\$	386.4
Deferred income taxes	\$	1.8	\$		\$		\$	1.8
Other liabilities (1)		152.4		104.8		45.7		302.9
Total liabilities	\$	154.2	\$	104.8	\$	45.7	\$	304.7

---

(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 trust; and CMBS includes an obligation to the bondholders.

We did not provide financial or other support to investees designated as VIEs for the nine months ended September 30, 2013 and 2012.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**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.

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 any of 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, some of which are classified as VIEs. The returns of the partnership are in the form of income tax credits and investment income. These entities are classified as VIEs as the general partner does not have an equity investment at risk in the entity. We have determined we are not the primary beneficiary because we are not the general partner, who makes all the significant decisions for the entity.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(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)	
<b>September 30, 2013</b>		
Fixed maturities, available-for-sale:		
Corporate	\$ 500.5	\$ 417.7
Residential mortgage-backed pass-through securities	2,758.5	2,680.0
Commercial mortgage-backed securities	3,983.5	4,076.8
Collateralized debt obligations	332.3	358.5
Other debt obligations	4,045.1	4,040.3
Fixed maturities, trading:		
Residential mortgage-backed pass-through securities	52.1	52.1
Commercial mortgage-backed securities	1.9	1.9
Collateralized debt obligations	62.5	62.5
Other debt obligations	1.5	1.5
Other investments:		
Other limited partnership interests	126.9	126.9
<b>December 31, 2012</b>		
Fixed maturities, available-for-sale:		
Corporate	\$ 523.2	\$ 403.7
Residential mortgage-backed pass-through securities	3,226.7	3,022.7
Commercial mortgage-backed securities	3,897.4	4,094.8
Collateralized debt obligations	379.2	428.8
Other debt obligations	3,779.2	3,756.9
Fixed maturities, trading:		
Residential mortgage-backed pass-through securities	77.7	77.7
Commercial mortgage-backed securities	2.8	2.8
Collateralized debt obligations	56.4	56.4
Other debt obligations	3.2	3.2
Other investments:		
Other limited partnership interests	136.2	136.2

(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***



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

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, 2013 and December 31, 2012, these VIEs held \$1.4 billion and \$1.5 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 that are considered VIEs as we generally earn performance-based management fees. 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, 2013**  
**(Unaudited)**

**4. Investments****Fixed Maturities and Equity Securities**

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock, nonredeemable preferred stock and mandatory 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 related to deferred acquisition costs (DAC), sales inducements, unearned revenue reserves, policyholder liabilities, 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). We also have a minimal amount of assets within trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. In addition, we have assets within the trading securities portfolio that represent mandatory regulatory required investments. Mark-to-market adjustments related to these trading securities 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 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 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)
<b>September 30, 2013</b>					
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 741.1	\$ 15.9	\$ 36.4	\$ 720.6	\$
Non-U.S. government and agencies	843.1	175.3	3.8	1,014.6	
States and political subdivisions	3,557.7	129.5	70.6	3,616.6	
Corporate	30,805.8	2,021.7	383.8	32,443.7	17.0
	<b>2,680.0</b>	<b>106.4</b>	<b>27.9</b>	<b>2,758.5</b>	

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

Residential mortgage-backed pass-through securities						
Commercial mortgage-backed securities	4,076.8	188.0	281.3	3,983.5	214.6	
Collateralized debt obligations	358.5	7.3	33.5	332.3	0.6	
Other debt obligations	4,040.3	51.2	46.4	4,045.1	78.6	
Total fixed maturities, available-for-sale	\$ 47,103.3	\$ 2,695.3	\$ 883.7	\$ 48,914.9	\$ 310.8	
Total equity securities, available-for-sale	\$ 116.8	\$ 10.1	\$ 12.9	\$ 114.0		
<b>December 31, 2012</b>						
Fixed maturities, available-for-sale:						
U.S. government and agencies	\$ 911.4	\$ 33.2	\$ 0.3	\$ 944.3	\$	
Non-U.S. government and agencies	944.9	264.3	0.9	1,208.3		
States and political subdivisions	2,940.4	241.1	2.7	3,178.8		
Corporate	31,615.4	3,029.9	319.9	34,325.4	19.5	
Residential mortgage-backed pass-through securities	3,022.7	204.4	0.4	3,226.7		
Commercial mortgage-backed securities	4,094.8	241.7	439.1	3,897.4	195.4	
Collateralized debt obligations	428.8	7.0	56.6	379.2	4.3	
Other debt obligations	3,756.9	73.5	51.2	3,779.2	82.8	
Total fixed maturities, available-for-sale	\$ 47,715.3	\$ 4,095.1	\$ 871.1	\$ 50,939.3	\$ 302.0	
Total equity securities, available-for-sale	\$ 132.4	\$ 12.6	\$ 8.5	\$ 136.5		

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

(1) Excludes \$145.4 million and \$95.0 million as of September 30, 2013 and December 31, 2012, 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, 2013, by expected maturity, were as follows:

	Amortized cost	Fair value
	(in millions)	
Due in one year or less	\$ 2,929.8	\$ 2,973.1
Due after one year through five years	13,024.2	13,658.8
Due after five years through ten years	8,659.6	9,127.7
Due after ten years	11,334.1	12,035.9
Subtotal	35,947.7	37,795.5
Mortgage-backed and other asset-backed securities	11,155.6	11,119.4
Total	\$ 47,103.3	\$ 48,914.9

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, which do not meet the criteria for classification as a discontinued operation and mark-to-market adjustments on trading securities that support investment strategies that involve the active and frequent purchase and sale of fixed maturities and on trading securities that represent mandatory required investments 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:

For the three months ended September 30,		For the nine months ended September 30,	
2013	2012	2013	2012
(in millions)			

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

Fixed maturities, available-for-sale:								
Gross gains	\$	5.8	\$	3.0	\$	27.6	\$	22.7
Gross losses		(18.2)		(44.1)		(98.6)		(131.0)
Other-than-temporary impairment losses reclassified to (from) OCI								
		(9.3)		9.2		8.8		31.2
Hedging, net		(9.6)		1.0		(99.4)		7.7
Fixed maturities, trading		2.1		4.7		(4.1)		5.7
Equity securities, available-for-sale:								
Gross gains		0.7		0.5		0.8		0.6
Gross losses				(0.6)		(0.1)		(0.6)
Equity securities, trading		0.1		(0.1)		11.6		30.6
Mortgage loans		(3.3)		(23.3)		(20.3)		(44.6)
Derivatives		(34.8)		(50.5)		(4.8)		(20.1)
Other		15.6		187.9		(3.4)		179.0
Net realized capital gains (losses)	\$	(50.9)	\$	87.7	\$	(181.9)	\$	81.2

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were \$415.7 million and \$236.1 million for the three months ended September 30, 2013 and 2012, and \$1,516.0 million and \$952.2 million for the nine months ended September 30, 2013 and 2012, 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:

	For the three months ended September 30,		For the nine months ended September 30,	
	2013	2012	2013	2012
	(in millions)			
Fixed maturities, available-for-sale	\$ (11.9)	\$ (43.5)	\$ (81.1)	\$ (126.3)

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

Equity securities, available-for-sale		(0.1)		<b>(0.1)</b>		(0.1)
Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities	<b>(11.9)</b>	(43.6)		<b>(81.2)</b>		(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) OCI (1)	<b>(9.3)</b>	9.2		<b>8.8</b>		31.2
Net impairment losses on available-for-sale securities	\$ <b>(21.2)</b>	\$ (34.4)	\$	<b>(72.4)</b>	\$	(95.2)

---

(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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 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,	
	2013	2012	2013	2012
	(in millions)			
Beginning balance	\$ (301.5)	\$ (375.5)	\$ (335.2)	\$ (434.8)
Credit losses for which an other-than-temporary impairment was not previously recognized	(4.9)	(2.2)	(11.1)	(19.1)
Credit losses for which an other-than-temporary impairment was previously recognized	(18.9)	(20.9)	(54.0)	(60.8)
Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold	14.6	32.4	83.1	146.2
Net reduction for positive changes in cash flows expected to be collected and amortization (1)	2.7	2.8	9.2	5.1
Ending balance	\$ (308.0)	\$ (363.4)	\$ (308.0)	\$ (363.4)

(1) Amounts are recognized in net investment income.

#### Gross Unrealized Losses for Fixed Maturities and Equity Securities



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

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:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	Less than twelve months		September 30, 2013 Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value  (in millions)	Gross unrealized losses	Fair value	Gross unrealized losses
Fixed maturities, available-for-sale:						
U.S. government and agencies	\$ 399.5	\$ 36.4	\$	\$	\$ 399.5	\$ 36.4
Non-U.S. governments	79.6	3.7	4.3	0.1	83.9	3.8
States and political subdivisions	1,221.6	61.2	45.0	9.4	1,266.6	70.6
Corporate	4,189.8	163.3	1,369.5	220.5	5,559.3	383.8
Residential mortgage-backed pass-through securities	795.6	27.8	3.0	0.1	798.6	27.9
Commercial mortgage-backed securities	563.2	12.9	543.2	268.4	1,106.4	281.3
Collateralized debt obligations	53.2	0.6	47.3	32.9	100.5	33.5
Other debt obligations	1,273.2	16.8	252.0	29.6	1,525.2	46.4
Total fixed maturities, available-for-sale	\$ 8,575.7	\$ 322.7	\$ 2,264.3	\$ 561.0	\$ 10,840.0	\$ 883.7
Total equity securities, available-for-sale	\$ 27.3	\$ 0.1	\$ 48.5	\$ 12.8	\$ 75.8	\$ 12.9

Of the total amounts, Principal Life Insurance Company's (Principal Life) consolidated portfolio represented \$10,197.8 million in available-for-sale fixed maturities with gross unrealized losses of \$827.8 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 84% were investment grade (rated AAA through BBB-) with an average price of 92 (carrying value/amortized cost) at September 30, 2013. Gross unrealized losses in our fixed maturities portfolio increased slightly during the nine months ended September 30, 2013, due to an increase 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 1,102 securities with a carrying value of \$8,186.9 million and unrealized losses of \$305.8 million reflecting an average price of 96 at September 30, 2013. Of this portfolio, 91% was investment grade (rated AAA through BBB-) at September 30, 2013, with associated unrealized losses of \$287.1 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 368 securities with a carrying value of \$2,010.9 million and unrealized losses of \$522.0 million. The average rating of this portfolio was BBB- with an average price of 79 at September 30, 2013. Of the \$522.0 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$268.4 million in unrealized losses with an average price of 67 and an average credit rating of BB-. The remaining unrealized losses consist primarily of \$181.6 million within the corporate sector at September 30, 2013. The average price of the corporate sector was 86 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, 2013.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	Less than twelve months		December 31, 2012 Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value  (in millions)	Gross unrealized losses	Fair value	Gross unrealized losses
Fixed maturities, available-for-sale:						
U.S. government and agencies	\$ 115.4	\$ 0.3	\$	\$	\$ 115.4	\$ 0.3
Non-U.S. governments	17.3	0.2	13.4	0.7	30.7	0.9
States and political subdivisions	235.3	2.1	8.8	0.6	244.1	2.7
Corporate	831.8	10.6	1,961.7	309.3	2,793.5	319.9
Residential mortgage-backed pass-through securities	70.4	0.3	2.4	0.1	72.8	0.4
Commercial mortgage-backed securities	98.9	3.3	785.0	435.8	883.9	439.1
Collateralized debt obligations	72.2	1.0	133.8	55.6	206.0	56.6
Other debt obligations	235.6	2.0	414.9	49.2	650.5	51.2
Total fixed maturities, available-for-sale	\$ 1,676.9	\$ 19.8	\$ 3,320.0	\$ 851.3	\$ 4,996.9	\$ 871.1
Total equity securities, available-for-sale	\$ 5.8	\$ 0.1	\$ 52.9	\$ 8.4	\$ 58.7	\$ 8.5

Of the total amounts, Principal Life's consolidated portfolio represented \$4,419.4 million in available-for-sale fixed maturities with gross unrealized losses of \$825.7 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 71% were investment grade (rated AAA through BBB-) with an average price of 84 (carrying value/amortized cost) at December 31, 2012. Gross unrealized losses in our fixed maturities portfolio decreased during the year ended December 31, 2012, due to a tightening of credit spreads, primarily in the corporate and commercial mortgage-backed securities sectors.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life's consolidated portfolio held 224 securities with a carrying value of \$1,382.1 million and unrealized losses of \$16.2 million reflecting an average price of 99 at December 31, 2012. Of this portfolio, 89% was investment grade (rated AAA through BBB-) at December 31, 2012, with associated unrealized losses of \$13.3 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 488 securities with a carrying value of \$3,037.3 million and unrealized losses of \$809.5 million. The average rating of this portfolio was BBB- with an average price of 79 at December 31, 2012. Of the \$809.5 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$435.8 million in unrealized losses with an average price of 64 and an average credit rating of BB+. The remaining unrealized losses consist primarily of \$268.1 million within the corporate sector at December 31, 2012. The average price of the corporate sector was 86 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, 2012.

**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 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 net of adjustments related to DAC, reinsurance assets or liabilities, sales inducements, unearned revenue reserves, changes in policyholder liabilities and applicable income taxes was as follows:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	September 30, 2013	(in millions)	December 31, 2012
Net unrealized gains on fixed maturities, available-for-sale (1)	\$ 2,155.8		\$ 3,562.5
Noncredit component of impairment losses on fixed maturities, available-for-sale	(310.8)		(302.0)
Net unrealized gains (losses) on equity securities, available-for-sale	(2.8)		4.1
Adjustments for assumed changes in amortization patterns	(278.7)		(515.2)
Adjustments for assumed changes in policyholder liabilities	(676.9)		(1,198.7)
Net unrealized gains on derivative instruments	60.6		90.7
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments	93.3		191.3
Provision for deferred income taxes	(345.0)		(597.0)
Net unrealized gains on available-for-sale securities and derivative instruments	\$ 695.5		\$ 1,235.7

(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, 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, 2013	(in millions)	December 31, 2012
Commercial mortgage loans	\$ 10,658.3		\$ 10,235.1
Residential mortgage loans	1,297.7		1,382.0
Total amortized cost	11,956.0		11,617.1
Valuation allowance	(87.9)		(97.4)
Total carrying value	\$ 11,868.1		\$ 11,519.7

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. We purchased \$64.8 million and \$59.5 million of residential mortgage loans during the three months ended September 30, 2013 and 2012, and \$135.8 million and \$121.8 million during the nine months ended September 30, 2013 and 2012, respectively. We sold \$0.0 million and \$2.2 million of residential mortgage loans during the three months ended September 30, 2013 and 2012, and \$0.0 million and \$14.3 million during the nine months ended September 30, 2013 and 2012,

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

respectively. We purchased \$0.0 million and \$0.1 million of commercial mortgage loans during the three months ended September 30, 2013 and 2012, and \$141.1 million and \$61.5 million during the nine months ended September 30, 2013 and 2012, respectively. We sold \$0.0 million and \$27.1 million of commercial mortgage loans during the three months ended September 30, 2013 and 2012, and \$13.0 million and \$31.1 million during the nine months ended September 30, 2013 and 2012, 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:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	September 30, 2013		December 31, 2012	
	Amortized cost	Percent of total	Amortized cost	Percent of total
(\$ in millions)				
<b>Geographic distribution</b>				
New England	\$ 551.2	5.2%	\$ 536.6	5.2%
Middle Atlantic	2,504.5	23.5	2,233.4	21.8
East North Central	567.5	5.3	635.6	6.2
West North Central	307.8	2.9	377.3	3.7
South Atlantic	2,043.9	19.2	2,135.0	20.9
East South Central	194.0	1.8	244.8	2.4
West South Central	828.4	7.8	767.9	7.5
Mountain	837.0	7.9	726.6	7.1
Pacific	2,783.2	26.0	2,562.3	25.0
International	40.8	0.4	15.6	0.2
Total	\$ 10,658.3	100.0%	\$ 10,235.1	100.0%
<b>Property type distribution</b>				
Office	\$ 3,525.8	33.1%	\$ 3,078.8	30.1%
Retail	2,716.3	25.5	2,928.3	28.6
Industrial	1,834.3	17.2	1,765.5	17.2
Apartments	1,874.2	17.6	1,685.9	16.5
Hotel	429.7	4.0	445.8	4.4
Mixed use/other	278.0	2.6	330.8	3.2
Total	\$ 10,658.3	100.0%	\$ 10,235.1	100.0%

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$416.8 million and \$495.7 million and first lien mortgages with an amortized cost of \$880.9 million and \$886.3 million as of September 30, 2013 and December 31, 2012, respectively. 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.

**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



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

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 imbalances in ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

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:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	Brick and mortar	September 30, 2013 CTL (in millions)		Total
A- and above	\$ 8,110.4	\$ 194.5	\$	8,304.9
BBB+ thru BBB-	1,676.2	266.8		1,943.0
BB+ thru BB-	176.7	0.5		177.2
B+ and below	231.1	2.1		233.2
Total	\$ 10,194.4	\$ 463.9	\$	10,658.3

	Brick and mortar	December 31, 2012 CTL (in millions)		Total
A- and above	\$ 7,257.7	\$ 231.3	\$	7,489.0
BBB+ thru BBB-	1,804.5	294.9		2,099.4
BB+ thru BB-	266.8	1.6		268.4
B+ and below	376.0	2.3		378.3
Total	\$ 9,705.0	\$ 530.1	\$	10,235.1

*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.

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

	Home equity	September 30, 2013 First liens (in millions)		Total
Performing	\$ 402.5	\$ 860.3	\$	1,262.8
Nonperforming	14.3	20.6		34.9
Total	\$ 416.8	\$ 880.9	\$	1,297.7

	Home equity	December 31, 2012 First liens (in millions)		Total
Performing	\$ 472.6	\$ 865.0	\$	1,337.6
Nonperforming	23.1	21.3		44.4
Total	\$ 495.7	\$ 886.3	\$	1,382.0

**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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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

	September 30, 2013	December 31, 2012
	(in millions)	
<b>Commercial:</b>		
Brick and mortar	\$ 110.7	\$ 44.5
<b>Residential:</b>		
Home equity	14.3	23.1
First liens	12.4	13.2
<b>Total</b>	<b>\$ 137.4</b>	<b>\$ 80.8</b>

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

	September 30, 2013						Recorded investment 90 days or more and accruing
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due (in millions)	Current	Total loans	
Commercial-brick and mortar	\$	\$ 10.2	\$ 36.2	\$ 46.4	\$ 10,148.0	\$ 10,194.4	\$
Commercial-CTL					463.9	463.9	
Residential-home equity	5.1	1.4	1.6	8.1	408.7	416.8	
Residential-first liens	29.7	6.4	18.6	54.7	826.2	880.9	8.2
<b>Total</b>	<b>\$ 34.8</b>	<b>\$ 18.0</b>	<b>\$ 56.4</b>	<b>\$ 109.2</b>	<b>\$ 11,846.8</b>	<b>\$ 11,956.0</b>	<b>\$ 8.2</b>

	December 31, 2012						Recorded investment 90 days or more and accruing
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due (in millions)	Current	Total loans	
Commercial-brick and mortar	\$ 32.8	\$ 13.7	\$	\$ 46.5	\$ 9,658.5	\$ 9,705.0	\$
Commercial-CTL					530.1	530.1	
Residential-home equity	5.7	2.8	3.9	12.4	483.3	495.7	
Residential-first liens	22.3	5.1	19.8	47.2	839.1	886.3	8.1
<b>Total</b>	<b>\$ 60.8</b>	<b>\$ 21.6</b>	<b>\$ 23.7</b>	<b>\$ 106.1</b>	<b>\$ 11,511.0</b>	<b>\$ 11,617.1</b>	<b>\$ 8.1</b>

**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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 major product type and/or risk level with an estimated loss ratio applied against each product type and/or risk level. The loss ratio is generally based upon historic loss experience for each loan type 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.

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, 2013		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 47.7	\$ 47.2	\$ 94.9
Provision	0.7	1.3	2.0
Charge-offs	(6.2)	(3.7)	(9.9)
Recoveries	0.2	0.7	0.9
Ending balance	\$ 42.4	\$ 45.5	\$ 87.9

	For the nine months ended September 30, 2013		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 51.8	\$ 45.6	\$ 97.4
Provision	6.7	12.6	19.3
Charge-offs	(16.9)	(15.0)	(31.9)

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

Recoveries		<b>0.8</b>		<b>2.4</b>		<b>3.2</b>
Effect of exchange rates				<b>(0.1)</b>		<b>(0.1)</b>
Ending balance	\$	<b>42.4</b>	\$	<b>45.5</b>	\$	<b>87.9</b>
Allowance ending balance by basis of impairment method:						
Individually evaluated for impairment	\$	<b>8.5</b>	\$	<b>10.4</b>	\$	<b>18.9</b>
Collectively evaluated for impairment		<b>33.9</b>		<b>35.1</b>		<b>69.0</b>
Allowance ending balance	\$	<b>42.4</b>	\$	<b>45.5</b>	\$	<b>87.9</b>
Loan balance by basis of impairment method:						
Individually evaluated for impairment	\$	<b>30.7</b>	\$	<b>34.7</b>	\$	<b>65.4</b>
Collectively evaluated for impairment		<b>10,627.6</b>		<b>1,263.0</b>		<b>11,890.6</b>
Loan ending balance	\$	<b>10,658.3</b>	\$	<b>1,297.7</b>	\$	<b>11,956.0</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the three months ended September 30, 2012		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 49.3	\$ 36.9	\$ 86.2
Provision	3.9	19.0	22.9
Charge-offs	(0.8)	(13.3)	(14.1)
Recoveries		0.6	0.6
Effect of exchange rates		0.1	0.1
Ending balance	\$ 52.4	\$ 43.3	\$ 95.7

	For the nine months ended September 30, 2012		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 64.8	\$ 37.3	\$ 102.1
Provision	14.3	32.2	46.5
Charge-offs	(26.7)	(28.9)	(55.6)
Recoveries		2.6	2.6
Effect of exchange rates		0.1	0.1
Ending balance	\$ 52.4	\$ 43.3	\$ 95.7
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	\$ 4.8	\$ 7.8	\$ 12.6
Collectively evaluated for impairment	47.6	35.5	83.1
Allowance ending balance	\$ 52.4	\$ 43.3	\$ 95.7
Loan balance by basis of impairment method:			
Individually evaluated for impairment	\$ 28.7	\$ 35.3	\$ 64.0
Collectively evaluated for impairment	9,959.4	1,370.2	11,329.6
Loan ending balance	\$ 9,988.1	\$ 1,405.5	\$ 11,393.6

**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, 2013	
Recorded investment	Unpaid principal balance (in millions)	Related allowance



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

With no related allowance recorded:					
Commercial-brick and mortar	\$	9.5	\$	16.0	\$
Residential-first liens		6.0		6.0	
With an allowance recorded:					
Commercial-brick and mortar		30.7		30.6	8.5
Residential-home equity		19.8		20.2	9.3
Residential-first liens		8.9		8.8	1.1
Total:					
Commercial	\$	40.2	\$	46.6	\$ 8.5
Residential	\$	34.7	\$	35.0	\$ 10.4

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	Recorded investment	December 31, 2012 Unpaid principal balance (in millions)		Related allowance
With no related allowance recorded:				
Commercial-brick and mortar	\$ 22.9	\$	25.3	\$
Residential-first liens	9.7		6.6	
With an allowance recorded:				
Commercial-brick and mortar	4.4		4.4	2.4
Residential-home equity	20.8		20.7	9.1
Residential-first liens	9.2		9.1	1.3
Total:				
Commercial	\$ 27.3	\$	29.7	\$ 2.4
Residential	\$ 39.7	\$	36.4	\$ 10.4

	For the three months ended September 30, 2013		For the nine months ended September 30, 2013	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
	(in millions)			
With no related allowance recorded:				
Commercial-brick and mortar	\$ 6.4	\$ 0.1	\$ 16.2	\$ 0.2
Residential-first liens	6.2		7.9	
With an allowance recorded:				
Commercial-brick and mortar	28.4	0.1	17.5	0.2
Residential-home equity	20.2	0.4	20.3	0.8
Residential-first liens	9.3		9.0	0.1
Total:				
Commercial	\$ 34.8	\$ 0.2	\$ 33.7	\$ 0.4
Residential	\$ 35.7	\$ 0.4	\$ 37.2	\$ 0.9

	For the three months ended September 30, 2012		For the nine months ended September 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
	(in millions)			
With no related allowance recorded:				
Commercial-brick and mortar	\$ 27.0	\$ 0.1	\$ 5.3	\$ 1.1
Residential-first liens	5.2		4.6	
With an allowance recorded:				
Commercial-brick and mortar	20.2	0.5	66.1	1.5
Residential-home equity	20.2	0.2	18.7	0.7
Residential-first liens	8.1		8.2	0.1
Total:				
Commercial	\$ 47.2	\$ 0.6	\$ 71.4	\$ 2.6

Residential	\$	33.5	\$	0.2	\$	31.5	\$	0.8
-------------	----	------	----	-----	----	------	----	-----

**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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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, 2013			
	Number of contracts	TDRs Recorded investment (in millions)	Number of contracts	TDRs in payment default Recorded investment (in millions)
Residential-home equity	12	\$ 0.8		
Residential-first liens			1	0.1
<b>Total</b>	<b>12</b>	<b>\$ 0.8</b>	<b>1</b>	<b>\$ 0.1</b>

	For the three months ended September 30, 2012			
	Number of contracts	TDRs Recorded investment (in millions)	Number of contracts	TDRs in payment default Recorded investment (in millions)
Commercial-brick and mortar	2	\$ 8.2		
Residential-home equity	134	6.4	1	
<b>Total</b>	<b>136</b>	<b>\$ 14.6</b>	<b>1</b>	<b>\$</b>

	For the nine months ended September 30, 2013			
	Number of contracts	TDRs Recorded investment (in millions)	Number of contracts	TDRs in payment default Recorded investment (in millions)
Commercial-brick and mortar	2	\$ 0.9		
Residential-home equity	60	3.1	13	
Residential-first liens	3	0.6	3	0.8
<b>Total</b>	<b>65</b>	<b>\$ 4.6</b>	<b>16</b>	<b>\$ 0.8</b>

	For the nine months ended September 30, 2012			
	Number of contracts	TDRs Recorded investment (in millions)	Number of contracts	TDRs in payment default Recorded investment (in millions)
Commercial-brick and mortar	3	\$ 22.0		

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

Residential-home equity	237		10.8	4	
Total	240	\$	32.8	4	\$

Commercial mortgage loans that have been designated as a TDR have been previously reserved in the mortgage loan valuation allowance to 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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Securities Posted as Collateral**

We posted \$1,564.1 million in fixed maturities, available-for-sale securities at September 30, 2013, to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements, Futures Commission Merchant ( FCM ) agreements and our obligation under funding agreements with the Federal Home Loan Bank of Des Moines ( FHLB Des Moines ). In addition, we posted \$2,534.0 million in commercial mortgage loans and home equity mortgages as of September 30, 2013, 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.

**Balance Sheet Offsetting**

We have financial instruments that are subject to master netting agreements or similar agreements. 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 Statement of Financial Position			
		Financial instruments (2)	Collateral received		Net amount
		(in millions)			
<b>September 30, 2013</b>					
Derivative assets	\$ 684.3	\$ (593.2)	\$ (91.1)	\$	
Reverse repurchase agreements	54.8		(54.8)		
Total	\$ 739.1	\$ (593.2)	\$ (145.9)	\$	
<b>December 31, 2012</b>					
Derivative assets	\$ 1,016.3	\$ (779.3)	\$ (225.5)	\$	11.5
Reverse repurchase agreements	148.2		(148.2)		
Total	\$ 1,164.5	\$ (779.3)	\$ (373.7)	\$	11.5

(1) The gross amount of recognized derivative and reverse repurchase agreement assets are reported with other investments on the consolidated statements of financial position. The above excludes \$0.3 million and \$0.4 million of derivative assets as of September 30, 2013 and December 31, 2012, respectively, 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.

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 Statement of Financial Position			Net amount
		Financial instruments (2)	Collateral pledged		
		(in millions)			
<b>September 30, 2013</b>					
Derivative liabilities	\$ 1,020.5	\$ (593.2)	\$ (342.3)	\$	85.0
<b>December 31, 2012</b>					
Derivative liabilities	\$ 1,198.2	\$ (779.3)	\$ (279.1)	\$	139.8

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

---

(1) The gross amount of recognized derivative liabilities are reported with other liabilities and contractholder funds on the consolidated statements of financial position. The above excludes \$241.8 million and \$329.8 million of derivative liabilities as of September 30, 2013 and December 31, 2012, respectively, which are primarily embedded derivatives that are not subject to master netting agreements or similar agreements. The gross amount of recognized repurchase agreement liabilities are reported with short-term debt on the consolidated statements of financial position. The gross amounts of derivative and repurchase agreement 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 5, 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, 2013 and December 31, 2012.

## **5. 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 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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

Interest rate options include 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 have also used currency forwards to hedge the currency risk associated with net investments in foreign operations. We did not use any currency forwards during 2013 or 2012 to hedge our net investment in foreign operations.

Currency options are contracts that give the holder the right, but not the obligation to buy or sell a specified amount of the identified currency within a limited period of time at a contracted price. The contracts are net settled in cash, based on the differential in the current foreign exchange rate and the strike price. Purchased and sold options can be combined to form a foreign currency collar where we receive a payment if the foreign exchange rate is below the purchased option strike price and make a payment if the foreign exchange rate is above the sold option strike price. We have used currency options to manage the foreign currency risk associated with a business combination.

### *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 previously sold an investment-type insurance contract with attributes tied to market indices (an embedded derivative as noted below), in which case we wrote an equity call option to convert the overall contract into a fixed-rate liability, essentially eliminating the equity component altogether. We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity products that credit interest based on changes in an external equity index. We use exchange-

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 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.

We sell investment-type insurance contracts in which the return is tied to a leveraged inflation index. In addition, we previously sold an investment-type insurance contract in which the return was tied to an external equity index. We economically hedge the risk associated with these investment-type insurance contracts.

We offer group benefit plan 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 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 reduced to zero. Declines in the equity markets may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these annuity 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, 2013**  
**(Unaudited)**

Derivatives may be traded on an exchange ( 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 \$369.7 million and \$296.9 million in cash and securities under collateral arrangements as of September 30, 2013 and December 31, 2012, respectively, to satisfy collateral requirements associated with our derivative credit support agreements and FCM agreements. Beginning in the second quarter 2013, 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, 2013 and December 31, 2012, was \$1,038.1 million and \$1,205.4 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 \$369.7 million and \$296.9 million as of September 30, 2013 and December 31, 2012, 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, 2013, we would be required to post an additional \$69.2 million of collateral to our counterparties.

As of September 30, 2013 and December 31, 2012, we had received \$30.0 million and \$207.8 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, 2013**  
**(Unaudited)**

	September 30, 2013	December 31, 2012
	(in millions)	
<b>Notional amounts of derivative instruments</b>		
<b>Interest rate contracts:</b>		
Interest rate swaps	\$ 19,601.8	\$ 18,381.2
Interest rate options	1,500.0	500.0
Swaptions	325.0	325.0
Interest rate futures	211.0	82.0
<b>Foreign exchange contracts:</b>		
Currency swaps	2,559.3	3,454.1
Currency forwards	264.0	557.2
Currency options		1,400.0
<b>Equity contracts:</b>		
Equity options	1,905.3	1,811.8
Equity futures	278.7	373.6
<b>Credit contracts:</b>		
Credit default swaps	1,078.2	1,378.3
Total return swaps	100.0	100.0
<b>Other contracts:</b>		
Embedded derivative financial instruments	7,115.0	5,893.2
Total notional amounts at end of period	\$ 34,938.3	\$ 34,256.4
<b>Credit exposure of derivative instruments</b>		
<b>Interest rate contracts:</b>		
Interest rate swaps	\$ 477.1	\$ 683.9
Interest rate options	29.3	48.5
Swaptions	1.1	0.7
<b>Foreign exchange contracts:</b>		
Currency swaps	187.3	263.8
Currency forwards	1.2	6.8
Currency options		1.9
<b>Equity contracts:</b>		
Equity options	36.1	74.3
<b>Credit contracts:</b>		
Credit default swaps	7.2	6.8
Total gross credit exposure	739.3	1,086.7
Less: collateral received	112.6	248.0
Net credit exposure	\$ 626.7	\$ 838.7



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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

	Derivative assets (1)		Derivative liabilities (2)	
	September 30, 2013	December 31, 2012	September 30, 2013	December 31, 2012
(in millions)				
<b>Derivatives designated as hedging instruments</b>				
Interest rate contracts	\$ 1.6	\$ 10.3	\$ 327.0	\$ 440.5
Foreign exchange contracts	120.2	190.0	64.0	127.2
Total derivatives designated as hedging instruments	\$ 121.8	\$ 200.3	\$ 391.0	\$ 567.7
<b>Derivatives not designated as hedging instruments</b>				
Interest rate contracts	\$ 467.7	\$ 677.1	\$ 460.9	\$ 493.9
Foreign exchange contracts	51.7	58.2	17.3	14.3
Equity contracts	36.2	74.3	109.1	27.7
Credit contracts	7.2	6.8	44.4	96.6
Other contracts			239.6	327.8
Total derivatives not designated as hedging instruments	562.8	816.4	871.3	960.3
Total derivative instruments	\$ 684.6	\$ 1,016.7	\$ 1,262.3	\$ 1,528.0

(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 \$49.3 million and \$170.5 million as of September 30, 2013 and December 31, 2012, 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 \$34.9 million as of September 30, 2013 and \$15.0 million as of December 31, 2012. These purchased credit derivative transactions had a net asset (liability) fair value of \$(0.3) million as of September 30, 2013 and \$0.2 million as of December 31, 2012. 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.

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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

September 30, 2013

	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
	(in millions)			
<b>Single name credit default swaps</b>				
Corporate debt				
AA	\$ 40.0	\$ 0.2	\$ 40.0	4.6
A	318.5	3.0	318.5	4.2
BBB	195.0	(2.4)	195.0	4.5
Structured finance				
Total single name credit default swaps	553.5	0.8	553.5	4.4
<b>Basket and index credit default swaps</b>				
Corporate debt				
Near default	110.4	(27.6)	110.4	3.5
Government/municipalities				
AA	30.0	(4.2)	30.0	4.0
Structured finance				
BBB	25.0	(2.4)	25.0	3.8
Total basket and index credit default swaps	165.4	(34.2)	165.4	3.6
Total credit default swap protection sold	\$ 718.9	\$ (33.4)	\$ 718.9	4.2

December 31, 2012

	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
	(in millions)			
<b>Single name credit default swaps</b>				
Corporate debt				
AA	\$ 70.0	\$ (0.2)	\$ 70.0	2.5
A	572.0	2.4	572.0	2.4
BBB	200.0	(1.6)	200.0	3.0
Structured finance				
Near default	11.1	(11.0)	11.1	8.5
Total single name credit default swaps	853.1	(10.4)	853.1	2.6
<b>Basket and index credit default swaps</b>				
Corporate debt				
Near default	110.4	(65.2)	110.4	4.2
Government/municipalities				
AA	30.0	(7.3)	30.0	4.7
Structured finance				
BBB	25.0	(5.6)	25.0	4.5
Total basket and index credit default swaps	165.4	(78.1)	165.4	4.4
Total credit default swap protection sold	\$ 1,018.5	\$ (88.5)	\$ 1,018.5	2.9

We also have invested in fixed maturities classified as available-for-sale that contain credit default swaps that do not require bifurcation and 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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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.

	September 30, 2013		Weighted average expected life (in years)
	Amortized cost	Carrying value (in millions)	
<b>Corporate debt</b>			
BBB	\$ 22.5	\$ 22.5	3.3
Total corporate debt	22.5	22.5	3.3
<b>Structured finance</b>			
A	21.6	20.2	4.1
BB	5.6	5.6	3.3
B	4.2	4.2	3.2
CCC	23.6	23.6	5.0
Total structured finance	55.0	53.6	4.4
Total fixed maturities with credit derivatives	\$ 77.5	\$ 76.1	4.0

	December 31, 2012		Weighted average expected life (in years)
	Amortized cost	Carrying value (in millions)	
<b>Corporate debt</b>			
BBB	\$ 20.5	\$ 20.5	4.0
B	25.0	24.9	0.5
Total corporate debt	45.5	45.4	2.1
<b>Structured finance</b>			
AA	4.6	4.6	17.0
BB	39.6	37.5	2.9
B	4.0	4.0	4.4
CCC	17.7	17.7	6.4
Total structured finance	65.9	63.8	4.9
Total fixed maturities with credit derivatives	\$ 111.4	\$ 109.2	3.8

**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.

We have sold callable investment-type insurance contracts and used cancellable interest rate swaps to hedge the changes in fair value of the callable feature.

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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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.

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)	
	2013	2012		2013	2012
	(in millions)			(in millions)	
Interest rate contracts	\$ 14.6	\$ 0.7	Fixed maturities, available-for-sale	\$ (14.1)	\$
Interest rate contracts	1.2		Investment-type insurance contracts	(1.5)	
Foreign exchange contracts	(1.1)	(0.3)	Fixed maturities, available-for-sale	1.2	0.8
Foreign exchange contracts	35.0	21.0	Investment-type insurance contracts	(34.9)	(24.7)
Total	\$ 49.7	\$ 21.4	Total	\$ (49.3)	\$ (23.9)

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, (1)		Hedging items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the nine months ended September 30, (1)	
	2013	2012		2013	2012
	(in millions)			(in millions)	
Interest rate contracts	\$ 110.9	\$ 7.3	Fixed maturities, available-for-sale	\$ (105.4)	\$ (3.9)
Interest rate contracts	1.2		Investment-type insurance contracts	(1.5)	
Foreign exchange contracts	0.2	1.3	Fixed maturities, available-for-sale		(0.3)
Foreign exchange contracts	(39.1)	14.0	Investment-type insurance contracts	38.7	(17.4)
Total	\$ 73.2	\$ 22.6	Total	\$ (68.2)	\$ (21.6)

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

(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,		Amount of gain (loss) for the nine months ended September 30,	
	2013	2012	2013	2012
	(in millions)			
Fixed maturities, available-for-sale (1)	\$ (30.9)	\$ (32.6)	\$ (92.1)	\$ (101.7)
Investment-type insurance contracts (2)	9.9	9.2	29.2	27.1

(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, 2013**  
**(Unaudited)**

**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 6.7 years. At September 30, 2013, we had \$75.3 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 OCI into net income. We reclassified \$0.2 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, 2013 and 2012, respectively.

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

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three 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 three months ended September 30,		
		2013	2012		2013	2012	
		(in millions)				(in millions)	
Interest rate contracts	Fixed maturities, available-for-sale	\$ (10.2)	\$ 3.6	Net investment income	\$ 3.0	\$ 2.3	
Interest rate contracts	Investment-type insurance contracts	0.6	0.6	Benefits, claims and settlement expenses			
Interest rate contracts	Debt			Operating expense	(1.7)	(1.5)	

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

Foreign exchange contracts	Fixed maturities, available-for-sale	(44.7)		(25.2)	Net realized capital losses	(3.2)		(0.3)
Foreign exchange contracts	Investment-type insurance contracts	2.8		(1.4)	Benefits, claims and settlement expenses			
Total		\$ (51.5)	\$	(22.4)	Total	\$ (1.9)	\$	0.5

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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,		
		2013	2012		2013	2012	
		(in millions)				(in millions)	
Interest rate contracts	Fixed maturities, available-for-sale	\$ (51.4)	\$ 29.5	Net investment income	\$ 8.6	\$ 6.4	
Interest rate contracts	Investment-type insurance contracts	1.7	1.2	Benefits, claims and settlement expenses			
Interest rate contracts	Debt			Operating expense	(4.9)	(4.4)	
Foreign exchange contracts	Fixed maturities, available-for-sale	(3.1)	3.2	Net realized capital losses	(5.3)	(12.2)	
Foreign exchange contracts	Investment-type insurance contracts	2.2	(4.2)	Benefits, claims and settlement expenses			
Total		\$ (50.6)	\$ 29.7	Total	\$ (1.6)	\$ (10.2)	

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,	
	2013	2012	2013	2012
(in millions)				
Fixed maturities, available-for-sale (1)	\$ 1.9	\$ 2.0	\$ 6.2	\$ 5.9
Investment-type insurance contracts (2)	(2.7)	(3.4)	(8.2)	(9.8)

- (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.

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 resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.1 million and \$0.1 million for the three months ended September 30, 2013 and 2012, respectively. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.5 million and \$0.4 million for the nine months ended September 30, 2013 and 2012, respectively.

We expect to reclassify net gains of \$2.4 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.

**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. Gains and losses on certain derivatives used in relation to certain trading portfolios are reported in net investment income 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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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,	
	2013	2012	2013	2012
	(in millions)			
Interest rate contracts	\$ (20.0)	\$ (13.8)	\$ (112.1)	\$ 12.4
Foreign exchange contracts	14.9	26.4	3.1	40.0
Equity contracts	(49.0)	(36.7)	(120.5)	(59.0)
Credit contracts	10.4	9.6	32.8	19.1
Other contracts	18.4	(37.1)	117.9	(14.9)
Total	\$ (25.3)	\$ (51.6)	\$ (78.8)	\$ (2.4)

**6. Income Taxes**

The effective income tax rate for both the three and nine months ended September 30, 2013, 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, 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 three months ended September 30, 2012, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. and a third quarter adjustment to reflect a decrease in our estimated annual effective income tax rate.

The effective income tax rate for the nine months ended September 30, 2012, 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 in net investment income and tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc.

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. A temporary exception (the active financing exception ) was applicable for tax years beginning before January 1, 2012, to avoid the current recognition of Subpart F income derived in the active conduct of a banking, financing, insurance or similar business. The U.S. Congress and the President enacted legislation on January 2, 2013, retroactive to January 1, 2012, to extend the active financing exception. The legislation did not have a material impact on our consolidated results for the three or nine months ended September 30, 2013.

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

The Internal Revenue Service ( IRS ) completed its examinations of tax years 2004 through 2008. We filed claims for refund for tax years 2004 and 2005 during 2012 and will file claims for refund relating to disputed adjustments for tax years 2006 through 2008. The IRS commenced audit of our federal income tax return for 2009 during the fourth quarter of 2011, for 2010 during the first quarter of 2012 and for 2011 during the first quarter of 2013. We do not expect the results of these audits or developments in other tax areas for all open tax years to significantly change the possible increase in the amount of unrecognized tax benefits, but the outcome of tax reviews is uncertain and unforeseen results can occur.

We do not believe there is a reasonable possibility the amount of our unrecognized tax benefits will significantly increase or decrease in the next twelve months. The range disclosed in our 2012 financial statements was prior to the January 2013 expiration of the right to appeal the U.S. District Court for the Southern District of Iowa decision in the case of Pritired 1, LLC. We believe we have adequate defenses against, or sufficient provisions for, contested issues, but final resolution of the contested issues could take several years while legal remedies are pursued. Consequently, we do not expect the ultimate resolution of issues from tax years 1995 - 2003 to have a material impact on our net income. Similarly, we believe there are adequate defenses against, or sufficient provisions for, any challenges that might arise in tax years subsequent to 2003.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**7. Employee and Agent Benefits****Components of Net Periodic Benefit Cost**

	Pension benefits				Other postretirement benefits			
	For the three months ended				For the three months ended			
	September 30,				September 30,			
	2013		2012		2013		2012	
	(in millions)							
Service cost	\$	14.3	\$	11.7	\$	0.3	\$	0.3
Interest cost		25.9		27.3		1.4		2.0
Expected return on plan assets		(31.8)		(28.6)		(7.2)		(8.3)
Amortization of prior service benefit		(2.1)		(2.4)		(6.5)		(7.2)
Recognized net actuarial loss		29.5		22.7		0.3		0.3
Net periodic benefit cost (income)	\$	35.8	\$	30.7	\$	(11.7)	\$	(12.9)

	Pension benefits				Other postretirement benefits			
	For the nine months ended				For the nine months ended			
	September 30,				September 30,			
	2013		2012		2013		2012	
	(in millions)							
Service cost	\$	42.9	\$	35.2	\$	0.9	\$	1.0
Interest cost		77.7		81.8		4.2		6.1
Expected return on plan assets		(95.6)		(85.9)		(21.6)		(25.1)
Amortization of prior service benefit		(6.3)		(7.0)		(19.5)		(21.5)
Recognized net actuarial loss		88.6		68.1		0.9		0.7
Net periodic benefit cost (income)	\$	107.3	\$	92.2	\$	(35.1)	\$	(38.8)

**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 2013 will be zero so we will not be required to fund our qualified pension plan during 2013. However, it is possible that we may fund the qualified and nonqualified pension plans in 2013 for a combined total of \$81.0 million to \$110.0 million. During the three and nine months ended September 30, 2013, we contributed \$27.0 million and \$81.0 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; life, health and disability 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.

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, the Federal Reserve Board and other regulatory agencies regularly make inquiries and conduct examinations or



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 November 8, 2006, a trustee of Fairmount Park Inc. Retirement Savings Plan filed a putative class action lawsuit in the United States District Court for the Southern District of Illinois against Principal Life. The complaint alleged, among other things, that Principal Life breached its alleged fiduciary duties while performing services to 401(k) plans by failing to disclose, or adequately disclose, to employers or plan participants the fact that Principal Life receives revenue sharing fees from mutual funds that are included in its pre-packaged 401(k) plans and allegedly failed to use the revenue to defray the expenses of the services provided to the plans. Plaintiff further alleged that these acts constitute prohibited transactions under ERISA. Plaintiff sought to certify a class of all retirement plans to which Principal Life was a service provider and for which Principal Life received and retained revenue sharing fees from mutual funds. On August 27, 2008, the plaintiff's motion for class certification was denied. On June 13, 2011, the court entered a consent judgment resolving the claims of the plaintiff. On July 12, 2011, plaintiff filed a notice of appeal related to the issue of the denial of class certification. On February 13, 2013, the Eighth Circuit Court of Appeals dismissed the appeal. Plaintiff filed a petition for a writ of certiorari with the U.S. Supreme Court, which was denied on October 7, 2013.

On October 28, 2009, Judith Curran filed a derivative action lawsuit on behalf of Principal Funds, Inc. Strategic Asset Management Portfolios in the United States District Court for the Southern District of Iowa against Principal Management Corporation; Principal Global Investors, LLC; and Principal Funds Distributor, Inc. (the Curran Defendants). The lawsuit alleges the Curran Defendants breached their fiduciary duty under Section 36(b) of the Investment Company Act by charging advisory fees and distribution fees that were excessive. The Curran Defendants filed a motion to dismiss the case on January 29, 2010. That motion was granted in part and overruled in part. Principal Global Investors, LLC was dismissed from the suit. The court dismissed this case on June 12, 2013.

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 funds. We are aggressively defending the lawsuit.

On December 2, 2009 and December 4, 2009, two plaintiffs, Cruise and Mullaney, each filed putative class action lawsuits in the United States District Court for the Southern District of New York against us; Principal Life; Principal Global Investors, LLC; Principal Management Corporation; and Principal Real Estate Investors, LLC (the Cruise/Mullaney Defendants). The lawsuits alleged the Cruise/Mullaney Defendants failed to manage the Principal U.S. Property Separate Account (PUSPSA) in the best interests of investors, improperly imposed a withdrawal freeze on September 26, 2008, and instituted a withdrawal queue to honor withdrawal requests as sufficient liquidity became available. Plaintiffs allege these actions constitute a breach of fiduciary duties under ERISA. Plaintiffs seek to certify a class including all qualified ERISA plans and the participants of those plans that invested in PUSPSA between September 26, 2008, and the present that have suffered losses caused by the queue. The two lawsuits, as well as two subsequently filed complaints asserting similar claims, have been consolidated and are now known as In re Principal U.S. Property Account Litigation. On September 30, 2013, the plaintiffs' motion for class certification was denied. The Cruise/Mullaney Defendants are aggressively defending the lawsuit.

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

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 has sought to recover from numerous sources significant amounts to which it claims entitlement under various theories. The estate is attempting to recover from us an unspecified amount, but possibly up to the amount paid to us, plus interest. We are one of numerous defendants to this action, which has been stayed by the bankruptcy court. We believe that we have meritorious defenses to Lehman's claims and intend to aggressively defend against them once the stay is lifted and we are allowed to do so.

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, 2013, 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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

We believe all of the litigation contingencies discussed above involve a chance of loss that is either remote or reasonably possible. 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 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, 2013.

**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, 2013, was approximately \$255.0 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 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 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.

**9. Stockholders Equity**

**Common Stock**

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

On September 27, 2013, we paid a quarterly dividend of \$76.5 million, equal to \$0.26 per share, to stockholders of record as of September 5, 2013. On June 28, 2013, we paid a quarterly dividend of \$67.6 million, equal to \$0.23 per share, to stockholders of record as of June 3, 2013. On March 29, 2013, we paid a quarterly dividend of \$67.6 million, equal to \$0.23 per share, to stockholders of record as of March 11, 2013. On September 28, 2012, we paid a quarterly dividend of \$61.6 million, equal to \$0.21 per share, to stockholders of record as of September 6, 2012. On June 29, 2012, we paid a quarterly dividend of \$53.7 million, equal to \$0.18 per share, to stockholders of record as of June 11, 2012. On March 30, 2012, we paid a quarterly dividend of \$54.3 million, equal to \$0.18 per share, to stockholders of record as of March 12, 2012.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Reconciliation of Outstanding Shares**

	Series A preferred stock	Series B preferred stock (in millions)	Common stock
Outstanding shares at January 1, 2012	3.0	10.0	301.1
Shares issued			3.0
Treasury stock acquired			(10.5)
Outstanding shares at September 30, 2012	3.0	10.0	293.6
Outstanding shares at January 1, 2013	<b>3.0</b>	<b>10.0</b>	<b>293.8</b>
Shares issued			<b>4.5</b>
Treasury stock acquired			<b>(4.4)</b>
Outstanding shares at September 30, 2013	<b>3.0</b>	<b>10.0</b>	<b>293.9</b>

In February 2012, our Board of Directors authorized a share repurchase program of up to \$100.0 million of our outstanding common stock. We completed this program in May 2012. In May 2012, our Board of Directors authorized a share repurchase program of up to \$200.0 million of our outstanding common stock. We completed this program in February 2013. Also in February 2013, our Board of Directors authorized a share repurchase program up to \$150.0 million of our outstanding common stock.

Our Board of Directors has authorized various repurchase programs under which we are allowed to purchase shares 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, 2013**  
**(Unaudited)**

**Other Comprehensive Income (Loss)**

	For the three months ended September 30, 2013			For the nine months ended September 30, 2013		
	Pre-Tax	Tax	After-Tax	Pre-Tax	Tax	After-Tax
	(in millions)					
Net unrealized losses on available-for-sale securities during the period	\$ (40.9)	\$ 9.1	\$ (31.8)	\$ (1,578.4)	\$ 511.6	\$ (1,066.8)
Reclassification adjustment for losses included in net income (1)	8.4	(2.9)	5.5	66.8	(22.7)	44.1
Adjustments for assumed changes in amortization patterns	29.3	(10.3)	19.0	241.1	(84.4)	156.7
Adjustments for assumed changes in policyholder liabilities	54.1	(17.5)	36.6	505.7	(163.4)	342.3
Net unrealized gains (losses) on available-for-sale securities	50.9	(21.6)	29.3	(764.8)	241.1	(523.7)
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	9.3	(2.9)	6.4	(8.8)	3.9	(4.9)
Adjustments for assumed changes in amortization patterns	(13.7)	4.9	(8.8)	(13.6)	4.9	(8.7)
Adjustments for assumed changes in policyholder liabilities	(0.2)	0.1	(0.1)	0.8	(0.3)	0.5
Noncredit component of impairment losses on fixed maturities, available-for-sale (2)	(4.6)	2.1	(2.5)	(21.6)	8.5	(13.1)
Net unrealized losses on derivative instruments during the period	(45.7)	15.9	(29.8)	(31.7)	11.7	(20.0)
Reclassification adjustment for losses included in net income (3)	1.9	(0.8)	1.1	1.6	(0.8)	0.8
Adjustments for assumed changes in amortization patterns	2.6	(1.0)	1.6	9.0	(3.2)	5.8
Adjustments for assumed changes in policyholder liabilities	2.7	(0.7)	2.0	15.3	(5.3)	10.0
Net unrealized losses on derivative instruments	(38.5)	13.4	(25.1)	(5.8)	2.4	(3.4)
Foreign currency translation adjustment	(32.0)	(1.5)	(33.5)	(177.3)	7.8	(169.5)
Amortization of prior service cost and actuarial loss included in net	21.2	(7.4)	13.8	63.7	(22.3)	41.4

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

periodic benefit cost (4)

Net unrecognized postretirement benefit obligation	21.2	(7.4)	13.8	63.7	(22.3)	41.4
Other comprehensive loss	\$ (3.0)	\$ (15.0)	\$ (18.0)	\$ (905.8)	\$ 237.5	\$ (668.3)

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the three months ended September 30, 2012			For the nine months ended September 30, 2012		
	Pre-Tax	Tax	After-Tax	Pre-Tax	Tax	After-Tax
	(in millions)					
Net unrealized gains on available-for-sale securities during the period	\$ 810.7	\$ (273.0)	\$ 537.7	\$ 1,436.7	\$ (468.4)	\$ 968.3
Reclassification adjustment for losses included in net income (1)	56.4	(20.3)	36.1	96.5	(34.3)	62.2
Adjustments for assumed changes in amortization patterns	(145.8)	51.1	(94.7)	(225.4)	78.9	(146.5)
Adjustments for assumed changes in policyholder liabilities	(271.5)	88.4	(183.1)	(474.1)	148.1	(326.0)
Net unrealized gains on available-for-sale securities	449.8	(153.8)	296.0	833.7	(275.7)	558.0
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	(9.2)	3.2	(6.0)	(31.2)	10.9	(20.3)
Adjustments for assumed changes in amortization patterns	3.0	(1.0)	2.0	8.5	(3.0)	5.5
Noncredit component of impairment losses on fixed maturities, available-for-sale (2)	(6.2)	2.2	(4.0)	(22.7)	7.9	(14.8)
Net unrealized gains (losses) on derivative instruments during the period	(23.9)	8.3	(15.6)	5.6	(2.0)	3.6
Reclassification adjustment for (gains) losses included in net income (3)	(0.5)	0.2	(0.3)	10.2	(3.7)	6.5
Adjustments for assumed changes in amortization patterns	(3.5)	1.2	(2.3)	26.4	(9.3)	17.1
Net unrealized gains (losses) on derivative instruments	(27.9)	9.7	(18.2)	42.2	(15.0)	27.2
Foreign currency translation adjustment	46.0	(0.6)	45.4	5.5	16.0	21.5
Amortization of prior service cost and actuarial loss included in net periodic benefit cost (4)	13.4	(4.7)	8.7	40.3	(14.1)	26.2
Net unrecognized postretirement benefit obligation	13.4	(4.7)	8.7	40.3	(14.1)	26.2
Other comprehensive income	\$ 475.1	\$ (147.2)	\$ 327.9	\$ 899.0	\$ (280.9)	\$ 618.1



- (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 5, 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, 2013**  
**(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)
<b>Balances at January 1, 2012</b>	\$ 860.7	\$ (167.2)	\$ 34.9	\$ (95.9)	\$ (361.1)	\$ 271.4
Other comprehensive income during the period, net of adjustments	495.8	(14.8)	20.7	20.5		522.2
Amounts reclassified from AOCI	62.2		6.5		26.2	94.9
Other comprehensive income	558.0	(14.8)	27.2	20.5	26.2	617.1
<b>Balances at September 30, 2012</b>	\$ 1,418.7	\$ (182.0)	\$ 62.1	\$ (75.4)	\$ (334.9)	\$ 888.5
<b>Balances at January 1, 2013</b>	\$ 1,418.3	\$ (173.9)	\$ (8.7)	\$ (106.9)	\$ (488.5)	\$ 640.3
Other comprehensive loss during the period, net of adjustments	(567.8)	(13.1)	(4.2)	(159.2)		(744.3)
Amounts reclassified from AOCI	44.1		0.8		41.4	86.3
Other comprehensive loss	(523.7)	(13.1)	(3.4)	(159.2)	41.4	(658.0)
<b>Balances at September 30, 2013</b>	\$ 894.6	\$ (187.0)	\$ (12.1)	\$ (266.1)	\$ (447.1)	\$ (17.7)

**Noncontrolling Interest**

Interest 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 subsidiaries 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, 2013**  
**(Unaudited)**

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

<b>Balance at January 1, 2012</b>	\$	22.2
Net income attributable to redeemable noncontrolling interest		1.6
Redeemable noncontrolling interest assumed related to acquisition		37.6
Distributions to redeemable noncontrolling interest		(1.3)
Foreign currency translation adjustment		0.9
<b>Balance at September 30, 2012</b>	\$	61.0
<b>Balance at January 1, 2013</b>	\$	60.4
Net income attributable to redeemable noncontrolling interest		9.0
Reclassification from stockholders' equity (1)		173.9
Contributions from redeemable noncontrolling interest		1.2
Distributions to redeemable noncontrolling interest		(9.9)
Purchase of subsidiary shares from redeemable noncontrolling interest		(2.4)
Change in redemption value of redeemable noncontrolling interest		5.6
Foreign currency translation adjustment		(3.3)
<b>Balance at September 30, 2013</b>	\$	234.5

(1) During the third quarter of 2013, we identified a classification error of certain of our noncontrolling interests. The classification error had no impact on net income, but did impact earnings per share to the extent the redemption value of the redeemable noncontrolling interest exceeds the fair value. We evaluated the classification error and related earnings per share impact based on qualitative and quantitative factors in accordance with SEC Staff Accounting Bulletins 99 and 108 and concluded the impact was not material in the current or any prior quarterly or annual periods presented. During the third quarter of 2013, we recorded a \$173.9 million increase to redeemable noncontrolling interest and a corresponding decrease to stockholders' equity. See related discussion in Note 13, Earnings Per Share.

## 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

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

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.
- **Level 3** Fair values are based on significant unobservable inputs 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, commercial mortgage loan investments and 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, 2013**

**(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. We did not make any significant changes to our valuation processes during 2013.

***Fixed Maturities***

Fixed maturities include bonds, redeemable preferred stock, asset-backed securities and certain nonredeemable preferred stock. 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.

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

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, 2013, 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.

***State 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.

***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.

Table of Contents

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**September 30, 2013**

**(Unaudited)**

***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 mandatory 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, 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 interest rate and equity 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 currency options and non-standard currency swaps that are valued using broker quotes. These are reflected within Level 3.

**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.

Table of Contents

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**September 30, 2013**

**(Unaudited)**

***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 primarily include seed money investments, for which the fair value is determined using the net asset value of the fund. The net asset value 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 net asset value is published are reflected in Level 1. Seed money investments in mutual funds or other investment funds in markets that do not have a published net asset value are reflected in Level 2.

Other investments reported at fair value also include commercial mortgage loans of consolidated VIEs and equity method real estate investments for which the fair value option was elected, which are reflected in Level 3. Fair value of the commercial mortgage loans is computed utilizing a discount rate based on the current market. The market discount rate is then adjusted based on various factors that differentiate it from our pool of loans. 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 public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. 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 lapse, mortality, utilization and withdrawal patterns). They are valued using a combination of historical data and actuarial judgment. Stochastic models are used to value the embedded derivatives that incorporate a spread reflecting our own creditworthiness and risk margins.

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.

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2013****(Unaudited)*****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. These obligations are valued either 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, or broker quotes, 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	As of September 30, 2013			
	Level 1	Fair value hierarchy level		Level 3
		Level 2		
	(in millions)			
<b>Assets</b>				
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 720.6	\$ 306.8	\$ 413.8	\$
Non-U.S. governments	1,014.6		966.8	47.8
States and political subdivisions	3,616.6		3,614.8	1.8
Corporate	32,443.7	45.0	32,235.7	163.0
Residential mortgage-backed securities	2,758.5		2,758.5	
Commercial mortgage-backed securities	3,983.5		3,983.5	
Collateralized debt obligations	332.3		294.3	38.0
Other debt obligations	4,045.1		3,997.8	47.3
Total fixed maturities, available-for-sale	48,914.9	351.8	48,265.2	297.9
Fixed maturities, trading	572.9		400.0	172.9
Equity securities, available-for-sale	114.0	35.1	61.7	17.2

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

Equity securities, trading	666.2	97.6	568.6	
Derivative assets (1)	684.6		627.1	57.5
Other investments (2)	331.3	7.7	183.1	140.5
Cash equivalents (3)	590.0	2.4	587.6	
Sub-total excluding separate account assets	51,873.9	494.6	50,693.3	686.0
Separate account assets	123,800.5	62,692.3	56,166.9	4,941.3
<b>Total assets</b>	<b>\$ 175,674.4</b>	<b>\$ 63,186.9</b>	<b>\$ 106,860.2</b>	<b>\$ 5,627.3</b>
<b>Liabilities</b>				
Investment-type insurance contracts (4)	\$ (49.3)	\$	\$	\$ (49.3)
Derivative liabilities (1)	(1,022.7)		(972.7)	(50.0)
Other liabilities (4)	(292.5)		(225.4)	(67.1)
<b>Total liabilities</b>	<b>\$ (1,364.5)</b>	<b>\$</b>	<b>\$ (1,198.1)</b>	<b>\$ (166.4)</b>
<b>Net assets (liabilities)</b>	<b>\$ 174,309.9</b>	<b>\$ 63,186.9</b>	<b>\$ 105,662.1</b>	<b>\$ 5,460.9</b>

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2013****(Unaudited)**

Assets/ (liabilities) measured at fair value	As of December 31, 2012			
	Level 1	Fair value hierarchy level		Level 3
		Level 2	Level 3	
	(in millions)			
<b>Assets</b>				
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 944.3	\$ 203.5	\$ 740.8	\$
Non-U.S. governments	1,208.3		1,164.0	44.3
States and political subdivisions	3,178.8		3,176.9	1.9
Corporate	34,325.4	85.9	34,065.0	174.5
Residential mortgage-backed securities	3,226.7		3,226.7	
Commercial mortgage-backed securities	3,897.4		3,897.4	
Collateralized debt obligations	379.2		301.6	77.6
Other debt obligations	3,779.2		3,764.5	14.7
<b>Total fixed maturities, available-for-sale</b>	<b>50,939.3</b>	<b>289.4</b>	<b>50,336.9</b>	<b>313.0</b>
Fixed maturities, trading	626.7	9.4	450.5	166.8
Equity securities, available-for-sale	136.5	54.4	66.8	15.3
Equity securities, trading	252.8	99.8	153.0	
Derivative assets (1)	1,016.7		941.6	75.1
Other investments (2)	272.1	64.1	94.1	113.9
Cash equivalents (3)	1,772.6	561.4	1,211.2	
Sub-total excluding separate account assets	55,016.7	1,078.5	53,254.1	684.1
Separate account assets	81,653.8	54,010.1	23,027.7	4,616.0
<b>Total assets</b>	<b>\$ 136,670.5</b>	<b>\$ 55,088.6</b>	<b>\$ 76,281.8</b>	<b>\$ 5,300.1</b>
<b>Liabilities</b>				
Investment-type insurance contracts (4)	\$ (170.5)	\$	\$	\$ (170.5)
Derivative liabilities (1)	(1,205.1)		(1,102.5)	(102.6)
Other liabilities (4)	(237.4)		(197.8)	(39.6)
<b>Total liabilities</b>	<b>\$ (1,613.0)</b>	<b>\$</b>	<b>\$ (1,300.3)</b>	<b>\$ (312.7)</b>
<b>Net assets (liabilities)</b>	<b>\$ 135,057.5</b>	<b>\$ 55,088.6</b>	<b>\$ 74,981.5</b>	<b>\$ 4,987.4</b>

(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 5, 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, 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.

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

(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, 2013****(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:

	Beginning asset/ (liability) balance as of June 30, 2013	For the three months ended September 30, 2013				Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of September 30, 2013	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net purchases, sales, issuances and settlements (4)	(in millions)				
<b>Assets</b>									
Fixed maturities, available-for-sale:									
Non-U.S. governments	\$ 44.7	\$	\$ (0.3)	\$ 3.4	\$	\$	\$ 47.8	\$	
States and political subdivisions	1.7		0.1				1.8		
Corporate	168.1	(0.1)	2.7	17.1	4.7	(29.5)	163.0	(0.1)	
Collateralized debt obligations	40.7		(0.1)			(2.6)	38.0		
Other debt obligations	18.4	(0.3)	0.6	13.6	15.0		47.3	(0.3)	
Total fixed maturities, available-for-sale	273.6	(0.4)	3.0	34.1	19.7	(32.1)	297.9	(0.4)	
Fixed maturities, trading	170.7	2.1		0.1			172.9	2.1	
Equity securities, available-for-sale	16.9		0.3				17.2		
Derivative assets	56.9	1.0		(0.4)			57.5	1.2	
Other investments	116.5	1.8		22.2			140.5	1.9	
Separate account assets (2)	4,841.7	134.6	0.1	(33.7)	4.9	(6.3)	4,941.3	122.0	
<b>Liabilities</b>									
Investment-type insurance contracts	(74.2)	17.6		7.3			(49.3)	19.8	
Derivative liabilities	(70.0)	14.1	0.3	5.6			(50.0)	14.2	
Other liabilities (3)	(59.6)	(7.5)					(67.1)	(7.6)	



Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2013****(Unaudited)**

	Beginning asset/ (liability) balance as of June 30, 2012	For the three months ended September 30, 2012				Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of September 30, 2012	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net purchases, sales, and settlements (4) (in millions)					
<b>Assets</b>									
Fixed maturities, available-for-sale:									
Non-U.S. governments	\$ 39.6	\$	\$	\$ 6.3	\$	\$	\$ 45.9	\$	
States and political subdivisions			0.2		1.8		2.0		
Corporate	199.6	(1.5)	4.4	(38.8)	28.8	(2.8)	189.7	(1.0)	
Collateralized debt obligations	77.6	(3.5)	7.1	(0.2)		(4.2)	76.8		
Other debt obligations	5.1		2.0	(0.5)	9.3		15.9		
Total fixed maturities, available-for-sale	321.9	(5.0)	13.7	(33.2)	39.9	(7.0)	330.3	(1.0)	
Fixed maturities, trading	185.7	5.1					190.8	5.0	
Equity securities, available-for-sale	17.1		(0.4)				16.7		
Derivative assets	58.8	10.7		0.5			70.0	12.6	
Other investments	83.6	(0.1)		30.7			114.2	(0.1)	
Separate account assets (2)	4,440.5	106.0		(26.6)			4,519.9	105.9	
<b>Liabilities</b>									
Investment-type insurance contracts	(179.4)	(37.0)	(0.1)	(5.2)			(221.7)	(37.6)	
Derivative liabilities	(147.1)	19.6	0.5	7.3			(119.7)	19.3	
Other liabilities (3)	(33.6)	(14.7)					(48.3)	(14.7)	

Table of Contents**Principal Financial Group, Inc.****Notes to Consolidated Financial Statements****September 30, 2013****(Unaudited)**

	Beginning asset/ (liability) balance as of December 31, 2013	For the nine months ended September 30, 2013					Ending asset/ (liability) balance as of September 30, 2013	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net purchases, sales, issuances and settlements (4) (in millions)	Transfers into Level 3	Transfers out of Level 3		
<b>Assets</b>								
Fixed maturities, available-for-sale:								
Non-U.S. governments	\$ 44.3	\$ (0.1)	\$ (0.8)	\$ 4.4	\$	\$	\$ 47.8	\$ (0.1)
States and political subdivisions	1.9			(0.1)			1.8	
Corporate	174.5	(4.9)	(7.0)	(25.3)	105.3	(79.6)	163.0	(2.0)
Collateralized debt obligations	77.6	2.1	7.4	(56.0)	31.7	(24.8)	38.0	
Other debt obligations	14.7	(0.3)	3.0	12.7	17.2		47.3	(0.3)
Total fixed maturities, available-for-sale	313.0	(3.2)	2.6	(64.3)	154.2	(104.4)	297.9	(2.4)
Fixed maturities, trading	166.8	6.0		0.1			172.9	6.1
Equity securities, available-for-sale	15.3		1.9				17.2	
Derivative assets	75.1	(21.3)		3.7			57.5	(21.6)
Other investments	113.9	7.1		19.5			140.5	7.1
Separate account assets (2)	4,616.0	427.2		(108.1)	12.7	(6.5)	4,941.3	406.3
<b>Liabilities</b>								
Investment-type insurance contracts	(170.5)	111.2		10.0			(49.3)	109.2
Derivative liabilities	(102.6)	44.4	(0.2)	8.4			(50.0)	43.8
Other liabilities (3)	(39.6)	(27.5)					(67.1)	(27.5)

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

For the nine months ended September 30, 2012

	Beginning asset/ (liability) balance as of December 31, 2011	Total realized/unrealized gains (losses)		Net purchases, sales, and settlements (4)	Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of September 30, 2012	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					
(in millions)								
<b>Assets</b>								
Fixed maturities, available-for-sale:								
Non-U.S. governments	\$ 22.9	\$	\$	\$ 8.5	\$ 14.5	\$	\$ 45.9	\$
States and political subdivisions			0.2		1.8		2.0	
Corporate	297.0	(6.9)	13.4	(70.3)	54.8	(98.3)	189.7	(3.0)
Collateralized debt obligations	102.5	(3.7)	4.1	5.1		(31.2)	76.8	(0.2)
Other debt obligations	27.3	(2.2)	1.3	(25.8)	15.3		15.9	(2.2)
Total fixed maturities, available-for-sale	449.7	(12.8)	19.0	(82.5)	86.4	(129.5)	330.3	(5.4)
Fixed maturities, trading	220.8	3.6		(43.1)	9.5		190.8	4.3
Equity securities, available-for-sale	18.0		(1.3)				16.7	
Derivative assets	60.2	6.9		2.9			70.0	8.0
Other investments	97.5	(0.8)		17.5			114.2	(0.8)
Separate account assets (2)	4,198.2	318.4	0.3	3.2	1.6	(1.8)	4,519.9	307.1
<b>Liabilities</b>								
Investment-type insurance contracts	(195.8)	(14.6)	(0.1)	(11.2)			(221.7)	(16.8)
Derivative liabilities	(177.1)	32.4	0.7	24.3			(119.7)	34.9
Other liabilities (3)	(24.2)	(24.1)					(48.3)	(24.1)

(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 operation.

(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, 2013**  
**(Unaudited)**

For the three months ended September 30, 2013

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 3.7	\$	\$	(0.3)	\$ 3.4
Corporate	18.2	(0.7)		(0.4)	17.1
Other debt obligations	15.0			(1.4)	13.6
Total fixed maturities, available-for-sale	36.9	(0.7)		(2.1)	34.1
Fixed maturities, trading				0.1	0.1
Derivative assets		(0.4)			(0.4)
Other investments	25.7			(3.5)	22.2
Separate account assets (5)	33.6	(54.7)	(1.4)	(11.2)	(33.7)
<b>Liabilities</b>					
Investment-type insurance contracts			5.4	1.9	7.3
Derivative liabilities		5.6			5.6

For the three months ended September 30, 2012

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 6.5	\$	\$	(0.2)	\$ 6.3
Corporate	3.1	(34.1)		(7.8)	(38.8)
Collateralized debt obligations		(0.3)		0.1	(0.2)
Other debt obligations				(0.5)	(0.5)
Total fixed maturities, available-for-sale	9.6	(34.4)		(8.4)	(33.2)
Derivative assets	0.5				0.5
Other investments	33.3			(2.6)	30.7
Separate account assets (5)	42.6	(72.9)	(57.8)	61.5	(26.6)
<b>Liabilities</b>					
Investment-type insurance contracts			(6.7)	1.5	(5.2)
Derivative liabilities	(1.9)	9.2			7.3

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

For the nine months ended September 30, 2013

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. government	\$ 9.2	\$ (3.9)	\$	\$ (0.9)	\$ 4.4
States and political subdivisions				(0.1)	(0.1)
Corporate	29.6	(32.4)		(22.5)	(25.3)
Collateralized debt obligations	17.0	(47.4)		(25.6)	(56.0)
Other debt obligations	15.0			(2.3)	12.7
Total fixed maturities, available-for-sale	70.8	(83.7)		(51.4)	(64.3)
Fixed maturities, trading				0.1	0.1
Derivative assets	7.2	(3.5)			3.7
Other investments	28.3			(8.8)	19.5
Separate account assets (5)	143.2	(223.4)	(7.6)	(20.3)	(108.1)
<b>Liabilities</b>					
Investment-type insurance contracts			5.6	4.4	10.0
Derivative liabilities	(3.1)	11.5			8.4

For the nine months ended September 30, 2012

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. government	\$ 13.2	\$ (3.9)	\$	\$ (0.8)	\$ 8.5
Corporate	21.2	(80.7)		(10.8)	(70.3)
Collateralized debt obligations	5.1	(0.3)		0.3	5.1
Other debt obligations				(25.8)	(25.8)
Total fixed maturities, available-for-sale	39.5	(84.9)		(37.1)	(82.5)
Fixed maturities, trading		(0.9)		(42.2)	(43.1)
Derivative assets	3.7	(0.8)			2.9
Other investments	33.3			(15.8)	17.5
Separate account assets (5)	211.1	(191.9)	(204.1)	188.1	3.2
<b>Liabilities</b>					
Investment-type insurance contracts			(14.8)	3.6	(11.2)
Derivative liabilities	(3.6)	27.9			24.3

(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, 2013**  
**(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, 2013					
	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)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						
Corporate	\$	\$	\$	\$ 4.7	\$	\$ 29.5
Collateralized debt obligations						2.6
Other debt obligations				15.0		
Total fixed maturities, available-for-sale				19.7		32.1
Separate account assets	7.1		6.9	4.9		6.3

	For the three months ended September 30, 2012					
	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)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						
States and political subdivisions	\$	\$	\$	\$ 1.8	\$	\$
Corporate				28.8		2.8
Collateralized debt obligations						4.2
Other debt obligations				9.3		
Total fixed maturities, available-for-sale				39.9		7.0
Separate account assets	7.8		0.3			

	For the nine months ended September 30, 2013					
	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)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						



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

Corporate	\$	\$	\$	\$	105.3	\$	\$	79.6
Collateralized debt obligations					31.7			24.8
Other debt obligations					17.2			
Total fixed maturities, available-for-sale					154.2			104.4
Separate account assets		250.9	0.1	11.7	12.6			6.5

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the nine months ended September 30, 2012					
	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)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						
Non-U.S. governments	\$	\$	\$	\$ 14.5	\$	\$
States and political subdivisions				1.8		
Corporate				54.8		98.3
Collateralized debt obligations						31.2
Other debt obligations				15.3		
Total fixed maturities, available-for-sale				86.4		129.5
Fixed maturities, trading				9.5		
Separate account assets	3,230.6	0.3	0.3	1.3		1.8

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

Separate account assets transferred between Level 1 and Level 2 during the nine months ended September 30, 2012, primarily related to foreign equity securities. When these securities are valued at the local close price of the exchange where the assets traded, they are reflected in Level 1. When events materially affecting the value occur between the close of the local exchange and the New York Stock Exchange, we use adjusted prices determined by a third party pricing vendor to update the foreign market closing prices and the fair value is reflected in Level 2.

Assets transferred into Level 3 during the nine months ended September 30, 2013 and 2012, 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 nine months ended September 30, 2013 and 2012, 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.

### 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,

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

which primarily consists of those valued using broker quotes. 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, 2013**  
**(Unaudited)**

As of September 30, 2013					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 12.1	Discounted cash flow	Discount rate (1)	2.3%	2.3%
Corporate	50.2	Discounted cash flow	Discount rate (1)	2.0%-8.2%	3.8%
			Earnings before interest, taxes, depreciation and amortization multiple	0x-4.5x	0.4x
			Probability of default	0%-100%	7.9%
			Potential loss severity	0%-17%	1.3%
			Illiquidity premium	0 basis points ( bps )-50bps	31bps
Collateralized debt obligations	13.6	Discounted cash flow	Discount rate (1)	1.6%	1.6%
			Illiquidity premium	400bps	400bps
Other debt obligations	16.1	Discounted cash flow	Discount rate (1)	7.3%-15.0%	11.4%
			Illiquidity premium	0bps-50bps	23bps
Fixed maturities, trading	40.0	Discounted cash flow	Discount rate (1)	1.7%-82.7%	4.5%
	110.4	See note (2)	Illiquidity premium	0bps-1,400bps	350bps

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

As of September 30, 2013					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
Other investments	72.6	Discounted cash flow - commercial mortgage loans of consolidated VIEs	Discount rate (1)	4.3%	4.3%
	67.9		Illiquidity premium	155bps	155bps
		Discounted cash flow - equity method real estate investments	Discount rate (1)	8.0%-8.4%	8.2%
			Terminal capitalization rate	5.5%-6.8%	6.1%
			Average market rent growth rate	3.5%-3.6%	3.6%
		Discounted cash flow - equity method real estate investment - debt	Loan to value	42.8%-60.6%	51.7%
			Credit spread rate	1.5%-2.0%	1.8%
Separate account assets	4,780.1	Discounted cash flow - mortgage loans	Discount rate (1)	0.7%-7.9%	3.6%
			Illiquidity premium	0bps-50bps	13bps
		Discounted cash flow - real estate	Credit spread rate	51bps-700bps	254bps
			Discount rate (1)	6.0%-16.0%	7.8%
			Terminal capitalization rate	4.5%-9.0%	6.7%
		Discounted cash flow - real estate debt	Average market rent growth rate	1.9%-5.0%	3.3%
			Loan to value	13.6%-69.6%	51.9%
			Credit spread rate	1.6%-4.9%	3.3%

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

As of September 30, 2013					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
<b>Liabilities</b>					
Investment-type insurance contracts	(49.3)	Discounted cash flow	Long duration interest rate	3.5%-3.7% (3)	
			Long-term equity market volatility	15.0%-39.8%	
			Non-performance risk	0.2%-1.3%	
			Utilization rate	See note (4)	
			Lapse rate	0.5%-14.6%	
			Mortality rate	See note (5)	
Derivative liabilities	(27.7)	See note (2)			
Other liabilities	(67.1)	See note (2)			

As of December 31, 2012					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 12.9	Discounted cash flow	Discount rate (1)	1.6%	1.6%
			Illiquidity premium	50 basis points ( bps )	50bps
Corporate	66.6	Discounted cash flow	Discount rate (1)	1.7%-29.0%	8.4%
			Illiquidity premium	0bps-100bps	39bps
			Earnings before interest, taxes, depreciation and amortization multiple	0x-3.5x	0.2x
			Probability of default	0%-100%	6.4%
			Potential loss severity	0%-30%	1.9%
Collateralized debt obligations	38.2	Discounted cash flow	Discount rate (1)	1.0%-19.8%	13.3%
			Illiquidity premium	400bps-1,000bps	791bps



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

As of December 31, 2012					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
Other debt obligations	14.7	Discounted cash flow	Discount rate (1)	6.5%-20.0%	11.8%
			Illiquidity premium	0bps-50bps	30bps
Fixed maturities, trading	35.9	Discounted cash flow	Discount rate (1)	1.2%-60.5%	4.1%
			Illiquidity premium	0bps-1,400bps	390bps
	110.4	See note (2)			
Other investments	80.3	Discounted cash flow - commercial mortgage loans of consolidated VIEs	Discount rate (1)	3.5%	3.5%
	33.6	Discounted cash flow - equity method real estate investment	Illiquidity premium	287bps	287bps
			Discount rate (1)	9.3%	9.3%
			Terminal capitalization rate	5.5%	5.5%
			Average market rent growth rate	3.6%	3.6%
		Discounted cash flow - equity method real estate investment debt	Loan to value	49.4%	49.4%
			Credit spread rate	3.3%	3.3%



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

As of December 31, 2012						
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average	
Separate account assets	4,449.0	Discounted cash flow - mortgage loans	Discount rate (1)	0.8%-10.4%	3.3%	
			Illiquidity premium	0bps-50bps	20bps	
			Credit spread rate	44bps-975bps	286bps	
		Discounted cash flow - real estate	Discount rate (1)	6.5%-16.0%	8.3%	
				Terminal capitalization rate	4.8%-9.0%	7.2%
				Average market rent growth rate	2.3%-5.5%	3.3%
		Discounted cash flow - real estate debt	Loan to value	17.0%-86.0%	54.8%	
Credit spread rate	1.6%-5.3%			3.5%		
<b>Liabilities</b>						
Investment-type insurance contracts	(170.5)	Discounted cash flow	Long duration interest rate	2.6%-2.8% (3)		
			Long-term equity market volatility	16.1%-38.3%		
			Non-performance risk	0.3%-1.6%		
			Utilization rate	See note (4)		
			Lapse rate	0.5%-14.6%		
			Mortality rate	See note (5)		
Derivative liabilities	(65.1)	See note (2)				
Other liabilities	(39.6)	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) Relates 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 other liabilities represent obligations to third party note holders due at maturity or termination of the trust. The value of the obligations 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 observable 20 and 30-year swap rates.

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

- (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.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 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, 2013, certain mortgage loans had been marked to fair value of \$101.6 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$4.6 million and \$22.3 million for the three and nine months ended September 30, 2013, 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 fair value of the underlying collateral is determined based on a discounted cash flow valuation either from an external broker opinion of value or an internal model. Significant inputs used in the discounted cash flow calculation include: a discount rate, terminal capitalization rate and average market rent growth. 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, 2013, were:

Discount rate = 8.0% - 20.0%

Terminal capitalization rate = 7.5% - 10.5%

Average market rent growth = 1.0% - 10.9%

During the nine months ended September 30, 2013, certain mortgage servicing rights had been marked to fair value of \$7.6 million. The net impact of impairments and subsequent improvements in estimated fair value of previously impaired mortgage servicing rights resulted in a net gain of zero and \$1.3 million for the three and nine months ended September 30, 2013, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans. The discount rate used in calculating the present value of the future servicing cash flows was 3.9% for the nine months ended September 30, 2013.

During the nine months ended September 30, 2012, certain mortgage loans had been marked to fair value of \$172.5 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$3.1 million and \$14.4 million for the three and nine months ended September 30, 2012, 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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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.

Discount rate = 8.0% - 20.0%

Terminal capitalization rate = 6.3% - 10.5%

Average market rent growth = 3.0% - 8.0%

During the nine months ended September 30, 2012, certain mortgage servicing rights had been written down to fair value of \$5.6 million. The net impact of impairments and improvements in estimated fair value of previously impaired mortgage servicing rights resulted in a net loss of \$0.2 million and \$0.3 million for the three and nine months ended September 30, 2012, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans. The discount rate used in calculating the present value of the future servicing cash flows was 3.0% for the nine months ended September 30, 2012.

During the nine months ended September 30, 2012, certain real estate had been written down to fair value of \$5.0 million, resulting in a loss of \$0.1 million for the three and nine months ended September 30, 2012, that was recorded in net realized capital gains (losses). This is a Level 3 fair value measurement, as the fair value of real estate is estimated using appraised values that involve significant unobservable inputs that are not developed internally.

**Fair Value Option**

As a result of our implementation of new authoritative guidance related to the accounting for VIEs effective January 1, 2010, we elected fair value accounting for certain assets and liabilities of newly 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 \$72.6 million and \$67.6 million as of September 30, 2013, and \$80.3 million and \$76.4 million as of December 31, 2012, respectively. The change in fair value of the loans resulted in a (\$0.5) million and \$0.3 million pre-tax gain (loss) for the three months ended September 30, 2013

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

and 2012, respectively, and a \$1.1 million and (\$0.3) million pre-tax gain (loss) for the nine months ended September 30, 2013 and 2012, 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 \$1.4 million and \$1.6 million for the three months ended September 30, 2013 and 2012, respectively, and \$4.3 million and \$5.1 million for the nine months ended September 30, 2013 and 2012, respectively.

The fair value and aggregate unpaid principal amounts of obligations for which the fair value option has been elected were \$102.2 million and \$178.0 million as of September 30, 2013, and \$85.0 million and \$186.8 million as of December 31, 2012, respectively. For the three months ended September 30, 2013 and 2012, the change in fair value of the obligations resulted in a pre-tax loss of \$7.2 million and \$14.7 million, which includes a pre-tax loss of \$7.6 million and \$14.7 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, 2013 and 2012, the change in fair value of the obligations resulted in a pre-tax loss of \$26.3 million and \$23.2 million, which includes a pre-tax loss of \$27.5 million and \$24.1 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 \$0.9 million and \$1.2 million for the three months ended September 30, 2013 and 2012, respectively, and \$2.7 million and \$3.9 million for the nine months ended September 30, 2013 and 2012, 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 \$67.9 million and \$33.6 million as of September 30, 2013 and December 31, 2012, respectively.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

The change in fair value of the investments resulted in a \$2.3 million and \$(0.5) million pre-tax gain (loss) for the three months ended September 30, 2013 and 2012, respectively, and \$6.1 million and \$(0.5) million pre-tax gain (loss) for the nine months ended September 30, 2013 and 2012, respectively.

**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, 2013				
	Carrying amount	Fair value	Level 1 (in millions)	Level 2	Level 3
<b>Assets (liabilities)</b>					
Mortgage loans	\$ 11,868.1	\$ 12,190.9	\$	\$	\$ 12,190.9
Policy loans	859.6	988.6			988.6
Other investments	183.4	184.2		136.3	47.9
Cash and cash equivalents	1,117.1	1,117.1	1,117.1		
Investments-type insurance contracts	(30,394.9)	(30,627.9)		(6,396.7)	(24,231.2)
Short-term debt	(175.5)	(175.5)		(175.5)	
Long-term debt	(2,593.3)	(2,721.9)		(2,677.0)	(44.9)
Separate account liabilities	(113,916.9)	(112,489.0)			(112,489.0)
Bank deposits	(1,898.6)	(1,901.7)	(1,184.0)	(717.7)	
Cash collateral payable	(30.0)	(30.0)	(30.0)		

	December 31, 2012				
	Carrying amount	Fair value	Level 1 (in millions)	Level 2	Level 3
<b>Assets (liabilities)</b>					
Mortgage loans	\$ 11,519.7	\$ 12,163.7	\$	\$	\$ 12,163.7
Policy loans	864.9	1,056.8			1,056.8
Other investments	280.1	280.5		195.3	85.2
Cash and cash equivalents	2,404.6	2,404.6	2,364.6	40.0	
Investments-type insurance contracts	(31,953.1)	(32,531.6)		(7,367.4)	(25,164.2)
Short-term debt	(40.8)	(40.8)		(40.8)	
Long-term debt	(2,671.3)	(2,951.4)		(2,921.7)	(29.7)
Separate account liabilities	(73,096.0)	(72,173.8)			(72,173.8)
Bank deposits	(2,174.7)	(2,177.7)	(1,404.4)	(773.3)	

Cash collateral payable	(205.6)	(205.6)	(205.6)
-------------------------	---------	---------	---------

***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 scheduled cash flows through the estimated maturity date using market interest rates that reflect the credit and interest rate risk inherent in



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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 value estimate. These are reflected in Level 3. The carrying value of the remaining investments reported in this line item approximate their fair value and are of a short-term nature. 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, 2013**  
**(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, there is 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, 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, U.S. 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.

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 other 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 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, 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.

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 U.S. tax returns and the estimated resolution of any disputes.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

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

	September 30, 2013		December 31, 2012	
	(in millions)			
<b>Assets:</b>				
Retirement and Investor Services	\$	124,202.2	\$	117,399.5
Principal Global Investors		1,273.8		1,282.2
Principal International		53,158.2		19,170.9
U.S. Insurance Solutions		19,754.7		19,017.2
Corporate		3,298.5		4,960.4
Total consolidated assets	\$	201,687.4	\$	161,830.2

	For the three months ended September 30,			For the nine months ended September 30,				
	2013	2012	(in millions)					
<b>Operating revenues by segment:</b>								
Retirement and Investor Services	\$	1,136.5	\$	1,570.7	\$	3,387.6	\$	3,707.0
Principal Global Investors		160.9		144.0		482.8		423.2
Principal International		303.3		203.8		825.9		676.9
U.S. Insurance Solutions		767.6		766.5		2,318.6		2,215.0
Corporate		(52.5)		(46.4)		(149.1)		(139.8)
Total segment operating revenues		2,315.8		2,638.6		6,865.8		6,882.3
Net realized capital gains (losses), net of related revenue adjustments		(76.7)		64.9		(253.4)		12.8
Exited group medical insurance business		0.5		1.2		4.5		24.1
Total revenues per consolidated statements of operations	\$	2,239.6	\$	2,704.7	\$	6,616.9	\$	6,919.2
<b>Operating earnings (loss) by segment, net of related income taxes:</b>								
Retirement and Investor Services	\$	172.9	\$	137.5	\$	515.2	\$	422.8
Principal Global Investors		23.1		20.6		72.4		55.0
Principal International		50.7		37.0		153.6		112.6
U.S. Insurance Solutions		54.0		(21.6)		136.9		78.8
Corporate		(31.5)		(31.2)		(104.2)		(100.7)
Total segment operating earnings, net of related income taxes		269.2		142.3		773.9		568.5
Net realized capital gains (losses), as adjusted (1)		(22.8)		88.8		(126.8)		39.6
Other after-tax adjustments (2)		(0.7)		(43.9)		(0.8)		(49.4)
Net income available to common stockholders per consolidated statements of operations	\$	245.7	\$	187.2	\$	646.3	\$	558.7



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(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,	
	2013	2012	2013	2012
	(in millions)			
<b>Net realized capital gains (losses):</b>				
Net realized capital gains (losses)	\$ (50.9)	\$ 87.7	\$ (181.9)	\$ 81.2
Certain derivative and hedging-related adjustments	(25.6)	(22.7)	(70.7)	(68.4)
Recognition of front-end fee revenue	(0.2)	(0.1)	(0.8)	
Net realized capital gains (losses), net of related revenue adjustments	(76.7)	64.9	(253.4)	12.8
Amortization of deferred acquisition costs and other actuarial balances	26.7	30.5	44.8	34.7
Capital gains distributed	(0.2)	(6.8)	(11.1)	(8.7)
Certain market value adjustments of embedded derivatives	18.7		18.4	(1.4)
Net realized capital losses associated with exited group medical insurance business				0.2
Noncontrolling interest capital gains	(0.2)		(0.2)	(8.2)
Income tax effect	8.9	0.2	74.7	10.2
Net realized capital gains (losses), as adjusted	\$ (22.8)	\$ 88.8	\$ (126.8)	\$ 39.6

(2) For the three months ended September 30, 2013, other after-tax adjustments included the negative effect of losses associated with our exited group medical insurance business that does not qualify for discontinued operations accounting treatment under U.S. GAAP.

For the three months ended September 30, 2012, other after-tax adjustments included the negative effect of (a) a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. (\$39.8 million) and (b) losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP (\$4.1 million).

For the nine months ended September 30, 2013, other after-tax adjustments included the negative effect of losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP.

For the nine months ended September 30, 2012, other after-tax adjustments included the negative effect of (a) a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. (\$39.8 million) and (b) losses associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP (\$9.6 million).





Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2013	2012	2013	2012
	(in millions)			
<b>Retirement and Investor Services:</b>				
Full service accumulation	\$ 369.9	\$ 339.0	\$ 1,087.7	\$ 1,006.1
Principal Funds	194.8	156.8	565.9	453.0
Individual annuities	334.5	302.1	881.8	864.0
Bank and trust services	24.4	26.1	74.9	75.9
Eliminations	(38.3)	(30.4)	(109.1)	(88.6)
Total Accumulation	885.3	793.6	2,501.2	2,310.4
Investment only	83.1	105.2	260.6	328.8
Full service payout	168.1	671.9	625.8	1,067.8
Total Guaranteed	251.2	777.1	886.4	1,396.6
Total Retirement and Investor Services	1,136.5	1,570.7	3,387.6	3,707.0
Principal Global Investors (1)	160.9	144.0	482.8	423.2
Principal International	303.3	203.8	825.9	676.9
<b>U.S. Insurance Solutions:</b>				
Individual life insurance	362.7	372.6	1,110.2	1,044.8
Specialty benefits insurance	405.0	393.9	1,208.6	1,170.2
Eliminations	(0.1)		(0.2)	
Total U.S. Insurance Solutions	767.6	766.5	2,318.6	2,215.0
Corporate	(52.5)	(46.4)	(149.1)	(139.8)
Total operating revenues	\$ 2,315.8	\$ 2,638.6	\$ 6,865.8	\$ 6,882.3
Total operating revenues	\$ 2,315.8	\$ 2,638.6	\$ 6,865.8	\$ 6,882.3
Net realized capital gains (losses), net of related revenue adjustments	(76.7)	64.9	(253.4)	12.8
Exited group medical insurance business	0.5	1.2	4.5	24.1
Total revenues per consolidated statements of operations	\$ 2,239.6	\$ 2,704.7	\$ 6,616.9	\$ 6,919.2

(1) Reflects inter-segment revenues of \$61.1 million and \$54.1 million for the three months ended September 30, 2013 and 2012, respectively, and \$179.9 million and \$160.0 million for the nine months ended September 30, 2013 and 2012, respectively.

## 12. Stock-Based Compensation Plans

As of September 30, 2013, we have the Amended and Restated 2010 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan, the Directors Stock Plan and the Long-Term Performance Plan ( Stock-Based Compensation Plans ). As of May 17, 2005, no new grants will be made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan. Under the terms of the Amended and Restated 2010 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 2005 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.

As of September 30, 2013, the maximum number of new shares of common stock that were available for grant under the Amended and Restated 2010 Stock Incentive Plan and the 2005 Directors Stock Plan was 6.5 million.

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:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

	For the nine months ended September 30,	
	2013	2012
	(in millions)	
Compensation cost	\$ 33.9	\$ 40.3
Related income tax benefit	14.6	13.3
Capitalized as part of an asset	1.9	1.8

**Nonqualified Stock Options**

Nonqualified stock options were granted to certain employees under the Amended and Restated 2010 Stock Incentive Plan. Total options granted were 0.8 million for the nine months ended September 30, 2013. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 3.0 percent, a weighted-average expected volatility of 53.3 percent, a weighted-average risk-free interest rate of 1.1 percent and a weighted-average expected term of 6.5 years. The weighted-average estimated fair value of stock options granted during the nine months ended September 30, 2013, was \$11.95 per share.

We previously determined expected volatility based on, among other factors, historical volatility using daily price observations. Beginning with nonqualified stock options granted in 2013, we determine expected volatility based on a combination of historical volatility using daily price observations and implied volatility from traded options on our common stock. We believe that incorporating both historical and implied volatility into our expected volatility assumption calculation better reflects market expectations.

As of September 30, 2013, there was \$5.4 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 Amended and Restated 2010 Stock Incentive Plan. Total performance share awards granted were 0.3 million for the nine months ended September 30, 2013. 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 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 \$30.70 per common share.

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

As of September 30, 2013, there was \$7.8 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 1.4 years.

### **Restricted Stock Units**

Restricted stock units were issued to certain employees and agents pursuant to the Amended and Restated 2010 Stock Incentive Plan and non-employee directors pursuant to the 2005 Directors Stock Plan. Total restricted stock units granted were 1.3 million for the nine months ended September 30, 2013. 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 \$30.99 per common share.

As of September 30, 2013, there was \$44.8 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 1.9 years.

### **Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan, employees purchased 0.5 million shares for the nine months ended September 30, 2013. The weighted average fair value of the discount on the stock purchased was \$12.72 per share.

As of September 30, 2013, a total of 5.5 million of new shares are available to be made issuable by us for this plan.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**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,	
	2013	2012	2013	2012
	(in millions, except per share data)			
Net income	\$ 259.1	\$ 198.8	\$ 685.7	\$ 598.7
Subtract:				
Net income attributable to noncontrolling interest	5.2	3.4	14.7	15.3
Preferred stock dividends	8.2	8.2	24.7	24.7
Adjustments to redemption amounts of redeemable noncontrolling interests (1)				
Total	\$ 245.7	\$ 187.2	\$ 646.3	\$ 558.7
Weighted-average shares outstanding:				
Basic	294.9	294.7	294.4	298.6
Dilutive effects:				
Stock options	1.7	1.0	1.4	1.0
Restricted stock units	1.7	1.5	1.6	1.4
Performance share awards	0.3	0.3	0.3	0.4
Diluted	298.6	297.5	297.7	301.4
Net income per common share:				
Basic	\$ 0.83	\$ 0.64	\$ 2.20	\$ 1.87
Diluted	\$ 0.82	\$ 0.63	\$ 2.17	\$ 1.85

(1) During the third quarter of 2013, we identified a classification error of certain of our noncontrolling interests, which had a related impact to earnings per share. See related discussion in Note 9, Stockholders' Equity - Noncontrolling Interest. The correction of the classification error in the third quarter of 2013 did not significantly impact earnings per share.

The calculation of diluted earnings per share for the three and nine months ended September 30, 2013 and 2012, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

**14. Condensed Consolidating Financial Information**

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

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, 2013 and December 31, 2012, and for the nine months ended September 30, 2013 and 2012.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in PFS, (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, 2013**  
(Unaudited)

**Condensed Consolidating Statements of Financial Position**

September 30, 2013

	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
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$ 42,736.2	\$ 6,567.9	\$ (389.2)	\$ 48,914.9
Fixed maturities, trading		254.9	318.0		572.9
Equity securities, available-for-sale		103.3	10.7		114.0
Equity securities, trading		0.3	665.9		666.2
Mortgage loans		10,857.9	1,334.5	(324.3)	11,868.1
Real estate		8.0	1,270.6		1,278.6
Policy loans		829.1	30.5		859.6
Investment in unconsolidated entities	11,642.3	3,392.1	4,396.6	(18,530.6)	900.4
Other investments	9.3	2,024.1	1,263.5	(1,203.3)	2,093.6
Cash and cash equivalents	50.8	651.6	934.8	69.9	1,707.1
Accrued investment income		508.8	63.9	(1.5)	571.2
Premiums due and other receivables		1,022.2	1,648.1	(1,509.6)	1,160.7
Deferred acquisition costs		2,790.2	217.4		3,007.6
Property and equipment		401.5	77.6		479.1
Goodwill		54.3	1,073.2		1,127.5
Other intangibles		27.1	1,470.3		1,497.4
Separate account assets		78,819.5	44,981.0		123,800.5
Other assets	66.7	893.1	1,859.7	(1,751.5)	1,068.0
<b>Total assets</b>	<b>\$ 11,769.1</b>	<b>\$ 145,374.2</b>	<b>\$ 68,184.2</b>	<b>\$ (23,640.1)</b>	<b>\$ 201,687.4</b>
<b>Liabilities</b>					
Contractholder funds	\$	\$ 35,435.4	\$ 1,254.4	\$ (287.1)	\$ 36,402.7
Future policy benefits and claims		17,888.0	4,709.9	(273.7)	22,324.2
Other policyholder funds		703.3	50.8	(0.5)	753.6
Short-term debt			175.5		175.5
Long-term debt	2,448.7	99.4	369.6	(324.4)	2,593.3
Income taxes currently payable			80.8	(72.9)	7.9
Deferred income taxes		(66.2)	869.3	(168.5)	634.6
Separate account liabilities		78,819.5	44,981.0		123,800.5
Other liabilities	42.0	5,138.6	3,716.6	(3,510.0)	5,387.2
<b>Total liabilities</b>	<b>2,490.7</b>	<b>138,018.0</b>	<b>56,207.9</b>	<b>(4,637.1)</b>	<b>192,079.5</b>
Redeemable noncontrolling interest			234.5		234.5

**Stockholders equity**

Series A preferred stock

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

Series B preferred stock	0.1				0.1
Common stock	4.6	2.5		(2.5)	4.6
Additional paid-in capital	9,749.3	5,505.9	9,160.8	(14,666.7)	9,749.3
Retained earnings	5,249.9	1,643.8	2,467.0	(4,110.8)	5,249.9
Accumulated other comprehensive income (loss)	(17.7)	204.0	14.5	(218.5)	(17.7)
Treasury stock, at cost	(5,707.8)				(5,707.8)
Total stockholders' equity attributable to PFG	9,278.4	7,356.2	11,642.3	(18,998.5)	9,278.4
Noncontrolling interest			99.5	(4.5)	95.0
Total stockholders' equity	9,278.4	7,356.2	11,741.8	(19,003.0)	9,373.4
Total liabilities and stockholders' equity	\$ 11,769.1	\$ 145,374.2	\$ 68,184.2	\$ (23,640.1)	\$ 201,687.4



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2012**

	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
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$ 44,614.6	\$ 6,681.7	\$ (357.0)	\$ 50,939.3
Fixed maturities, trading	10.5	284.4	331.8		626.7
Equity securities, available-for-sale		131.3	5.2		136.5
Equity securities, trading		0.3	252.5		252.8
Mortgage loans		10,054.2	1,775.5	(310.0)	11,519.7
Real estate		8.4	1,171.9		1,180.3
Policy loans		834.0	30.9		864.9
Investment in unconsolidated entities	11,853.3	3,309.2	4,808.3	(19,101.8)	869.0
Other investments	11.1	2,834.0	1,208.4	(1,631.4)	2,422.1
Cash and cash equivalents	207.1	1,698.4	2,286.9	(15.2)	4,177.2
Accrued investment income		521.6	64.5	(1.7)	584.4
Premiums due and other receivables	0.1	916.7	1,327.1	(1,159.5)	1,084.4
Deferred acquisition costs		2,394.8	195.2		2,590.0
Property and equipment		402.2	62.0		464.2
Goodwill		54.3	489.1		543.4
Other intangibles		27.9	886.8		914.7
Separate account assets		69,217.8	12,436.0		81,653.8
Other assets	78.0	947.8	1,567.7	(1,586.7)	1,006.8
<b>Total assets</b>	<b>\$ 12,160.1</b>	<b>\$ 138,251.9</b>	<b>\$ 35,581.5</b>	<b>\$ (24,163.3)</b>	<b>\$ 161,830.2</b>
<b>Liabilities</b>					
Contractholder funds	\$	\$ 37,053.3	\$ 1,011.9	\$ (278.7)	\$ 37,786.5
Future policy benefits and claims		17,944.9	4,679.6	(188.3)	22,436.2
Other policyholder funds		676.5	40.3	(0.4)	716.4
Short-term debt			40.8		40.8
Long-term debt	2,448.6	99.4	433.3	(310.0)	2,671.3
Income taxes currently payable			84.7	(69.4)	15.3
Deferred income taxes		324.5	378.4	(102.9)	600.0
Separate account liabilities		69,217.8	12,436.0		81,653.8
Other liabilities	28.1	5,375.1	4,538.4	(3,795.5)	6,146.1
<b>Total liabilities</b>	<b>2,476.7</b>	<b>130,691.5</b>	<b>23,643.4</b>	<b>(4,745.2)</b>	<b>152,066.4</b>
Redeemable noncontrolling interest			60.4		60.4
<b>Stockholders equity</b>					
Series A preferred stock					

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

Series B preferred stock	0.1				0.1
Common stock	4.5	2.5		(2.5)	4.5
Additional paid-in capital	9,730.9	5,747.6	9,393.8	(15,141.4)	9,730.9
Retained earnings	4,862.0	1,167.7	1,783.4	(2,951.1)	4,862.0
Accumulated other comprehensive income	640.3	642.6	676.1	(1,318.7)	640.3
Treasury stock, at cost	(5,554.4)				(5,554.4)
Total stockholders' equity attributable to PFG	9,683.4	7,560.4	11,853.3	(19,413.7)	9,683.4
Noncontrolling interest			24.4	(4.4)	20.0
Total stockholders' equity	9,683.4	7,560.4	11,877.7	(19,418.1)	9,703.4
Total liabilities and stockholders' equity	\$ 12,160.1	\$ 138,251.9	\$ 35,581.5	\$ (24,163.3)	\$ 161,830.2

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
(Unaudited)

**Condensed Consolidating Statements of Operations**

**For the nine months September 30, 2013**

	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
<b>Revenues</b>					
Premiums and other considerations	\$	\$ 1,853.6	\$ 281.3	\$	\$ 2,134.9
Fees and other revenues		1,272.3	1,325.8	(257.7)	2,340.4
Net investment income	0.4	1,775.7	526.5	20.9	2,323.5
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	6.3	(630.7)	514.8	0.1	(109.5)
Total other-than-temporary impairment losses on available-for-sale securities		(75.4)	(5.8)		(81.2)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income		11.4	(2.6)		8.8
Net impairment losses on available-for-sale securities		(64.0)	(8.4)		(72.4)
Net realized capital gains (losses)	6.3	(694.7)	506.4	0.1	(181.9)
Total revenues	6.7	4,206.9	2,640.0	(236.7)	6,616.9
<b>Expenses</b>					
Benefits, claims and settlement expenses		2,828.8	466.7	(9.1)	3,286.4
Dividends to policyholders		144.3			144.3
Operating expenses	105.2	1,378.6	1,113.2	(224.9)	2,372.1
Total expenses	105.2	4,351.7	1,579.9	(234.0)	5,802.8
Income (loss) before income taxes	(98.5)	(144.8)	1,060.1	(2.7)	814.1
Income taxes (benefits)	(39.4)	(136.0)	304.0	(0.2)	128.4
Equity in the net income (loss) of subsidiaries	730.1	530.2	(11.2)	(1,249.1)	
Net income	671.0	521.4	744.9	(1,251.6)	685.7
Net income attributable to noncontrolling interest			14.8	(0.1)	14.7
Net income attributable to PFG	671.0	521.4	730.1	(1,251.5)	671.0
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 646.3	\$ 521.4	\$ 730.1	\$ (1,251.5)	\$ 646.3

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

Net income	\$	671.0	\$	521.4	\$	744.9	\$	(1,251.6)	\$	685.7
Other comprehensive loss		(683.9)		(438.6)		(225.6)		679.8		(668.3)
Comprehensive income (loss)	\$	(12.9)	\$	82.8	\$	519.3	\$	(571.8)	\$	17.4

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the nine months September 30, 2012**

	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
<b>Revenues</b>					
Premiums and other considerations	\$	\$ 2,265.7	\$ 253.6	\$	\$ 2,519.3
Fees and other revenues	0.3	1,115.0	1,018.9	(225.1)	1,909.1
Net investment income	2.7	1,869.8	521.9	15.2	2,409.6
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		(296.9)	496.8	(23.5)	176.4
Total other-than-temporary impairment losses on available-for-sale securities		(111.5)	(14.8)	(0.1)	(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income		27.1	4.1		31.2
Net impairment losses on available-for-sale securities		(84.4)	(10.7)	(0.1)	(95.2)
Net realized capital gains (losses)		(381.3)	486.1	(23.6)	81.2
Total revenues	3.0	4,869.2	2,280.5	(233.5)	6,919.2
<b>Expenses</b>					
Benefits, claims and settlement expenses		3,542.3	436.7	(9.5)	3,969.5
Dividends to policyholders		149.5			149.5
Operating expenses	90.8	1,286.3	920.2	(196.2)	2,101.1
Total expenses	90.8	4,978.1	1,356.9	(205.7)	6,220.1
Income (loss) before income taxes	(87.8)	(108.9)	923.6	(27.8)	699.1
Income taxes (benefits)	(34.4)	(126.4)	261.7	(0.5)	100.4
Equity in the net income (loss) of subsidiaries	636.8	438.6	(9.7)	(1,065.7)	
Net income	583.4	456.1	652.2	(1,093.0)	598.7
Net income attributable to noncontrolling interest			15.4	(0.1)	15.3
Net income attributable to PFG	583.4	456.1	636.8	(1,092.9)	583.4
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 558.7	\$ 456.1	\$ 636.8	\$ (1,092.9)	\$ 558.7

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

Net income	\$	583.4	\$	456.1	\$	652.2	\$	(1,093.0)	\$	598.7
Other comprehensive income		564.6		546.2		104.7		(597.4)		618.1
Comprehensive income	\$	1,148.0	\$	1,002.3	\$	756.9	\$	(1,690.4)	\$	1,216.8

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the nine months September 30, 2013**

	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
<b>Operating activities</b>					
Net cash provided by (used in)					
operating activities	\$ (12.8)	\$ 1,412.5	\$ (132.2)	\$ 130.4	\$ 1,397.9
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases		(6,094.0)	(926.7)	8.4	(7,012.3)
Sales		1,281.4	370.1	(24.8)	1,626.7
Maturities		5,186.5	596.7		5,783.2
Mortgage loans acquired or originated		(2,226.3)	(175.6)	381.9	(2,020.0)
Mortgage loans sold or repaid		1,408.3	583.2	(420.7)	1,570.8
Real estate acquired			(59.0)		(59.0)
Net purchases of property and equipment		(20.2)	(2.5)		(22.7)
Purchases of interests in subsidiaries, net of cash acquired			(1,268.3)		(1,268.3)
Dividends and returns of capital received from unconsolidated entities	169.3	157.9	169.3	(496.5)	
Net change in other investments	(3.2)	76.1	(128.4)	24.3	(31.2)
Net cash provided by (used in) investing activities	166.1	(230.3)	(841.2)	(527.4)	(1,432.8)
<b>Financing activities</b>					
Issuance of common stock	80.2				80.2
Acquisition of treasury stock	(153.4)				(153.4)
Proceeds from financing element derivatives		46.7			46.7
Payments for financing element derivatives		(36.9)			(36.9)
Excess tax benefits from share-based payment arrangements		2.5	6.1		8.6
Purchase of subsidiary shares from noncontrolling interest			(51.7)		(51.7)
Sale of subsidiary shares to noncontrolling interest			32.1		32.1
Dividends to common stockholders	(211.7)				(211.7)
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt			24.1		24.1

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

Principal repayments of long-term debt			(197.8)	(14.4)	(212.2)
Net proceeds from short-term borrowings			131.6		131.6
Dividends and capital paid to parent	(169.3)		(327.2)	496.5	
Investment contract deposits	4,985.4		284.8		5,270.2
Investment contract withdrawals	(7,051.1)		(4.5)		(7,055.6)
Net decrease in banking operation deposits			(276.2)		(276.2)
Other		(6.3)			(6.3)
Net cash used in financing activities	(309.6)	(2,229.0)	(378.7)	482.1	(2,435.2)
Net decrease in cash and cash equivalents	(156.3)	(1,046.8)	(1,352.1)	85.1	(2,470.1)
Cash and cash equivalents at beginning of period	207.1	1,698.4	2,286.9	(15.2)	4,177.2
Cash and cash equivalents at end of period	\$ 50.8	\$ 651.6	\$ 934.8	\$ 69.9	\$ 1,707.1



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the nine months September 30, 2012**

	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
<b>Operating activities</b>					
Net cash provided by (used in)					
operating activities	\$ 49.2	\$ 2,369.3	\$ (204.2)	\$ 159.4	\$ 2,373.7
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases		(5,753.7)	(739.5)	25.7	(6,467.5)
Sales		862.7	98.8	(15.0)	946.5
Maturities		4,058.9	643.8		4,702.7
Mortgage loans acquired or originated		(1,687.2)	(177.4)	52.8	(1,811.8)
Mortgage loans sold or repaid		1,104.6	280.3	(218.2)	1,166.7
Real estate acquired			(114.8)		(114.8)
Net purchases of property and equipment		(22.4)	(13.2)		(35.6)
Purchases of interests in subsidiaries, net of cash acquired			(62.5)		(62.5)
Dividends and returns of capital received from unconsolidated entities	539.8	435.0	539.8	(1,514.6)	
Net change in other investments	(0.2)	(14.8)	(14.8)	(13.1)	(42.9)
Net cash provided by (used in) investing activities	539.6	(1,016.9)	440.5	(1,682.4)	(1,719.2)
<b>Financing activities</b>					
Issuance of common stock	24.7				24.7
Acquisition of treasury stock	(272.7)				(272.7)
Proceeds from financing element derivatives		51.6			51.6
Payments for financing element derivatives		(38.3)			(38.3)
Excess tax benefits from share-based payment arrangements		4.7	5.1		9.8
Dividends to common stockholders	(169.6)				(169.6)
Dividends to preferred stockholders	(16.5)				(16.5)
Issuance of long-term debt	593.8		9.1		602.9
Principal repayments of long-term debt			(45.7)	43.6	(2.1)
Net repayments of short-term borrowings			(81.0)		(81.0)

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

Dividends and capital paid to parent		(539.8)		(974.8)		1,514.6		
Investment contract deposits		4,481.7		317.0				4,798.7
Investment contract withdrawals		(6,123.8)		(2.2)				(6,126.0)
Net increase in banking operation deposits				14.9				14.9
Other		(5.8)						(5.8)
Net cash provided by (used in) financing activities	159.7		(2,169.7)		(757.6)		1,558.2	(1,209.4)
Net increase (decrease) in cash and cash equivalents	748.5		(817.3)		(521.3)		35.2	(554.9)
Cash and cash equivalents at beginning of period	226.7		1,344.5		1,277.6		(14.9)	2,833.9
Cash and cash equivalents at end of period	\$ 975.2	\$	527.2	\$	756.3	\$	20.3	\$ 2,279.0

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

On May 24, 2011, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2008, as it was scheduled to expire in June 2011. Under our current shelf registration, we have the ability to issue 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 statement.

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, 2013 and December 31, 2012, and for the nine months ended September 30, 2013 and 2012.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG's interest in PFS 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, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**September 30, 2013**

	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
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$	\$ 48,914.9	\$	\$ 48,914.9
Fixed maturities, trading			572.9		572.9
Equity securities, available-for-sale			114.0		114.0
Equity securities, trading			666.2		666.2
Mortgage loans			11,868.1		11,868.1
Real estate			1,278.6		1,278.6
Policy loans			859.6		859.6
Investment in unconsolidated entities	11,642.3	11,404.6	900.3	(23,046.8)	900.4
Other investments	9.3	55.8	2,028.6	(0.1)	2,093.6
Cash and cash equivalents	50.8	491.0	1,822.1	(656.8)	1,707.1
Accrued investment income			571.2		571.2
Premiums due and other receivables		0.9	2,261.2	(1,101.4)	1,160.7
Deferred acquisition costs			3,007.6		3,007.6
Property and equipment			479.1		479.1
Goodwill			1,127.5		1,127.5
Other intangibles			1,497.4		1,497.4
Separate account assets			123,800.5		123,800.5
Other assets	66.7	88.1	1,116.4	(203.2)	1,068.0
Total assets	\$ 11,769.1	\$ 12,040.4	\$ 202,886.2	\$ (25,008.3)	\$ 201,687.4
<b>Liabilities</b>					
Contractholder funds	\$	\$	\$ 36,402.7	\$	\$ 36,402.7
Future policy benefits and claims			22,324.2		22,324.2
Other policyholder funds			753.6		753.6
Short-term debt			453.9	(278.4)	175.5
Long-term debt	2,448.7		1,228.9	(1,084.3)	2,593.3
Income taxes currently payable		10.9	55.2	(58.2)	7.9
Deferred income taxes			776.0	(141.4)	634.6
Separate account liabilities			123,800.5		123,800.5
Other liabilities	42.0	387.2	5,357.1	(399.1)	5,387.2
Total liabilities	2,490.7	398.1	191,152.1	(1,961.4)	192,079.5
Redeemable noncontrolling interest			234.5		234.5
<b>Stockholders equity</b>					

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

Series A preferred stock					
Series B preferred stock	<b>0.1</b>				<b>0.1</b>
Common stock	<b>4.6</b>		<b>17.8</b>	<b>(17.8)</b>	<b>4.6</b>
Additional paid-in capital	<b>9,749.3</b>	<b>9,160.8</b>	<b>9,068.4</b>	<b>(18,229.2)</b>	<b>9,749.3</b>
Retained earnings	<b>5,249.9</b>	<b>2,467.0</b>	<b>2,327.3</b>	<b>(4,794.3)</b>	<b>5,249.9</b>
Accumulated other comprehensive income (loss)	<b>(17.7)</b>	<b>14.5</b>	<b>(6.9)</b>	<b>(7.6)</b>	<b>(17.7)</b>
Treasury stock, at cost	<b>(5,707.8)</b>		<b>(2.0)</b>	<b>2.0</b>	<b>(5,707.8)</b>
Total stockholders' equity attributable to PFG	<b>9,278.4</b>	<b>11,642.3</b>	<b>11,404.6</b>	<b>(23,046.9)</b>	<b>9,278.4</b>
Noncontrolling interest			<b>95.0</b>		<b>95.0</b>
Total stockholders' equity	<b>9,278.4</b>	<b>11,642.3</b>	<b>11,499.6</b>	<b>(23,046.9)</b>	<b>9,373.4</b>
Total liabilities and stockholders' equity	<b>\$ 11,769.1</b>	<b>\$ 12,040.4</b>	<b>\$ 202,886.2</b>	<b>\$ (25,008.3)</b>	<b>\$ 201,687.4</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2012**

	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
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$	\$ 50,939.3	\$	\$ 50,939.3
Fixed maturities, trading	10.5		616.2		626.7
Equity securities, available-for-sale			136.5		136.5
Equity securities, trading			252.8		252.8
Mortgage loans			11,519.7		11,519.7
Real estate			1,180.3		1,180.3
Policy loans			864.9		864.9
Investment in unconsolidated entities	11,853.3	10,632.1	860.2	(22,476.6)	869.0
Other investments	11.1	39.6	2,371.4		2,422.1
Cash and cash equivalents	207.1	612.5	4,241.3	(883.7)	4,177.2
Accrued investment income			584.4		584.4
Premiums due and other receivables	0.1	1,122.1	2,206.7	(2,244.5)	1,084.4
Deferred acquisition costs			2,590.0		2,590.0
Property and equipment			464.2		464.2
Goodwill			543.4		543.4
Other intangibles			914.7		914.7
Separate account assets			81,653.8		81,653.8
Other assets	78.0	51.0	1,003.5	(125.7)	1,006.8
Total assets	\$ 12,160.1	\$ 12,457.3	\$ 162,943.3	\$ (25,730.5)	\$ 161,830.2
<b>Liabilities</b>					
Contractholder funds	\$	\$	\$ 37,786.5	\$	\$ 37,786.5
Future policy benefits and claims			22,436.2		22,436.2
Other policyholder funds			716.4		716.4
Short-term debt			2,564.1	(2,523.3)	40.8
Long-term debt	2,448.6		222.7		2,671.3
Income taxes currently payable		0.1	47.2	(32.0)	15.3
Deferred income taxes			686.1	(86.1)	600.0
Separate account liabilities			81,653.8		81,653.8
Other liabilities	28.1	603.9	6,117.8	(603.7)	6,146.1
Total liabilities	2,476.7	604.0	152,230.8	(3,245.1)	152,066.4
Redeemable noncontrolling interest			60.4		60.4
<b>Stockholders equity</b>					

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

Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	4.5		17.8	(17.8)	4.5
Additional paid-in capital	9,730.9	9,393.8	8,287.7	(17,681.5)	9,730.9
Retained earnings	4,862.0	1,783.4	1,666.7	(3,450.1)	4,862.0
Accumulated other comprehensive income	640.3	676.1	661.9	(1,338.0)	640.3
Treasury stock, at cost	(5,554.4)		(2.0)	2.0	(5,554.4)
Total stockholders' equity attributable to PFG	9,683.4	11,853.3	10,632.1	(22,485.4)	9,683.4
Noncontrolling interest			20.0		20.0
Total stockholders' equity	9,683.4	11,853.3	10,652.1	(22,485.4)	9,703.4
Total liabilities and stockholders' equity	\$ 12,160.1	\$ 12,457.3	\$ 162,943.3	\$ (25,730.5)	\$ 161,830.2

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the nine months September 30, 2013**

	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
<b>Revenues</b>					
Premiums and other considerations	\$	\$	\$ 2,134.9	\$	\$ 2,134.9
Fees and other revenues		0.9	2,357.8	(18.3)	2,340.4
Net investment income	0.4	1.1	2,321.8	0.2	2,323.5
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	6.3	2.6	(118.4)		(109.5)
Total other-than-temporary impairment losses on available-for-sale securities			(81.2)		(81.2)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income			8.8		8.8
Net impairment losses on available-for-sale securities			(72.4)		(72.4)
Net realized capital gains (losses)	6.3	2.6	(190.8)		(181.9)
Total revenues	6.7	4.6	6,623.7	(18.1)	6,616.9
<b>Expenses</b>					
Benefits, claims and settlement expenses			3,286.4		3,286.4
Dividends to policyholders			144.3		144.3
Operating expenses	105.2	8.4	2,276.6	(18.1)	2,372.1
Total expenses	105.2	8.4	5,707.3	(18.1)	5,802.8
Income (loss) before income taxes	(98.5)	(3.8)	916.4		814.1
Income taxes (benefits)	(39.4)	(2.2)	170.0		128.4
Equity in the net income of subsidiaries	730.1	731.7		(1,461.8)	
Net income	671.0	730.1	746.4	(1,461.8)	685.7
Net income attributable to noncontrolling interest			14.7		14.7
Net income attributable to PFG	671.0	730.1	731.7	(1,461.8)	671.0
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 646.3	\$ 730.1	\$ 731.7	\$ (1,461.8)	\$ 646.3



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

Net income	\$	671.0	\$	730.1	\$	746.4	\$	(1,461.8)	\$	685.7
Other comprehensive loss		(683.9)		(671.8)		(679.2)		1,366.6		(668.3)
Comprehensive income (loss)	\$	(12.9)	\$	58.3	\$	67.2	\$	(95.2)	\$	17.4

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the nine months September 30, 2012**

	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
<b>Revenues</b>					
Premiums and other considerations	\$	\$	\$ 2,519.3	\$	\$ 2,519.3
Fees and other revenues	0.3		1,909.6	(0.8)	1,909.1
Net investment income	2.7	0.1	2,406.4	0.4	2,409.6
Net realized capital gains, excluding impairment losses on available-for-sale securities		1.0	175.4		176.4
Total other-than-temporary impairment losses on available-for-sale securities			(126.4)		(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income			31.2		31.2
Net impairment losses on available-for-sale securities			(95.2)		(95.2)
Net realized capital gains		1.0	80.2		81.2
Total revenues	3.0	1.1	6,915.5	(0.4)	6,919.2
<b>Expenses</b>					
Benefits, claims and settlement expenses			3,969.5		3,969.5
Dividends to policyholders			149.5		149.5
Operating expenses	90.8	4.4	2,006.3	(0.4)	2,101.1
Total expenses	90.8	4.4	6,125.3	(0.4)	6,220.1
Income (loss) before income taxes	(87.8)	(3.3)	790.2		699.1
Income taxes (benefits)	(34.4)	(4.7)	139.5		100.4
Equity in the net income of subsidiaries	636.8	635.4		(1,272.2)	
Net income	583.4	636.8	650.7	(1,272.2)	598.7
Net income attributable to noncontrolling interest			15.3		15.3
Net income attributable to PFG	583.4	636.8	635.4	(1,272.2)	583.4
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 558.7	\$ 636.8	\$ 635.4	\$ (1,272.2)	\$ 558.7

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

Net income	\$	583.4	\$	636.8	\$	650.7	\$	(1,272.2)	\$	598.7
Other comprehensive income		564.6		615.4		578.3		(1,140.2)		618.1
Comprehensive income	\$	1,148.0	\$	1,252.2	\$	1,229.0	\$	(2,412.4)	\$	1,216.8

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the nine months September 30, 2013**

	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
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (12.8)	\$ 870.9	\$ 1,473.4	\$ (933.6)	\$ 1,397.9
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases			(7,012.3)		(7,012.3)
Sales			1,626.7		1,626.7
Maturities			5,783.2		5,783.2
Mortgage loans acquired or originated			(2,020.0)		(2,020.0)
Mortgage loans sold or repaid			1,570.8		1,570.8
Real estate acquired			(59.0)		(59.0)
Net purchases of property and equipment			(22.7)		(22.7)
Purchases of interests in subsidiaries, net of cash acquired			(1,268.3)		(1,268.3)
Dividends and returns of capital received from (contributions to) unconsolidated entities	169.3	(809.2)		639.9	
Net change in other investments	(3.2)	(13.9)	(14.1)		(31.2)
Net cash provided by (used in) investing activities	166.1	(823.1)	(1,415.7)	639.9	(1,432.8)
<b>Financing activities</b>					
Issuance of common stock	80.2				80.2
Acquisition of treasury stock	(153.4)				(153.4)
Proceeds from financing element derivatives			46.7		46.7
Payments for financing element derivatives			(36.9)		(36.9)
Excess tax benefits from share-based payment arrangements			8.6		8.6
Purchase of subsidiary shares from noncontrolling interest			(51.7)		(51.7)
Sale of subsidiary shares to noncontrolling interest			32.1		32.1
Dividends to common stockholders	(211.7)				(211.7)
Dividends to preferred stockholders	(24.7)				(24.7)

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

Issuance of long-term debt			<b>1,108.4</b>	<b>(1,084.3)</b>	<b>24.1</b>
Principal repayments of long-term debt			<b>(212.2)</b>		<b>(212.2)</b>
Net proceeds from (repayments of) short-term borrowings			<b>(2,113.2)</b>	<b>2,244.8</b>	<b>131.6</b>
Capital received from (dividends and capital paid to) parent	<b>(169.3)</b>		<b>809.2</b>	<b>(639.9)</b>	
Investment contract deposits			<b>5,270.2</b>		<b>5,270.2</b>
Investment contract withdrawals			<b>(7,055.6)</b>		<b>(7,055.6)</b>
Net decrease in banking operation deposits			<b>(276.2)</b>		<b>(276.2)</b>
Other			<b>(6.3)</b>		<b>(6.3)</b>
Net cash used in financing activities	<b>(309.6)</b>	<b>(169.3)</b>	<b>(2,476.9)</b>	<b>520.6</b>	<b>(2,435.2)</b>
Net decrease in cash and cash equivalents	<b>(156.3)</b>	<b>(121.5)</b>	<b>(2,419.2)</b>	<b>226.9</b>	<b>(2,470.1)</b>
Cash and cash equivalents at beginning of period	<b>207.1</b>	<b>612.5</b>	<b>4,241.3</b>	<b>(883.7)</b>	<b>4,177.2</b>
Cash and cash equivalents at end of period	<b>\$ 50.8</b>	<b>\$ 491.0</b>	<b>\$ 1,822.1</b>	<b>\$ (656.8)</b>	<b>\$ 1,707.1</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2013**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the nine months September 30, 2012**

	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
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ 49.2	\$ (164.6)	\$ 2,303.2	\$ 185.9	\$ 2,373.7
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases			(6,467.5)		(6,467.5)
Sales			946.5		946.5
Maturities			4,702.7		4,702.7
Mortgage loans acquired or originated			(1,811.8)		(1,811.8)
Mortgage loans sold or repaid			1,166.7		1,166.7
Real estate acquired			(114.8)		(114.8)
Net purchases of property and equipment			(35.6)		(35.6)
Purchases of interests in subsidiaries, net of cash acquired			(62.5)		(62.5)
Dividends and returns of capital received from unconsolidated entities	539.8	538.6		(1,078.4)	
Net change in other investments	(0.2)	(27.1)	(15.6)		(42.9)
Net cash provided by (used in) investing activities	539.6	511.5	(1,691.9)	(1,078.4)	(1,719.2)
<b>Financing activities</b>					
Issuance of common stock	24.7				24.7
Acquisition of treasury stock	(272.7)				(272.7)
Proceeds from financing element derivatives			51.6		51.6
Payments for financing element derivatives			(38.3)		(38.3)
Excess tax benefits from share-based payment arrangements			9.8		9.8
Dividends to common stockholders	(169.6)				(169.6)
Dividends to preferred stockholders	(16.5)				(16.5)
Issuance of long-term debt	593.8		9.1		602.9
Principal repayments of long-term debt			(2.1)		(2.1)
Net repayments of short-term borrowings		(50.0)	(13.6)	(17.4)	(81.0)

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

Dividends and capital paid to parent		(539.8)		(538.6)		1,078.4		
Investment contract deposits				4,798.7				4,798.7
Investment contract withdrawals				(6,126.0)				(6,126.0)
Net increase in banking operation deposits				14.9				14.9
Other				(5.8)				(5.8)
Net cash provided by (used in) financing activities	159.7	(589.8)		(1,840.3)		1,061.0		(1,209.4)
Net increase (decrease) in cash and cash equivalents	748.5	(242.9)		(1,229.0)		168.5		(554.9)
Cash and cash equivalents at beginning of period	226.7	702.4		2,787.9		(883.1)		2,833.9
Cash and cash equivalents at end of period	\$ 975.2	\$ 459.5	\$	1,558.9	\$	(714.6)	\$	2,279.0

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, 2013, compared with December 31, 2012, and our consolidated results of operations for the three and nine months ended September 30, 2013 and 2012, 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, 2012, 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) continued difficult 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 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 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 fixed maturities, equity securities and derivatives may include methodologies, estimations and assumptions which are subject to differing interpretations and could result in changes to investment valuations that may materially adversely affect our results of operations or financial condition; (7) the determination of the amount of allowances and impairments taken on our investments requires estimations and assumptions which are subject to differing interpretations and could materially impact our results of operations or financial position; (8) any impairments of or valuation allowances against our deferred tax assets could adversely affect our results of operations and financial condition; (9) gross unrealized losses may be realized or result in future impairments, resulting in a reduction in our net income; (10) 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; (11) we may not be able to protect our intellectual property and may be subject to infringement claims; (12) 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; (13) our efforts to reduce the impact of interest rate changes on our profitability and retained earnings may not be effective; (14) 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; (15) 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; (16) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (17) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (18) 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; (19) 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; (20) we may need to fund deficiencies in our Closed Block assets; (21) a pandemic, terrorist attack or other catastrophic event could adversely affect our net income; (22) our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and financial condition; (23) we face risk arising from acquisition of businesses; (24) we face risks arising from the acquisition



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

of Cuprum; (25) changes in laws, regulations or accounting standards may reduce our profitability; (26) we may be unable to mitigate the impact of Regulation XXX and Actuarial Guideline 38, potentially resulting in a negative impact to our capital position and/or a reduction in sales of term and universal life insurance products; (27) a computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our profitability; (28) 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; (29) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (30) 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; (31) fluctuations in foreign currency exchange rates could reduce our profitability; (32) applicable laws and our certificate of incorporation and by-laws may

Table of Contents

discourage takeovers and business combinations that some stockholders might consider in their best interests and (33) our financial results may be adversely impacted by global climate changes.

**Overview**

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

- Retirement and Investor Services, which consists of our asset accumulation operations that provide retirement savings and related investment products and services. We provide a comprehensive portfolio of asset accumulation products and services to businesses and individuals in the U.S., with a concentration on small and medium-sized businesses. We offer to businesses products and services for defined contribution pension plans, including 401(k) and 403(b) plans, defined benefit pension plans, nonqualified executive benefit plans and employee stock ownership plan consulting services. We also offer annuities, mutual funds and bank products and services to the employees of our business customers and other individuals.
- 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 as well as specialty benefits in the U.S. Our individual life insurance products include universal and variable universal life insurance and traditional life insurance. Our specialty benefit 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, U.S. income tax risks and certain income, expenses and other after-tax adjustments not allocated to the segments based on the nature of such items.

**Transactions Affecting Comparability of Results of Operations**

*Acquisitions*

We entered into acquisition agreements for the following businesses during 2013 and 2012.

**Liongate Capital Management.** On May 1, 2013, we finalized the purchase of a 55% interest in Liongate Capital Management ( Liongate ), a global alternative investment boutique based in London and New York. Liongate is focused on managing portfolios of hedge funds and had \$1.4 billion in AUM at the time of acquisition. Liongate is accounted for on the equity method within the Principal Global Investors segment.

**AFP Cuprum S.A.** On February 4, 2013, we finalized the purchase of Cuprum, a premier pension manager in Chile. As a result of the public tender offer, we initially acquired a 91.55% ownership stake in Cuprum for a purchase price of \$1.3 billion. Cuprum had \$34.3 billion in AUM at the time of acquisition and is consolidated within the Principal International segment on a one-month lag. For additional information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 2, Acquisitions.

**First Dental Health.** On November 1, 2012, we finalized the purchase of a 100% interest in First Dental Health, a California based independent dental preferred provider organization. First Dental Health is consolidated within the U.S. Insurance Solutions segment.

**Claritas Administração de Recursos Ltda./Claritas Investments, Ltd.** On April 2, 2012, we finalized the purchase of a 60% indirect ownership in Claritas, a leading Brazilian mutual fund and asset management company. The Sao Paulo-based company manages equity funds, balanced funds, managed accounts and other strategies for affluent clients and institutions through its multi-channel distribution network. Claritas had \$1.8 billion in AUM at the time of acquisition and is consolidated within the Principal International 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 improvements as necessary. During third quarter 2013, our review and update did not result in a material impact to net income. During the third quarter of 2012, improvements were made resulting in an unlocking of DAC and other actuarial balances that decreased total company net income by \$85.2 million for both the three and nine months ended September 30, 2012.

We updated our actuarial models to reflect the lower interest rate environment in our U.S. operations. The updates to our long-term interest rate assumptions and related refinements to the interest rate component of our actuarial models resulted in an unlocking that negatively impacted operating earnings. The negative unlocking from the lower interest rates was partially offset by the positive impact from the increased expected persistency in our individual annuities business. The net negative segment operating earnings impact was \$66.3 million, which was comprised of \$55.2 million for our U.S. Insurance Solutions segment and \$11.1 million for our Retirement and Investor Services segment.

In addition to the interest rate assumption update, we updated our assumptions and made model refinements that resulted in a net negative unlocking and a \$12.9 million decrease to operating earnings in total for the Retirement and Investor Services and U.S. Insurance Solutions segments for both the three and nine months ended September 30, 2012.

Within our individual life insurance business, we have an integrated actuarial model that impacts several line items within our income statement. Operating earnings for the individual life insurance business was negatively impacted \$62.9 million for both the three and nine months ended September 30, 2012. The impact on the income statement line items was as follows – fee revenues increased \$13.5 million; benefits, claims and settlement expenses increased \$67.2 million; and operating expenses increased \$43.0 million.

**Catalyst Health Solutions, Inc.** In July 2012, Catalyst Health Solutions, Inc. merged with a wholly-owned subsidiary of SXC Health Solutions Corp. As a result of the merger, we realized an after-tax gain. We subsequently contributed appreciated stock of the ultimate surviving corporation (now known as Catamaran Corp.) to The Principal Financial Group Foundation, Inc. and sold our remaining interest in Catamaran Corp., resulting in a total after-tax net realized capital gain of \$141.2 million.

**Individual Life Insurance Amortization.** During the first quarter of 2012, our individual life insurance business changed its basis for amortizing DAC and other actuarial balances on a portion of our universal life insurance products. The actuarial balances for these products are now amortized based on estimated gross revenues instead of estimated gross profits. This change required an unlocking of the actuarial balances to reflect the pattern of estimated gross revenues, which resulted in volatility within certain income statement line items. Specifically, fee revenues decreased \$46.6 million; benefits, claims and settlement expenses increased \$87.9 million; and operating expenses decreased \$139.6 million. However, on a net basis the impact was a net gain of \$3.3 million after-tax, which is not material.

**Group Medical Insurance Business.** On September 30, 2010, we announced our decision to exit the group medical insurance business (insured and administrative services only) and entered into an agreement with United Healthcare Services, Inc. to renew group medical insurance coverage for our customers. The exiting of the group medical insurance business does not qualify for discontinued operations treatment under U.S. GAAP. Therefore, the results of operations for the group medical insurance business are still included in our consolidated income from

continuing operations.

With the exception of corporate overhead, amounts related to our group medical insurance business previously included in segment operating earnings have been removed from operating earnings for all periods presented and are reported as other after-tax adjustments. The operating revenues associated with our exited group medical insurance business were \$0.5 million and \$1.2 million for the three months ended September 30, 2013 and 2012, respectively, and \$4.5 million and \$24.1 million for the nine months ended September 30, 2013 and 2012, respectively. The other after-tax adjustments associated with the after-tax earnings (loss) of our exited group medical insurance business were \$(0.7) million and \$(4.1) million for the three months ended September 30, 2013 and 2012, respectively, and \$(0.8) million and \$(9.6) million for the nine months ended September 30, 2013 and 2012, respectively.

#### **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.

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 by \$3.2

Table of Contents

million and \$4.1 million for the three and nine months ended September 30, 2013, respectively, 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 2013 annual defined benefit pension expense for substantially all of our employees and certain agents is expected to be \$143.3 million pre-tax, which is a \$21.0 million increase from the 2012 pre-tax pension expense of \$122.3 million. This increase is primarily due to a decrease in the discount rate from 5.15% for 2012 to 4.00% for 2013. Also, the expected long-term return on plan assets used to develop the 2013 expense decreased to 7.50% from 8.00% used in 2012. Pre-tax pension expense of \$35.8 million and \$107.3 million was reflected in the determination of net income for the three and nine months ended September 30, 2013, respectively.

The 2013 annual other postemployment benefit ( OPEB ) plan expense (income) for employees and certain agents is expected to be \$(47.0) million pre-tax, which is an \$8.2 million decrease from the 2012 pre-tax OPEB income of \$(55.2) million. The weighted average expected long-term return on plan assets used to develop the expense (income) in 2013 decreased to 5.62% from 7.30%, which was based on weighted average expected long-term asset returns for the medical, life and long-term care plans. The expected long-term rates for the medical, life and long-term care plans were 5.40%, 7.75% and 5.85%, respectively. The expected rate of return for the medical plans was reduced to 5.40% to reflect the after-tax return on the plan assets resulting from the decision to have taxes paid by the trust instead of Principal Life. The discount rate used to develop the 2013 expense (income) decreased to 4.00%, down from the 5.15% discount rate used in 2012. The pre-tax expense (income) of \$(11.7) million and \$(35.1) million was reflected in the determination of net income for the three and nine months ended September 30, 2013, 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 captions, Revisions of Previously Issued Financial Statements and Recent Accounting Pronouncements.

Table of Contents**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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
<b>Revenues:</b>						
Premiums and other considerations	\$ 703.0	\$ 1,158.2	\$ (455.2)	\$ 2,134.9	\$ 2,519.3	\$ (384.4)
Fees and other revenues	803.0	675.0	128.0	2,340.4	1,909.1	431.3
Net investment income	784.5	783.8	0.7	2,323.5	2,409.6	(86.1)
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	(29.7)	122.1	(151.8)	(109.5)	176.4	(285.9)
Total other-than-temporary impairment losses on available-for-sale securities	(11.9)	(43.6)	31.7	(81.2)	(126.4)	45.2
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income	(9.3)	9.2	(18.5)	8.8	31.2	(22.4)
Net impairment losses on available-for-sale securities	(21.2)	(34.4)	13.2	(72.4)	(95.2)	22.8
Net realized capital gains (losses)	(50.9)	87.7	(138.6)	(181.9)	81.2	(263.1)
Total revenues	2,239.6	2,704.7	(465.1)	6,616.9	6,919.2	(302.3)
<b>Expenses:</b>						
Benefits, claims and settlement expenses	1,096.2	1,647.0	(550.8)	3,286.4	3,969.5	(683.1)
Dividends to policyholders	48.5	49.7	(1.2)	144.3	149.5	(5.2)
Operating expenses	774.6	816.4	(41.8)	2,372.1	2,101.1	271.0
Total expenses	1,919.3	2,513.1	(593.8)	5,802.8	6,220.1	(417.3)
Income before income taxes	320.3	191.6	128.7	814.1	699.1	115.0
Income taxes (benefits)	61.2	(7.2)	68.4	128.4	100.4	28.0
Net income	259.1	198.8	60.3	685.7	598.7	87.0
Net income attributable to noncontrolling interest	5.2	3.4	1.8	14.7	15.3	(0.6)
Net income attributable to Principal Financial Group, Inc.	253.9	195.4	58.5	671.0	583.4	87.6

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

Preferred stock dividends	<b>8.2</b>	8.2	<b>24.7</b>	24.7
Net income available to common stockholders	\$ <b>245.7</b>	\$ 187.2	\$ 58.5	\$ <b>646.3</b>
			\$ 558.7	\$ 87.6

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012*

**Net Income Available to Common Stockholders**

Net income available to common stockholders increased primarily due to higher earnings in our U.S. Insurance Solutions segment due to unlocking associated with a change in our long-term interest rate assumptions and model refinements in 2012, which had a negative impact on 2012 earnings. In addition, net income available to common stockholders increased due to higher earnings in our Retirement and Investor Services segment stemming from positive equity market performance and growth in the business. These increases in net income available to common stockholders were partially offset by an after-tax increase in net realized capital losses due to the net after-tax gain in 2012 resulting from the Catalyst Health Solutions, Inc. transaction.



Table of Contents

**Total Revenues**

Premiums decreased \$470.1 million for the Retirement and Investor Services segment primarily due to lower sales of single premium group annuities with life contingencies. The single premium 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.

Fee revenues increased \$78.0 million for the Retirement and Investor Services segment primarily due to an increase in average account values, which resulted from positive equity market performance and growth in the business. In addition, fee revenues increased \$48.6 million for the Principal International segment primarily due to the Cuprum acquisition.

Net investment income increased due to higher inflation-based investment returns on average invested assets and cash as a result of higher inflation in Chile, which was partially offset by the weakening of the Latin American currencies against the U.S. dollar and lower investment yields in our U.S. operations. For additional information, see Investments Investment Results.

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 2013 as compared to net realized capital gains in 2012 due to a gain associated with the merger of Catalyst Health Solutions, Inc. and the subsequent disposition of our remaining interest in the surviving corporation in the third quarter of 2012. For additional information, see Investments Investment Results.

**Total Expenses**

Benefits, claims and settlement expenses decreased \$523.4 million for the Retirement and Investor Services segment primarily due to a decrease in change in reserves resulting from lower sales of single premium group annuities with life contingencies.

Operating expenses decreased primarily due to a \$61.2 million charitable contribution of appreciated stock to The Principal Financial Group Foundation within our Corporate segment in 2012 and unlocking associated with a change in our long-term interest rate assumptions and model refinements within our U.S. Insurance Solutions segment in 2012. Partially offsetting these decreases was an increase in operating expenses within our Principal International segment primarily due to the Cuprum acquisition. In addition, operating expenses increased within our Retirement and Investor Services segment primarily due to higher expenses stemming from growth in the business and positive equity market performance.

**Income Taxes**

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

The effective income tax rates were 19% and -4% for the three months ended September 30, 2013 and 2012, respectively. The effective income tax rate for the three months ended September 30, 2013, 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 lower tax rates of foreign jurisdictions. The effective income tax rate for the three months ended September 30, 2012, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. and a third quarter adjustment to reflect a decrease in our estimated annual effective income tax rate. The effective income tax rate increased to 19% from -4% for the three months ended September 30, 2013 and 2012, respectively, primarily due to tax benefits associated with a third quarter 2012 contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. and higher income before income taxes in third quarter 2013.

### *Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

#### **Net Income Available to Common Stockholders**

Net income available to common stockholders increased primarily due to higher earnings in our Retirement and Investor Services segment stemming from positive equity market performance and growth in the business. In addition, net income available to common stockholders increased due to higher earnings in our U.S. Insurance Solutions segment due to unlocking associated with a change in our long-term interest rate assumptions and model refinements in the third quarter of 2012, which had a negative impact on 2012 earnings. These increases in net income available to common stockholders were partially offset by an after-tax increase in net realized capital losses due to the net after-tax gain in 2012 resulting from the Catalyst Health Solutions, Inc. transaction.

Table of Contents

**Total Revenues**

Premiums decreased \$426.7 million for the Retirement and Investor Services segment primarily due to lower sales of single premium group annuities with life contingencies. The single premium 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.

Fee revenues increased \$206.0 million for the Retirement and Investor Services segment primarily due to an increase in average account values, which resulted from positive equity market performance and growth in the business. In addition, fee revenues increased \$137.1 million for the Principal International segment primarily due to the Cuprum acquisition.

Net investment income decreased primarily due to lower investment yields in our U.S. operations. For additional information, see Investments Investment Results.

Net realized capital losses increased primarily due to a gain associated with the merger of Catalyst Health Solutions, Inc. and the subsequent disposition of our remaining interest in the surviving corporation in the third quarter of 2012 and increased losses on derivatives not designated as hedging instruments. For additional information, see Investments Investment Results.

**Total Expenses**

Benefits, claims and settlement expenses decreased \$572.4 million for the Retirement and Investor Services segment primarily due to a decrease in change in reserves resulting from lower sales of single premium group annuities with life contingencies. In addition, benefits, claims and settlement expenses decreased \$120.0 million for the U.S. Insurance Solutions segment primarily due to the change in basis for amortizing DAC and other actuarial balances in the first quarter of 2012 and the result of unlocking associated with a change in our long-term interest rate assumptions and model refinements in the third quarter of 2012.

Operating expenses increased within our U.S. Insurance Solutions segment primarily due to the change in basis for amortizing DAC and other actuarial balances in the first quarter of 2012, partially offset by the result of unlocking associated with a change in our long-term interest rate assumptions and model refinements in the third quarter of 2012. In addition, operating expenses increased within our Retirement and Investor Services segment primarily due to higher expenses stemming from growth in the business and positive equity market performance. Furthermore, operating expenses also increased within our Principal International segment primarily due to acquisition and growth initiatives across the segment. These increases were partially offset by a \$61.2 million charitable contribution of appreciated stock to The Principal Financial Group Foundation within our Corporate segment in 2012.

**Income Taxes**

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

The effective income tax rates were 16% and 14% for the nine months ended September 30, 2013 and 2012, respectively. The effective income tax rate for the nine months ended September 30, 2013, 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 in net investment income and lower tax rates of foreign jurisdiction. The effective income tax rate for the nine months ended September 30, 2012, 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 in net investment income and tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc.

### **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 increased due to improvement 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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
Net revenue:						
Accumulation	\$ 580.9	\$ 512.0	\$ 68.9	\$ 1,719.2	\$ 1,501.5	\$ 217.7
Guaranteed	40.2	37.1	3.1	137.6	120.3	17.3
Total Retirement and Investor Services	\$ 621.1	\$ 549.1	\$ 72.0	\$ 1,856.8	\$ 1,621.8	\$ 235.0

*Retirement and Investor Services Segment Summary Financial Data*

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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
Operating revenues:						
Premiums and other considerations	\$ 181.4	\$ 651.5	\$ (470.1)	\$ 551.5	\$ 978.2	\$ (426.7)
Fees and other revenues	460.1	382.1	78.0	1,327.3	1,121.3	206.0
Net investment income	495.0	537.1	(42.1)	1,508.8	1,607.5	(98.7)
Total operating revenues	1,136.5	1,570.7	(434.2)	3,387.6	3,707.0	(319.4)
Expenses:						
Benefits, claims and settlement expenses, including dividends to policyholders	515.4	1,021.6	(506.2)	1,530.8	2,085.2	(554.4)
Operating expenses	400.0	375.8	24.2	1,194.5	1,080.0	114.5
Total expenses	915.4	1,397.4	(482.0)	2,725.3	3,165.2	(439.9)
Operating earnings before income taxes	221.1	173.3	47.8	662.3	541.8	120.5
Income taxes	48.2	35.8	12.4	147.1	119.0	28.1
Operating earnings	\$ 172.9	\$ 137.5	\$ 35.4	\$ 515.2	\$ 422.8	\$ 92.4

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012***Operating Earnings**

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

Operating earnings increased \$34.1 million in our Accumulation business primarily due to positive equity market performance and growth in the business.

### **Net Revenue**

Net revenue increased \$68.9 million in our Accumulation business primarily due to higher fees stemming from an increase in average account values, which resulted from positive equity market performance and growth in the business.

### **Operating Expenses**

Operating expenses increased \$23.3 million in our Accumulation business primarily due to an increase in non-deferrable distribution costs resulting from growth in the business, higher staff-related costs, including pension and other postretirement benefit expense, and an increase in sub-advisory fees stemming from positive equity market performance. These increases were partially offset by lower DAC amortization, resulting primarily from our review and update of our actuarial assumptions in 2012.

### **Income Taxes**

The effective income tax rates for the segment were 22% and 21% for the three months ended September 30, 2013 and 2012, 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 and the interest exclusion from taxable income.

Table of Contents

*Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

**Operating Earnings**

Operating earnings increased \$82.1 million in our Accumulation business primarily due to positive equity market performance and growth in the business.

**Net Revenue**

Net revenue increased \$217.7 million in our Accumulation business primarily due to higher fees stemming from an increase in average account values, which resulted from positive equity market performance and growth in the business.

**Operating Expenses**

Operating expenses increased \$113.4 million in our Accumulation business primarily due to an increase in non-deferrable distribution costs resulting from growth in the business, higher sub-advisory fees stemming from positive equity market performance and an increase in staff-related costs, including pension and other postretirement benefit expense.

**Income Taxes**

The effective income tax rate for the segment was 22% for both the nine months ended September 30, 2013 and 2012. The effective income tax rate was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received and the interest exclusion from taxable income.

**Principal Global Investors Segment**

*Principal Global Investors Segment Summary Financial Data*

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

AUM is a key indicator of earnings growth for our 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 and real estate 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,	
	2013	2012	2013	2012
	(in billions)			
AUM, beginning of period	\$ 271.2	\$ 243.9	\$ 263.2	\$ 227.8
Net cash flow	1.8	4.6	3.2	11.2
Investment performance	8.6	8.8	16.9	20.1
Operations acquired (1)			1.4	
Other		1.1	(3.1)	(0.7)
AUM, end of period	\$ 281.6	\$ 258.4	\$ 281.6	\$ 258.4

---

(1) Reflects the acquisition of Liongate in May 2013.



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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
<b>Operating revenues:</b>						
Fees and other revenues	\$ 158.8	\$ 141.2	\$ 17.6	\$ 474.0	\$ 413.8	\$ 60.2
Net investment income	2.1	2.8	(0.7)	8.8	9.4	(0.6)
Total operating revenues	160.9	144.0	16.9	482.8	423.2	59.6
<b>Expenses:</b>						
Total expenses	121.0	110.0	11.0	360.3	332.1	28.2
<b>Operating earnings before income taxes and noncontrolling interest</b>						
Income taxes	39.9	34.0	5.9	122.5	91.1	31.4
Income taxes	12.7	10.5	2.2	40.1	29.4	10.7
<b>Operating earnings attributable to noncontrolling interest</b>						
Operating earnings	\$ 4.1	2.9	1.2	\$ 10.0	6.7	3.3
Operating earnings	\$ 23.1	\$ 20.6	\$ 2.5	\$ 72.4	\$ 55.0	\$ 17.4

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012***Operating Earnings**

Operating earnings increased primarily due to higher fee revenues driven by an increase in average AUM. These increases were partially offset by higher variable compensation costs resulting from growth in the business.

**Income Taxes**

The effective income tax rates for the segment were 32% and 31% for the three months ended September 30, 2013 and 2012, respectively. The effective income tax rates were 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, 2013 Compared to Nine Months Ended September 30, 2012***Operating Earnings**

Operating earnings increased primarily due to higher fee revenues driven by an increase in average AUM as well as a performance fee realized in our real estate business. These increases were partially offset by higher variable compensation costs resulting from growth in the business.

**Income Taxes**

The effective income tax rates for the segment were 33% and 32% for the nine months ended September 30, 2013 and 2012, respectively. The effective income tax rates were 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.

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,			
	2013	2012	(in billions)		2013	2012		
AUM, beginning of period	\$	<b>102.9</b>	\$	60.3	\$	<b>69.3</b>	\$	52.8
Net cash flow		<b>1.1</b>		2.7		<b>5.8</b>		7.3
Investment performance		<b>0.5</b>		1.9		<b>0.8</b>		5.5
Operations acquired (1)				0.2		<b>34.3</b>		2.0
Effect of exchange rates		<b>(1.5)</b>		1.1		<b>(7.2)</b>		(1.2)
Other		<b>(0.1)</b>				<b>(0.1)</b>		(0.2)
AUM, end of period	\$	<b>102.9</b>	\$	66.2	\$	<b>102.9</b>	\$	66.2

(1) Reflects the April 2012 acquisition of Claritas in Brazil and the February 2013 acquisition of Cuprum in Chile.

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,								
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)						
	(in millions)											
Net revenue	\$	<b>141.3</b>	\$	94.4	\$	46.9	\$	<b>412.3</b>	\$	275.1	\$	137.2

Net revenue increased primarily due to the Cuprum acquisition in Chile.



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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
<b>Operating revenues:</b>						
Premiums and other considerations	\$ 75.8	\$ 65.3	\$ 10.5	\$ 225.6	\$ 213.6	\$ 12.0
Fees and other revenues	107.1	58.5	48.6	296.3	159.2	137.1
Net investment income	120.4	80.0	40.4	304.0	304.1	(0.1)
Total operating revenues	303.3	203.8	99.5	825.9	676.9	149.0
<b>Expenses:</b>						
Benefits, claims and settlement expenses	162.0	109.4	52.6	413.6	401.8	11.8
Operating expenses	86.8	54.9	31.9	242.1	160.3	81.8
Total expenses	248.8	164.3	84.5	655.7	562.1	93.6
<b>Operating earnings before income taxes and noncontrolling interest</b>						
Income taxes	3.2	2.1	1.1	12.7	1.8	10.9
<b>Operating earnings attributable to noncontrolling interest</b>						
Operating earnings	\$ 50.7	\$ 37.0	\$ 13.7	\$ 153.6	\$ 112.6	\$ 41.0

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012***Operating Earnings**

Operating earnings increased primarily due to the Cuprum acquisition.

**Operating Revenues**

Premiums increased \$10.6 million in Chile primarily due to higher sales of single premium annuities with life contingencies partially offset by the weakening of the Chilean peso against the U.S. dollar.

Fees and other revenues increased primarily due to the Cuprum acquisition.

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

Net investment income increased primarily due to higher inflation-based investment returns on average invested assets and cash as a result of higher inflation in Chile partially offset by the weakening of the Latin American currencies against the U.S. dollar.

### **Total Expenses**

Benefits, claims and settlement expenses increased primarily due to higher inflation-based interest crediting rates to customers and higher sales of single premium annuities with life contingencies in Chile.

Operating expenses increased primarily due to the Cuprum acquisition.

### **Income Taxes**

The effective income tax rates for the segment were 6% and 5% for the three months ended September 30, 2013 and 2012, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to the presentation of taxes on our share of earnings generated from our equity method investments. Specifically, our share of earnings generated from equity method investments, net of foreign taxes incurred, are reported within net investment income whereas any residual U.S. tax expense or benefit related to equity method investments is reported in income taxes. Lower tax rates of foreign jurisdictions also contributed to the lower effective income tax rates.

Table of Contents

*Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

**Operating Earnings**

Operating earnings increased primarily due to the Cuprum acquisition.

**Operating Revenues**

Premiums increased \$12.1 million in Chile primarily due to higher sales of single premium annuities with life contingencies.

Fees and other revenues increased primarily due to the Cuprum acquisition.

Net investment income decreased primarily due to lower inflation-based investment returns on average invested assets and cash as a result of lower inflation in Chile and Mexico partially offset by higher average invested assets in Chile.

**Total Expenses**

Benefits, claims and settlement expenses increased \$13.3 million in Chile primarily due to higher sales of single premium annuities with life contingencies partially offset by lower inflation-based interest crediting rates to customers.

Operating expenses increased primarily due to acquisition and growth initiatives across the segment.

**Income Taxes**

The effective income tax rates for the segment were 7% and 2% for the nine months ended September 30, 2013 and 2012, respectively. The effective income tax rates were lower than the U.S. statutory rate primarily due to taxes on our share of earnings generated from our equity method investments. Specifically, our share of earnings generated from equity method investments, net of foreign taxes incurred, are reported within net investment income whereas any residual U.S. tax expense or benefit related to equity method investments is reported in income taxes. Lower tax rates of foreign jurisdictions also contributed to the lower effective income tax rates. The effective income tax rate increased to 7% from 2% for the nine months ended September 30, 2013 and 2012, respectively, primarily due to the Cuprum acquisition in Chile, which

increased our distribution of operating earnings from our consolidated entities compared to our equity method investments. This was partially offset by lower tax rates of foreign jurisdictions.

## U.S. Insurance Solutions Segment

### *Individual Life Insurance Trends*

Our life insurance premium and fees are influenced by both economic and industry trends. Due to the declining interest rate environment in recent years, we have intentionally increased sales of non-interest sensitive traditional products.

The following table provides a summary of our individual universal and variable universal life insurance fee revenues and our individual traditional life insurance premiums for the periods indicated:

	For the three months ended September 30,		For the nine months ended September 30,	
	2013	2012	2013	2012
	(in millions)			
Universal and variable universal life insurance fee revenues (1)	\$ 130.9	\$ 138.5	\$ 398.4	\$ 331.7
Traditional life insurance premiums	121.8	122.0	380.0	371.0

(1) Fee revenues for the three and nine months ended September 30, 2012, reflect a \$13.5 million increase due to unearned revenue unlocking associated with a change in our long-term interest rate assumptions and model refinements. Fee revenues for the nine months ended September 30, 2012, reflects a \$46.6 million reduction due to unlocking of unearned revenue associated with the change in basis for amortizing DAC and other actuarial balances in the first quarter of 2012.

### *Specialty Benefits Insurance Trends*

Premium and fees in our specialty benefits insurance business are also influenced by economic and industry trends. Premium and fees have risen slower in recent years due to more moderate increases in underlying salaries and lower membership growth in existing group contracts.



Table of Contents

The following table provides a summary of our specialty benefits insurance premium and fees for the periods indicated:

	For the three months ended September 30,			For the nine months ended September 30,				
	2013		2012	2013		2012		
	(in millions)							
Premium and fees:								
Group dental and vision insurance	\$	<b>145.4</b>	\$	144.0	\$	<b>436.8</b>	\$	431.8
Group life insurance		<b>85.5</b>		81.6		<b>251.8</b>		245.4
Group disability insurance		<b>76.7</b>		73.5		<b>227.4</b>		217.1
Individual disability insurance		<b>64.3</b>		59.7		<b>190.1</b>		174.7
Wellness (1)				1.8		<b>4.9</b>		6.8

(1) On July 1, 2013, we completed the transfer of ownership of Principal Wellness Company to Accountable Health, Inc. We have an equity interest in Accountable Health, Inc., which is reflected in the Corporate segment.

*U.S. Insurance Solutions Segment Summary Financial Data*

There are several key indicators for earnings growth in our 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.

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,						
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)				
	(in millions)									
Operating revenues:										
Premiums and other considerations	\$	<b>445.7</b>	\$	441.3	\$	<b>1,354.5</b>	\$	1,324.7	\$	29.8
Fees and other revenues (1)		<b>142.2</b>		151.7		<b>437.8</b>		373.1		64.7
Net investment income		<b>179.7</b>		173.5		<b>526.3</b>		517.2		9.1
Total operating revenues		<b>767.6</b>		766.5		<b>2,318.6</b>		2,215.0		103.6
Expenses:										
Benefits, claims and settlement expenses (1)		<b>446.2</b>		524.4		<b>1,383.8</b>		1,494.9		(111.1)
Dividends to policyholders		<b>48.0</b>		49.2		<b>143.1</b>		148.0		(4.9)
Operating expenses (1)		<b>193.2</b>		229.2		<b>590.0</b>		460.8		129.2
Total expenses		<b>687.4</b>		802.8		<b>2,116.9</b>		2,103.7		13.2
Operating earnings (losses) before income taxes		<b>80.2</b>		(36.3)		<b>201.7</b>		111.3		90.4

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

Income taxes (benefits)		<b>26.2</b>		(14.7)		40.9		<b>64.8</b>		32.5		32.3
Operating earnings (losses)	\$	<b>54.0</b>	\$	(21.6)	\$	75.6	\$	<b>136.9</b>	\$	78.8	\$	58.1

(1) For further details related to the impact associated with the actuarial assumption update and the change in basis for

amortizing DAC and other actuarial balances on results for the three and nine months ended September 30, 2012, see Transactions Affecting Comparability of Results of Operations Actuarial Assumption Updates and Individual Life Insurance Amortization.

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012*

**Operating Earnings**

Operating earnings increased \$60.2 million in our individual life insurance business primarily due to unfavorable unlocking associated with a change in our long-term interest rate assumptions and model refinements in 2012, partially offset by higher mortality in 2013. Operating earnings in our specialty benefits insurance business increased \$15.4 million primarily due to improved claim experience and growth in our business.

Table of Contents

**Operating Revenues**

Premiums increased \$12.3 million in our specialty benefits insurance business primarily due to growth as a result of solid sales in the block of business and stable employment and salary trends. This increase was partially offset by a decrease in premiums of \$7.9 million in our individual life insurance business primarily due to higher ceded premium in our universal life and variable universal life lines of business.

Fees and other revenues decreased \$8.5 million in our individual life insurance business primarily due to unearned revenue unlocking associated with a change in our long-term interest rate assumptions and model refinements in 2012.

Net investment income increased due to higher prepayment fee income and an increase in average invested assets.

**Total Expenses**

Benefits, claims and settlement expenses decreased \$63.0 million in our individual life insurance business primarily due to unlocking associated with a change in our long-term interest rate assumptions and model refinements in 2012, partially offset by higher mortality in 2013. Benefits, claims and settlements expenses in our specialty benefits insurance business decreased \$15.2 million due to improved claim experience, somewhat offset by growth in the business.

Operating expenses decreased \$36.0 million primarily due to unlocking associated with a change in our long-term interest rate assumptions and model refinements in our individual life insurance business in 2012.

**Income Taxes**

The effective income tax rates for the segment were 33% and 40% for the three months ended September 30, 2013 and 2012, respectively. The effective income tax rate for the three months ended September 30, 2013, 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. The effective income tax rate for the three months ended September 30, 2012, reflects the pre-tax operating loss incurred and the benefits from the interest exclusion from taxable income and income tax deductions allowed for corporate dividends received. The effective income tax rate decreased to 33% from 40% for the three months ended September 30, 2013 and 2012, respectively, primarily due to the higher pre-tax income in third quarter 2013.

*Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

**Operating Earnings**

Operating earnings increased \$37.3 million in our individual life insurance business primarily due to unfavorable unlocking associated with a change in our long-term interest rate assumptions and model refinements in the third quarter of 2012, partially offset by higher mortality and an increase in reserves associated with growth in our lines of business in 2013. In addition, operating earnings in our specialty benefits insurance business increased \$20.8 million primarily due to improved claim experience, partially offset by higher staff-related costs, including pension and other postretirement benefit expense.

**Operating Revenues**

Premiums increased \$35.2 million in our specialty benefits insurance business primarily due to growth as a result of solid sales in the block of business and stable employment and salary trends.

Fees and other revenues increased \$64.8 million in our individual life insurance business primarily due to unlocking of unearned revenue associated with the change in basis for amortizing DAC and other actuarial balances in the first quarter of 2012 and growth in our universal life and variable universal life lines of business in 2013. This increase was partially offset by a decrease in fees and revenues due to unlocking associated with a change in our long-term interest rate assumptions and model refinements in the third quarter of 2012.

Table of Contents**Total Expenses**

Total expense increased \$7.7 million in our individual life insurance business primarily due to the change in basis for amortizing DAC and other actuarial balances in the first quarter of 2012, higher mortality and growth in 2013. These increases were partially offset by a decrease in operating expenses due to unlocking associated with the change in our long-term interest rate assumptions and model refinements in the third quarter of 2012. In addition, total expenses increased \$5.7 million in our specialty benefit insurance business due to growth and higher staff related costs, including pension and other postretirement benefits, partially offset by improved claim experience.

**Income Taxes**

The effective income tax rates for the segment were 32% and 29% for the nine months ended September 30, 2013 and 2012, 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.

**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,		
	2013	2012	Increase (decrease)	2013	2012	Increase (decrease)
	(in millions)					
Total operating revenues	\$ (52.5)	\$ (46.4)	\$ (6.1)	\$ (149.1)	\$ (139.8)	\$ (9.3)
Total expenses	(9.7)	(6.4)	(3.3)	(9.1)	(18.4)	9.3
Operating loss before income taxes, preferred stock dividends and noncontrolling interest	(42.8)	(40.0)	(2.8)	(140.0)	(121.4)	(18.6)
Income tax benefits	(19.8)	(17.1)	(2.7)	(61.1)	(45.4)	(15.7)
Preferred stock dividends	8.2	8.2		24.7	24.7	
Operating earnings attributable to noncontrolling interest	0.3	0.1	0.2	0.6		0.6
Operating loss	\$ (31.5)	\$ (31.2)	\$ (0.3)	\$ (104.2)	\$ (100.7)	\$ (3.5)

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012*

**Operating Loss**

The operating loss increased due to higher after-tax interest expense on corporate debt.

*Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

**Operating Loss**

The operating loss increased primarily due to higher after-tax interest expense on corporate debt. The one-time costs associated with the first quarter 2013 acquisition of Cuprum were largely offset by interest income earned on the assets used to fund the Cuprum acquisition.

**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 which 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. As of September 30, 2013, approximately \$9.9 billion, or 99%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. Our life insurance and annuity liabilities contain provisions limiting early surrenders.

As of September 30, 2013 and December 31, 2012, we had short-term credit facilities with various financial institutions in an aggregate amount of \$1,105.0 million and \$905.0 million, respectively. As of September 30, 2013 and December 31, 2012, we had \$175.5 million and \$40.8 million, respectively, of outstanding borrowings, with no assets pledged as support as of September 30, 2013. Our credit facilities include a \$500.0 million 4-year facility that matures in March 2016, with PFG, PFS and Principal Life as co-borrowers. We also have a \$300.0 million 364-day facility for Principal Life only that was refinanced in April 2013. Also in April 2013, we added a \$200.0 million 3-year facility with PFG, PFS, Principal Life and Principal Financial Services V (UK) LTD as borrowers. These credit facilities are committed facilities and provide 100% back-stop support for our commercial paper program. The 4-year facility is supported by eighteen banks; the 364-day facility and 3-year facility are supported by fifteen banks, most of which have other relationships with us. 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 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 laws, 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, 2012, statutory results, the dividend limitation for Principal Life is approximately \$472.0 million. No stockholder dividends were paid by Principal Life to its parent as of



Table of Contents

September 30, 2013, however, on September 28, 2013, Principal Life distributed paid-in and contributed surplus in the amount of \$150.0 million to its parent company.

**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 \$1,397.9 million and \$2,373.7 million for the nine months ended September 30, 2013 and 2012, respectively. From our insurance business, we typically generate 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 decrease in cash provided by operating activities in 2013 compared to 2012 is primarily due to fluctuations in receivables and payables associated with the timing of settlements.

Net cash used in investing activities was \$1,432.8 million and \$1,719.2 million for the nine months ended September 30, 2013 and 2012, respectively. The decrease in cash used in investing activities in 2013 compared to 2012 is primarily the result of fewer net purchases of investments in the current year. This decrease is largely offset by the first quarter 2013 acquisition of Cuprum.

Net cash used in financing activities was \$2,435.2 million and \$1,209.4 million for the nine months ended September 30, 2013 and 2012, respectively. The increase in cash used in financing activities is primarily due to net repayments of debt in 2013, as compared to net borrowings in 2012. Additionally, cash used in financing activities increased due to the transfer of certain Principal Bank deposits as part of the bank's transformation to a limited purpose trust institution.

**Shelf Registration.** On May 24, 2011, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2008. 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.

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

**Preferred Stock Dividend Restrictions and Payments.** The certificates of designation for the Series A and B Preferred Stock restrict the declaration of preferred dividends if we fail to meet specified capital adequacy, net income or stockholders' equity levels. As of September 30, 2013, we have no preferred dividend restrictions. The dividend payments on our preferred stock are not mandatory or cumulative, as our Board of Directors approves each quarterly dividend payment.

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

	September 30, 2013	December 31, 2012
	(in millions)	
Short-term credit facilities	\$ 135.3	\$
Other recourse short-term debt	40.2	40.8
Total short-term debt	\$ 175.5	\$ 40.8

**Long-Term Debt.** As of September 30, 2013, there have been no significant changes to long-term debt since December 31, 2012.

**Stockholders' Equity.** The following table summarizes our return of capital to common stockholders.

Table of Contents

	September 30, 2013	December 31, 2012
	(in millions)	
Dividends to stockholders	\$ (211.7)	\$ (231.3)
Repurchase of common stock	(153.4)	(272.7)
Total cash returned to stockholders	\$ (365.1)	\$ (504.0)

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:

	September 30, 2013	December 31, 2012
	(in millions)	
Debt:		
Short-term debt	\$ 175.5	\$ 40.8
Long-term debt	2,593.3	2,671.3
Total debt	2,768.8	2,712.1
Equity excluding AOCI	9,296.1	9,043.1
Total capitalization excluding AOCI	\$ 12,064.9	\$ 11,755.2
Debt to equity excluding AOCI	30%	30%
Debt to capitalization excluding AOCI	23%	23%

As of September 30, 2013, we had \$216.5 million of excess capital in the holding companies, consisting of cash and highly liquid assets available for debt maturities, interest, preferred stock dividends and other holding company obligations. In addition, we continue to maintain sufficient capital levels in Principal Life based on our current financial strength ratings.

**Contractual Obligations and Contractual Commitments**

As of September 30, 2013, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2012.

**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 3, Variable Interest Entities.

**Guarantees and Indemnifications.** As of September 30, 2013, there have been no significant changes to guarantees and indemnifications since December 31, 2012. 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 a semi-annual review completed in October, Fitch affirmed the financial strength ratings of PFG and its subsidiaries noting PFG's strong capitalization and stable, balanced operating profitability. The outlook remains as negative which reflects concerns related to execution risk associated with our ongoing integration of Cuprum, combined with financial leverage at the high end of rating expectations.

A.M. Best affirmed a stable outlook on the U.S. life insurance sector. Fitch and Standard & Poor's maintain a stable outlook, and Moody's maintains a negative outlook. Regardless of their published outlook on the sector, these rating agencies note that current

Table of Contents

challenges for the industry are the result of sustained low interest rates, global sovereign uncertainty, equity market volatility, and lingering unemployment and fiscal tightening.

In early July, following a review of PFG and its subsidiaries under its revised criteria, Standard & Poor's affirmed the financial strength rating of Principal Life and Principal National Life Insurance Company. The outlook was revised to stable from negative. The change in outlook reflects Standard & Poor's positive view of our solid operating performance, diversification by product line and geography, as well as financial leverage, fixed charge coverage and capital adequacy supportive of the ratings.

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
<b>Principal Financial Group</b>				
Senior Unsecured Debt (1)	a-		BBB+	Baa1
Preferred Stock (2)	bbb		BBB-	Baa3
<b>Principal Financial Services</b>				
Senior Unsecured Debt	a-		BBB+	A3
Commercial Paper	AMB-1		A-2	P-2
<b>Principal Life Insurance Company</b>				
Insurer Financial Strength	A+	AA-	A+	Aa3
Issuer Credit Rating	aa-			
Commercial Paper	AMB-1+		A-1+	P-1
Surplus Notes	a		A-	A2
Enterprise Risk Management Rating			Strong	
<b>Principal National Life Insurance Company</b>				
Insurer Financial Strength	A+	AA-	A+	Aa3

(1) Moody's has rated Principal Financial Group's senior debt issuance A3

(2) S&P has rated Principal Financial Group's preferred stock issuance BB+

**Fair Value Measurement**

Fair value is 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 for disclosure purposes. 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.

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

As of September 30, 2013, 36% of our net assets (liabilities) were Level 1, 61% were Level 2 and 3% were Level 3. Excluding separate account assets as of September 30, 2013, 1% of our net assets (liabilities) were Level 1, 98% were Level 2 and 1% were Level 3.

As of December 31, 2012, 41% of our net assets (liabilities) were Level 1, 55% were Level 2 and 4% were Level 3. Excluding separate account assets as of December 31, 2012, 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, 2013, were \$5,460.9 million as compared to \$4,987.4 million as of December 31, 2012. The increase was primarily related to gains on other invested assets and real estate included in our separate account assets, as well as gains on bifurcated embedded derivatives in investment-type insurance contracts and derivative liabilities.

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of September 30, 2012, were \$4,852.2 million as compared to \$4,647.3 million as of December 31, 2011. The increase was primarily related to gains on other invested assets and real estate included in our separate account assets. This increase was largely offset by

Table of Contents

sales and net transfers out of Level 3 into Level 2 for certain fixed maturities, available-for-sale. The transfers out of Level 3 were due to our obtaining prices from third party pricing vendors or using internal models based on substantially observable market information versus relying on broker quotes or utilizing significant unobservable inputs.

**Investments**

We had total consolidated assets as of September 30, 2013, of \$201,687.4 million, of which \$67,268.3 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, 2013, 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.

	September 30, 2013		December 31, 2012	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Fixed maturities:				
Public	\$ 34,367.7	51%	\$ 36,136.2	52%
Private	15,120.1	22	15,429.8	22
Equity securities	780.2	1	389.3	1
Mortgage loans:				
Commercial	10,615.9	16	10,183.3	15
Residential	1,252.2	2	1,336.4	2
Real estate held for sale	168.3		87.0	
Real estate held for investment	1,110.3	2	1,093.3	2
Policy loans	859.6	1	864.9	1
Other investments	2,994.0	5	3,291.1	5
Total invested assets	67,268.3	100%	68,811.3	100%
Cash and cash equivalents	1,707.1		4,177.2	
Total invested assets and cash	\$ 68,975.4		\$ 72,988.5	

**Investment Results*****Net Investment Income***

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

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 fixed maturities and equity securities are calculated using amortized cost and cost, respectively. All other yields are calculated using carrying amounts.



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

Table of Contents

	For the three months ended September 30, 2013				Increase (decrease) 2013 vs. 2012				For the nine months ended September 30, 2013				Increase (decrease) 2013 vs. 2012	
	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount
Fixed maturities	5.0%	\$ 594.9	4.9%	\$ 598.8	0.1%	\$ (3.9)	4.9%	\$ 1,754.6	5.1%	\$ 1,857.3	(0.2)%	\$ (102.7)		
Equity securities	(1.6)	(3.3)	3.6	3.3	(5.2)	(6.6)	1.3	5.7	3.6	11.7	(2.3)	(6.0)		
Mortgage loans commercial	5.1	136.9	5.7	140.9	(0.6)	(4.0)	5.2	406.6	5.8	420.6	(0.6)	(14.0)		
Mortgage loans residential	6.7	21.0	4.1	13.7	2.6	7.3	5.2	50.3	5.3	53.8	(0.1)	(3.5)		
Real estate	4.1	13.0	7.8	23.2	(3.7)	(10.2)	4.5	42.0	5.5	47.8	(1.0)	(5.8)		
Policy loans	5.8	12.5	6.1	13.2	(0.3)	(0.7)	5.8	37.4	6.2	40.8	(0.4)	(3.4)		
Cash and cash equivalents	0.6	2.2	0.5	2.6	0.1	(0.4)	0.5	12.2	0.4	6.9	0.1	5.3		
Other investments	3.5	26.2	1.0	7.7	2.5	18.5	3.0	71.6	1.4	31.9	1.6	39.7		
Total before investment expenses	4.8	803.4	4.8	803.4			4.6	2,380.4	4.8	2,470.8	(0.2)	(90.4)		
Investment expenses	(0.1)	(18.9)	(0.1)	(19.6)		0.7	(0.1)	(56.9)	(0.1)	(61.2)		4.3		
Net investment income	4.7%	\$ 784.5	4.7%	\$ 783.8		0.7	4.5%	\$ 2,323.5	4.7%	\$ 2,409.6	(0.2)%	\$ (86.1)		

*Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012*

Net investment income increased due to higher inflation-based investment returns on average invested assets and cash as a result of higher inflation in Chile, partially offset by the weakening of the Latin American currencies against the U.S. dollar. This increase was offset by a decrease in net investment income due to lower yields offset by an increase in average invested assets and cash in our U.S. operations.

*Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012*

Net investment income decreased primarily due to lower investment yields offset by an increase in average invested assets and cash in our U.S. operations. Within our international operations, net investment income decreased primarily due to lower inflation-based investment returns on average invested assets and cash as a result of lower inflation in Chile and Mexico, partially offset by higher average invested assets in Chile.

*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.

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

	For the three months ended September 30,		Increase (decrease)	For the nine months ended September 30,		Increase (decrease)
	2013	2012	2013 vs. 2012	2013	2012	2013 vs. 2012
	(in millions)					
Fixed maturities, available-for-sale credit impairments (1)	\$ (21.2)	\$ (34.3)	\$ 13.1	\$ (70.4)	\$ (95.1)	\$ 24.7
Commercial mortgages credit impairments	(0.7)	(4.0)	3.3	(6.4)	(11.9)	5.5
Other credit impairments	(2.5)	(19.3)	16.8	(13.9)	(32.8)	18.9
Fixed maturities, available-for-sale and trading noncredit	1.6	7.1	(5.5)	4.1	23.7	(19.6)
Derivatives and related hedge activities (2)	(43.6)	(74.8)	31.2	(107.2)	(30.1)	(77.1)
Other gains (losses)	15.5	213.0	(197.5)	11.9	227.4	(215.5)
Net realized capital gains (losses)	\$ (50.9)	\$ 87.7	\$ (138.6)	\$ (181.9)	\$ 81.2	\$ (263.1)

(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 \$2.1 million and \$0.0 million for the nine months ended September 30, 2013 and 2012, respectively. There were no credit gains on sales for the three months ended September 30, 2013 and 2012.

(2) Includes fixed maturities, available-for-sale impairment-related net gains of \$0.2 million and \$0.0 for the nine months ended September 30, 2013 and 2012, respectively, which were hedged by derivatives reflected in this line. There were no fixed maturities available-for-sale impairment-related net gains in this line for the three months ended September 30, 2013 and 2012.

Table of Contents

***Three Months Ended September 30, 2013 Compared to Three Months Ended September 30, 2012***

Net realized capital losses on fixed maturities, available-for-sale credit impairments decreased primarily due to lower impairments on commercial mortgage-backed and other asset-backed securities as a result of improved market conditions.

Net realized capital losses on other-credit impairments decreased due to lower losses on residential mortgage loans as a result of improved market conditions.

Net realized capital losses on derivatives and related hedge activities decreased due to lower losses on the GMWB embedded derivatives, including changes in the spread reflecting our own creditworthiness, and related hedging instruments. This was partially offset by decreased gains on currency forwards and currency swaps due to changes in exchange rates.

Other net realized capital gains decreased due to \$184.3 million of net gains realized in the third quarter of 2012 related to the merger of Catalyst Health Solutions, Inc. and the subsequent disposition of our remaining interest in the merged entity.

***Nine Months Ended September 30, 2013 Compared to Nine Months Ended September 30, 2012***

Net realized capital losses on fixed maturities, available-for-sale-credit impairments decreased primarily due to lower impairments on commercial mortgage-backed and other asset-backed securities as a result of improved market conditions.

Net realized capital losses on other-credit impairments decreased due to lower losses on residential mortgage loans as a result of improved market conditions.

Net realized capital gains on fixed maturities, noncredit decreased as a result of lower gains on sales and mark-to-market adjustments on fixed maturity securities.

Net realized capital losses on derivatives and related hedge activities increased due to losses versus gains on derivatives not designated as hedging instruments including interest rate swaps due to changes in interest rates and currency forwards and currency swaps due to changes in exchange rates. Losses increased on the GMWB embedded derivatives, including changes in the spread reflecting our own creditworthiness, and related hedging instruments.

Other net realized capital gains decreased due to \$184.3 million of net gains realized in the third quarter of 2012 related to the merger of Catalyst Health Solutions, Inc. and the subsequent disposition of our remaining interest in the merged entity. In addition, other net realized capital gains decreased due to increased foreign currency translation losses on cash held for the Cuprum acquisition that was completed in the first quarter 2013 and a 2013 realized loss resulting from the write-off of impaired corporate owned real estate.

### **U.S. Investment Operations**

Of our invested assets, \$61,047.2 million were held by our U.S. operations as of September 30, 2013. 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:

- 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, 2013, there are thirteen members on the Investment Committee, one of whom is a member of our Board of Directors. The remaining members are senior management members representing various areas of our company.

Table of Contents

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, was \$789.9 million and 4.7%, respectively, as of September 30, 2013. 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 was \$4,091.6 million and 3.7%, respectively, as of September 30, 2013.

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.

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.

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:

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

	Weighted average loan-to-value ratio		Debt service coverage ratio	
	September 30, 2013	December 31, 2012	September 30, 2013	December 31, 2012
New mortgages	46%	48%	2.8x	3.2x
Entire mortgage portfolio	51%	54%	2.4x	2.2x

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, 2013		December 31, 2012	
	Carrying amount	% of total	Carrying amount	% of total
(\$ in millions)				
<b>Fixed maturities:</b>				
Public	\$ 30,899.5	51%	\$ 32,437.5	52%
Private	15,119.5	25	15,429.8	25
Equity securities	254.3		263.2	
<b>Mortgage loans:</b>				
Commercial	10,575.1	17	10,167.7	16
Residential	566.8	1	657.7	1
Real estate held for sale	164.6		80.0	
Real estate held for investment	1,107.8	2	1,092.5	2
Policy loans	834.0	1	838.2	1
Other investments	1,525.6	3	1,847.4	3
Total invested assets	61,047.2	100%	62,814.0	100%
Cash and cash equivalents	1,612.9		4,071.8	
Total invested assets and cash	\$ 62,660.1		\$ 66,885.8	

*Fixed Maturities*

Fixed maturities consist of publicly traded and privately placed bonds, MBS, ABS, redeemable preferred stock and certain nonredeemable preferred stock. Included in the privately placed category as of September 30, 2013 and December 31, 2012, were \$10.2 billion and \$9.9 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, 2013		December 31, 2012	
	Carrying amount	% of total	Carrying amount	% of total
(\$ in millions)				
U.S. government and agencies	\$ 720.6	2%	\$ 953.7	2%
States and political subdivisions	3,756.2	8	3,327.8	7
Non-U.S. governments	526.0	1	663.4	1
Corporate - public	17,438.6	38	18,718.2	39
Corporate - private	12,363.4	27	12,808.6	27
Residential mortgage-backed pass-through securities	2,787.4	6	3,277.4	7
Commercial mortgage-backed securities	3,985.4	9	3,900.2	8
Residential collateralized mortgage obligations	1,038.3	2	1,115.3	2
Asset-backed securities	3,403.1	7	3,102.7	7
Total fixed maturities	\$ 46,019.0	100%	\$ 47,867.3	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 2013 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 diversify the risks of ABS by holding 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 27% of total fixed maturities as of September 30, 2013, and 27% as of December 31, 2012. 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, 2013	December 31, 2012
	(in millions)	
European Union, excluding UK	\$ 4,023.2	\$ 4,415.8
United Kingdom	2,745.3	2,663.6
Asia-Pacific	1,499.4	1,390.7
Australia/New Zealand	1,303.2	1,383.8
Europe, non EU	1,047.8	1,126.0
Latin America	912.3	886.3
Middle East and Africa	442.4	505.4
Other (1)	310.8	352.4
<b>Total</b>	<b>\$ 12,284.4</b>	<b>\$ 12,724.0</b>

(1) Includes exposure from one country and various supranational organizations as of both September 30, 2013, and December 31, 2012.

International fixed maturities are 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, 2013 and December 31, 2012, our investments in Canada totaled \$1,560.4 million and \$1,819.0 million, respectively.

Economic and fiscal conditions in select European countries, including Greece, Ireland, Italy, Portugal and Spain, continue to cause credit concerns particularly to financial institutions and banks with exposure to the European periphery region. Our exposure to the region within our U.S. investment operations fixed maturities portfolio is modest and manageable, representing 2.0% and 2.2% of total fixed maturities as of September 30, 2013 and December 31, 2012, respectively. Additionally, we did not hold any sovereign debt issuances of the selected countries and had not bought or sold credit protection on sovereign issuances as of September 30, 2013 and December 31, 2012.

The fixed maturities within our U.S. operations portfolio with exposure to the region are primarily corporate credit issuances of large multinational companies where the majority of revenues are coming from outside the country where the parent company is domiciled. Our

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

experience indicates multinational companies have demonstrated better market price performance and credit ratings stability. As of September 30, 2013, 96% of our total portfolio exposure consists of investment grade bonds with an average price of 103 (carrying value/amortized cost) and a weighted average time to maturity of 5 years.

Table of Contents

The following table presents the carrying amount of our European periphery zone fixed maturities exposure for the periods indicated:

Select European Exposure	Greece	Ireland	September 30, 2013			Spain	Total
			Italy	Portugal	(in millions)		
Non-Sovereign:							
Financial institutions	\$	\$ 42.1	\$ 45.0	\$	\$ 127.0	\$	214.1
Non-financial institutions		274.9	191.2	20.0	239.5		725.6
Total	\$	\$ 317.0	\$ 236.2	\$ 20.0	\$ 366.5	\$	939.7

Select European Exposure	Greece	Ireland	December 31, 2012			Spain	Total
			Italy	Portugal	(in millions)		
Non-Sovereign:							
Financial institutions	\$	\$ 59.9	\$ 44.4	\$	\$ 138.5	\$	242.8
Non-financial institutions		270.5	225.7	26.7	278.1		801.0
Total	\$	\$ 330.4	\$ 270.1	\$ 26.7	\$ 416.6	\$	1,043.8

For further details on our International investment operations exposure to these European countries, see International Investment Operations Fixed Maturities Exposure.

**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, 2013.

	Amortized cost (in millions)
General Electric Co.	\$ 207.1
AT&T Inc.	176.9
Berkshire Hathaway Inc.	163.1
Verizon Communications Inc	162.3
Duke Energy Corp.	157.5
JPMorgan Chase & Co.	149.0
Wells Fargo & Co.	148.7
Merck & Co Inc.	146.5
Prudential Financial Inc.	144.6
Republic of Korea	142.5
Total top ten exposures	\$ 1,598.2

**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

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

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 National Association of Insurance Commissioners ( 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

Table of Contents

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.

1	AAA/AA/A	\$ 26,992.4	\$ 28,033.1	61%	\$ 26,880.3	\$ 28,943.8	60%
2	BBB	13,891.8	14,680.2	32	14,331.8	15,596.0	33
3	BB	2,485.9	2,448.5	5	2,416.0	2,330.1	5
4	B	567.8	527.8	1	677.2	615.7	1
5	CCC and lower	244.9	182.8	1	335.9	254.7	1
6	In or near default	221.6	146.6		259.2	127.0	
	Total fixed maturities	\$ 44,404.4	\$ 46,019.0	100%	\$ 44,900.4	\$ 47,867.3	100%

Fixed maturities include 18 securities with an amortized cost of \$216.3 million, gross gains of \$1.2 million, gross losses of \$5.3 million and a carrying amount of \$212.2 million as of September 30, 2013, 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 and Home Equity Asset-Backed Securities Portfolios.** As of September 30, 2013, based on amortized cost, 53% of our CMBS portfolio had ratings of A or higher and 35% was issued prior to 2005 and after 2008 and 6% of our ABS home equity portfolio had ratings of A or higher and 65% was issued prior to 2005.

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, 2013					
AAA	AA	A	BBB	BB+ and Below	Total

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

	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	\$ 21.5	\$ 22.2	\$ 9.9	\$ 11.4	\$ 0.7	\$ 0.8	\$ 27.8	\$ 31.4	\$ 85.6	\$ 78.7	\$ 145.5	\$ 144.5
2004	44.0	44.9	61.5	63.3	44.3	45.8	30.5	32.3	78.8	68.8	259.1	255.1
2005	315.2	331.8	52.2	56.0	39.3	39.4	116.2	118.5	186.4	138.7	709.3	684.4
2006	85.9	90.1	48.4	49.6	72.5	77.3	118.8	124.7	142.7	117.8	468.3	459.5
2007	73.4	76.3	74.3	84.1	141.8	157.2	252.4	272.7	799.3	663.4	1,341.2	1,253.7
2008	11.0	11.5	43.6	49.5			18.4	19.3	67.3	75.1	140.3	155.4
2009	81.8	86.6	94.4	99.5							176.2	186.1
2010	63.7	70.1	60.0	61.8							123.7	131.9
2011	102.4	103.4	121.5	122.3							223.9	225.7
2012	210.7	211.3	153.4	153.2							364.1	364.5
2013	98.2	96.2	28.9	28.4							127.1	124.6
Total (1)	\$ 1,107.8	\$ 1,144.4	\$ 748.1	\$ 779.1	\$ 298.6	\$ 320.5	\$ 564.1	\$ 598.9	\$ 1,360.1	\$ 1,142.5	\$ 4,078.7	\$ 3,985.4

(1) The CMBS portfolio included agency CMBS with a \$407.6 million amortized cost and a \$411.0 million carrying amount.

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

Table of Contents

	December 31, 2012											
	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	\$ 40.8	\$ 41.7	\$ 24.1	\$ 24.3	\$ 37.7	\$ 38.2	\$ 60.5	\$ 61.4	\$ 118.2	\$ 98.2	\$ 281.3	\$ 263.8
2004	73.2	76.3	56.9	59.5	49.2	48.1	31.2	26.5	97.0	71.5	307.5	281.9
2005	345.0	373.2	47.3	51.7	39.6	39.1	91.7	88.8	211.7	140.0	735.3	692.8
2006	124.2	132.1	30.7	32.4	72.9	79.2	93.7	101.8	160.8	110.6	482.3	456.1
2007	117.1	118.4	59.5	69.9	158.6	181.2	231.7	261.6	758.4	544.8	1,325.3	1,175.9
2008	11.2	12.2	43.5	52.3			23.4	26.0	31.5	32.6	109.6	123.1
2009	92.3	101.2	100.5	108.1							192.8	209.3
2010	64.1	73.1	65.1	68.9							129.2	142.0
2011	97.5	100.6	122.2	128.3							219.7	228.9
2012	157.7	163.2	156.9	163.2							314.6	326.4
Total (1)	\$ 1,123.1	\$ 1,192.0	\$ 706.7	\$ 758.6	\$ 358.0	\$ 385.8	\$ 532.2	\$ 566.1	\$ 1,377.6	\$ 997.7	\$ 4,097.6	\$ 3,900.2

(1) The CMBS portfolio included agency CMBS with a \$403.8 million amortized cost and a \$423.0 million carrying amount.

The following tables present our exposure by credit quality, based on the lowest NRSRO designation, and vintage for our ABS home equity portfolio supported by subprime first lien mortgages as of the periods indicated.

	September 30, 2013											
	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	\$ 1.0	\$ 1.0	\$ 4.6	\$ 4.6	\$ 6.3	\$ 6.5	\$ 19.3	\$ 19.7	\$ 129.4	\$ 121.3	\$ 160.6	\$ 153.1
2004					5.9	6.0	17.8	18.2	43.6	42.0	67.3	66.2
2005					3.0	3.1			70.9	65.3	73.9	68.4
2006									13.1	13.3	13.1	13.3
2007									37.5	35.0	37.5	35.0
Total	\$ 1.0	\$ 1.0	\$ 4.6	\$ 4.6	\$ 15.2	\$ 15.6	\$ 37.1	\$ 37.9	\$ 294.5	\$ 276.9	\$ 352.4	\$ 336.0

	December 31, 2012											
	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	\$ 2.0	\$ 2.0	\$ 4.8	\$ 5.0	\$ 5.7	\$ 5.8	\$ 21.6	\$ 21.5	\$ 141.4	\$ 127.8	\$ 175.5	\$ 162.1
2004					5.9	5.7	19.4	19.2	44.9	40.2	70.2	65.1
2005					3.0	3.1			71.4	58.0	74.4	61.1
2006									13.8	12.6	13.8	12.6
2007									37.2	32.9	37.2	32.9
Total	\$ 2.0	\$ 2.0	\$ 4.8	\$ 5.0	\$ 14.6	\$ 14.6	\$ 41.0	\$ 40.7	\$ 308.7	\$ 271.5	\$ 371.1	\$ 333.8

**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) as to which

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

principal and/or interest payments are 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 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.



Table of Contents

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, 2013		December 31, 2012
	(\$ in millions)		
Total fixed maturities (public and private)	\$	46,019.0	\$ 47,867.3
Problem fixed maturities (1)	\$	438.2	\$ 385.8
Potential problem fixed maturities		165.6	204.6
Restructured problem fixed maturities			15.2
Total problem, potential problem and restructured fixed maturities	\$	603.8	\$ 605.6
Total problem, potential problem and restructured fixed maturities as a percent of total fixed maturities		1.31%	1.27%

(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 4, 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.

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

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 \$68.5 million and \$95.1 million for the nine months ended September 30, 2013 and 2012, respectively.

### *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.

Table of Contents

		September 30, 2013			Carrying amount
		Amortized cost	Gross unrealized gains	Gross unrealized losses	
		(in millions)			
Finance	Banking	\$ 4,153.4	\$ 162.8	\$ 166.5	\$ 4,149.7
Finance	Brokerage	271.5	18.3	1.2	288.6
Finance	Finance Companies	158.0	9.4	0.2	167.2
Finance	Financial Other	543.6	64.2	1.0	606.8
Finance	Insurance	2,497.6	201.0	9.5	2,689.1
Finance	REITS	904.2	49.4	7.8	945.8
Industrial	Basic Industry	1,645.2	80.6	18.0	1,707.8
Industrial	Capital Goods	1,624.2	120.1	4.1	1,740.2
Industrial	Communications	2,101.9	145.4	14.6	2,232.7
Industrial	Consumer Cyclical	1,602.3	112.6	8.7	1,706.2
Industrial	Consumer Non-Cyclical	3,143.5	205.6	16.4	3,332.7
Industrial	Energy	1,972.6	165.1	10.5	2,127.2
Industrial	Other	367.0	20.5	0.7	386.8
Industrial	Technology	961.6	50.1	5.4	1,006.3
Industrial	Transportation	805.4	43.6	8.3	840.7
Utility	Electric	2,744.3	199.6	36.1	2,907.8
Utility	Natural Gas	1,099.2	86.0	14.4	1,170.8
Utility	Other	280.7	19.6	1.6	298.7
	Government guaranteed	1,280.3	112.4	6.2	1,386.5
	Total corporate securities	28,156.5	1,866.3	331.2	29,691.6
	Residential mortgage-backed pass-through securities	2,658.6	104.6	27.9	2,735.3
	Commercial mortgage-backed securities	4,076.8	188.0	281.3	3,983.5
	Residential collateralized mortgage obligations	1,028.5	20.2	10.4	1,038.3
	Asset-backed securities Home equity (1)	352.4	10.1	26.5	336.0
	Asset-backed securities All other	2,659.4	20.9	9.5	2,670.8
	Collateralized debt obligations Credit	54.5		31.1	23.4
	Collateralized debt obligations CMBS	40.7	2.8	1.7	41.8
	Collateralized debt obligations Loans	263.3	4.5	0.7	267.1
	Total mortgage-backed and other asset-backed securities	11,134.2	351.1	389.1	11,096.2
	U.S. government and agencies	741.1	15.9	36.4	720.6
	States and political subdivisions	3,557.7	129.5	70.6	3,616.6
	Non-U.S. governments	446.9	80.1	1.0	526.0
	Total fixed maturities, available-for-sale	\$ 44,036.4	\$ 2,442.9	\$ 828.3	\$ 45,651.0

(1) This exposure is all related to sub-prime mortgage loans.

Table of Contents

		December 31, 2012			
		Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
		(in millions)			
Finance	Banking	\$ 4,243.6	\$ 219.9	\$ 234.1	\$ 4,229.4
Finance	Brokerage	377.2	31.0	1.1	407.1
Finance	Finance Companies	173.7	12.2		185.9
Finance	Financial Other	519.5	79.9		599.4
Finance	Insurance	2,748.2	280.2	11.0	3,017.4
Finance	REITS	982.8	66.3	4.1	1,045.0
Industrial	Basic Industry	1,589.0	149.7	1.0	1,737.7
Industrial	Capital Goods	2,012.7	188.1	0.6	2,200.2
Industrial	Communications	2,025.7	242.2	1.9	2,266.0
Industrial	Consumer Cyclical	1,551.0	174.1	2.9	1,722.2
Industrial	Consumer Non-Cyclical	3,303.0	332.5	1.4	3,634.1
Industrial	Energy	1,985.7	296.9	1.6	2,281.0
Industrial	Other	477.8	38.2		516.0
Industrial	Technology	904.8	66.4	0.4	970.8
Industrial	Transportation	730.2	64.4	0.7	793.9
Utility	Electric	2,739.5	310.6	12.1	3,038.0
Utility	Natural Gas	1,033.7	136.4	0.9	1,169.2
Utility	Other	291.1	34.1		325.2
Government guaranteed		1,126.7	152.8	1.6	1,277.9
Total corporate securities		28,815.9	2,875.9	275.4	31,416.4
Residential mortgage-backed pass-through securities		2,997.8	202.3	0.4	3,199.7
Commercial mortgage-backed securities		4,094.8	241.7	439.1	3,897.4
Residential collateralized mortgage obligations		1,091.9	31.2	8.9	1,114.2
Asset-backed securities Home equity (1)		371.1	4.7	42.0	333.8
Asset-backed securities All other		2,293.9	37.6	0.3	2,331.2
Collateralized debt obligations Credit		79.3		40.0	39.3
Collateralized debt obligations CMBS		92.2	3.4	15.1	80.5
Collateralized debt obligations Loans		242.3	3.6	1.1	244.8
Collateralized debt obligations ABS		15.0		0.4	14.6
Total mortgage-backed and other asset-backed securities		11,278.3	524.5	547.3	11,255.5
U.S. government and agencies		911.4	33.2	0.3	944.3
States and political subdivisions		2,940.4	241.1	2.7	3,178.8
Non-U.S. governments		545.5	117.9		663.4
Total fixed maturities, available-for-sale		\$ 44,491.5	\$ 3,792.6	\$ 825.7	\$ 47,458.4

(1) This exposure is all related to sub-prime mortgage loans.

Of the \$828.3 million in gross unrealized losses as of September 30, 2013, there were \$2.5 million in losses attributed to securities scheduled to mature in one year or less, \$33.1 million attributed to securities scheduled to mature between one to five years, \$88.7 million attributed to securities scheduled to mature between five to ten years, \$314.9 million attributed to securities scheduled to mature after ten years and \$389.1 million related to mortgage-backed and other ABS that are not classified by maturity year. As of September 30, 2013, we were in a \$1,614.6 million net unrealized gain position as compared to a \$2,966.9 million net unrealized gain position as of December 31, 2012. The \$1,352.3 million decrease in net unrealized gains for the nine months ended September 30, 2013, can primarily be attributed to an approximate 53 basis

points increase in interest rates.

***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

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

Table of Contents

management information, strengthened negotiated protective covenants, call protection features and, where 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.

	September 30, 2013				December 31, 2012			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)							
Investment grade:								
Public	\$ 27,739.0	\$ 1,639.7	\$ 363.5	\$ 29,015.2	\$ 28,273.4	\$ 2,604.1	\$ 198.9	\$ 30,678.6
Private	12,823.0	708.7	155.8	13,375.9	12,684.2	1,065.2	142.7	13,606.7
Below investment grade:								
Public	1,807.8	45.6	162.3	1,691.1	1,723.1	55.2	258.8	1,519.5
Private	1,666.6	48.9	146.7	1,568.8	1,810.8	68.1	225.3	1,653.6
Total fixed maturities, available-for-sale	\$ 44,036.4	\$ 2,442.9	\$ 828.3	\$ 45,651.0	\$ 44,491.5	\$ 3,792.6	\$ 825.7	\$ 47,458.4

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.

	September 30, 2013					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 583.9	\$ 5.0	\$ 433.8	\$ 6.8	\$ 1,017.7	\$ 11.8
Greater than three to six months	4,363.4	194.7	1,659.9	55.0	6,023.3	249.7
Greater than six to nine months	179.0	10.7	81.1	3.1	260.1	13.8
Greater than nine to twelve months	131.5	11.8	22.0	2.3	153.5	14.1
Greater than twelve to twenty-four months	74.9	6.0	25.5	0.1	100.4	6.1
Greater than twenty-four to thirty-six months	70.5	5.3	66.5	8.3	137.0	13.6
Greater than thirty-six months	503.5	130.0	407.1	80.2	910.6	210.2
Total fixed maturities, available-for-sale	\$ 5,906.7	\$ 363.5	\$ 2,695.9	\$ 155.8	\$ 8,602.6	\$ 519.3

	December 31, 2012					
	Public		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	\$ 646.6	\$ 3.7	\$ 227.1	\$ 1.5	\$ 873.7	\$ 5.2
Greater than three to six months	148.4	2.1	31.8	0.4	180.2	2.5
Greater than six to nine months	21.3	0.3	50.6	0.6	71.9	0.9
Greater than nine to twelve months	34.6	1.0	7.1	0.1	41.7	1.1
Greater than twelve to twenty-four months	205.8	17.7	167.6	10.0	373.4	27.7
Greater than twenty-four to thirty-six months	72.2	8.8	41.9	0.9	114.1	9.7
Greater than thirty-six months	811.6	165.3	706.9	129.2	1,518.5	294.5
Total fixed maturities, available-for-sale	\$ 1,940.5	\$ 198.9	\$ 1,233.0	\$ 142.7	\$ 3,173.5	\$ 341.6

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.

Table of Contents

	Public		September 30, 2013 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 157.7	\$ 2.7	\$ 223.1	\$ 2.3	\$ 380.8	\$ 5.0
Greater than three to six months	196.7	6.5	180.3	8.2	377.0	14.7
Greater than six to nine months	0.1		19.1	0.8	19.2	0.8
Greater than nine to twelve months	7.4	0.1	11.7	0.6	19.1	0.7
Greater than twelve to twenty-four months			16.4	2.3	16.4	2.3
Greater than twenty-four to thirty-six months	18.6	2.8	18.3	7.2	36.9	10.0
Greater than thirty-six months	471.1	150.2	302.4	125.3	773.5	275.5
Total fixed maturities, available-for-sale	\$ 851.6	\$ 162.3	\$ 771.3	\$ 146.7	\$ 1,622.9	\$ 309.0

	Public		December 31, 2012 Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 32.9	\$ 0.4	\$ 47.6	\$ 0.8	\$ 80.5	\$ 1.2
Greater than three to six months	7.5	0.1	76.1	1.6	83.6	1.7
Greater than six to nine months	11.0	1.2	17.1	1.4	28.1	2.6
Greater than nine to twelve months			26.7	1.6	26.7	1.6
Greater than twelve to twenty-four months	17.7	5.1	33.5	2.8	51.2	7.9
Greater than twenty-four to thirty-six months	6.8	0.3	12.4	8.4	19.2	8.7
Greater than thirty-six months	556.2	251.7	400.4	208.7	956.6	460.4
Total fixed maturities, available-for-sale	\$ 632.1	\$ 258.8	\$ 613.8	\$ 225.3	\$ 1,245.9	\$ 484.1

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, 2013 All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	\$ 7.0	\$ 1.8	\$ 5.5	\$ 2.2	\$ 12.5	\$ 4.0
Greater than three to six months	13.1	4.1	8.8	2.9	21.9	7.0
Greater than six to nine months			21.4	11.0	21.4	11.0
Greater than nine to twelve months		0.1	1.2	1.5	1.2	1.6
Greater than twelve months	154.9	214.8	322.8	172.2	477.7	387.0
Total fixed maturities, available-for-sale	\$ 175.0	\$ 220.8	\$ 359.7	\$ 189.8	\$ 534.7	\$ 410.6



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

	Problem, potential problem, and restructured		December 31, 2012 All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
			(in millions)			
Three months or less	\$	\$	\$ 7.7	\$ 2.4	\$ 7.7	\$ 2.4
Greater than three to six months			1.1	0.7	1.1	0.7
Greater than six to nine months			0.4	0.3	0.4	0.3
Greater than nine to twelve months	3.0	2.5	17.6	5.7	20.6	8.2
Greater than twelve months	194.1	269.0	457.0	379.5	651.1	648.5
Total fixed maturities, available-for-sale	\$ 197.1	\$ 271.5	\$ 483.8	\$ 388.6	\$ 680.9	\$ 660.1

Table of Contents

***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 \$10,575.1 million and \$10,167.7 million as of September 30, 2013 and December 31, 2012, respectively. The carrying amount of our residential mortgage loan portfolio was \$566.8 million and \$657.7 million as of September 30, 2013 and December 31, 2012, 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 solid, 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 21% and 20% of our commercial mortgage loan portfolio as of September 30, 2013 and December 31, 2012, 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, 2013 and December 31, 2012, the total number of commercial mortgage loans outstanding was 974 and 977, of which 66% and 68% were for loans with

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

principal balances less than \$10 million, respectively. The average loan size of our commercial mortgage portfolio was \$10.9 million and \$10.4 million as of September 30, 2013 and December 31, 2012, 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 4, 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 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.

There has been a decrease in the total level of problem, potential problem and restructured commercial mortgages during 2013 primarily due to loan payoffs, foreclosures and improvement in general market fundamentals such as increases in employment, falling vacancies and relatively little new construction.

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.

Table of Contents

	September 30, 2013	December 31, 2012
	(\$ in millions)	
Total commercial mortgages	\$ 10,575.1	\$ 10,167.7
Problem commercial mortgages	\$ 102.3	\$ 40.1
Potential problem commercial mortgages	51.3	177.6
Restructured problem commercial mortgages	0.9	
Total problem, potential problem and restructured commercial mortgages	\$ 154.5	\$ 217.7
Total problem, potential problem and restructured commercial mortgages as a percent of total commercial mortgages	1.46%	2.14%

**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 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 valuation allowance, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Investments Mortgage Loan Valuation Allowance.

The valuation allowance decreased \$9.4 million for the nine months ended September 30, 2013, and decreased \$13.0 million for the year ended December 31, 2012. The decrease in the level of valuation allowance during 2013 and 2012 was related to the same market factors as those causing the decrease in the level of problem, potential problem and restructured commercial mortgages for the nine months ended September 30, 2013.

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

	September 30, 2013	December 31, 2012
	(\$ in millions)	
Balance, beginning of period	\$ 51.8	\$ 64.8
Provision	6.7	13.5
Charge-offs	(16.9)	(26.7)
Recoveries	0.8	0.2
Balance, end of period	\$ 42.4	\$ 51.8
Valuation allowance as % of carrying value before reserves	0.40%	0.51%

**Residential Mortgage Loans.** The residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$416.8 million and \$495.7 million and first lien mortgages with an amortized cost of \$194.6 million and \$206.4 million as of September 30, 2013 and December 31, 2012, 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 \$22.9 million and \$32.3 million as of September 30, 2013 and December 31, 2012, respectively.

We establish the residential mortgage loan valuation allowance at levels considered adequate to absorb 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.

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

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 valuation allowance for the periods indicated.

	September 30, 2013	December 31, 2012
	(\$ in millions)	
Balance, beginning of period	\$ 44.4	\$ 36.0
Provision	12.8	39.9
Charge-offs	(15.0)	(35.1)
Recoveries	2.4	3.6
Balance, end of period	\$ 44.6	\$ 44.4
Valuation allowance as % of carrying value before reserves	7.3%	6.3%

Table of Contents

***Real Estate***

Real estate consists primarily of commercial equity real estate. As of September 30, 2013 and December 31, 2012, the carrying amount of our equity real estate investment was \$1,272.4 million, or 2%, and \$1,172.5 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 \$1,107.8 million and \$1,092.5 million as of September 30, 2013 and December 31, 2012, respectively. The carrying value of real estate held for investment is generally adjusted for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized losses and, accordingly, are reflected in our consolidated results of operations. For the nine months ended September 30, 2013 and the year ended December 31, 2012, there were no such impairment adjustments.

The carrying amount of real estate held for sale was \$164.6 million and \$80.0 million as of September 30, 2013 and December 31, 2012, respectively. There were no valuation allowances as of September 30, 2013 or December 31, 2012. Once we identify a real estate property to be sold and commence a plan for marketing the property, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Equity real estate is distributed across geographic regions of the country with 76% of the concentration in the South Atlantic, Pacific, and West South Central regions of the United States as of September 30, 2013. By property type, there is a concentration in office and retail that represented approximately 64% of the equity real estate portfolio as of September 30, 2013.

***Other Investments***

Our other investments totaled \$1,525.6 million as of September 30, 2013, compared to \$1,847.4 million as of December 31, 2012. Derivative assets accounted for \$668.2 million and \$996.0 million in other investments as of September 30, 2013 and December 31, 2012, respectively. The remaining invested assets include equity method investments, which include real estate properties owned jointly with venture partners and operated by the partners.

**International Investment Operations**

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

Of our invested assets, \$6,221.1 million were held by our Principal International segment as of September 30, 2013. The assets are managed by either our Principal Global Investors segment or 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 as of September 30, 2013 and December 31, 2012, was fixed maturities. The following table excludes invested assets of the separate accounts.

Table of Contents

	September 30, 2013		December 31, 2012	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
<b>Fixed maturities:</b>				
Public	\$ 3,468.2	56%	\$ 3,698.7	62%
Private	0.6			
Equity securities	525.9	8	126.1	2
<b>Mortgage loans:</b>				
Commercial	40.8	1	15.6	
Residential	685.4	11	678.7	11
Real estate held for sale	3.7		7.0	
Real estate held for investment	2.5		0.8	
Policy loans	25.6		26.7	1
<b>Other investments:</b>				
Investment in equity method subsidiaries	655.1	11	718.0	12
Direct financing leases	737.2	12	655.1	11
Derivative assets and other short-term investments	76.1	1	70.6	1
<b>Total invested assets</b>	<b>6,221.1</b>	<b>100%</b>	<b>5,997.3</b>	<b>100%</b>
Cash and cash equivalents	94.2		105.4	
<b>Total invested assets and cash</b>	<b>\$ 6,315.3</b>		<b>\$ 6,102.7</b>	

Per Chilean regulation, in order to offer its pension products, Cuprum is required to hold a 1% investment ( encaje ) in each of the five funds it manages for its clients. Cuprum's investment in the encaje is dictated by client activity and all investment performance from encaje is retained by Cuprum. We acquired \$340.5 million of encaje assets in conjunction with our February 4, 2013, acquisition of Cuprum. The encaje assets are classified as equity securities, trading within our consolidated statements of financial position, with all mark-to-market changes reflected in net investment income.

***Fixed Maturities Exposure***

Economic and fiscal conditions in select European countries, including Greece, Ireland, Italy, Portugal and Spain, continue to cause credit concerns particularly to financial institutions and banks with exposure to the European periphery region. Our exposure to the region within our International investment operations fixed maturities portfolio is manageable, representing 5.7% and 6.2% of our total International invested assets as of September 30, 2013 and December 31, 2012, respectively. Portfolio holdings with exposure to this region consist of fixed maturities issued in the same countries as our International operations by local subsidiaries of the European parent. Nearly all of the exposure is to bonds issued in Chile. In addition, we did not hold any sovereign debt issuances of the selected countries and had not bought or sold credit protection on sovereign issuances as of September 30, 2013 and December 31, 2012.

Financial sector exposure is to local subsidiary banks, subject to local capital requirements and banking regulation. The current financial exposure carries an average AA local rating from S&P and the average time to maturity is 17 years. Non-financial sector exposure consists primarily of infrastructure bonds, which are backed by the project itself, often with minimum revenue guarantees from the government. The current non-financial exposure carries an average AA local rating from S&P. The current Italian exposure has an average time to maturity of 14 years. In addition, the current Spanish exposure has an average time to maturity of 13 years. As of September 30, 2013, our total portfolio exposure had an average price of 108 (carrying value/amortized cost).

The following table presents the carrying amount of our European periphery zone fixed maturities exposure for the periods indicated.



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

Select European Exposure	September 30, 2013			December 31, 2012		
	Italy	Spain	Total	Italy	Spain	Total
(in millions)						
Non-Sovereign:						
Financial institutions	\$	\$	224.0	\$	\$	237.3
Non-financial institutions	14.7	118.8	133.5	11.1	125.4	136.5
Total	\$	\$	342.8	\$	\$	362.7
						373.8

Table of Contents

For further details on our U.S. investment operations exposure to these European countries, see U.S. Investment Operations Fixed Maturities.

**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 exposure is to changes in interest rates, although we also have exposures to changes in equity prices and foreign currency exchange rates.

We enter into market-sensitive instruments primarily for purposes other than trading. The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges by using the following approaches:

- rebalance our existing asset or liability portfolios;
- control the risk structure of newly acquired assets and liabilities or
- use derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

**Interest Rate Risk**

Interest rate risk is the risk 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 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.

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

- 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 unlocking of our DAC asset and other actuarial balances.
- During a period of rising interest rates, policy surrenders, withdrawals, and requests for policy loans may increase as customers seek to achieve higher returns. 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.
- 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 total company level from a hypothetical 100 basis point immediate, parallel increase in interest rates as of September 30, 2013, and December 31, 2012. 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.

Table of Contents

	As of September 30, 2013			
	Notional	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		\$ 48,914.9	\$ 46,663.6	\$ (2,251.3)
Fixed maturities, trading		572.9	548.1	(24.8)
Mortgage loans		12,190.9	11,690.7	(500.2)
Policy loans		988.6	912.0	(76.6)
Equity securities, trading		403.9	387.7	(16.2)
Other investments		116.9	116.6	(0.3)
Financial liabilities with interest rate risk:				
Investment-type insurance contracts		(30,677.2)	(29,817.9)	859.3
Long-term debt		(2,721.9)	(2,476.9)	245.0
Bank deposits		(1,901.7)	(1,891.9)	9.8
Derivatives with interest rate risk				
Interest rate swaps	\$ 19,601.8	(349.0)	(428.9)	(79.9)
Currency swaps	2,559.3	92.7	91.9	(0.8)
Equity options	1,624.7	(82.2)	(113.7)	(31.5)
Interest rate options	1,500.0	29.3	25.6	(3.7)
Swaptions	325.0	1.1	3.6	2.5
Interest rate futures	211.0	2.7	13.5	10.8
Net estimated potential loss in fair value				\$ (1,857.9)

Table of Contents

	As of December 31, 2012			Hypothetical changes in fair value
	Notional	Asset (liability) fair value	Hypothetical fair value after +100 basis point parallel yield curve shift (in millions)	
<b>Financial assets with interest rate risk:</b>				
Fixed maturities, available-for-sale		\$ 50,939.3	\$ 48,651.7	\$ (2,287.6)
Fixed maturities, trading		626.7	600.6	(26.1)
Mortgage loans		12,163.7	11,686.6	(477.1)
Policy loans		1,056.8	985.9	(70.9)
Equity securities, trading		81.1	76.0	(5.1)
Other investments		119.8	117.7	(2.1)
<b>Financial liabilities with interest rate risk:</b>				
Investment-type insurance contracts		(32,702.1)	(31,754.6)	947.5
Long-term debt		(2,951.4)	(2,671.6)	279.8
Bank deposits		(2,177.7)	(2,166.3)	11.4
<b>Derivatives with interest rate risk</b>				
Interest rate swaps	\$ 18,381.2	(296.1)	(377.2)	(81.1)
Currency swaps	3,454.1	102.2	101.3	(0.9)
Equity options	1,559.7	34.5	(1.7)	(36.2)
Interest rate options	500.0	48.5	19.2	(29.3)
Swaptions	325.0	0.7	2.6	1.9
Interest rate futures	82.0		2.6	2.6
Net estimated potential loss in fair value				\$ (1,773.2)

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 \$29,036.3 million of liabilities relating to insurance contracts involving significant mortality or morbidity risk as of September 30, 2013 and \$28,815.5 million as of December 31, 2012, 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.

The fair value sensitivity table above replaces our 2012 Form 10-K sensitivity table, which showed the duration gap between our liabilities and the assets backing them, as well as the net fair value change for a 100 basis point immediate, parallel increase in interest rates. We believe the new disclosure provides more useful information, as it presents our assets and liabilities at a more granular level. The new disclosure also provides better perspective on the sensitivity of AOCI to interest rate changes. Therefore, we believe the new disclosure provides a clearer and more comprehensive indication of the potential impact on our consolidated statements of financial position from a 100 basis point change in interest rates.

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

Our net estimated potential loss in fair value as of September 30, 2013, increased \$84.7 million from December 31, 2012, primarily due to a slight increase in the duration of our financial assets and a slight decrease in the duration of our financial liabilities.

The following table provides detail on the differences between the interest rates being credited to contractholders as of September 30, 2013, 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.

Table of Contents

	Account values (1)					
	At GMIR	Up to 0.50% above GMIR	Excess of crediting rates over GMIR: 0.51% to 1.00% above GMIR (\$ in millions)	1.01% to 2.00% above GMIR	2.01% or more above GMIR	Total
<b>Guaranteed minimum interest rate Retirement and Investor Services</b>						
Up to 1.00%	\$ 444.4	\$ 583.6	\$ 3,454.6	\$ 759.2	\$ 46.4	\$ 5,288.2
1.01% - 2.00%	241.3	200.4	324.7	60.9		827.3
2.01% - 3.00%	8,647.5	74.7	336.8	441.1	1.6	9,501.7
3.01% - 4.00%	251.3					251.3
Subtotal	9,584.5	858.7	4,116.1	1,261.2	48.0	15,868.5
<b>U.S. Insurance Solutions</b>						
Up to 1.00%			24.0	11.8		35.8
1.01% - 2.00%	247.3		100.0	35.7	2.6	385.6
2.01% - 3.00%	1,803.1	976.2	165.7	68.4	0.1	3,013.5
3.01% - 4.00%	1,416.9	21.8	17.0	44.8	6.4	1,506.9
4.01% - 5.00%	144.1	103.6	79.8	21.9		349.4
Subtotal	3,611.4	1,101.6	386.5	182.6	9.1	5,291.2
Total	\$ 13,195.9	\$ 1,960.3	\$ 4,502.6	\$ 1,443.8	\$ 57.1	\$ 21,159.7
Percentage of total	62.3%	9.3%	21.3%	6.8%	0.3%	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, 2013 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 \$3 million and \$6 million pre-tax during the 12 months ending September 30, 2014 and 2015, respectively, compared to a scenario where market interest rates remain unchanged from their September 30, 2013 levels. This hypothetical scenario reflects only the impact related to the approximately \$21 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 liabilities with features such as puts or other options that can be



Table of Contents

exercised against the company at inopportune times. For example, as of September 30, 2013, approximately \$9.9 billion, or 99%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. 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.

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, 2012.

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, 2012, for additional discussion of the impact interest rate increases would have on fixed maturities, available-for-sale.

**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 maturities and our international operations, including potential acquisition and divestiture activity.

We estimate that as of September 30, 2013, 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, 2012. 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.

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

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 \$312.3 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of September 30, 2013, as compared to an estimated \$184.2 million, or 10%, reduction as of December 31, 2012. The Cuprum acquisition increased total equity excluding noncontrolling interests exposed to foreign currency risk and the corresponding dollar impact of the foreign currency exchange rates compared to December 31, 2012. 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 \$5.9 million, or 12%, reduction in the operating earnings of our international operations for the three months ended September 30, 2013, as compared to an estimated \$4.2 million, or 11%, reduction for the three months ended September 30, 2012. 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 \$17.3 million, or 11%, reduction in the operating earnings of our international operations for the nine months ended September 30, 2013, as compared to an estimated \$12.9 million, or 11%, reduction for the nine months ended September 30, 2012.

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 payments to our

Table of Contents

functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities was \$1,425.0 million and \$2,209.6 million as of September 30, 2013 and December 31, 2012, respectively. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturities was \$1,030.2 million and \$1,164.0 million as of September 30, 2013 and December 31, 2012, 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 operations in Chile had currency swaps with a notional amount of \$104.1 million and \$80.5 million as of September 30, 2013 and December 31, 2012, respectively. Chile also utilized currency forwards with a notional amount of \$264.0 million and \$257.2 million as of September 30, 2013 and December 31, 2012, respectively.

We used currency options with a notional amount of \$1,400.0 million and currency forwards with a notional amount of \$300.0 million as of December 31, 2012, to manage the foreign currency risk associated with a business combination. There were no hedges of business combinations outstanding at September 30, 2013. Additionally, from time to time we take measures to hedge our net equity investments in our foreign subsidiaries from currency risks. There were no outstanding net equity investment hedges in 2013 or 2012.

**Equity Risk**

Equity risk is the risk we will incur economic losses due to adverse fluctuations in common stock prices. As of September 30, 2013 and December 31, 2012, the fair value of our equity securities was \$780.2 million and \$389.3 million, respectively. The increase is primarily due to equity securities that we acquired as part of the Cuprum acquisition that was completed in first quarter 2013. As of September 30, 2013, 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 \$78.0 million, as compared to a decline in fair value of the equity securities of \$38.9 million as of December 31, 2012.

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 Policy Acquisition Costs and Other Actuarial Balances in our Annual Report on Form 10-K for the year ended December 31, 2012.

The selection of a 10% unfavorable change in the equity markets should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. Our exposure will change as a result of changes in our mix of business.

We also have equity risk associated with (1) fixed deferred annuity contracts that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a GMWB rider that allows the customer to 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 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, 2012.

**Use of Derivatives to Manage Equity Risk.** We economically hedge the fixed deferred annuity product, where the interest credited is linked to an external equity index, by purchasing options that match the product's profile. We economically hedge the GMWB exposure, which includes interest rate risk and equity risk, using futures, options and interest rate swaps with notional amounts of \$489.7 million, \$1,624.7 million, and \$3,140.5 million, respectively, as of September 30, 2013, and notional amounts of \$455.6 million, \$1,539.7 million, and \$2,904.8 million, respectively, as of December 31, 2012. 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.

### **Credit Risk**

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. Our ability to manage credit risk is essential to our business and our profitability. See Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations Investments for additional information about credit risk.

Table of Contents

**Use of Derivatives to Diversify or Hedge Credit Risk.** We purchase credit default swaps to hedge credit exposures in our investment portfolio and total return swaps to hedge our investment portfolio from credit losses. 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 5, Derivative Financial Instruments under the caption, Credit Derivatives Sold.

We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of \$359.3 million and \$359.8 million and total return swaps of \$100.0 million and \$100.0 million as of September 30, 2013 and December 31, 2012, respectively. We had credit exposure through credit default swaps with a notional amount of \$110.4 million and \$110.4 million as of September 30, 2013 and December 31, 2012, respectively, by investing in various tranches of a synthetic collateralized debt obligation. In addition, we sold credit default swaps creating replicated assets with a notional amount of \$608.5 million and \$908.1 million as of September 30, 2013 and December 31, 2012, respectively.

**Derivative Counterparty Risk**

In conjunction with our use of derivatives, we are exposed to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- obtaining approval of all new counterparties by the Investment Committee;
- establishing exposure limits that take into account non-derivative exposure we have with the counterparty as well as derivative exposure;
- performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;
- diversifying our risk across numerous approved counterparties;
- 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 believe the risk of incurring losses due to nonperformance by our counterparties is manageable. For further information on derivatives, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 5, Derivative Financial Instruments.

Based on our accounting policy, our disclosed exposure measures the fair value of derivatives that have become favorable to us and, therefore, is a combined credit exposure if all of the involved counterparties failed to fulfill their obligations. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 5, Derivative Financial Instruments under the caption, Exposure.

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Investments under the caption, Balance Sheet Offsetting. We have not incurred any material losses on derivative financial instruments due to counterparty nonperformance. As a result of our management of counterparty risk and the collateralization of our derivative portfolio, any credit exposure to derivative counterparties is immaterial as of September 30, 2013.

#### **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.

Table of Contents

**Disclosure Controls and Procedures**

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chief Executive Officer and our Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer, Larry D. Zimpleman, and our Chief Financial Officer, Terrance J. Lillis, have reviewed and evaluated our disclosure controls and procedures as of September 30, 2013, 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 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, 2012. 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. Except as described below, 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, 2012. The following risk factor has been updated and restated in its entirety.

**We may be unable to mitigate the impact of Regulation XXX and Actuarial Guideline 38, potentially resulting in a negative impact to our capital position and/or a reduction in sales in term and universal life insurance products.**

The NAIC Model Regulation entitled Valuation of Life Insurance Policies, commonly known as Regulation XXX, establishes statutory reserve requirements for term life insurance policies and universal life insurance policies with secondary guarantees. Actuarial Guideline 38 ( AG38 )

clarifies the application of Regulation XXX with respect to certain universal life insurance products with secondary guarantees.

The NAIC amended AG38 in 2012 in order to create more clarity around reserving practices for certain policies that are accounted for under this guideline. The effects of the changes to AG38 are two-fold:

- Reserves for certain inforce policies may be subject to additional statutory reserve minimums effective for the December 31, 2012, reporting period and
- Reserves for products designed in a specific manner and sold after January 1, 2013 will be subject to a higher statutory reserve basis.

We have implemented reinsurance transactions utilizing affiliated reinsurers to mitigate the capital impact of Regulation XXX and AG38 on our term and universal life insurance business. The NAIC has formed a Capital and Special Purpose Vehicle Use Subgroup of the Financial Condition Committee to investigate the utilization of certain affiliated reinsurance transactions and could recommend changes to criteria that permit reinsurance credit and the types of assets that can support certain portions of ceded reserves in these transactions. We cannot provide assurances that we will be able to continue to utilize these transactions for reinsuring certain portions of our term and universal life insurance reserves. If we are unable to mitigate the impact of Regulation XXX and AG38 on these products, additional capital may be required to support those products, and we may be required to increase prices and/or reduce sales of our term and universal life insurance products.

The State of New York enforces AG38 through New York Regulation 147 ( Reg. 147 ). The New York Department of Financial Services ( NYDFS ) implemented regulatory requirements to Reg. 147 which supported the NAIC AG38 amendment for December 31, 2012 reserve calculations, but in September 2013, the NYDFS withdrew those regulatory requirements. NYDFS has stated an intent to implement a different and more conservative interpretation of Reg. 147, which in effect would increase what we



Table of Contents

report in New York as reserves.

Principal Life is licensed to sell life insurance products in all 50 states, including New York. As a result, Principal Life is required to annually file a Supplement to the Life and Accident and Health Annual Statement ( Supplement ) that adjusts the statutory financial statements filed with the State of Iowa. The Supplement includes balance sheets, income statements and other key financial metrics to comply with New York's regulations. At this time, however, we do not know the amount by which we may be required to increase reserves in the Supplement or other actions we may take in response to the interpretation New York may make of Reg. 147.

**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, 2013 – January 31, 2013	800,177	\$ 29.55	796,502	\$ 18.6
February 1, 2013 – February 28, 2013	623,549	\$ 30.94	600,853	\$ 150.0
March 1, 2013 – March 31, 2013	1,472,980	\$ 32.53	996,654	\$ 117.0
April 1, 2013 – April 30, 2013	2,964	\$ 33.87		\$ 117.0
May 1, 2013 – May 31, 2013	9,806	\$ 36.66		\$ 117.0
June 1, 2013 – June 30, 2013	203	\$ 37.85		\$ 117.0
July 1, 2013 – July 31, 2013	306,000	\$ 38.64	306,000	\$ 105.2
August 1, 2013 – August 31, 2013	348,477	\$ 41.90	347,166	\$ 90.6
September 1, 2013 – September 30, 2013	839,014	\$ 42.45	838,946	\$ 55.0
Total	4,403,170		3,886,121	

(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) Our Board of Directors authorized a repurchase program in May 2012 of up to \$200.0 million of our outstanding common stock. The program was completed in February 2013. In February 2013, our Board of Directors authorized a repurchase program of up to \$150.0 million of our outstanding common stock.

Table of Contents

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description</b>
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Larry D. Zimpleman
31.2	Certification of Terrance J. Lillis
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis
101	The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 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 30, 2013

By

/s/ Terrance J. Lillis  
Terrance J. Lillis  
Senior Vice President and Chief Financial Officer

Duly Authorized Officer, Principal Financial Officer,  
and Chief Accounting Officer

Table of Contents

**Exhibit Index**

<b>Exhibit Number</b>	<b>Description</b>
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Larry D. Zimpleman
31.2	Certification of Terrance J. Lillis
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Larry D. Zimpleman
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Terrance J. Lillis
101	The following materials from Principal Financial Group, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013 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.