

PRINCIPAL FINANCIAL GROUP INC  
Form 10-K  
February 09, 2018

Use these links to rapidly review the document

[TABLE OF CONTENTS](#)

[Item 8. Financial Statements and Supplementary Data](#)

[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K**

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 1-16725

**PRINCIPAL FINANCIAL GROUP, INC.**

(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**711 High Street,  
Des Moines, Iowa 50392**  
(Address of principal executive offices)  
**(515) 247-5111**

**42-1520346**  
(I.R.S. Employer  
Identification Number)

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value \$0.01	Nasdaq Global Select Market

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes  No

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 Website, 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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment of this Form 10-K.

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 the definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer       Accelerated filer       Non-accelerated filer       Smaller reporting company       Emerging growth company   
(Do not check if a smaller reporting company)

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of February 2, 2018, there were outstanding 289,656,803 shares of Common Stock, \$0.01 par value per share of the Registrant.

The aggregate market value of the shares of the Registrant's common equity held by non-affiliates of the Registrant was approximately \$18.5 billion based on the closing price of \$64.07 per share of Common Stock on June 30, 2017.

### Documents Incorporated by Reference

The information required to be furnished pursuant to Part III of this Form 10-K is set forth in, and is hereby incorporated by reference herein from, the Registrant's definitive proxy statement for the annual meeting of stockholders to be held on May 22, 2018, to be filed by the Registrant with the United States Securities and Exchange Commission pursuant to Regulation 14A not later than 120 days after the year ended December 31, 2017.

---

Table of Contents

**PRINCIPAL FINANCIAL GROUP, INC.  
TABLE OF CONTENTS**

<u>PART I</u>		<u>4</u>
<u>Item 1.</u>	<u>Business</u>	<u>4</u>
<u>Item 1A.</u>	<u>Risk Factors</u>	<u>17</u>
<u>Item 1B.</u>	<u>Unresolved Staff Comments</u>	<u>31</u>
<u>Item 2.</u>	<u>Properties</u>	<u>31</u>
<u>Item 3.</u>	<u>Legal Proceedings</u>	<u>31</u>
<u>Executive Officers of the Registrant</u>		<u>31</u>
<u>PART II</u>		<u>32</u>
<u>Item 5.</u>	<u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	<u>32</u>
<u>Item 6.</u>	<u>Selected Financial Data</u>	<u>33</u>
<u>Item 7.</u>	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>34</u>
<u>Item 7A.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	<u>74</u>
<u>Item 8.</u>	<u>Financial Statements and Supplementary Data</u>	<u>81</u>
	<u>Report of Independent Registered Public Accounting Firm on Internal Control Over Financial Reporting</u>	<u>82</u>
	<u>Report of Independent Registered Public Accounting Firm</u>	<u>83</u>
	<u>Consolidated Statements of Financial Position</u>	<u>84</u>
	<u>Consolidated Statements of Operations</u>	<u>85</u>
	<u>Consolidated Statements of Comprehensive Income</u>	<u>86</u>
	<u>Consolidated Statements of Stockholders' Equity</u>	<u>87</u>
	<u>Consolidated Statements of Cash Flows</u>	<u>88</u>
	<u>Notes to Consolidated Financial Statements</u>	<u>89</u>
<u>Item 9.</u>	<u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	<u>211</u>
<u>Item 9A.</u>	<u>Controls and Procedures</u>	<u>211</u>
<u>Item 9B.</u>	<u>Other Information</u>	<u>211</u>
<u>PART III</u>		<u>211</u>
<u>Item 10.</u>	<u>Directors, Executive Officers and Corporate Governance</u>	<u>211</u>
<u>Item 11.</u>	<u>Executive Compensation</u>	<u>212</u>
<u>Item 12.</u>	<u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	<u>212</u>
<u>Item 13.</u>	<u>Certain Relationships and Related Transactions, and Director Independence</u>	<u>212</u>
<u>Item 14.</u>	<u>Principal Accounting Fees and Services</u>	<u>212</u>
<u>PART IV</u>		<u>213</u>
<u>Item 15.</u>	<u>Exhibits and Financial Statement Schedules</u>	<u>213</u>
<u>Signatures</u>		<u>216</u>
<u>Schedule I</u>	<u>Summary of Investments Other Than Investments in Related Parties</u>	<u>217</u>
<u>Schedule II</u>	<u>Condensed Financial Information of Registrant (Parent Only)</u>	<u>218</u>
<u>Schedule III</u>	<u>Supplementary Insurance Information</u>	<u>222</u>
<u>Schedule IV</u>	<u>Reinsurance</u>	<u>224</u>

Table of Contents

**NOTE CONCERNING FORWARD-LOOKING STATEMENTS**

This Annual Report on Form 10-K, including the Management's Discussion and Analysis of Financial Condition and Results of Operations, contains statements that constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995, including statements relating to trends in operations and financial results and the business and the products of the Registrant and its subsidiaries, as well as other statements including words such as "anticipate," "believe," "plan," "estimate," "expect," "intend" and other 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. Those risks and uncertainties include, but are not limited to, the risk factors listed in Item 1A. "Risk Factors."

Table of Contents

**PART I**

**Item 1. Business**

Principal Financial Group, Inc. ("PFG") is a leader in global investment management offering businesses, individuals and institutional clients a wide range of financial products and services, including retirement, asset management and insurance through our diverse family of financial services companies. We had \$668.6 billion in assets under management ("AUM") and approximately 22.8 million customers worldwide as of December 31, 2017.

Our global asset management businesses serve a broad range of investors in 87 countries through offices in 19 countries, including in the major financial centers worldwide. We provide long-term investment strategies to institutional, retirement, high net worth and retail clients by offering a range of capabilities including equity, fixed income, real estate and other alternative investments, as well as fund offerings.

In the U.S., we primarily focus on small and medium-sized businesses, which we define as companies with fewer than 1,000 employees, by offering a broad array of retirement and employee benefit solutions and individual insurance solutions to meet the needs of the business owner and their employees. We are a leading provider of corporate defined contribution plans. We are also a leading employee stock ownership plan consultant. In addition, we are a leading provider of nonqualified plans, defined benefit plans and plan termination annuities. We are also one of the largest providers of specialty benefits insurance product solutions. We believe small and medium-sized businesses are an underserved market, offering attractive growth opportunities in the retirement and employee benefit markets.

Additionally, we believe we have a significant opportunity to leverage our U.S. retirement expertise in select international markets that have adopted or are moving toward private sector defined contribution pension systems. Our international asset management and accumulation businesses focus on the opportunities created as aging populations around the world drive increased demand for retirement accumulation, retirement asset management and retirement income management solutions.

**Our Reportable Segments**

We organize our businesses into the following reportable segments:

Retirement and Income Solutions;

Principal Global Investors;

Principal International and

U.S. Insurance Solutions.

We also have a Corporate segment, which consists of the assets and activities that have not been allocated to any other segment.

See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 16, Segment Information" for financial results of our segments.

**Retirement and Income Solutions Segment**

Our asset accumulation activities in the U.S. date back to the 1940s when we first began providing pension plan products and services. We now offer a comprehensive portfolio of products and services for retirement savings and retirement income:

To businesses of all sizes with a concentration on small and medium-sized businesses, we offer products and services for defined contribution plans, including 401(k) and 403(b) plans, defined benefit pension plans, nonqualified executive benefit plans, employee stock ownership plan ("ESOP") services and full service payout services (including pension risk transfer). For more basic retirement services, we offer SIMPLE Individual Retirement Accounts ("IRA") and payroll deduction plans;

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

To large institutional clients, we also offer investment only products, including investment only guaranteed investment contracts ("GICs"); and

To employees of businesses and other individuals, we offer the ability to accumulate savings for retirement and other purposes through mutual funds, individual annuities and bank products.

We organize our Retirement and Income Solutions operations into two business groupings:

Retirement and Income Solutions Fee: includes full service accumulation, trust services and individual variable annuities; and

Retirement and Income Solutions Spread: includes individual fixed annuities, investment only, full service payout and banking services.

Table of Contents

**Retirement and Income Solutions Fee**

***Full Service Accumulation***

We offer a wide variety of investment and administrative products and services for defined contribution plans, including 401(k) and 403(b) plans; defined benefit pension plans; nonqualified executive benefit plans and ESOPs. A 403(b) plan is a plan described in Section 403(b) of the Internal Revenue Code that provides retirement benefits for employees of tax-exempt organizations and public schools.

*Products*

Full service accumulation products respond to the needs of plan sponsors seeking both administrative and investment services for defined contribution plans or defined benefit plans. The investment component of both the defined contribution and defined benefit plans may be in the form of a guaranteed account, separate account, a mutual fund offering or a collective investment trust. In addition, defined contribution plan sponsors may also offer their own employer securities as an investment option under the plan.

We deliver both administrative and investment services to our defined contribution plan and defined benefit plan customers through annuity contracts, collective investment trusts and mutual funds. Group annuity contracts and collective investment trusts used to fund qualified plans are not required to be registered with the United States Securities and Exchange Commission ("SEC"). Our mutual fund service platform is called Principal Advantage. It is a qualified plan service package based on our series mutual fund, Principal Funds, Inc. ("PFI"). We offer investments covering the full range of stable value, equity, fixed income, real estate and international investment options managed by our Principal Global Investors segment as well as third party asset managers. In addition, full service accumulation offers plan sponsors trust services through an affiliated trust company.

As of December 31, 2017, we provided full service accumulation products to (a) over 37,300 defined contribution plans including \$159.1 billion in assets and covering 4.7 million eligible plan participants, and (b) to over 2,100 defined benefit plans, including \$20.0 billion in assets and covering over 306,800 eligible plan participants. As of December 31, 2017, approximately 54% of our full service accumulation account values were managed by our Principal Global Investors segment. Third party asset managers provide asset management services with respect to the remaining assets. As it relates to our full service accumulation account values, 30% were managed entirely by the third party asset managers that were not under contract to sub-advise a PFG product, 9% were sub-advised and 7% represented employer securities.

*Markets and Distribution*

We offer our full service accumulation products and services to plans, including qualified and nonqualified defined contribution plans and defined benefit plans. Our primary target market is plans sponsored by small and medium-sized businesses, which we believe remains under-penetrated. According to Retirement Resources, Inc., in 2015, only 24% of businesses with between 10 and 49 employees, 51% of businesses with between 50 and 99 employees, 61% of businesses with between 100 and 249 employees and 73% of businesses with between 250 and 499 employees offered a 401(k) plan. The same study indicates that 81% of employers with between 500 and 999 employees, 95% of employers with between 1,000 and 4,999 employees and 95% of employers with 5,000 or more employees offered a 401(k) plan in 2015. According to Retirement Resources, Inc., no significant changes in market penetration occurred during 2016. As such, it has not, as yet, updated its statistics on the percentage of businesses offering a 401(k) plan.

We distribute our full service accumulation products and services nationally, primarily through a captive retirement services sales force. As of December 31, 2017, 109 retirement services sales representatives in 41 offices, operating as a wholesale distribution network, maintained relationships with over 14,600 independent advisors, consultants and agents. Retirement services sales representatives are an integral part of the sales process alongside the referring consultant or independent advisor. We compensate retirement services sales representatives through a blend of salary and production-based incentives, while we pay independent advisors, consultants and agents a commission or fee.

As of December 31, 2017, we had a separate staff of over 260 service and education specialists located in the sales offices. These specialists play a key role in the ongoing servicing of plans by providing local services to our customers, such as reviewing plan performance, investment options and plan design; communicating the customers' needs and feedback to us and helping employees understand the benefits of their plans. The following summarizes our distribution channels:

We distribute our annuity-based products through intermediaries who are primarily state licensed individuals.

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

Principal Advantage platform is targeted at defined contribution plans through broker-dealer distribution channels. Principal Advantage gives us access to Financial Industry Regulatory Authority-registered distributors who are not traditional sellers of annuity-based products and broadens opportunities for us in the investment advisor and broker-dealer distribution channels.

Through our Retire Secure strategy we provide financial education and other assistance to individual investors who are participants/members of employer-based accumulation solutions to help them achieve financial security.



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

## Table of Contents

We believe our approach to full service accumulation plan services distribution, which gives us a local sales and service presence, differentiates us from many of our competitors. We have also established a number of marketing and distribution relationships to increase the sales of our products and services.

### ***Individual Variable Annuities***

We offer variable annuities to individuals and plans. Individual variable annuities are savings vehicles through which the customer makes one or more deposits of varying amounts and intervals.

### *Products*

Our individual variable deferred annuities provide customers with the flexibility to allocate their deposits to mutual funds managed by the Principal Global Investors segment or unaffiliated third party asset managers. As of December 31, 2017, 93% of our \$10.1 billion in variable annuity account balances was allocated to mutual funds managed by the Principal Global Investors segment and our guaranteed option. The remaining 7% was allocated to mutual funds managed by unaffiliated third party asset managers. Generally speaking, the customers bear the investment risk for the variable options and have the right to allocate their assets among various separate mutual funds. The value of the annuity fluctuates in accordance with the experience of the mutual funds chosen by the customer. Customers have the option to allocate all or a portion of their account to our guaranteed option, in which case we credit interest at rates we determine, subject to contractual minimums.

Customers may elect a living benefit guarantee (commonly known in the industry as a guaranteed minimum withdrawal benefit, or "GMWB"). We bear the GMWB investment risk. Our goal is to hedge the GMWB investment risk through the use of sophisticated risk management techniques. As of December 31, 2017, \$6.9 billion of the \$9.7 billion of variable annuity separate account values had the GMWB rider. Our major source of revenue from variable annuities is mortality and expense fees we charge to the customer, generally determined as a percentage of the market value of the assets held in a separate investment sub-account. Account balances of variable annuity contracts with the GMWB rider were invested in separate account investment options as follows:

	December 31, 2017		December 31, 2016
	<i>(in millions)</i>		
Balanced funds	\$ 6,512.2	\$	5,898.2
Equity funds	243.8		258.6
Bond funds	128.6		138.5
Money market funds	2.6		3.8
Specialty funds	1.2		1.2
Total	\$ 6,888.4	\$	6,300.3
Percent of total variable annuity separate account values	71%		70%

### *Markets and Distribution*

Our target markets for individual variable annuities include owners, executives and employees of small and medium-sized businesses and individuals seeking to accumulate and/or eventually receive distributions of assets for retirement. We market variable annuities to individuals for both qualified and nonqualified retirement savings.

We sell our individual variable annuity products through our affiliated financial representatives, including Principal Connection, who collectively accounted for 97%, 96% and 95% of annuity sales for the years ended December 31, 2017, 2016 and 2015, respectively. The remaining sales were made primarily through unaffiliated broker-dealer firms. Principal Connection is our direct response distribution channel for retail financial services products to individuals. Principal Connection's services are available over the phone, on the internet or by mail. Affiliated financial representatives continue to be the primary distribution channel of our variable deferred annuities.

### **Retirement and Income Solutions Spread**

***Individual Fixed Annuities***

Individual fixed annuities may be categorized in two ways: (1) deferred, in which case assets accumulate until the contract is surrendered, the customer dies or the customer begins receiving benefits under an annuity payout option, or (2) payout, in which case payments are made for a fixed period of time or for life.

***Products***

***Fixed Deferred Annuities.*** Our individual fixed deferred annuities consist of both single premium deferred annuity contracts and flexible premium deferred annuity contracts ("FPDAs"). Some FPDA contracts limit the period of time deposits are allowed (e.g., only one year). For certain contracts, the principal amount is guaranteed. We credit the customer's account with a fixed interest rate for a specified number of years. Thereafter, we reset the interest rate credited to the contract based upon our discretion, subject to contractual minimums, by taking into account market and

Table of Contents

other conditions. We also offer a fixed deferred annuity where the interest credited is linked to an external equity index, subject to maximum and minimum values. One source of income from fixed deferred annuities is the difference between the investment income earned on the underlying general account assets and the interest rate credited to the contracts. We bear the investment risk because, while we credit customers' accounts with a stated interest rate, we cannot be certain the investment income we earn on our general account assets will exceed that rate. The Principal Global Investors segment manages the assets supporting these contracts.

**Fixed Income Annuities.** Our individual fixed income annuities consist of single premium immediate annuity contracts ("SPIAs") and deferred income annuity contracts ("DIAs"). SPIAs and DIAs are products where the customer pays a premium in return for periodic benefit payments. SPIA payments begin immediately and DIA payments begin after a deferral period, during which a return-of-premium death benefit is included. Payments may be contingent upon the survival of one or two individuals or payments may be fixed, meaning payments are contractually guaranteed and do not depend on the continuing survival of any individual. Our major source of income from fixed immediate annuities is the difference between the investment income earned on the underlying general account assets and the interest rate implied in the calculation of annuity benefit payments. We bear the investment risk because we cannot be certain the investment income we earn on our general account assets will exceed the rate implied in the SPIA and DIA contracts. The Principal Global Investors segment manages the assets supporting these contracts.

*Markets and Distribution*

Our target markets for individual fixed annuities include owners, executives and employees of small and medium-sized businesses and individuals seeking to accumulate and/or eventually receive distributions of assets for retirement. We market fixed annuities to individuals for both qualified and nonqualified retirement savings.

We sell our individual fixed annuity products through our affiliated financial representatives, including Principal Connection, who collectively accounted for 7%, 7% and 6% of annuity sales for the years ended December 31, 2017, 2016 and 2015, respectively. The remaining sales were made through banks, brokerage general agencies, mutual fund companies and unaffiliated broker-dealer firms. The majority of overall annuity sales were from non-affiliated distribution channels, as a result of focused efforts to increase fixed annuity sales through these channels.

**Investment Only**

*Products*

The two primary products for which we provide investment only services are: GICs and funding agreements.

GICs and funding agreements pay a specified rate of return. The rate of return can be a floating rate based on an external market index or a fixed rate. Our investment only products contain provisions disallowing or limiting early surrenders, including penalties for early surrenders and minimum notice requirements.

Deposits to investment only products are predominantly in the form of single payments. As a result, the level of new deposits can fluctuate from one fiscal quarter to another. The amounts earned by us are derived in part from the difference between the investment income earned by us and the amount credited to the customer. The Principal Global Investors segment manages the assets supporting the contractual promises.

*Markets and Distribution*

We issue GICs and funding agreements primarily to plan sponsors and other institutions. We also offer GICs as part of our full service accumulation products. We issue our GICs primarily to tax-qualified retirement plans. We sell our funding agreements directly to institutions that may or may not be pension funds and unconsolidated special purpose vehicles domiciled either in the U.S. or offshore for funding agreement-backed note programs. The funding agreements issued as part of these funding agreement-backed note programs work by having investors purchase debt obligations from the special purpose vehicle which, in turn, purchases the funding agreement from us with terms similar to those of the debt obligations. The strength of this market is dependent on debt capital market conditions. As a result, our sales through this channel can vary widely from one quarter to another. The special purpose vehicle issues the funding agreement-backed notes to U.S. and foreign institutional investors.

**Full Service Payout**

*Products*

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

Full service payout products respond primarily to the needs of pension plan sponsors in the form of single premium group annuities, which are immediate or deferred annuities that provide a current or future specific income amount, fully guaranteed by us. The majority of our business originates from defined benefit plans that are being terminated. In these situations, the plan sponsor transfers all its obligations under the plan to an insurer by paying a single premium. Generally, plan sponsors restrict their purchases to insurance companies with superior or excellent financial quality ratings because the Department of Labor has mandated that annuities be purchased only from the "safest available" insurers.

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

### Table of Contents

Since premium received from full service payout products is generally in the form of single payments, the level of premiums can fluctuate depending on the number of large-scale annuity sales in a particular quarter. The Principal Global Investors segment manages the assets supporting full service payout account values.

#### *Markets and Distribution*

Our primary distribution channel for full service payout products is comprised of several specialized home office sales consultants working through consultants and brokers that specialize in this type of business. Our sales consultants also make sales directly to institutions. Our nationally dispersed retirement services sales representatives act as a secondary distribution channel for these products.

#### **Banking Services**

IRAs are provided by Principal Bank, primarily funded by retirement savings rolled over from qualified retirement plans. Principal Bank is a U.S. federal savings bank that was formed in February 1998. As of December 31, 2017, Principal Bank had nearly 374,000 customers and approximately \$2.5 billion in assets. Principal Bank operates under a limited purpose charter and may only accept deposits held in a fiduciary capacity, may not hold demand deposits or own commercial loans and cannot originate loans.

#### *Products*

The IRAs offered by Principal Bank provide Federal Deposit Insurance Corporation ("FDIC")-insured retirement solutions for its customers. The IRAs are held in savings accounts, money market accounts and certificates of deposit. The deposit products provide a relatively stable source of funding and liquidity for Principal Bank and are backed by purchases of investment securities and residential mortgage loans.

#### *Markets and Distribution*

Principal Bank offers bank products and services to participants rolling out of qualified retirement plans primarily serviced by affiliates of PFG. Principal Bank services customers by telephone, mail and internet.

#### **Principal Global Investors Segment**

Our Principal Global Investors segment manages assets for sophisticated investors around the world, using a multi-boutique strategy that provides diverse investment capabilities including equity, fixed income, real estate and other alternative investments. We also have experience in asset allocation, stable value management and other structured investment strategies. We focus on providing services to our other segments in addition to our retail mutual fund and third party institutional clients. We maintain offices in Australia, Brazil, China, Germany, Hong Kong, Japan, the Netherlands, Singapore, Switzerland, the United Arab Emirates, the United Kingdom and the United States.

We deliver our products and services through our network of specialized investment groups and boutiques including Principal Global Equities; Principal Global Fixed Income; Aligned Investors; Principal Real Estate Investors, LLC; Principal Enterprise Capital, LLC; Spectrum Asset Management, Inc.; Post Advisory Group, LLC; Columbus Circle Investors; Edge Asset Management; Morley Financial Services, Inc.; Macro Currency Group; Finisterre Capital LLP; Origin Asset Management LLP; and Principal Portfolio Strategies. As of December 31, 2017, Principal Global Investors and its boutiques managed \$430.9 billion in assets.

We have been providing mutual funds to customers since 1969. We offer mutual funds to individuals, businesses and institutional investors for use within variable life contracts, variable annuity contracts and employer-sponsored pension plans; as a rollover investment option and for general investment purposes. We plan to grow into a top advisor-sold mutual fund company with a sales force focused on multiple channels. As of December 31, 2017, as reported by the Strategic Insight, we are ranked 15<sup>th</sup> according to AUM (long-term funds) of the intermediary sold mutual fund companies.

We also maintain various other domestic and global fund platforms, separately managed accounts and segregated accounts for some larger institutional and retail investors.

Our products and services are provided for a fee as defined by client mandates. Our fees are generally driven by AUM.

#### **Boutiques**

Our multi-boutique strategy is diversified across the following primary asset classes and service delivery options.

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

**Equity Investments.** As of December 31, 2017, Principal Global Equities, Aligned Investors and Principal Real Estate Investors, LLC along with Columbus Circle Investors, Edge Asset Management and Origin Asset Management LLP managed \$173.9 billion in global equity assets. Our equity capabilities encompass large-cap stocks, mid-cap stocks, small-cap stocks and real estate investment trusts in developed and emerging markets worldwide.

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

## Table of Contents

**Fixed Income Investments.** As of December 31, 2017, Principal Global Fixed Income and Principal Real Estate Investors, LLC along with Spectrum Asset Management, Inc.; Post Advisory Group, LLC; Edge Asset Management and Morley Financial Services, Inc. managed \$191.8 billion in global fixed income assets. Collectively, our experience in fixed income management spans multiple economic and credit market cycles and encompasses all major fixed income sectors, including commercial mortgage-backed securities ("CMBS"), and security types. Our research and risk management capabilities in worldwide debt markets provide a strong foundation for broadly diversified "multi-sector" portfolios, tailored to specific client objectives.

**Alternative Investments.** We offer products and services through other alternative asset classes including managing private real estate equity, commercial mortgages and bridge/mezzanine loans through Principal Real Estate Investors, LLC; managing real estate operating companies through Principal Enterprise Capital, LLC; managing currency mandates through our Macro Currency Group boutique and managing hedge fund mandates through our Finisterre Capital LLP boutique. As of December 31, 2017, we managed \$61.0 billion in alternative asset classes.

**Principal Portfolio Strategies.** Principal Portfolio Strategies is a specialized asset allocation boutique offering multi-asset and/or multi-manager portfolio construction services that aim to deliver reliable, risk-adjusted investment outcomes to individual investors, institutional investors and participants in employer-sponsored plans.

## **Products and Services**

Products offered by the Principal Global Investors segment include individually managed accounts, separately managed accounts for high net worth individuals and several fund platforms for retail and institutional investors, as described below.

**Principal Funds, Inc.** PFI is a series mutual fund that, as of December 31, 2017, offered 85 investment options for defined contribution plans, individuals, institutional investors, adviser fee-based programs, and other retirement plan clients. We report the results for this fund in the Retirement and Income Solutions segment or Principal Global Investors segment based on the distribution channel associated with the AUM.

**Principal Variable Contracts Funds, Inc.** Principal Variable Contracts Funds, Inc. is a series mutual fund that provides investment options for variable annuity and variable life insurance contracts issued by the Principal Life Insurance Company ("Principal Life") and other insurance companies not affiliated with Principal Life. AUM backing our variable annuity contracts is reported in the Retirement and Income Solutions segment. AUM backing our variable life insurance contracts is reported in the U.S. Insurance Solutions segment.

**Other Principal Global Investors Funds.** Principal Global Investors maintains various fund platforms including Qualifying Investor Alternative Fund and Undertaking for Collective Investment in Transferable Securities funds domiciled in Dublin, Collective Investment Trusts, Business Trusts, Exchange Traded Funds and other boutique sponsored funds. These funds are generally managed by our boutiques.

## **Markets and Distribution**

Our products and services are distributed through various channels to reach and meet the needs of a broad investor base. We distribute our services through institutional and retail sales representatives, relationship management, and client service professionals who work with consultants and directly with investors to acquire and retain institutional clients, retail clients and other investors. We also maintain relationships with independent broker-dealers to distribute our products and services, maintaining relationships with over 61,300 independent brokers, consultants and agents. As of December 31, 2017, Principal Global Investors and its boutiques had 834 third party institutional clients in 42 countries with \$137.0 billion of AUM.

## **Principal International Segment**

Our Principal International segment has operations in Latin America and Asia. We focus on locations with growing middle classes, favorable demographics and increasing long-term savings, ideally with defined contribution retirement markets. We entered these locations through acquisitions, start-up operations and joint ventures.

The activities of our Principal International segment reflect our efforts to accelerate the growth of our AUM by capitalizing on the international trend toward private sector defined contribution pension systems and individual long-term savings. We offer pension accumulation products and services, mutual funds, asset management, income annuities and life insurance accumulation products.

## **Markets, Products and Distribution**

### **Latin America**

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

**Brazil.** We offer pension accumulation and income annuity products through a co-managed joint venture, Brasilprev Seguros e Previdencia S.A. ("Brasilprev"). We owned 25% of the economic interest and 50.01% of the voting shares as of December 31, 2017. The partner is Banco do Brasil ("Banco"), which had approximately 4,900 Brazilian branches as of September 30, 2017.



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

### Table of Contents

Brasilprev has the exclusive distribution rights of its pension accumulation and income annuity products through the Banco network until October 2032. Our joint venture provides products for the retirement needs of individuals and employers. Banco's employees sell these products directly to individual clients through its bank branches. In addition, our joint venture reaches corporate clients through two wholesale distribution channels: (1) a network of independent brokers who sell to the public and (2) Banco's corporate account executives who sell to existing and prospective corporate clients. As of December 31, 2017, Brasilprev had \$72.0 billion of AUM.

We also distribute pension and other protection products through a digital insurance brokerage company, Ciclic Corretora De Seguros S.A ("Ciclic"). We owned 100% of the economic and voting shares of Ciclic as of December 31, 2017. BB Corretora De Seguros e Administradora De Bens S.A. (a subsidiary of Banco) has agreed to acquire 75% of the economic interest and 49.99% of the voting shares, subject to regulatory approvals.

We offer mutual fund and asset management services through Claritas Administração de Recursos Ltda. ("Claritas"), our wholly owned Brazilian mutual fund and asset management company with \$1.7 billion of AUM as of December 31, 2017. The company manages equity funds, balanced funds, managed accounts and other strategies for affluent clients, mass affluent clients and institutions and sells through its multi-channel distribution network.

**Chile.** We offer a complete array of pension accumulation and income annuity products. We also offer mutual fund, asset management services and life insurance accumulation products. Our subsidiaries in Chile had \$48.5 billion of AUM as of December 31, 2017.

We offer mandatory employee-funded pension and voluntary savings plans through Administradora de Fondos de Pensiones Cuprum S.A. ("Cuprum"). We owned 97.97% of Cuprum as of December 31, 2017, and the rest is publicly floated. Cuprum's products are sold through a proprietary sales network of approximately 950 sales employees as of December 31, 2017.

We offer income annuity and life insurance accumulation products through Principal Compañía de Seguros de Vida Chile S.A., our wholly owned life insurance company. The annuity products are distributed through a network of brokers and independent agents. Life insurance accumulation products are also offered to individuals through brokers and financial advisors.

We offer voluntary savings plans and mutual funds through Principal Administradora General de Fondos S.A., our wholly owned mutual fund company. Products are distributed to retail clients through our proprietary sales force, financial advisors, brokerage houses and alliances with financial institutions.

**Mexico.** We offer pension accumulation, mutual funds, income annuities and asset management services through our wholly owned companies with \$9.6 billion of AUM as of December 31, 2017.

We offer mandatory pension plans through Principal Afore, S.A. de C.V., Principal Grupo Financiero. We manage and administer individual retirement accounts under the mandatory privatized social security system for all employees in Mexico. As of December 31, 2017, we had approximately 2.7 million individual retirement accounts. We distribute products and services through a proprietary sales force of approximately 760 sales representatives as of December 31, 2017, as well as independent brokers who sell directly to individuals.

On October 26, 2017, we announced an agreement to acquire full ownership of MetLife Afore, S.A. de C.V. ("MetLife Afore"), MetLife, Inc.'s mandatory pension business in Mexico, subject to regulatory approvals. By integrating MetLife Afore into Principal Afore, Principal will gain additional scale, a larger distribution network and the capacity to better support its customers in Mexico. We expect the transaction to close in the first half of 2018.

We offer mutual funds and asset management services through Principal Fondos de Inversión, S.A. de C.V., Operadora de Fondos de Inversión, Principal Grupo Financiero. We distribute products and services through a sales force of approximately 60 employees as of December 31, 2017, and through distribution agreements with other financial entities. We offer both domestic and international products, typically sold directly to clients.

We also administer previously sold income annuities and life products.

### **Asia**

**China.** We offer mutual funds and asset management services to individuals and institutions through a joint venture, CCB Principal Asset Management Co., Ltd. We owned 25% and China Construction Bank ("CCB") is the majority partner with 65% ownership as of December 31, 2017. CCB Principal Asset Management distributes its mutual funds through CCB, third party distributors such as banks, securities brokers and e-channels such as Alibaba. CCB provides widespread distribution support for the joint venture via its extensive network of approximately

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

15,000 bank branches as of December 31, 2016, and brand awareness. Although not included in our reported AUM, the joint venture had \$124.4 billion of AUM as of December 31, 2017.

**Hong Kong SAR.** We offer both pension saving and mutual fund products to corporate and retail clients through wholly owned companies with \$9.3 billion in AUM as of December 31, 2017.

We offer two types of pension saving schemes, Mandatory Provident Fund ("MPF") and Occupational Retirement Schemes Ordinance ("ORSO"), which we distribute through third party intermediaries such as insurance companies,

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

## Table of Contents

independent financial advisors, brokers and employee benefit consultants. Our most significant partnership is with AXA Hong Kong with whom we have a 15-year distribution partnership through 2030. We serviced approximately 580,000 accounts as of December 31, 2017. To help Hong Kong customers save for retirement beyond the mandatory pension schemes, Principal also offers mutual funds to retail customers through third party intermediaries, the most significant being banks.

**India.** We offer mutual funds and asset management services to both retail and corporate customers through our joint venture Principal Pnb Asset Management Company Private Limited. As of December 31, 2017, our joint ventures in India had \$1.0 billion of AUM. We owned 78.6% as of December 31, 2017, and the partner is Punjab National Bank ("PNB"), a large Indian commercial bank. In January 2018, Principal and PNB announced the signing of a shares purchase agreement to give Principal full ownership of the joint venture, pending regulatory approvals. Mutual funds are sold through independent distributors, including banks, and directly through proprietary sales offices.

**Southeast Asia.** We offer mutual funds, asset management services and pension accumulation products through our joint venture CIMB-Principal Asset Management Berhad ("CPAM"). We owned 40% of CPAM and 50% of CIMB Principal Islamic Asset Management ("CPIAM") as of December 31, 2017. The partner is CIMB Group ("CIMB"), which has a strong presence in many Asian countries. CPAM also manages a significant amount of institutional asset mandates. The joint ventures had \$18.6 billion of AUM as of December 31, 2017.

On January 11, 2018, Principal and CIMB announced that they have signed agreements for Principal to gain additional ownership of CPAM and CPIAM, pending regulatory approval. Once complete, Principal will increase its ownership to 60% with CIMB retaining 40% ownership in the entities. The joint ventures will continue to be co-managed by both companies.

CPAM has wholly owned subsidiaries in Singapore (CIMB-Principal Asset Management (S) Pte. Ltd.), Indonesia (PT CIMB-Principal Asset Management) and Thailand (CIMB-Principal Asset Management Company Limited).

CPAM distributes conventional and Islamic mutual funds through the branches of its partner bank (over 1,000 bank branches throughout Malaysia, Indonesia, Thailand and Singapore) and through an agency sales force of approximately 8,000 agents selling to retail customers as of December 31, 2017. CPAM also distributes its mutual funds through third party institutions including other banks and security houses.

## **U.S. Insurance Solutions Segment**

Our U.S. Insurance Solutions segment offers group and individual insurance solutions. We focus on providing comprehensive insurance solutions for small and medium-sized businesses and their owners and executives. We organize our operations into two divisions: Specialty Benefits Insurance and Individual Life Insurance. However, we share key resources in our core areas such as strategic leadership, distribution and marketing.

### **Specialty Benefits Insurance**

Specialty benefits insurance, which includes group dental, vision, life, critical illness and disability insurance and individual disability insurance, is an important component of the employee benefit offering at small and medium-sized businesses. We offer voluntary products for group dental, vision, life, critical illness and disability. We also offer group dental, vision and disability on a fee-for-service basis. Our individual disability insurance is also sold on an individual or multi-life basis.

### **Products and Services**

**Group Dental and Vision Insurance.** We began selling group dental and vision insurance in the late 1960s. Our plans provide partial reimbursement for dental and vision expenses. As of December 31, 2017, we had almost 55,000 group dental and vision insurance policies in force covering nearly 1.5 million employee lives. According to Life Insurance and Market Research Association ("LIMRA"), we were the 7th largest group dental insurer in terms of number of contracts/employer groups in force in 2016. In addition to indemnity and preferred provider organization dental offered on both an employer paid and voluntary basis, we offer a prepaid dental plan in Arizona through our Employers Dental Services, Inc. subsidiary. We also offer a discount dental product nationally. Our indemnity vision product and our managed care vision product are offered on both an employer paid and voluntary basis.

**Group Life Insurance.** Group life insurance was one of our first group products beginning in the early 1940s. Our group life insurance provides coverage to employees and their dependents for a specified period. As of December 31, 2017, we had over 60,000 group policies providing \$144 billion of group life insurance in force to approximately 2.4 million employee lives. According to LIMRA, in 2016 we were ranked 2nd in the U.S. in terms of the number of group life insurance contracts in force. We currently sell traditional group life insurance that does not provide for accumulation of cash values on both an employer paid and voluntary basis. Our group life insurance business remains focused on the traditional, annually renewable term product. Group term life and group universal life accounted for 99% and 1%, respectively,

of our total group life insurance in force as of December 31, 2017. We no longer market group universal life insurance to new employer groups.

Table of Contents

**Group Disability Insurance.** Group disability insurance has also been sold since the early 1940s. Our group disability insurance provides a benefit to insured employees who become disabled. In most instances, this benefit is in the form of a monthly income. Our group disability products include both short-term and long-term disability, offered on both an employer paid and voluntary basis. As of December 31, 2017, long-term disability represented 61% of total group disability premium, while short-term disability represented 39% of total group disability premium. We also provide disability management services, called rehabilitation services, to assist individuals in returning to work as quickly as possible following disability. We work with disability claimants to improve the approval rate of Social Security benefits, thereby reducing payment of benefits by the amount of Social Security payments received. As of December 31, 2017, we served approximately 1.9 million employee lives through more than 45,000 contracts. According to LIMRA, our group short-term disability business was ranked 4th and our group long-term disability business was ranked 3rd in the U.S. as of December 31, 2016, in terms of number of contracts/employer groups in force. We also offer voluntary critical illness insurance, which provides a lump-sum cash benefit to pay for additional expenses associated with the five most common critical illnesses.

**Individual Disability Insurance.** Individual disability insurance has been sold since the early 1950s. Our individual disability insurance products provide income protection to the insured member and/or business in the event of disability. In most instances, this benefit is in the form of a monthly income. In addition to income replacement, we offer products to pay business-related costs such as overhead expenses for a disabled business owner, buy-out costs for business owners purchasing a disabled owner's interest in the business, expenditures for replacement of a key person and business loan payments. We also offer a product to protect retirement savings in the event of disability. As of December 31, 2017, we served approximately 191,000 individual disability policyholders. According to LIMRA, our individual disability business was ranked 5th in the U.S. in terms of premium in force in the non-cancellable segment of the market and 5th overall, as of December 31, 2016.

**Fee-for-Service.** We offer administration of group dental, disability and vision benefits on a fee-for-service basis.

#### **Individual Life Insurance**

We began as an individual life insurer in 1879 when we began selling traditional life insurance products to individuals. We now specialize in providing solutions for small to medium-sized companies to protect against risk and loss, assist with succession planning and wealth transfer and to build and protect wealth for retirement. We also provide solutions to meet the personal needs of business owners, executives and affluent individuals. Our U.S. operations administered approximately 619,000 individual life insurance policies with over \$340 billion of individual life insurance in force as of December 31, 2017.

#### **Products and Services**

Our Business Owner and Executive Solutions platform as well as our nonqualified deferred compensation offering combines administration and consulting to service our clients' needs. We target the business and personal insurance needs of owners and executives of small and medium-sized businesses with an increasing focus on providing insurance solutions for nonqualified executive benefits. In addition, we market our products to meet traditional retail insurance needs. We offer a variety of individual life insurance products, both interest sensitive (including universal life, variable universal life and indexed universal life insurance) and traditional.

**Interest Sensitive.** Our interest sensitive products include universal life, variable universal life and indexed universal life insurance. These products offer the policyholder the option of adjusting both the premium and the death benefit amounts of the insurance contract. Universal life insurance typically includes a cash value account that accumulates at a credited interest rate based on the investment returns of the block of business. Variable universal life insurance is credited with the investment returns of the various investment options selected. Indexed universal life is credited with investment returns tied to an external index, subject to a contractual minimum and maximum. For the year ended December 31, 2017, interest sensitive products represented 26% of individual life insurance in force and generated 61% of individual life insurance annualized first year premium sales.

After a deduction for policy level expenses, we credit net deposits to an account maintained for the policyholder. For universal life contracts, the entire account balance is invested in the general account. Interest is credited to the policyholder's account based on the earnings on general account investments, subject to contractual minimums. For variable universal life contracts, the policyholder may allocate the account balance among our general account and a variety of mutual funds underlying the contract. Interest is credited on amounts allocated to the general account in the same manner as for universal life. Net investment performance on mutual funds is allocated directly to the policyholder accounts; the policyholder bears the investment risk. For indexed universal life, the policyholder may allocate the account balance among our general account and two index funds. Interest is credited on amounts allocated to the general account in the same manner as for universal life. Net investment performance on the index funds is allocated directly to the policyholder accounts, subject to the contractual minimum and maximum. Some of our interest sensitive contracts contain what are commonly referred to as "secondary" or "no-lapse" guarantee provisions. These no-lapse guarantees keep the contract in force, even if the contractholder's account balance is insufficient to cover all of the contract charges, provided that the contractholder has continually paid a specified minimum premium.



Table of Contents

**Traditional Life Insurance.** Traditional life insurance includes participating whole life, adjustable life and non-participating term life insurance products. Participating products and non-participating term life insurance products represented 39% of our individual life insurance annualized first year premium sales for the year ended December 31, 2017, and 74% of individual life insurance in force as of December 31, 2017. Adjustable life insurance products provide a guaranteed benefit in return for the payment of a fixed premium and allow the policyholder to set the coverage period, premium and face amount combination. Term insurance products provide a guaranteed death benefit for a specified period of time in return for the payment of a fixed premium. Policyholder dividends are not paid on term insurance.

***U.S. Insurance Solutions Markets and Distribution***

For each of our products, administration and distribution channels are customized to meet customer needs and expectations for that product.

We market our group dental, vision, life, critical illness and disability insurance products to small and medium-sized businesses, primarily targeting our sales toward owners and human resources professionals. We sell our group products in all 50 states and the District of Columbia. We continually adapt our products and pricing to meet local market conditions. We market our fee-for-service capabilities to employers that self-insure their employees' dental, disability and vision benefits. We market our fee-for-service businesses in all 50 states and the District of Columbia.

The group insurance market continues to see a shift to voluntary/worksites products due to various pressures on employers. In keeping with this market change, which shifts the funding of such products from the employer to the employee, we continue to place an enhanced focus on our voluntary benefits platform. We believe the voluntary/worksites market presents growth opportunities and we will continue to develop strategies to capitalize on this expanding market.

As of December 31, 2017, we had 137 sales representatives and 160 service representatives in 26 local markets. Our sales representatives accounted for 98% of our group insurance sales for the year ended December 31, 2017. The service representatives play a key role in servicing the case by providing local, responsive services to our customers and their brokers, such as renewing contracts, revising plans, solving administrative issues and communicating the customers' needs and feedback to us.

We sell our individual life and individual disability income products in all 50 states and the District of Columbia, primarily targeting owners and executives of small and medium-sized businesses. Small and medium-sized business sales represented 52% of individual life sales and 60% of individual disability sales for the year ended December 31, 2017. Much of our life insurance sales efforts focus on the Business Owner and Executive Solutions market. This strategy offers solutions to address business owner financial challenges such as exiting the business, business transition, retaining key employees and retirement planning. Key employees also have needs to supplement retirement income, survivor income, and business protection. We believe the Business Owner and Executive Solutions segment offers growth opportunities and we will continue to develop strategies to capitalize on this expanding market.

We distribute our individual life and individual disability insurance products through our affiliated financial representatives and independent brokers, as well as other marketing and distribution alliances. Affiliated financial representatives were responsible for 16% of individual life insurance sales based on first year annualized premium and 12% of individual disability sales for the year ended December 31, 2017. We had 945 affiliated financial representatives in 33 offices as of December 31, 2017. Although they are independent contractors, we have a close tie with affiliated financial representatives and we offer them benefits, training and access to tools and expertise. To meet the needs of the various marketing channels, particularly the independent brokers, we employ wholesale distributors Regional Vice Presidents for individual life and Regional Vice Presidents for individual disability. A key differentiator in the nonqualified executive benefit sale is our Regional Vice Presidents-Nonqualified Plans, who are not only wholesalers but also consultants and subject-matter experts providing point-of-sale support in closing cases.

**Corporate Segment**

Our 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 financing costs and preferred stock dividends), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other adjustments not allocated to the segments based on the nature of such items. Results of Principal Securities, Inc., our retail broker-dealer and registered investment advisor, and our exited group medical and long-term care insurance businesses are reported in this segment.

**Competition**

Competition in our segments is based on a number of factors including: scale, service, product features, price, investment performance, commission structure, distribution capacity, financial strength ratings and name recognition. We compete with a large number of financial

services companies such as banks, mutual funds, broker-dealers, insurers and asset managers. Some of these companies offer a broader array of products, more competitive pricing, greater diversity of distribution sources, better brand recognition or, with respect to insurers, higher financial strength ratings. Some may also



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

## Table of Contents

have greater financial resources with which to compete or may have better investment performance at various times. We believe we distinguish ourselves from our competitors through our:

full service platform;

strong customer relationships;

focus on investment performance and

expansive product portfolio.

## **Ratings**

Insurance companies are assigned financial strength ratings by rating agencies based upon factors relevant to policyholders. Financial strength ratings are generally defined as opinions as to an insurer's financial strength and ability to meet ongoing obligations to policyholders. Information about ratings provides both industry participants and insurance consumers meaningful insights on specific insurance companies. Higher ratings generally indicate financial stability and a stronger ability to pay claims.

Principal Life and Principal National Life Insurance Company ("PNLIC") have been assigned the following insurer financial strength ratings:

<b>Rating Agency</b>	<b>Financial Strength Rating</b>	<b>Rating Structure</b>
A.M. Best Company, Inc.	A+ ("Superior") with a stable outlook	Second highest of 13 rating levels
Fitch Ratings Ltd.	AA ("Very Strong") with a stable outlook	Fourth highest of 19 rating levels
Moody's Investors Service	A1 ("Good") with a stable outlook	Fifth highest of 21 rating levels
S&P Global	A+ ("Strong") with a stable outlook	Fifth highest of 20 rating levels

A.M. Best's ratings for insurance companies range from "A++" to "S". A.M. Best indicates that "A++" and "A+" ratings are assigned to those companies that in A.M. Best's opinion have superior ability to meet ongoing insurance obligations. Fitch's ratings for insurance companies range from "AAA" to "C". Fitch "AA" ratings indicate very strong capacity to meet policyholder and contract obligations. Moody's Investors Service ("Moody's") ratings for insurance companies range from "Aaa" to "C". Moody's indicates that "A" ratings are assigned to those companies that offer good financial security. S&P Global's ("S&P") ratings for insurance companies range from "AAA" to "D". S&P indicates that "A" ratings are assigned to those companies that have strong financial security characteristics. In evaluating a company's financial and operating performance, these rating agencies review its profitability, leverage and liquidity, as well as its book of business, the adequacy and soundness of its reinsurance, the quality and estimated market value of its assets, the adequacy of its policy reserves, the soundness of its risk management programs, the experience and competency of its management and other factors.

In the fourth quarter of 2017, Moody's and Fitch changed their outlook on the U.S. life insurance sector to 'stable' from 'negative'. S&P continues to maintain a 'stable' outlook as well. This outlook reflects their expectation that despite ongoing concerns over evolving issues that could negatively impact the U.S. life insurance sector, insurers have shown resilience by exhibiting very strong balance sheet fundamentals and good earnings and liquidity.

A.M. Best continues to reflect a 'negative' outlook reflecting its view that a negative impact on the U.S. life insurance sector could come from pressures such as the flattening yield curve, low treasury rates and evolving regulatory issues.

We believe our strong ratings are an important factor in marketing our products to our distributors and customers, as ratings information is broadly disseminated and generally used throughout the industry. Our ratings reflect each rating agency's opinion of our financial strength, operating performance and ability to meet our obligations to policyholders and are not evaluations directed toward the protection of investors. Such ratings are neither a rating of securities nor a recommendation to buy, hold or sell any security, including our common stock. For more information on ratings, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources – Financial Strength and Credit Ratings."

**Regulation**

Our businesses are subject to regulation and supervision by U.S. federal and state regulatory authorities as well as non-U.S. regulatory authorities for our operations outside the U.S., which can have a significant effect on our business. Our businesses are also affected by U.S. federal, state and local tax laws as well as tax laws for jurisdictions outside the U.S.

PFG, our parent holding company, is not licensed as an insurer, investment advisor, broker-dealer, bank or other regulated entity. However, because it is the holding company for all of our operations, it is subject to regulation in connection with our regulated entities, including as an insurance holding company. We are subject to legal and regulatory requirements applicable to public companies, including public reporting and disclosure, securities trading, accounting and financial reporting and corporate governance.

Table of Contents

***U.S. Insurance Regulation***

We are subject to the insurance holding company laws in the states where our insurance companies are domiciled. Principal Life and PNLIC are domiciled in Iowa and their principal insurance regulatory authority is the Insurance Division of the Department of Commerce of the State of Iowa. Our other U.S. insurance companies are principally regulated by the insurance departments of the states in which they are domiciled. These laws generally require each insurance company directly or indirectly owned by the holding company to register with the insurance department in the insurance company's state of domicile and to furnish financial and other information about the operations of the companies within the holding company system. Transactions affecting the insurers in the holding company system must be fair and at arm's length. Most states have insurance laws that require regulatory approval of a direct or indirect change in control of an insurer or an insurer's holding company and laws that require prior notification to state insurance departments of a change in control of a non-domiciliary insurance company doing business in that state.

Annually, our U.S. insurance companies must submit an opinion from a board-appointed qualified actuary to state insurance regulators, where licensed, on whether the statutory assets held backing statutory reserves are sufficient to meet contractual obligations and related expenses of the insurer. If such an opinion cannot be rendered noting the sufficiency of assets, the insurance company must set up additional statutory reserves drawing from available statutory surplus until such an opinion can be given.

State insurance departments have broad administrative powers over the insurance business, including insurance company licensing and examination, agent licensing, establishment of reserve requirements and solvency standards, premium rate regulation, admittance of assets to statutory surplus, policy form approval, unfair trade and claims practices regulation and other matters. State insurance statutes also typically place restrictions and limitations on the amount of dividends or other distributions payable by insurance company subsidiaries to their parent companies. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Liquidity and Capital Resources" for further details.

In order to enhance the regulation of insurer solvency, the National Association of Insurance Commissioners ("NAIC") has established risk-based capital standards. The standards require life insurers to submit a report to state regulators on an annual basis regarding their risk-based capital based upon four categories of risk: asset risk, insurance risk, interest rate risk and business risk. As of December 31, 2017, the statutory surplus of each of our U.S. life insurance companies exceeded the minimum risk-based capital requirements.

State and federal insurance and securities regulatory authorities and other state law enforcement agencies and attorneys general regularly make inquiries and conduct examinations or investigations regarding our compliance with, among other things, insurance laws and securities laws.

Each state has insurance guaranty association laws under which insurers doing business in a state can be assessed, up to prescribed limits, in order to cover contractual benefit obligations of insolvent insurance companies. The guaranty associations levy assessments on each member insurer in a jurisdiction on the basis of the proportionate share of the premiums written by such insurer in the lines of business in which the insolvent insurer is engaged. Some jurisdictions permit the member insurers to recover the assessments paid through full or partial premium tax offsets.

***Securities Regulation***

Insurance and investment products such as variable annuities, variable life insurance and some funding agreements that constitute securities and mutual fund products are subject to securities laws and regulations, including U.S. state securities regulation as well as U.S. federal regulation under the SEC, the Financial Industry Regulatory Authority and other regulatory authorities. These regulations affect investment advice, sales and related activities for these products.

We also have entities that are registered as investment advisers with the SEC under, and are therefore subject to, the Investment Advisers Act of 1940.

***Employee Retirement Income Security Act***

As we provide products and services for U.S. employee benefit plans, we are subject to regulation under the Employee Retirement Income Security Act ("ERISA"). ERISA provisions include reporting and disclosure requirements and standards of conduct.

***Banking Regulation***

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

Principal Bank, a wholly owned subsidiary, is a U.S. federal savings bank regulated by the Office of the Comptroller of the Currency. Principal Bank's deposits are insured by the FDIC, making the Bank subject to certain of the FDIC's regulations.

Table of Contents

***Environmental Regulation***

As we own and operate real property, we are subject to U.S. federal, state and local environmental laws and could be subject to environmental liabilities and costs associated with required remediation of our properties. We routinely have environmental assessments performed for real estate being acquired or used as collateral for commercial mortgages we use for investment.

***Regulation of International Businesses***

Our international businesses are supervised by regulatory authorities in the jurisdictions in which they operate.

**Risk Management**

Like all financial services companies, we are exposed to a wide variety of financial, operational and other risks, as described in Item 1A. "Risk Factors." Effective enterprise risk management is, therefore, a key component of our business model.

Enterprise risk management helps us to manage risk to meet our customer obligations, satisfy regulatory requirements, adequately provide for contingencies in case of stress, optimize shareholder returns, support our core values and maintain our reputation.

We utilize an integrated risk management framework to help us identify, assess, monitor, report, manage and aggregate our material risks within established risk appetites and risk tolerances. The framework delivers important perspective that is used in strategic and tactical decision making and is adaptable to changes in our businesses and in the external environments in which we operate. Our approach also requires a commitment to continuous improvement and periodic validation.

Our governance structure includes Board of Directors oversight, internal risk committees, a corporate risk management function and embedded risk professionals in our business units and functional areas. Our Board of Directors, Audit Committee, Finance Committee, Human Resource Committee and Nominating and Governance Committee provide oversight no less frequently than quarterly, addressing relevant aspects of our risk profile.

Our internal risk committees meet on a regular and frequent basis to discuss various issues and review profile status. Each business unit has its own committee that is responsible for oversight of the material risks within the unit or area. These committees may include corporate leaders. We also have internal committees that provide oversight around a certain risk or group of related risks across the organization. This matrix approach helps us maintain comprehensive risk coverage and preserve an integrated view of risks. The Enterprise Risk Management Committee, comprised of members from the executive management team, exercises enterprise-wide oversight for our most significant risk profiles.

The business units and functional areas are responsible for identifying, assessing, monitoring, reporting and managing their own risks. Chief Risk Officers embedded within each business unit or risk professionals in functional areas help align risk management practice with the strategies of the unit as well as with enterprise-wide objectives. The Corporate Chief Risk Officer and supporting staff are separate from the business units and provide objective oversight, framework enablement and aggregated risk analysis. Internal Audit provides independent assurance around effective risk management design and control execution.

Risk appetites, tolerances and limits have been established from an enterprise-wide and business unit perspective for specific risk categories, where appropriate. We monitor a variety of risk metrics on an ongoing basis and take the appropriate steps to manage our established risk appetites and tolerances. Quarterly risk reporting provides a feedback loop between business units, functional areas, our internal risk committees and the corporate risk management function. This reporting also includes perspectives on emerging risk. To the extent potentially significant business activities or operational initiatives are considered, analysis of the possible impact on our risk profile takes place. This analysis includes, but is not limited to, the capital implications; the impact on near term and long-term earnings; the ability to meet our targets with respect to return on equity, liquidity, debt/capital, cash coverage, business risk and operational risk; and the impact to our reputation.

**Employees**

As of December 31, 2017, we had 15,378 employees. None of our employees are subject to collective bargaining agreements except a group of employees within our Cuprum organization in Chile. We believe that our employee relations are satisfactory.

**Internet Website**

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

Our internet website can be found at [www.principal.com](http://www.principal.com). We make available free of charge, on or through our internet website, access to our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after such material is filed with or furnished to the SEC. Also available free of charge on our internet website is our code of business conduct and ethics, corporate governance

Table of Contents

guidelines and charters for the Audit, Finance, Human Resources and Nominating and Governance committees of our Board of Directors. Also see Item 10. "Directors, Executive Officers and Corporate Governance."

**Item 1A. Risk Factors**

This section provides an overview of the risks that may impact our performance in the future.

**Risks relating to economic conditions, market conditions and investments**

**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.**

Our results of operations, financial condition, cash flows and statutory capital position could be materially adversely affected by volatility, uncertainty and disruption in the capital and credit markets.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed adequate to meet anticipated short-term and long-term benefit and expense payment obligations. However, withdrawal and surrender levels may differ from anticipated levels for a variety of reasons, such as changes in economic conditions or changes in our claims paying ability and financial strength ratings. For additional information regarding our exposure to interest rate risk and the impact of a downgrade in our financial strength ratings, see " Changes in interest rates or credit spreads or a sustained low interest rate environment may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period to period" and " 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." In addition, mark-to-market adjustments on our derivative instruments may lead to fluctuations in our reported statutory capital. Volatility, uncertainty or disruptions in the capital or credit markets may result in the need for additional capital to maintain a targeted level of statutory capital relative to the NAIC's risk-based capital requirements. In the event our current internal sources of liquidity do not satisfy our needs, we may have to seek additional financing and, in such case, we may not be able to successfully obtain additional financing on favorable terms, or at all. The availability of additional financing will depend on a variety of factors such as market conditions, the general availability of credit, the volume of trading activities, the overall availability of credit to the financial services industry, our credit ratings and credit capacity, as well as customers' or lenders' perception of our long- or short-term financial prospects. Similarly, our access to funds may be impaired if regulatory authorities or rating agencies take negative actions against us.

Disruptions, uncertainty or volatility in the capital and credit markets may limit our access to capital required to operate our business, most significantly our insurance operations. Such market conditions may limit our ability to replace, in a timely manner, maturing liabilities; satisfy statutory capital requirements; fund redemption requests on insurance or other financial products; generate fee income and market-related revenue to meet liquidity needs and access the capital necessary to grow our business. As such, we may be forced to delay raising capital, issue shorter tenor securities than we prefer, utilize available internal resources or bear an unattractive cost of capital, which could decrease our profitability and significantly reduce our financial flexibility and liquidity.

In addition, we maintain credit facilities with various financial institutions as a potential source of excess liquidity. These facilities are in place to bridge timing in cash flows to minimize the cost of meeting our obligations, particularly during periods when alternative sources of liquidity are limited. Our ability to borrow funds under these facilities is conditioned on our satisfaction of covenants and other requirements contained in the facilities. Our failure to comply with these covenants, or the failure of lenders to fund their lending commitments, would restrict our ability to access these credit facilities and, consequently, could limit our flexibility in meeting our cash flow needs.

For further discussion on liquidity risk management, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources."

**Conditions in the global capital markets and the economy generally may materially and adversely affect our business and results of operations.**

Our results of operations are materially affected by conditions in the global capital markets and the economy generally, both in the U.S. and elsewhere around the world. Adverse economic conditions may result in a decline in our AUM and revenues and erosion of our profit margins. In addition, in the event of extreme prolonged market events and economic downturns, we could incur significant losses. Even in the absence of a market downturn, we are exposed to substantial risk of loss due to market volatility.

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

Factors such as consumer spending, business investment, government spending, the volatility and strength of the capital markets, investor and consumer confidence, foreign currency exchange rates and inflation levels all affect the business and economic environment and, ultimately, the amount and profitability of our business. In an economic downturn characterized by higher unemployment, lower family income, lower corporate earnings, lower business investment, negative investor sentiment and lower consumer spending, the demand for our financial and insurance products could be adversely affected. In addition, we may experience an elevated incidence of claims and lapses or surrenders of policies. Our policyholders may choose to defer paying insurance premiums or stop paying insurance



Table of Contents

premiums altogether. In addition, reductions in employment levels of our existing employer customers may result in a reduction in membership levels and premium income for our specialty benefits products. Participants within the retirement plans for which we provide administrative services may elect to reduce or stop their payroll deferrals to these plans, which would reduce AUM and revenues. In addition, reductions in employment levels may result in a decline in employee deposits into retirement plans. Adverse changes in the economy could affect net income negatively and could have a material adverse effect on our business, results of operations and financial condition.

An economic downturn may also lead to weakening of foreign currencies against the U.S. dollar, which would adversely affect the translation of segment pre-tax operating earnings and equity of our international operations into our consolidated financial statements. For further discussion on foreign currency exchange risk, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk."

**Volatility or declines in the equity, bond or real estate markets could reduce our 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.**

Because the revenues of our asset management and accumulation businesses are, to a large extent, based on the value of AUM, a decline in domestic and global equity, bond or real estate markets will decrease our revenues. Turmoil in these markets could lead investors to withdraw from these markets, decrease their rates of investment or refrain from making new investments, which may reduce our net income, revenues and AUM.

For further discussion on equity risk management, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Equity Risk."

**Changes in interest rates or credit spreads or a sustained low interest rate environment may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period to period.**

Although the Federal Reserve increased the federal funds rate in 2017, interest rates remain at or near historically low levels. During periods of declining interest rates or sustained low interest rates, the interest rates we earn on our assets may be lower than the rates assumed in pricing our products, thereby reducing our profitability. For some of our products, such as GICs and funding agreements, we are unable to lower the rate we credit to customers in response to the lower return we will earn on our investments. In addition, guaranteed minimum interest rates on our life insurance and annuity products may constrain our ability to lower the rate we credit to customers. If interest rates remain low over a sustained period of time, this may result in increases in our reserves and true-ups or unlocking of our deferred acquisition cost ("DAC") asset and other actuarial balances. During periods of declining interest rates, borrowers may prepay or redeem mortgages and bonds that we own, which would force us to reinvest the proceeds at lower interest rates. Furthermore, declining interest rates may reduce the rate of policyholder surrenders and withdrawals on our life insurance and annuity products, thus increasing the duration of the liabilities and creating asset and liability duration mismatches. Low interest rates may also increase the cost of hedging our GMWB rider. Declining interest rates or a sustained low interest rate environment may also result in changes to the discount rate used for valuing our pension and other postretirement benefit ("OPEB") obligations, which could negatively impact our results of operations and financial condition. In addition, certain statutory capital and reserve requirements are based on formulas or models that consider interest rates and a prolonged period of low interest rates may increase the statutory capital we are required to hold as well as the amount of assets we must maintain to support statutory reserves.

Increases in market interest rates may also adversely affect our results of operations, financial condition and liquidity. During periods of increasing market interest rates, we may offer higher crediting rates on our insurance and annuity products in order to keep these products competitive. Because returns on our portfolio of invested assets may not increase as quickly as current interest rates, we may have to accept lower spreads, thus reducing our profitability. Rapidly rising interest rates may also result in an increase in policy surrenders, withdrawals and requests for policy loans as customers seek to achieve higher returns. In addition, rising interest rates would cause a decrease in the value of financial assets held at fair value on our consolidated statements of financial position. We may be required to sell assets to raise the cash necessary to respond to an increase in surrenders, withdrawals and loans, thereby realizing capital losses on the assets sold. An increase in policy surrenders and withdrawals may also require us to accelerate amortization of our DAC asset relating to these products, which would further reduce our profitability. Rising interest rates may also cause a decline in the value of the fixed income assets we manage, resulting in a reduction in our fee revenue in the short term. In addition, a significant increase in interest rates may cause a reduction in the fair value of intangible assets in our reporting units, potentially leading to an impairment of goodwill or other intangible assets.

For further discussion about interest rate risk management, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk."

Our exposure to credit spreads primarily relates to market price variability and reinvestment risk associated with changes in credit spreads. A widening of credit spreads would cause unrealized losses in our investment portfolio, would increase losses associated with credit-based derivatives we have sold that do not qualify or have not been designated for hedge accounting where we assume credit exposure and, if issuer

credit spreads increase as a result of fundamental credit deterioration, would likely result in higher other-than-temporary impairments. Credit spread tightening will reduce net investment income associated with new purchases of fixed maturities. Credit spread tightening may also cause an increase

Table of Contents

in the reported value of certain liabilities that are valued using a discount rate that reflects our own credit spread. In addition, market volatility may make it difficult to value certain of our securities if trading becomes less frequent. As such, valuations may include assumptions or estimates that may have significant period-to-period changes from market volatility, which could have a material adverse effect on our results of operations or financial condition.

**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.**

*An increase in defaults or write-downs on our fixed maturities portfolio may reduce our profitability.*

We are subject to the risk that the issuers of the fixed maturities we own will default on principal and interest payments. As of December 31, 2017, our U.S. investment operations held \$56.0 billion of fixed maturities, or 75% of total U.S. invested assets, of which approximately 5% were below investment grade and \$73.6 million, or 0.13% of our total fixed maturities that were classified as either "problem," "potential problem" or "restructured." See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Investments U.S. Investment Operations Fixed Maturities."

As of December 31, 2017, the international investment operations of our fully consolidated subsidiaries held \$4.0 billion of fixed maturities, or 50%, of total international invested assets, of which 12% are government bonds. Some non-government bonds have been rated on the basis of the issuer's country credit rating. However, the ratings relationship between national ratings and global ratings is not linear with the U.S. The starting point for national ratings differs by country, which makes the assessment of credit quality more difficult. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Investments International Investment Operations." An increase in defaults on our fixed maturities portfolio could harm our financial strength and reduce our profitability.

*An increased rate of delinquency and defaults on our commercial mortgage loans, including balloon maturities with and without amortizing payments, may adversely affect our profitability.*

Our commercial mortgage loan portfolio faces both delinquency and default risk. Commercial mortgage loans of \$12.9 billion represented 16% of our total invested assets as of December 31, 2017. As of December 31, 2017, there were no loans in the process of foreclosure in our commercial mortgage loan portfolio. The performance of our commercial mortgage loan investments, however, may fluctuate in the future. An increase in the delinquency rate of, and defaults under, our commercial mortgage loan portfolio could harm our financial strength and decrease our profitability.

As of December 31, 2017, approximately \$10.5 billion, or 82%, of our U.S. investment operations commercial mortgage loans before valuation allowance had balloon payment maturities. A balloon maturity is a loan with all or a meaningful portion of the loan amount due at the maturity of the loan. The default rate on commercial mortgage loans with balloon payment maturities has historically been higher than for commercial mortgage loans with a fully amortizing loan structure. Since a significant portion of the principal is repaid at maturity, the amount of loss on a default is generally greater than fully amortizing commercial mortgage loans. An increase in defaults on balloon maturity loans as a result of the foregoing factors could harm our financial strength and decrease our profitability.

*Mark-to-market adjustments on certain equity method investments and trading securities may reduce our profitability or cause volatility in our reported earnings.*

Our investment portfolio includes certain equity method investments and trading securities that are reported at fair value on the consolidated statements of financial position, with changes in fair value reported in net investment income on the consolidated statements of operations. Mark-to-market adjustments on these investments may reduce our profitability or cause our net income to vary from period to period. We anticipate that acquisition and investment activities may increase the number and magnitude of these investments in the future.

*We may have difficulty selling our privately placed fixed maturities, mortgage loans and real estate investments because they are less liquid than our publicly traded fixed maturities.*

We hold certain investments that may be less liquid, such as privately placed fixed maturities, mortgage loans and real estate investments. These asset classes represented approximately 42% of the value of our invested assets as of December 31, 2017.

If we require significant amounts of cash on short notice, we may have difficulty selling these investments in a timely manner, be forced to sell them for less than we otherwise would have been able to realize or both. The reported value of our relatively illiquid types of investments, our investments in the asset classes described above and, at times, our high quality, generally liquid asset classes, do not necessarily reflect the lowest possible price for the asset. If we were forced to sell certain of our assets in the current market, there can be no assurance we will be able

to sell them for the prices at which we have recorded them and we may be forced to sell them at significantly lower prices.

Table of Contents***The impairment of derivative counterparties could adversely affect us.***

We use derivative instruments to hedge various risks we face in our businesses. See Item 7A. "Quantitative and Qualitative Disclosures About Market Risk." We enter into a variety of derivative instruments with a number of counterparties in the financial services industry, including brokers and dealers, commercial banks, investment banks, clearinghouses, exchanges and other institutions. For transactions where we are in-the-money, we are exposed to credit risk in the event of default of our counterparty. We establish collateral agreements with nominal thresholds for a large majority of our counterparties to limit our exposure. However, our credit risk may be exacerbated when the collateral held by us cannot be realized or is liquidated at prices not sufficient to recover the full amount of the loan or derivative exposure. With regard to our derivative exposure, we have over-collateralization requirements on the portion of collateral we hold, based on the risk profile of the assets posted as collateral. We also have exposure to these financial institutions in the form of unsecured debt instruments and equity investments. Such losses or impairments to the carrying value of these assets may materially and adversely affect our business and results of operations.

***Our requirements to post collateral or make payments related to declines in market value of specified assets may adversely affect our liquidity and expose us to counterparty credit risk.***

Many of our derivative transactions with financial and other institutions specify the circumstances under which the parties are required to post collateral. The amount of collateral we may be required to post under these agreements may increase under certain circumstances, which could adversely affect our liquidity. In addition, under the terms of some of our transactions we may be required to make payment to our counterparties related to any decline in the market value of the specified assets. Such payments could have an adverse effect on our liquidity. Furthermore, with respect to any such payments, we will have unsecured risk to the counterparty as these amounts are not required to be segregated from the counterparty's other funds, are not held in a third party custodial account, and are not required to be paid to us by the counterparty until the termination of the transaction.

***Environmental liability exposure may result from our commercial mortgage loan portfolio and real estate investments.***

Liability under environmental protection laws resulting from our commercial mortgage loan portfolio and real estate investments may harm our financial strength and reduce our profitability. Under the laws of several states and other jurisdictions, contamination of a property may give rise to a lien on the property to secure recovery of the costs of cleanup. In some states, this kind of lien has priority over the lien of an existing mortgage against the property, which would impair our ability to foreclose on that property should the related loan be in default. In addition, under the laws of some states and under the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980, we may be liable for costs of addressing releases or threatened releases of hazardous substances that require remedy at a property securing a mortgage loan held by us, if our agents or employees have become sufficiently involved in the hazardous waste aspects of the operations of the related obligor on that loan, regardless of whether or not the environmental damage or threat was caused by the obligor. We also may face this liability after foreclosing on a property securing a mortgage loan held by us. This may harm our financial strength and decrease our profitability.

***Regional concentration of our commercial mortgage loan portfolio in California may subject us to losses attributable to economic downturns or catastrophes in that state.***

Commercial mortgage lending in the state of California accounted for 18%, or \$2.3 billion, of our U.S. investment operations commercial mortgage loan portfolio before valuation allowance as of December 31, 2017. Due to this concentration of commercial mortgage loans in California, we are exposed to potential losses resulting from the risk of an economic downturn in California as well as to catastrophes, including but not limited to earthquakes, that may affect the region. While we generally do not require earthquake insurance for properties on which we make commercial mortgage loans, we do take into account property specific engineering reports, construction type and geographical concentration by fault lines in our investment underwriting guidelines. If economic conditions in California deteriorate or catastrophes occur, we may in the future experience delinquencies or defaults on the portion of our commercial mortgage loan portfolio located in California, which may harm our financial strength and reduce our profitability.

***Gross unrealized losses may be realized or result in future impairments, resulting in a reduction in our net income.***

Fixed maturities that are classified as available-for-sale ("AFS") are reported on the consolidated statements of financial position at fair value. Unrealized gains or losses on AFS securities are recognized as a component of accumulated other comprehensive income ("AOCI") and are, therefore, excluded from net income. Our U.S. investment operations had gross unrealized losses on fixed maturities of \$0.2 billion pre-tax as of December 31, 2017, and the component of gross unrealized losses for securities trading down 20% or more for over six months was less than \$0.1 billion pre-tax. The accumulated change in fair value of the AFS securities is recognized in net income when the gain or loss is realized upon the sale of the asset or in the event that the decline in fair value is determined to be other than temporary (referred to as an other-than-temporary impairment). Realized losses or impairments may have a material adverse impact on our net income in a particular quarterly or annual period.



Table of Contents

***Fluctuations in foreign currency exchange rates could adversely impact our profitability and financial condition.***

Principal International sells products denominated in various local currencies and generally invests the associated assets in local currencies. For diversification purposes, assets backing the products may be partially invested in non-local currencies. In our U.S. operations, we also issue foreign currency-denominated funding agreements to nonqualified investors in the institutional market or invest in foreign currency-denominated investments. The associated foreign currency exchange risk in each instance is hedged or managed to specific risk tolerances. Although our investment and hedging strategies limit the effect of currency exchange rate fluctuation on operating results, weakening of foreign currencies against the U.S. dollar would adversely affect the translation of the results of our international operations into our consolidated financial statements. For further discussion on foreign currency exchange risk, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk."

**Risks relating to estimates, assumptions and valuations**

**Our valuation of investments and the determinations of the amount of allowances and impairments taken on our investments may include methodologies, estimations and assumptions which are subject to differing interpretations and, if changed, could materially adversely affect our results of operations or financial condition.**

Fixed maturities, equity securities and derivatives represent the majority of total cash and invested assets reported at fair value on our consolidated statements of financial position, excluding separate accounts. 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). Fair value estimates are made based on available market information and judgments about the financial instrument at a specific point in time. Considerable judgment is often required to develop estimates of fair value, and the use of different assumptions or valuation methodologies may have a material effect on the estimated fair value amounts.

For additional information on our valuation methodology, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements."

During periods of market disruption including periods of significantly rising or high interest rates, rapidly widening credit spreads or illiquidity, it may be difficult to value certain securities, for example collateralized mortgage obligations and collateralized debt obligations, if trading becomes less frequent and/or market data becomes less observable. There may be certain asset classes that were in active markets with significant observable data that become illiquid due to the current financial environment. In such cases, the valuation process may require more subjectivity and management judgment. As such, valuations may include inputs and assumptions that are less observable or require greater estimation as well as valuation methods that require greater estimation, which could result in values that are different from the value at which the investments may be ultimately sold. Further, rapidly changing credit and equity market conditions could materially impact the valuation of securities as reported within our consolidated financial statements and the period-to-period changes in value could vary significantly. Decreases in value may have a material adverse effect on our results of operations or financial condition.

The determination of the amount of allowances and impairments varies by investment type and is based upon our periodic evaluation and assessment of known and inherent risks associated with the respective asset class. Such evaluations and assessments require significant judgment and are revised as conditions change and new information becomes available. Additional impairments may need to be taken or allowances provided for in the future, and the ultimate loss may exceed management's current estimate of impairment amounts.

Additionally, our management considers a wide range of factors about the instrument issuer and uses its best judgment in evaluating the cause of the decline in the estimated fair value of the instrument and in assessing the prospects for recovery. Inherent in management's evaluation of the instrument are assumptions and estimates about the operations of the issuer and its future earnings potential. For further information regarding our impairment and allowance methodologies, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Investments U.S. Investment Operations" under the captions "Fixed Maturities" and "Mortgage Loans" and 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."

**Any impairments of or valuation allowances against our deferred tax assets could adversely affect our results of operations and financial condition.**

Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates expected to be in effect during the years in which the basis differences reverse. We are required to evaluate the recoverability of our deferred tax assets each quarter and establish a valuation allowance, if necessary, to reduce our deferred tax assets to an amount that is more likely than not to be realizable. In determining the need for a valuation allowance, we consider many factors, including future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards,

taxable income in prior carryback years and implementation of any feasible and prudent tax planning strategies management would employ to realize the tax benefit.



Table of Contents

Inherent in the provision for income taxes are estimates regarding the deductibility of certain items, the timing of income and expense recognition and the current or future realization of operating losses, capital losses, certain tax credits and future enacted changes in applicable tax rates as well as the tax base. In the event these estimates differ from our prior estimates due to the receipt of new information, we may be required to significantly change the provision for income taxes recorded in the consolidated financial statements. Any such change could significantly affect the amounts reported in the consolidated financial statements in the year these estimates change. A further significant decline in value of assets incorporated into our tax planning strategies could lead to an increase of our valuation allowance on deferred tax assets having an adverse effect on current and future results.

For additional information, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates – Income Taxes."

**We may face losses if our actual experience differs significantly from our pricing and reserving assumptions.**

Our profitability depends significantly upon the extent to which our actual experience is consistent with the assumptions used in setting prices for our products and establishing liabilities for future insurance and annuity policy benefits and claims. The premiums we charge and the liabilities we hold for future policy benefits are based on assumptions reflecting a number of factors, including the amount of premiums we will receive in the future, rate of return on assets we purchase with premiums received, expected claims, mortality, morbidity, lapse rates and expenses. However, due to the nature of the underlying risks and the high degree of uncertainty associated with the determination of the liabilities for unpaid policy benefits and claims, we cannot determine precisely the amounts we will ultimately pay to settle these liabilities, the timing of such payments, or whether the assets supporting the liabilities, together with any future premiums, will be sufficient to satisfy the liabilities. As a result, we may experience volatility in the level of our profitability and our reserves from period to period. To the extent that actual experience is less favorable than our underlying assumptions, we could be required to increase our liabilities, which may harm our financial strength and reduce our profitability.

For example, if mortality or morbidity rates are higher than our pricing assumptions, we may be required to make greater claims payments on our insurance policies or pay claims sooner than we had projected. Concentrations of risk, by both geography and industry, may cause mortality or morbidity rates in our group insurance or individual disability insurance to be higher than anticipated.

Our results of operations may also be adversely impacted if our actual investment earnings differ from our pricing and reserve assumptions. Changes in economic conditions may lead to changes in market interest rates or changes in our investment strategies, either of which could cause our actual investment earnings to differ from our pricing and reserve assumptions.

For additional information on our insurance reserves, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates – Insurance Reserves."

**The pattern of amortizing our DAC asset 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 our DAC asset and other actuarial balances and the timing of our net income.**

Amortization of our DAC asset and other actuarial balances depends on the actual and expected profits generated by the lines of business that incurred the expenses. Expected profits are dependent on assumptions regarding a number of factors including investment returns, benefit payments, expenses, mortality and policy lapse. Due to the uncertainty associated with establishing these assumptions, we cannot, with precision, determine the exact pattern of profit emergence. As a result, amortization of these balances will vary from period to period. To the extent actual experience emerges less favorably than expected or our expectation for future profits decreases, our DAC asset and other actuarial balances may be adjusted, reducing our profitability in the current period.

For additional information, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations – Critical Accounting Policies and Estimates – Deferred Acquisition Costs and Other Actuarial Balances."

**Legal, regulatory and tax risks**

**Changes in laws or regulations may reduce our profitability.**

Our businesses are subject to comprehensive regulation and supervision throughout the U.S. and in the international markets in which we operate. We are also impacted by federal legislation and administrative policies in areas such as securities laws, employee benefit plan regulation, financial services regulations, U.S. federal taxation and international taxation. Changes in laws or regulations or the interpretation thereof could significantly increase our compliance costs and reduce our profitability. Failure to comply with applicable regulations may expose

us to significant penalties, the suspension or revocation of licenses to conduct business and reputational damage.

Table of Contents

***Changes in insurance regulations may reduce our profitability.***

Our insurance subsidiaries are subject to extensive supervision and regulation. In particular, in the U.S., the laws of the various states establish insurance departments with broad powers to supervise and regulate insurance companies. The supervision and regulation relate to numerous aspects of our business and financial condition, including insurance company laws that apply to PFG and to various transactions between our insurance companies and subsidiaries and other affiliates. The primary purpose of insurance regulation is to protect policyholders, not stockholders or creditors.

State insurance regulators, federal regulators and the NAIC continually reexamine existing laws and regulations, and may impose changes in the future. New interpretations of existing laws and the passage of new legislation may harm our ability to sell new policies, increase our claims exposure on policies we issued previously and adversely affect our profitability and financial strength.

State insurance guaranty associations have the right to assess insurance companies doing business in their state for funds to help pay the obligations of insolvent insurance companies to policyholders and claimants. Because the amount and timing of an assessment are beyond our control, the liabilities we have established for these potential assessments may not be adequate. In addition, regulators may change their interpretation or application of existing laws and regulations.

The NAIC regularly reviews and updates its statutory reserve and risk-based capital requirements. Changes to these requirements may increase the amount of reserves and capital our U.S. insurance companies are required to hold and may adversely impact Principal Life's ability to pay dividends to us. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a discussion of regulatory restrictions on Principal Life's ability to pay us dividends. In addition, changes in statutory reserve or risk-based capital requirements may adversely impact our financial strength ratings. See the risk factor entitled "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" for a discussion of risks relating to our financial strength ratings.

State regulators have implemented a principles-based reserving ("PBR") approach for individual life insurance. The framework became effective in 2017 and can be adopted by companies for new business at any time during a permitted three-year transition period. Under the PBR framework, statutory reserves will reflect a combination of company experience and prescribed assumptions and methodologies. In addition, beginning in 2018, the NAIC is revising the valuation interest rates used to calculate statutory reserves for payout annuity products. The NAIC is also considering future changes to the statutory reserve requirements for individual deferred annuities. The ultimate financial impact of these changes is uncertain, but they could result in higher reserves, more volatile reserves and uncertain tax treatment.

We have implemented reinsurance transactions utilizing affiliated reinsurers and highly rated third parties to finance a portion of the reserves for our term life insurance policies and universal life insurance policies with secondary guarantees. Our ability to enter into new reserve financing transactions will continue to be dependent on the cost and forms of financing available in the market and our ability to obtain required regulatory approvals. Once life insurance PBR becomes fully effective, there may no longer be any financial advantage to pursuing the use of these affiliate reinsurance transactions for new business. For additional information regarding our use of affiliated reinsurance transactions, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 15, Statutory Insurance Financial Information."

The NAIC is pursuing a variety of reforms to its risk-based capital ("RBC") framework. In addition, the NAIC may choose to revise the RBC formula in response to the Tax Cuts and Jobs Act ("U.S. tax reform") enacted on December 22, 2017. The NAIC is also pursuing the development of a group-wide capital calculation. This calculation is not intended to be a regulatory capital requirement, but it could be used by regulators in their supervisory process.

Our international insurance businesses are also subject to comprehensive regulation and supervision from central and/or local governmental authorities in each country in which we operate. New interpretations of existing laws and regulations or the adoption of new laws and regulations may harm our international businesses, increase the cost of compliance and reduce our profitability in those businesses.

The International Association of Insurance Supervisors ("IAIS") has proposed a common framework for the supervision of Internationally Active Insurance Groups ("IAIGs"). For systemic risk management, the Financial Stability Board is continuing to implement group supervisory and capital requirements for Global Systemically Important Insurers ("G-SIIs"). We currently are not designated as an IAIG or a G-SII. If we were so designated in the future, we may be subject to supervision and capital requirements beyond those applicable to any competitors without those designations. These international frameworks may influence the regulatory capital requirements in the jurisdictions in which we operate, potentially leading to an increase in our capital requirements.

***Changes in federal, state and international securities laws may reduce our profitability.***

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

Our asset management and accumulation and life insurance businesses are subject to various levels of regulation under federal, state and international securities laws. For example, insurance and investment products such as variable annuities, variable life insurance, mutual fund products and some funding agreements that constitute securities are

Table of Contents

subject to securities laws and regulations, including state securities regulation as well as federal regulation under the SEC, the Financial Industry Regulatory Authority and other regulatory authorities. These laws and regulations are primarily intended to protect investors in the securities markets or investment advisory or brokerage clients and generally grant supervisory agencies and self-regulatory organizations broad administrative powers, including the power to limit or restrict the conduct of business for failure to comply with such laws and regulations. Changes to these laws or regulations, or the interpretation thereof, that restrict the conduct of our business could significantly increase our compliance costs and reduce our profitability.

The revised Markets in Financial Instruments Directive ("MiFID II") became effective across the European Union on January 3, 2018. MiFID II is designed to increase the transparency of financial markets and strengthen investor protections. Some of the key changes under MiFID II include enhanced disclosure and reporting requirements, enhanced business conduct and governance requirements, additional regulation of trading venues, new requirements regarding client commissions and payment for research and changes in the rules relating to independent investment advice and compensation. Initial and ongoing compliance with, and industry changes related to, MiFID II may lead to increased compliance and operating costs in PGI's investment management businesses.

***Changes in employee benefit regulations may reduce our profitability.***

We provide products and services to certain employee benefit plans that are subject to ERISA or the Internal Revenue Code of 1986, as amended. The U.S. Congress has, from time to time, considered legislation relating to changes in ERISA to permit application of state law remedies, such as consequential and punitive damages, in lawsuits for wrongful denial of benefits, which, if adopted, could increase our liability for damages in future litigation. In addition, reductions in contribution levels to defined contribution plans may decrease our profitability.

On June 9, 2017, most provisions of the Department of Labor's ("DOL's") fiduciary rule became applicable. The regulation broadens the definition of a fiduciary under ERISA to include persons providing investment advice to an employee benefit plan or an IRA for a fee or other compensation. The DOL also released two new prohibited transaction class exemptions and amendments to current prohibited transaction exemptions. Broker-dealers and advisors continue to work through the implications of the regulations on business models and how they proceed could impact our business. Even with this fluid environment, our preliminary assessment of the new regulation's impact to our business and future financial results indicates the costs will not have a significant effect on our financial condition or results of operations.

The final applicability date for certain provisions of the DOL fiduciary rule, such as the Best Interest Contract Exemption, was originally scheduled for January 1, 2018. However, in November 2017, the DOL delayed the applicability date of these provisions to July 1, 2019. The delay in the applicability date will provide additional time for the DOL and the SEC to evaluate the rule's impact on access to financial information and advice. This evaluation may result in revisions to, or potentially rescission of, the rule.

In addition, uncertainty or delay relating to the DOL fiduciary rule is driving increased state legislative and regulatory activity. Nevada expanded the scope of an existing state fiduciary duty in 2017, the NAIC has proposed addition of a "best interest" standard of care to its existing annuity suitability model, and the New York Department of Financial Services ("DFS") has proposed distinct "best interest" amendments to its existing annuity suitability regulation. The DFS amendments also include an expansion of the scope to sales of life insurance. Related state fiduciary or "best interest" legislation is expected in additional states in 2018.

***Financial services regulatory reform may reduce our profitability, impact how we do business or limit our ability to engage in certain capital expenditures.***

On July 21, 2010, the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") became law. The Dodd-Frank Act makes extensive changes to the laws regulating financial services firms and requires various federal agencies to adopt a broad range of new implementation rules and regulations, including regulations surrounding the use of derivatives. The federal agencies were given significant discretion in drafting the implementation rules and regulations, and consequently, some of the impacts of the Dodd-Frank Act are not fully known yet. It is likely that new margining aspects of the law will increase hedging costs and possibly cause fundamental shifts to the way risks are hedged. Additionally, the Trump Administration has issued an Executive Order that calls for a comprehensive review of the Dodd-Frank Act. It is uncertain whether changes to, or legislative replacement of, the Dodd-Frank Act, if any, will result in a material effect on our business operations.

***Changes in cybersecurity or privacy regulations may reduce our profitability.***

We are subject to numerous federal, state, and international regulations regarding the privacy and security of personal information. These laws vary widely by jurisdiction. Recent regulations with a significant impact on our operations include the European Union ("EU") General Data Protection Regulation ("GDPR") and the New York Department of Financial Services Part 500 cybersecurity requirements for financial services companies. GDPR will become effective in May 2018 for EU data subjects. GDPR includes numerous protections for EU citizens, including but not limited to notification requirements for data breaches, the right to access personal data, and the right to be forgotten. The New

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

York Department of Financial Services Part 500 cybersecurity requirements, which became effective in March 2017, focus on minimum standards for cybersecurity programs. It is anticipated that additional federal, state and

Table of Contents

international regulations will continue to be enacted in the future. Changes in existing cybersecurity and privacy regulations or the enactment of new regulations may increase our compliance costs and reduce our profitability. In addition, failure to comply with these regulations may lead to reputational damage, fines, and increased regulatory scrutiny.

***Changes in tax laws could increase our tax costs and reduce sales of our insurance, annuity and investment products.***

Many of the insurance, annuity, and investment products we issue receive favorable tax treatment under current U.S. federal income tax laws. Changes in U.S. federal income tax laws could reduce or eliminate the tax advantages of certain of our products, thus making these products less attractive to our customers. This may lead to a reduction in sales and deposits, which may adversely impact our profitability.

In addition, we benefit from certain tax items, including but not limited to, dividends received deductions, tax credits (such as foreign tax credits), tax-exempt bond interest and insurance reserve deductions. From time to time, the U.S. Congress, as well as foreign, state and local governments, consider legislative changes that could reduce or eliminate the benefits associated with these and other tax items, some of which were impacted by the U.S. tax reform. The Organisation for Economic Co-operation and Development has released proposed policies around Base Erosion and Profit Shifting that more countries are enacting. Our profitability could be negatively impacted as such legislation is adopted by participating countries. We continue to evaluate the impact potential tax reform proposals may have on our future results of operations and financial condition.

For a discussion of the impact of recently adopted tax legislation, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes."

**We may not be able to protect our intellectual property and may be subject to infringement claims.**

We rely on a combination of contractual rights and copyright, trademark, patent and trade secret laws to establish and protect our intellectual property. Although we use a broad range of measures to protect our intellectual property rights, third parties may infringe or misappropriate our intellectual property. We may have to litigate to enforce and protect our copyrights, trademarks, patents, trade secrets and know-how or to determine their scope, validity or enforceability, which represents a diversion of resources that may be significant in amount and may not prove successful. The loss of intellectual property protection or the inability to secure or enforce the protection of our intellectual property assets could have a material adverse effect on our business and our ability to compete.

We also may be subject to costly litigation in the event another party alleges our operations or activities infringe upon such other party's intellectual property rights. Third parties may have, or may eventually be issued, patents or other protections that could be infringed by our products, methods, processes or services or could otherwise limit our ability to offer certain product features. Any party that holds such a patent could make a claim of infringement against us. We may also be subject to claims by third parties for breach of copyright, trademark, license usage rights, or misappropriation of trade secret rights. Any such claims and any resulting litigation could result in significant liability for damages. If we were found to have infringed or misappropriated a third party patent or other intellectual property rights, we could incur substantial liability, and in some circumstances could be enjoined from providing certain products or services to our customers or utilizing and benefiting from certain methods, processes, copyrights, trademarks, trade secrets or licenses, or alternatively could be required to enter into costly licensing arrangements with third parties, all of which could have a material adverse effect on our business, results of operations and financial condition.

**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.**

We are an insurance holding company whose assets include all of the outstanding shares of the common stock of Principal Life and other subsidiaries. Our ability to pay dividends to our stockholders and meet our obligations, including paying operating expenses and any debt service, depends upon the receipt of dividends from Principal Life. Iowa insurance laws impose limitations on the ability of Principal Life to pay dividends to us. Any inability of Principal Life to pay dividends to us in the future may cause us to be unable to pay dividends to our stockholders and meet our other obligations. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Liquidity and Capital Resources" for a discussion of regulatory restrictions on Principal Life's ability to pay us dividends.

**Changes in accounting standards may adversely affect our reported results of operations and financial condition.**

Our consolidated financial statements are prepared in conformity with U.S. generally accepted accounting principles ("U.S. GAAP"). From time to time, we are required to adopt new or revised accounting standards issued by the Financial Accounting Standards Board ("FASB"). The required adoption of future accounting standards may adversely affect our reported results of operations and financial condition. For a discussion of the impact of accounting pronouncements issued but not yet implemented, see Item 8. "Financial Statements and Supplementary Data, Notes

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

to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies". The FASB is currently considering significant changes to the accounting standards for insurance contracts. While the effects of proposed changes in accounting standards on our financial statements cannot be meaningfully assessed, these proposed changes, if adopted, could have the potential to negatively impact our reported profitability and financial ratios. In addition, the



Table of Contents

required adoption of new accounting standards may result in significant incremental costs associated with initial implementation and ongoing compliance.

**Litigation and regulatory investigations may affect our financial strength or reduce our profitability.**

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 and disability insurance; and our investment activities. We are, from time to time, also involved in various governmental, regulatory and administrative proceedings and inquiries.

Legal liability or adverse publicity with respect to current or future legal or regulatory actions, whether or not involving us, may affect our financial strength or reduce our profitability. For further discussion on litigation and regulatory investigation risk, see Item 3. "Legal Proceedings," Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Contingencies, Guarantees and Indemnifications" under the caption, "Litigation and Regulatory Contingencies" and Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes" under the caption "Other Tax Information."

**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.**

We are subject to income taxes in the United States as well as many other jurisdictions. In determining our provisions for income taxes and our accounting for tax-related matters in general, we are required to exercise judgment. We regularly make estimates where the ultimate tax determination is uncertain. The final determination of any tax audit, appeal of the decision of a taxing authority, tax litigation or similar proceedings may be materially different from that reflected in our historical financial statements. The assessment of additional taxes, interest and penalties could be materially adverse to our current and future results of operations and financial condition.

**Applicable laws and our certificate of incorporation and by-laws may discourage takeovers and business combinations that some stockholders might consider in their best interests.**

State laws and our certificate of incorporation and by-laws may delay, defer, prevent, or render more difficult a takeover attempt that some stockholders might consider in their best interests. For instance, they may prevent our stockholders from receiving the benefit from any premium to the market price of our common stock offered by a bidder in a takeover context. Even in the absence of a takeover attempt, the existence of these provisions may adversely affect the prevailing market price of our common stock if they are viewed as discouraging takeover attempts in the future.

State laws and our certificate of incorporation and by-laws may also make it difficult for stockholders to replace or remove our management. These provisions may facilitate management entrenchment, which may delay, defer or prevent a change in our control, which may not be in the best interests of our stockholders.

The following provisions, included in our certificate of incorporation and by-laws, may also have anti-takeover effects and may delay, defer or prevent a takeover attempt that some stockholders might consider in their best interests. In particular, our certificate of incorporation and by-laws:

permit our Board of Directors to issue one or more series of preferred stock;

divide our Board of Directors into three classes;

limit the ability of stockholders to remove directors;

prohibit stockholders from filling vacancies on our Board of Directors;

prohibit stockholders from calling special meetings of stockholders;

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

impose advance notice requirements for stockholder proposals and nominations of directors to be considered at stockholder meetings and

require the approval of at least 75% of the voting power of our outstanding common stock for the amendment of our by-laws and provisions of our certificate of incorporation governing:

the classified board,

the director's discretion in determining what he or she reasonably believes to be in the best interests of Principal Financial Group, Inc.,

the liability of directors,

the removal of directors by shareholders,

the prohibition on stockholder actions by written consent and

the supermajority voting requirements.

Table of Contents

In addition, Section 203 of the General Corporation Law of the State of Delaware may limit the ability of an "interested stockholder" to engage in business combinations with us. An interested stockholder is defined to include persons owning 15% or more of our outstanding voting stock.

**Risks relating to our business**

**Competition, including 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.**

We believe our ability to compete is based on a number of factors including scale, service, product features, price, investment performance, commission structure, distribution capacity, financial strength ratings and name recognition. We compete with a large number of financial services companies such as banks, mutual funds, broker-dealers, insurers and asset managers, many of which have advantages over us in one or more of the above competitive factors.

Each of our segments faces strong competition:

The primary competitors for our Retirement and Income Solutions and Principal Global Investors segments are asset managers, banks, broker-dealers and insurers. Our ability to increase and retain AUM is directly related to the performance of our investments as measured against market averages and the performance of our competitors. Even when securities prices are generally rising, performance can be affected by investment styles.

Competition for our Principal International segment comes primarily from local financial services firms and other international companies operating on a stand-alone basis or in partnership with local firms.

Our U.S. Insurance Solutions segment competes with other insurance companies.

In the event competitors charge lower premiums or fees for substantially similar products, we may face pressure to lower our prices in order to attract and retain customers and distributors. Reductions in the premiums and fees we charge may adversely affect our revenues and profitability.

**Damage to our reputation may adversely affect our revenues and profitability.**

Our continued success is dependent upon our ability to earn and maintain the trust and confidence of customers, distributors, employees and other stakeholders. Damage to our reputation may arise from a variety of sources including, but not limited to, litigation or regulatory actions, compliance failures, employee misconduct, unfavorable press coverage, and unfavorable comments on social media. Adverse developments within our industry may also, by association, negatively impact our reputation or result in greater regulatory or legislative scrutiny. Any damage to our reputation could adversely affect our ability to attract and retain customers, distributors and employees, potentially leading to a reduction in our revenues and profitability.

**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.**

A.M. Best, Fitch, Moody's and S&P publish financial strength ratings on U.S. life insurance companies as well as some of our international insurance companies. These ratings indicate the applicable rating agency's opinion regarding an insurance company's ability to meet contractholder and policyholder obligations. These rating agencies also assign credit ratings on non-life insurance entities, such as PFG and Principal Financial Services, Inc. ("PFS"). Credit ratings indicate the applicable rating agency's opinion regarding a debt issuer's ability to meet the terms of debt obligations in a timely manner and are important factors in overall funding profile and ability to access external capital.

Ratings are important factors in establishing the competitive position of insurance companies and maintaining public confidence in products being offered. Our ratings could be downgraded at any time without advance notice by any rating agency. A ratings downgrade, or the potential for such a downgrade, could, among other things:

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

materially increase the number of surrenders for all or a portion of the net cash values by the owners of policies and contracts we have issued, and materially increase the number of withdrawals by policyholders of cash values from their policies;

result in the termination of our relationships with broker-dealers, banks, agents, wholesalers and other distributors of our products and services;

reduce new sales, particularly with respect to full service payout products and general account GICs and funding agreements purchased by pension plans and other institutions;

cause some of our existing liabilities to be subject to acceleration, additional collateral support, changes in terms, or creation of additional financial obligations and

increase our cost of capital and limit our access to the capital markets.

Any of these consequences could adversely affect our profitability and financial condition.

Table of Contents

**Client terminations or withdrawals or changes in investor preferences may lead to a reduction in revenues for our asset management and accumulation businesses.**

Revenues from our asset management and accumulation products are primarily fee-based. Our asset-based fees are typically calculated as a percentage of the market value of assets under management. Our asset management and accumulation clients may elect to terminate their relationship with us or withdraw funds, generally on short notice. Client terminations and withdrawals may be driven by a variety of factors, including economic conditions, investment performance, investor preferences or changes in our reputation in the marketplace. Significant terminations or withdrawals may reduce our AUM, thus adversely affecting our revenues and profitability.

In addition, fee levels can vary significantly among different types of investments. We generally earn higher fees on liquid alternatives and equity investments vs. fixed income investments and on actively managed investments vs. indexed or passive investment strategies. Therefore, our fee revenue is impacted by both the value and the composition of our AUM. Investor preferences with respect to asset classes and investment strategies may shift over time due to market conditions, tax law changes, regulatory changes and various other factors. Changes in the composition of our assets under management may adversely affect our revenues and profitability.

**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.**

Certain of our variable annuity products include guaranteed minimum death benefits and/or guaranteed minimum withdrawal benefits. Periods of significant and sustained downturns in equity markets, increased equity volatility or reduced interest rates could result in an increase in the valuation of the future policy benefit or contractholder fund liabilities associated with such products, resulting in a reduction to net income. We use derivative instruments to attempt to mitigate changes in the liability exposure related to interest rate, equity market and volatility movements, and the volatility of net income associated with these liabilities. However, we remain liable for the guaranteed benefits in the event that derivative counterparties are unable or unwilling to pay. The liability exposure and volatility of net income may also be influenced by changes in market credit spreads reflecting our own creditworthiness, for which we do not attempt to hedge. In addition, we are subject to the risk that hedging and other management procedures prove ineffective or that unanticipated policyholder behavior or mortality, combined with adverse market events, produces economic losses beyond the scope of the risk management techniques employed. These, individually or collectively, may have a material adverse effect on our net income, financial condition or liquidity. We are also subject to the risk that the cost of hedging these guaranteed minimum benefits increases as implied volatilities increase and/or interest rates decrease, resulting in a reduction to net income.

**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.**

Our continued success is largely dependent on our ability to attract and retain qualified employees. We face intense competition in attracting and retaining key employees, including investment, marketing, finance, information technology, legal, compliance and other professionals. If we are unable to attract and retain qualified employees, our results of operations and financial condition may be adversely impacted.

We distribute our asset accumulation, asset management and life and specialty benefit insurance products and services through a variety of distribution channels, including our own internal sales representatives, independent brokers, banks, broker-dealers and other third-party marketing organizations. We must attract and retain sales representatives to sell our products. Strong competition exists among financial services companies for efficient sales representatives. We compete with other financial services companies for sales representatives primarily on the basis of our financial position, support services and compensation and product features. If we are unable to attract and retain sufficient sales representatives to sell our products, our ability to compete and revenues from new sales would suffer.

Our ability to increase and retain AUM is directly related to the performance of our investments as measured against market averages and the performance of our competitors. If we are unable to attract and retain qualified portfolio managers, we may face reduced sales and increased cash outflows in our asset accumulation and asset management businesses.

**An interruption in telecommunication, information technology, or other systems, or a failure to maintain the confidentiality, integrity, or availability of data residing on such systems, could disrupt our business, damage our reputation and adversely impact our profitability.**

We rely on telecommunication, information technology, and other systems to conduct business, including customer service, marketing and sales activities, customer relationship management and producing financial statements. In addition, we store and process confidential and proprietary business information on both company owned and third party managed systems.

Financial services companies have increasingly become targets of cyberattacks resulting in unauthorized access to confidential information, theft of funds from online accounts, disruption or degradation of service or other damage.

Table of Contents

These attacks may take a variety of forms, including web application attacks, denial of service attacks, ransomware and other viruses or malware and social engineering, including phishing. While we have policies, procedures, security controls and monitoring, automation and backup plans designed to prevent, or limit the effect of failure, the sophistication of cybercriminals may still result in disruptions or breaches beyond our control. The failure of our telecommunication, information technology, or other systems, for any reason, could disrupt our operations, result in the loss of customer business and adversely impact our profitability.

Any compromise of the security of our systems that results in the disclosure of personally identifiable customer or employee information could damage our reputation, deter customers from purchasing our products and services, expose us to litigation, increase regulatory scrutiny and require us to incur significant technical, legal and other expenses. In addition, data breaches impacting other companies, such as the Equifax data breach in 2017, may allow cybercriminals to obtain personally identifiable information about our customers. Cybercriminals may then use this information to attempt to gain unauthorized access to our customers' accounts, which could have a material adverse impact on our reputation, results of operations, and financial condition.

**Our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses.**

Our international businesses face political, legal, operational and other risks that we do not face in our operations in the U.S. We face the risk of discriminatory regulation, nationalization or expropriation of assets, price controls and exchange controls or other restrictions that prevent us from transferring funds from these operations out of the locations in which they operate or converting local currencies we hold into U.S. dollars or other currencies. Some of our international businesses are, and are likely to continue to be, in emerging or potentially volatile markets. In addition, we rely on local staff, including local sales forces, in those locations where there is a risk we may encounter labor problems with local staff, especially in locations where workers' associations and trade unions are strong.

**We face risks arising from our participation in joint ventures.**

We participate in joint ventures, primarily in our international businesses and real estate investment operations. In these joint ventures, we lack complete management and operational control over the operations, and our joint venture partners may have objectives that are not fully aligned with our interests. These factors may limit our ability to take action to protect or increase the value of our investment in the joint venture.

**We may need to fund deficiencies in our Closed Block assets.**

In connection with its conversion in 1998 into a stock life insurance company, Principal Life established an accounting mechanism, known as a "Closed Block" for the benefit of participating ordinary life insurance policies that had a dividend scale in force on July 1, 1998. We allocated assets to the Closed Block as of July 1, 1998, in an amount such that we expected their cash flows, together with anticipated revenues from the policies in the Closed Block, to be sufficient to support the Closed Block business, including payment of claims, certain direct expenses, charges and taxes and to provide for the continuation of aggregate dividend scales in accordance with the 1997 policy dividend scales if the experience underlying such scales continued, and to allow for appropriate adjustments in such scales if the experience changed. We will continue to pay guaranteed benefits under the policies included in the Closed Block, in accordance with their terms. The Closed Block assets, cash flows generated by the Closed Block assets and anticipated revenues from policies included in the Closed Block may not be sufficient to provide for the benefits guaranteed under these policies. If they are not sufficient, we must fund the shortfall. Even if they are sufficient, we may choose for business reasons to support dividend payments on policies in the Closed Block with our general account funds.

The Closed Block assets, cash flows generated by the Closed Block assets and anticipated revenues from policies in the Closed Block will benefit only the holders of those policies. In addition, to the extent these amounts are greater than the amounts estimated at the time we funded the Closed Block, dividends payable in respect of the policies included in the Closed Block may be greater than they would have been in the absence of a Closed Block. Any excess net income will be available for distribution over time to Closed Block policyholders but will not be available to our stockholders. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 6, Closed Block" for further details.

**A pandemic, terrorist attack, military action or other catastrophic event could adversely affect our net income.**

The occurrence of pandemic disease, man-made disasters such as terrorist attacks and military actions, and natural disasters could adversely affect our operations, net income or financial condition. For example, our mortality and morbidity experience could be adversely impacted by a catastrophic event. In addition, a severe catastrophic event may cause significant volatility in global financial markets, disruptions to commerce and reduced economic activity. The resulting macroeconomic conditions could adversely affect our cash flows, as well as the value and liquidity of our invested assets. We may also experience operational disruptions if our employees are unable or unwilling to come to work due to a pandemic or other catastrophe.





Table of Contents

**Our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and financial condition.**

We cede life, disability, health and long-term care insurance to other insurance companies through reinsurance. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies." The collectability of reinsurance recoverables is largely dependent on the solvency of the individual insurers. We remain liable to the policyholder, even if the reinsurer defaults on its obligations with respect to the ceded business. In addition, a reinsurer's insolvency may cause us to lose our reserve credits on the ceded business, in which case we would be required to establish additional reserves.

The premium rates we charge are based, in part, on the assumption that reinsurance will be available at a certain cost. Most of our reinsurance contracts contain provisions that limit the reinsurer's ability to increase rates on in-force business; however, some do not. If a reinsurer raises the rates it charges on a block of in-force business, our profitability may be negatively impacted if we are not able to pass the increased costs on to the customer. If reinsurers raise the rates they charge on new business, we may be forced to raise the premiums we charge, which could have a negative impact on our competitive position.

**We face risks arising from acquisitions of businesses.**

We have acquired businesses in the past, and expect to continue to do so in the future. We face a number of risks arising from acquisition transactions, including difficulties in integrating the acquired business into our operations, difficulties in assimilating and retaining employees and intermediaries, difficulties in retaining the existing customers of the acquired entity, unforeseen liabilities that arise in connection with the acquired business, unfavorable market conditions that could negatively impact our growth expectations for the acquired business and sustained declines in the equity market that could reduce the AUM and fee revenues for certain acquired businesses. These risks may prevent us from realizing the expected benefits from acquisitions and could result in the impairment of goodwill and/or intangible assets recognized at the time of acquisition.

For additional information on our goodwill and other intangible assets, see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Goodwill and Other Intangible Assets."

**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.**

We rely on services and products provided by many vendors in the United States and abroad. These include, for example, vendors of computer hardware and software and vendors of services. In the event that one or more of our vendors suffers a bankruptcy or otherwise becomes unable to continue to provide products or services, or fails to protect personal information of our customers or employees, we may suffer operational impairments, reputational damage and financial losses.

**Our enterprise risk management framework may not be fully effective in identifying or mitigating all of the risks to which we are exposed.**

We utilize an integrated risk management framework, which is designed to manage material risks within established risk appetites and risk tolerances. Nonetheless, our policies and procedures may not be fully effective in identifying or mitigating every risk to which we are exposed. Many of our methods for managing and mitigating risk rely on models and assumptions that are based, in part, on observed historical data. As a result, these methods may not accurately predict future exposures, which may be significantly greater than our historical measures indicate. We may be exposed to unanticipated risks as a result of changes in market conditions, new products or new business strategies, catastrophes or other unforeseen circumstances. If our risk management framework proves ineffective, we may suffer unexpected losses, which may adversely affect our results of operations and financial condition.

**Our financial results may be adversely impacted by global climate changes.**

Atmospheric concentrations of carbon dioxide and other greenhouse gases have increased dramatically since the industrial revolution, resulting in a gradual increase in global average temperatures and an increase in the frequency and severity of natural disasters. These trends are expected to continue in the future and have the potential to impact nearly all sectors of the economy to varying degrees. We cannot predict the long-term impacts of climate change, but we will continue to monitor new developments in the future.

Potential impacts may include the following:

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

Changes in temperatures and air quality may adversely impact our mortality and morbidity rates. For example, increases in the level of pollution and airborne allergens may cause an increase in upper respiratory and cardiovascular diseases, leading to increased claims in our insurance businesses. However, the risk of increased mortality on our life insurance business may be partly offset by our payout annuity business, where an increase in mortality results in a decrease in benefit payments.

Table of Contents

Climate change may impact asset prices, as well as general economic conditions. For example, rising sea levels may lead to decreases in real estate values in coastal areas. Additionally, government policies to slow climate change (e.g., setting limits on carbon emissions) may have an adverse impact on sectors such as utilities, transportation and manufacturing. Changes in asset prices may impact the value of our fixed income, real estate and commercial mortgage investments. We manage our investment risks by maintaining a well-diversified portfolio, both geographically and by sector. We also monitor our investments on an ongoing basis, allowing us to adjust our exposure to sectors and/or geographical areas that face severe risks due to climate change.

A natural disaster that affects one of our office locations could disrupt our operations and pose a threat to the safety of our employees. However, we have extensive Business Continuity and Disaster Recovery planning programs in place to help mitigate this risk.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

As of December 31, 2017, we owned 33 properties in our home office complex in Des Moines, Iowa, and in various other locations. Of these 33 properties, 17 are office buildings, 1 is a warehouse facility, 12 are parking lots and ramps, 1 is a park/green space, 1 is a childcare center and 1 is a power generation plant. Of the office and warehouse space, we occupy approximately 92.5% of the 2.6 million square feet of space in these buildings. The balance of the space in these buildings is rented to commercial tenants or is occupied by the property management company servicing these properties. We lease office space for various offices located throughout the U.S. and internationally. We believe that our owned and leased properties are suitable and adequate for our current business operations.

**Item 3. Legal Proceedings**

Disclosure concerning material legal proceedings can be found in Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Contingencies, Guarantees and Indemnifications" under the caption, "Litigation and Regulatory Contingencies" and Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes" under the caption, "Other Tax Information," which are incorporated here by this reference.

**Executive Officers of the Registrant**

The following information is furnished with respect to our executive officers, each of whom is elected by and serves at the pleasure of the Board of Directors.

**Timothy M. Dunbar, 60**, has been Executive Vice President of the Company and Principal Life and Chief Investment Officer of the Company since January 2014. Prior to that date, he served as Senior Vice President of the Company and Principal Life since 2011, and Chief Investment Officer of the Company and Principal Life since January 2013. Prior to that date, Mr. Dunbar was in charge of Strategy and Finance for the Company and Principal Life in 2011 and 2012, overseeing the business management and strategic direction of the capital markets, corporate strategy and corporate treasury areas. He retains his responsibility for capital markets. Mr. Dunbar previously served as the executive director and head of equities for Principal Global Investors from 2004 until 2011.

**Nora M. Everett, 58**, has been President, Retirement and Income Solutions of the Company and Principal Life since March 2015. Prior to her current position, she served as President and Chief Executive Officer of Principal Funds since 2008 and Senior Vice President and Deputy General Counsel of the Company and Principal Life since 2004.

**Amy C. Friedrich, 46**, has been President of U.S. Insurance Solutions since May 2017. Prior to that time, she was Senior Vice President of the Specialty Benefits Insurance division of U.S. Insurance Solutions since 2015, and Vice President of Specialty Benefits since 2008.

**Daniel J. Houston, 56**, has been a director of the Company and Principal Life and President and Chief Executive Officer of the Company and Principal Life since August 2015. Prior to that date, he held the same positions except was Chief Operating Officer (and not Chief Executive Officer) since November 2014. Previously, he served as President, Retirement, Insurance and Financial Services of the Company and Principal

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

Life since 2010. He was President, Retirement and Income Solutions of the Company and Principal Life from 2008 until 2010, and was Executive Vice President, Retirement and Income Solutions of the Company and Principal Life from 2006 to 2008.

**Julia M. Lawler, 58**, serves as Senior Vice President and Chief Risk Officer of the Company and Principal Life effective January 1, 2018. Prior to that time, she served as Senior Executive Director Multi-Asset Allocation since 2015, was Chief Investment Officer of Retirement and Income Solutions since 2014, and previously served as Senior Vice President and Chief Investment Officer of the Company and Principal Life since 2002.

**James P. McCaughan, 64**, who heads the Principal Global Investors segment of our operations, has been President, Principal Global Investors of the Company and Principal Life since 2003.

Table of Contents

**Gary P. Scholten, 60**, has been Chief Digital Officer since May 2017 and Executive Vice President and Chief Information Officer of the Company and Principal Life since February 2014. Prior to that date, he was Senior Vice President and Chief Information Officer of the Company and Principal Life since 2002.

**Karen E. Shaff, 63**, has been Executive Vice President and General Counsel of the Company and Principal Life since 2004 and, in addition, Secretary of the Company and Principal Life since January 2014. Prior thereto, she was Senior Vice President and General Counsel of the Company since 2001, and Senior Vice President and General Counsel of Principal Life since 2000.

**Deanna D. Strable-Soethout, 49**, has been Executive Vice President and Chief Financial Officer of the Company and Principal Life since February 2017. Prior to that date, she was Executive Vice President of the Company and Principal Life since September 2016 and President, U.S. Insurance Solutions of the Company and Principal Life since March 2015. Prior to that, she served as Senior Vice President of the Company and Principal Life since 2006.

**Luis Valdes, 60**, has been the head of the Principal International segment of our operations since 2012, has been President, Principal International of the Company and Principal Life since 2011. Prior to his current position, he was Senior Vice President and President PFG Latin America of the Company and Principal Life since 2010, and was Vice President Principal International of Principal Life from 2000 until 2010.

**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock began trading on the New York Stock Exchange under the symbol "PFG" on October 23, 2001. Prior to such date, there was no established public trading market for our common stock. Effective December 15, 2017, we changed our listing to the Nasdaq Global Select Market and began trading under the symbol "PFG". On February 2, 2018, there were 280,782 stockholders of record of our common stock.

The following table presents the high and low prices per share for our common stock for the periods indicated and the dividends declared per share during such periods.

	High	Low	Dividends declared
<b>2017</b>			
First quarter	\$ 64.65	\$ 56.12	\$ 0.45
Second quarter	\$ 66.12	\$ 60.35	\$ 0.46
Third quarter	\$ 67.73	\$ 59.62	\$ 0.47
Fourth quarter	\$ 72.23	\$ 64.46	\$ 0.49
<b>2016</b>			
First quarter	\$ 44.30	\$ 33.09	\$ 0.38
Second quarter	\$ 44.90	\$ 38.03	\$ 0.39
Third quarter	\$ 51.72	\$ 38.84	\$ 0.41
Fourth quarter	\$ 61.34	\$ 50.96	\$ 0.43

Future dividend decisions will be based on and affected by a number of factors, including our results and financial requirements and the impact of regulatory restrictions. See Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources" for a discussion of regulatory restrictions on Principal Life's ability to pay dividends.

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

### Table of Contents

The following table presents the amount of our share purchase activity for the periods indicated:

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, 2017 - January 31, 2017	604,484	\$ 58.55	596,709	\$ 183.0
February 1, 2017 - February 28, 2017	655,087	\$ 60.57	376,814	\$ 160.8
March 1, 2017 - March 31, 2017	1,072,130	\$ 63.19	961,667	\$ 100.0
April 1, 2017 - April 30, 2017	1,125	\$ 62.75	\$	100.0
May 1, 2017 - May 31, 2017	117,417	\$ 61.60	117,000	\$ 342.8
June 1, 2017 - June 30, 2017	302,843	\$ 63.45	302,843	\$ 323.6
July 1, 2017 - July 31, 2017	117,572	\$ 64.60	117,700	\$ 316.0
August 1, 2017 - August 31, 2017	297,683	\$ 63.61	297,196	\$ 297.1
September 1, 2017 - September 30, 2017	358,548	\$ 61.93	356,374	\$ 275.0
October 1, 2017 - October 31, 2017	1,509	\$ 50.30	\$	275.0
November 1, 2017 - November 30, 2017	33,444	\$ 68.03	\$	275.0
December 1, 2017 - December 31, 2017	255	\$ 71.53	\$	275.0
<b>Total</b>	<b>3,562,097</b>		<b>3,126,303</b>	

(1) Includes the number of shares of common stock utilized to execute certain stock incentive awards and shares purchased as part of a publicly announced program.

(2) In February 2016, our Board of Directors authorized a repurchase program of up to \$400.0 million of our outstanding common stock. In May 2017, our Board of Directors authorized an additional repurchase of up to \$250.0 million of our outstanding common stock.

### **Item 6. Selected Financial Data**

The following table sets forth certain selected historical consolidated financial information. We derived the consolidated financial information (except for amounts referred to as "Other Supplemental Data") for each of the years ended December 31, 2017, 2016 and 2015 and as of December 31, 2017 and 2016 from our audited consolidated financial statements and notes to the financial statements included in this Form 10-K. We derived the consolidated financial information (except for amounts referred to as "Other Supplemental Data") for the years ended December 31, 2014 and 2013 and as of December 31, 2015, 2014 and 2013 from our audited consolidated financial statements not included in this Form 10-K. The following summary of consolidated financial information (except for amounts referred to as "Other Supplemental Data") has been prepared in accordance with U.S. GAAP.

In order to fully understand our consolidated financial information, please also see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our audited consolidated financial statements and the notes to the financial statements included in this Form 10-K. The results for past accounting periods are not necessarily indicative of the results to be expected for any future accounting period.

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

## Table of Contents

	As of or for the year ended December 31,				
	2017 (1)	2016 (1)	2015 (1)	2014	2013
	<i>(\$ in millions, except per share data and as noted)</i>				
<b>Income Statement Data:</b>					
Revenue:					
Premiums and other considerations	\$ 6,217.4	\$ 5,299.1	\$ 5,310.3	\$ 3,722.9	\$ 3,154.1
Fees and other revenues	3,892.3	3,627.4	3,653.1	3,482.1	3,222.2
Net investment income	3,459.3	3,296.5	3,052.1	3,257.9	3,138.4
Net realized capital gains (losses)	524.2	171.1	(51.1)	14.7	(225.2)
<b>Total revenues</b>	<b>\$ 14,093.2</b>	<b>\$ 12,394.1</b>	<b>\$ 11,964.4</b>	<b>\$ 10,477.6</b>	<b>\$ 9,289.5</b>
Income from continuing operations, net of related income taxes	\$ 2,324.5	\$ 1,361.8	\$ 1,253.2	\$ 1,176.4	\$ 936.1
Net income	\$ 2,324.5	\$ 1,361.8	\$ 1,253.2	\$ 1,176.4	\$ 936.1
<b>Earnings per Share Data:</b>					
Income from continuing operations, net of related income taxes, per share:					
Basic	\$ 8.00	\$ 4.55	\$ 4.11	\$ 3.70	\$ 2.99
Diluted	\$ 7.88	\$ 4.50	\$ 4.06	\$ 3.65	\$ 2.95
Net income per share:					
Basic	\$ 8.00	\$ 4.55	\$ 4.11	\$ 3.70	\$ 2.99
Diluted	\$ 7.88	\$ 4.50	\$ 4.06	\$ 3.65	\$ 2.95
Dividends declared per common share	\$ 1.87	\$ 1.61	\$ 1.50	\$ 1.28	\$ 0.98
<b>Balance Sheet Data:</b>					
Total assets	\$ 253,941.2	\$ 228,014.3	\$ 218,660.3	\$ 219,087.0	\$ 208,191.4
Long-term debt	\$ 3,178.4	\$ 3,125.7	\$ 3,265.2	\$ 2,531.2	\$ 2,601.4
Series A preferred stock	\$	\$	\$	\$	\$
Series B preferred stock	\$	\$	\$	\$ 0.1	\$ 0.1
Total stockholders' equity	\$ 12,921.9	\$ 10,293.8	\$ 9,377.4	\$ 10,232.0	\$ 9,777.0
<b>Other Supplemental Data:</b>					
AUM (\$ in billions)	\$ 668.6	\$ 591.6	\$ 527.4	\$ 519.3	\$ 483.2

(1) For a discussion of items materially affecting the comparability of 2017, 2016 and 2015, please see Item 7. "Management's Discussion and Analysis of Financial Condition and Results of Operations - Transactions Affecting Comparability of Results of Operations."

## Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of December 31, 2017, compared with December 31, 2016, our consolidated results of operations for the years ended December 31, 2017, 2016 and 2015, and, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our audited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-K.

### 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," and other 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. Those risks and uncertainties include, but are not limited to, the risk factors listed in Item 1A. "Risk Factors."

**Overview**

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

Retirement and Income Solutions;

Principal Global Investors;

Principal International and

U.S. Insurance Solutions.

We also have a Corporate segment, which consists of the assets and activities that have not been allocated to any other segment. See Item 1. "Business" for a description of our reportable segments.



Table of Contents

**Economic Factors and Trends**

Positive market performance and net customer cash flows led to account value increases in our Retirement and Income Solutions segment. Positive market performance has also led to AUM increases in our Principal Global Investors segment. Since account values and AUM are the base by which these businesses generate revenues, the increase in account values and AUM has contributed to the overall improvement of our fee revenues in these segments.

In our Principal International segment, we continued to grow our business organically through our existing subsidiaries and joint ventures and through strategic acquisitions and start-up operations. Local currency AUM, a key indicator of earnings growth for the segment, increased significantly as a result of positive net customer cash flows and market performance. The financial results for the Principal International segment are also impacted by fluctuations of the foreign currency to U.S. dollar exchange rates for the locations in which we have business.

The U.S. Insurance Solutions segment has been impacted by lower interest rates in recent years, which has caused spread compression and led to higher reserves. We have mitigated some of the impact through changes in our investment strategy and changes to certain product offerings.

**Profitability**

Our profitability depends in large part upon our:

amount of AUM;

ability to manage the difference between the investment income we earn and the interest we credit to policyholders;

ability to generate fee revenues by providing administrative and investment management services;

ability to price our insurance products at a level that enables us to earn a margin over the cost of providing benefits and the related expenses;

ability to manage our investment portfolio to maximize investment returns and minimize risks such as interest rate changes or defaults or impairments of invested assets;

ability to effectively hedge fluctuations in foreign currency to U.S. dollar exchange rates on certain transactions and

ability to manage our operating expenses.

**Critical Accounting Policies and Estimates**

The increasing complexity of the business environment and applicable authoritative accounting guidance requires us to closely monitor our accounting policies. Our significant accounting policies are described in Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies." We have identified critical accounting policies that are complex and require significant judgment and estimates about matters that are inherently uncertain. A summary of our critical accounting policies is intended to enhance the reader's ability to assess our financial condition and results of operations and the potential volatility due to changes in estimates and changes in guidance. The identification, selection and disclosure of critical accounting estimates and policies have been discussed with the Audit Committee of the Board of Directors.

***Valuation and Impairment of Fixed Income Investments***

**Fixed Maturities.** Fixed maturities include bonds, asset-backed securities ("ABS"), redeemable preferred stock and certain non-redeemable preferred securities. We classify our fixed maturities as either AFS or trading and, accordingly, carry them at fair value in the consolidated statements of financial position. Volatility in net income can result from changes in fair value of fixed maturities classified as trading. Volatility in other comprehensive income can result from changes in fair value of fixed maturities classified as AFS.

The fair values of our public fixed maturities are primarily based on market prices from third party pricing vendors. We have regular interactions with these vendors to ensure we understand their pricing methodologies and to confirm they are utilizing observable market information. In addition, 6% of our invested asset portfolio as of December 31, 2017, was invested in privately placed fixed maturities with no readily available market quotes to determine the fair market value. The majority of these assets are valued using a matrix pricing valuation approach that utilizes observable market inputs. 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 be impacted by company specific factors. This excludes privately placed securities subject to Rule 144A of the Securities Act of 1933 that are primarily based on market prices from third party pricing vendors, similar to public fixed maturities.

Table of Contents

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. These are reflected in Level 3 in the fair value hierarchy and can include fixed maturities across all asset classes. As of December 31, 2017, less than 1% of our total fixed maturities were Level 3 securities valued using internal pricing models. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements" for further discussion.

The \$1,130.5 million increase in net unrealized gains from U.S. investment operations for the year ended December 31, 2017, can primarily be attributed to tightening of credit spreads. For additional information about interest rate risk see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk".

Fixed maturities classified as AFS are subject to impairment reviews. When evaluating fixed maturities for impairment, 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 a 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 a security is deemed to be other than temporarily impaired, an impairment loss is recognized. See item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 4, Investments - Other-Than-Temporary Impairments" for further discussion.

A number of significant risks and uncertainties are 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. As of December 31, 2017, we had \$14,657.2 million in AFS fixed maturities with gross unrealized losses totaling \$267.0 million. Included in the gross unrealized losses are losses attributable to both movements in market interest rates as well as movement in credit spreads.

**Mortgage Loans.** Mortgage loans consist primarily of commercial mortgage loans on real estate. As of December 31, 2017, the carrying value of our commercial mortgage loans was \$12,871.5 million. Commercial mortgage loans on real estate are generally reported at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances.

Commercial mortgage loans on real estate are considered impaired when, based on current information and events, it is probable we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine a loan is impaired, a valuation allowance is established equal to the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. Estimated value is based on either the present value of the expected future cash flows discounted at the loan's effective interest rate, the loan's observable market price or fair value of the collateral. Subsequent changes in the estimated value are reflected in the valuation allowance. Amounts on loans deemed to be uncollectible are charged off and removed from the valuation allowance. The change in the valuation allowance provision is included in net realized capital gains (losses) on our consolidated statements of operations.

The valuation allowance is maintained at a level believed adequate by management to absorb estimated probable credit losses. Management's periodic evaluation and assessment of the valuation allowance adequacy is based on known and inherent risks in the portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, portfolio delinquency information, underwriting standards, peer group information, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component is subjective, as it requires the estimation of timing and amount of future cash flows expected to be received on impaired loans. For more detailed information concerning mortgage loan valuation allowances and impairments, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 4, Investments - Mortgage Loan Valuation Allowance."

We have a large experienced commercial real estate staff centrally located in Des Moines, which includes commercial mortgage underwriters, loan closers, loan servicers, engineers, appraisers, credit analysts, research staff, legal staff, information technology personnel and portfolio managers. Experienced commercial real estate senior management adheres to a disciplined process in reviewing all transactions for approval on a consistent basis. During 2017, the typical new commercial mortgage loan at origination averaged 51% loan-to-value with a 2.5 times debt service coverage ratio and was internally rated A on a bond equivalent basis. Our entire commercial mortgage loan portfolio averaged 45% loan-to-value ratio with a 2.7 times debt service coverage ratio as of December 31, 2017. We believe the large equity



Table of Contents

cushion and strong debt service coverage in our commercial mortgage loan investments should help insulate us from stress during times of weak commercial real estate fundamentals.

***Derivatives***

We use derivatives primarily to hedge or reduce exposure to market risks. The fair values of exchange-traded derivatives are determined through quoted market prices. Exchange-traded derivatives include futures that are settled daily, which reduces their fair value in the consolidated statements of financial position. The fair values of privately negotiated contracts, which are usually referred to as over-the-counter ("OTC") derivatives, that are cleared through centralized clearinghouses are determined through market prices published by the clearinghouses. Beginning in 2017, variation margin associated with OTC cleared derivatives is settled daily, which reduces their fair value in the consolidated statements of financial position. The fair values of non-cleared OTC derivatives are determined using either pricing valuation models that utilize market observable inputs or broker quotes. On an absolute fair value basis as of December 31, 2017, 95% of our OTC derivative assets and liabilities were valued using pricing valuation models and the remaining 5% using broker quotes. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements" for further discussion. The fair values of our derivative instruments can be impacted by changes in interest rates, foreign exchange rates, credit spreads, equity indices and volatility, as well as other contributing factors. For additional information see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk".

We also issue certain annuity contracts and other insurance contracts that include embedded derivatives that have been bifurcated from the host contract. They are valued using a combination of historical data and actuarial judgment. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements" for further discussion. We include our assumption for own non-performance risk in the valuation of these embedded derivatives. As our credit spreads widen or tighten, the fair value of the embedded derivative liabilities decrease or increase, leading to an increase or decrease in net income. If the current market credit spreads reflecting our own creditworthiness move to zero (tighten), the reduction to net income would be approximately \$101.0 million, net of DAC and income taxes, based on December 31, 2017, reported amounts. In addition, the policyholder behavior assumptions used in the valuation of embedded derivatives include risk margins, which increase the fair value of the embedded derivative liabilities.

The accounting for derivatives is complex and interpretations of the applicable accounting standards continue to evolve. Judgment is applied in determining the availability and application of hedge accounting designations and the appropriate accounting treatment. Judgment and estimates are used to determine the fair value of some of our derivatives. Volatility in net income can result from changes in fair value of derivatives that do not qualify or are not designated for hedge accounting and changes in fair value of embedded derivatives.

***Deferred Acquisition Costs and Other Actuarial Balances***

Incremental direct costs of contract acquisition as well as certain costs directly related to acquisition activities (underwriting, policy issuance and processing, medical and inspection and sales force contract selling) for the successful acquisition of new and renewal insurance policies and investment contract business are capitalized to the extent recoverable. Maintenance costs and acquisition costs that are not deferrable are charged to net income as incurred.

***Amortization Based on Estimated Gross Profits.*** DAC for universal life-type insurance contracts and certain investment contracts are amortized over the expected lifetime of the contracts in relation to estimated gross profits ("EGPs"). In addition to DAC, the following actuarial balances are also amortized in relation to EGPs.

**Sales inducement asset** Sales inducements are amounts that are credited to the contractholder's account balance as an inducement to purchase the contract. Like DAC, the cost of the sales inducement is capitalized and amortized over the expected life of the contract, in proportion to EGPs.

**Unearned revenue liability** An unearned revenue liability is established when we collect fees or other policyholder assessments that represent compensation for services to be provided in future periods. These revenues are deferred and then amortized over the expected life of the contract, in proportion to EGPs.

**Reinsurance asset or liability** For universal-life type products that are reinsured, a reinsurance asset or liability is established to spread the expected net reinsurance costs or profits in proportion to the EGPs on the underlying business.

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

We also have additional benefit reserves that are established for annuity or universal life-type contracts that provide benefit guarantees, or for contracts that are expected to produce profits followed by losses. The liabilities are accrued in relation to estimated contract assessments.

Key assumptions used in the calculation of EGPs include mortality, morbidity, lapses, equity returns, general account investment yields and expenses as well as the change in our liability for certain guarantees and the difference between actual and expected reinsurance premiums and recoveries, depending on the nature of the contract. Our general account investment yield assumption reflects our long-term projections of interest rates and net realized capital gains (losses). We develop an estimate of EGPs at issue and each valuation date. As actual experience and market conditions emerge, the

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

### Table of Contents

gross profits may vary from those expected either in magnitude or timing, in which case a true-up of actuarial balances occurs as a charge or credit to current net income. In addition, we are required to revise our assumptions regarding future experience if actual experience or other evidence suggests that earlier estimates should be revised; we refer to this as unlocking. Both actions, reflecting actual experience and market conditions and changing future estimates, can change both the current amount and the future amortization pattern of the DAC asset and related actuarial balances.

For individual variable life insurance, individual variable annuities and group annuities that have separate account U.S. equity investment options, we utilize a mean reversion methodology (reversion to the mean assumption), a common industry practice, to determine the future domestic equity market growth rate assumption used for the calculation of EGPs. If actual annualized U.S. equity market performance varies from our 8% long-term assumption, we assume different performance levels in the short-term such that the weighted average return is equal to the long-term assumption over the mean reversion period. However, our mean reversion process generally limits assumed returns to a range of 4-12% during the mean reversion period. For additional details concerning methods of DAC amortization see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies - Deferred Acquisition Costs."

**Internal Replacements.** We review policies for modifications that result in the exchange of an existing contract for a new contract. If the new contract is determined to be an internal replacement that is substantially changed from the replaced contract, any unamortized DAC and related actuarial balances are written off and acquisition costs related to the new contract are capitalized as appropriate. If the new contract is substantially unchanged from the replaced contract, we continue to amortize the existing DAC and related actuarial balances.

**Recoverability.** DAC and sales inducement assets are subject to recoverability testing at the time of policy issue and loss recognition testing on an annual basis, or when an event occurs that may warrant loss recognition. If loss recognition or impairment is necessary, the asset balances are written off to the extent it is determined that future policy premiums and investment income or gross profits are not adequate to cover the balances.

**Actuarial Assumption Updates.** We periodically review and update actuarial assumptions that are inputs to the models for DAC and other actuarial balances and make model refinements as necessary. For more information see "Transactions Affecting Comparability of Results of Operations - Other - Actuarial Assumption Updates."

**Sensitivities.** As of December 31, 2017, the net balance of DAC and related actuarial balances, excluding balances affected by changes in other comprehensive income ("OCI"), was a \$1,254.4 million asset. We perform sensitivity analyses to assess the impact that certain assumptions have on these balances. The following table shows the estimated immediate impact of various assumption changes on our DAC and related actuarial balances.

	Estimated impact to net income (1) (in millions)
Reducing the future equity return assumption by 1%	\$ (8)
Reducing the long-term general account investment yield assumption by 0.5%	(34)

(1) Reflects the net impact of changes to the DAC asset, sales inducement asset, unearned revenue liability, reinsurance asset or liability, additional benefit reserves and related taxes. Includes the impact on net income of changes in DAC and related actuarial balances for our equity method subsidiaries. The DAC and related actuarial balances of the equity method subsidiaries are not included in the total DAC balance listed above as they are not fully consolidated.

### **Goodwill and Other Intangible Assets**

Goodwill and other intangible assets include the cost of acquired subsidiaries in excess of the fair value of the net tangible assets recorded in connection with acquisitions. Goodwill and intangible assets with indefinite lives are not amortized; rather, we test the carrying value for impairment at least annually. Goodwill is tested at the reporting unit level, which is a business one level below the operating segment. We formally conduct our annual goodwill and other intangible asset impairment testing during the third quarter. Under certain circumstances, interim impairment tests may be required if events occur or circumstances change that would more-likely-than-not reduce the fair value of a reporting unit below its carrying value.

As our business changes, we review the reporting units at which goodwill and other intangible assets are tested. Through this review in 2017, we determined we should change Principal International's reporting units from country level to regional level. Principal International's

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

reporting units are structured at the regional level and management is in place to oversee each region. Management reviews and assesses our position as a retirement leader and our respective international product offerings in each of our markets collectively, and reports results primarily at the regional level. The reorganization of the reporting units did not involve a split of any previously identified reporting units; therefore, the country level reporting units were merely combined into new reporting units and the relative fair value assessment model did not apply.



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

## Table of Contents

The operating segments and associated reporting units at which we perform our testing are as follows:

Retirement and Income Solutions: Retirement and Income Solutions    Fee and Retirement and Income Solutions    Spread

Principal Global Investors: Equity Investments, Fixed Income Investments, Real Estate and Other Alternative Investments, Mutual Funds Complex

Principal International: Latin America and Asia

U.S. Insurance Solutions: Specialty Benefits Insurance and Individual Life Insurance

Corporate: Corporate subsidiaries

**Goodwill.** U.S. GAAP permits entities to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the quantitative impairment test of the two-step goodwill impairment test. We continue to perform a two-step test in our evaluation of the carrying value of goodwill.

In Step 1 of the evaluation, the fair value of each reporting unit is determined and compared to the carrying value of the reporting unit. If the fair value is greater than the carrying value, the carrying value of the reporting unit is deemed to be recoverable, and Step 2 is not required. After completion of our 2017 Step 1 analysis, it was determined that fair values exceeded the carrying amounts for all businesses one level below the operating segment and we did not have any business at risk of failing the Step 1 goodwill impairment test. If the fair value estimate had been less than the carrying value, it is an indicator that impairment may exist, and Step 2 would be required. In Step 2, the reporting unit's goodwill implied fair value is determined. The reporting unit's fair value as determined in Step 1 is assigned to all of its net assets (recognized and unrecognized) as if the reporting unit were acquired in a business combination as of the date of the impairment test. If the implied fair value of the reporting unit's goodwill is lower than its carrying amount, goodwill is impaired and written down to its implied fair value.

The determination of fair value for our reporting units is primarily based on an income approach whereby we use discounted cash flows for each reporting unit. When available, and as appropriate, we use market approaches or other valuation techniques to corroborate discounted cash flow results. The discounted cash flow model used for each reporting unit is based on either income or distributable cash flow, depending on the reporting unit being valued. We use different discount rates based upon the weighted average cost of capital adjusted for risks associated with the operations.

For the income model, we determine fair value based on the present value of the most recent income projections for each reporting unit and calculate a terminal value utilizing a terminal growth rate. The significant assumptions in the income model include: income projections, including the underlying assumptions; discount rate and terminal growth rate.

For the distributable cash flow model, we determine fair value based on the present value of projected statutory net income and changes in required capital to determine distributable income for the respective reporting unit. The significant assumptions in the distributable cash flow model include: required capital levels; income projections, including the underlying assumptions; discount rate; new business projection period and new business production growth. We did not recognize an impairment in our 2017 consolidated statement of operations.

**Other Intangible Assets.** U.S. GAAP permits entities to first assess qualitative factors to determine whether it is more-likely-than-not that the fair value of an intangible asset with an indefinite life is less than its carrying amount to determine whether it is necessary to perform a quantitative assessment. We utilize the qualitative approach on a limited basis for testing of intangible assets with indefinite lives. Intangible assets with finite lives are amortized as related benefits emerge and are reviewed periodically for indicators of impairment in value. If facts and circumstances suggest possible impairment, the sum of the estimated undiscounted future cash flows expected to result from the use of the asset is compared to the current carrying value of the asset. If the undiscounted future cash flows are less than the carrying value, an impairment loss is recognized for the excess of the carrying amount of assets over their fair value. For those assets amortized as related benefits emerge, the most significant assumptions involved in the estimation of future benefits include surrender/lapse rates and margins. We did not recognize an impairment in our 2017 consolidated statement of operations.

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

**Sensitivities.** In connection with our annual impairment testing process, we performed a sensitivity analysis for goodwill impairment with respect to each of our reporting units and determined that a hypothetical 10% decline in the fair value would not result in an impairment of goodwill for any reporting unit. The most significant goodwill and other intangible assets within our 2017 consolidated statement of financial position resulted from our 2013 acquisition of Cuprum, whereby we recorded \$631.8 million of goodwill, and from our 2006 purchase of WM Advisors, Inc., whereby we acquired \$608.0 million of investment management contracts which are considered an indefinite-lived intangible. We cannot predict certain future events that might adversely affect the reported value of goodwill and other intangible assets that totaled \$1,068.8 million and \$1,314.7 million, respectively, as of December 31, 2017. Such events include, but are not limited to, strategic decisions made in response to economic and competitive conditions, the impact of the economic environment on our customer base, interest rate movements, declines in the equity markets, the legal environment in which the businesses operate or a material negative change in our relationships with significant customers. For further information see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies," and "Note 2, Goodwill and Other Intangible Assets."

Table of Contents

**Insurance Reserves**

Reserves are liabilities representing estimates of the amounts that will come due, at some point in the future, to or on behalf of our policyholders. U.S. GAAP, allowing for some degree of managerial judgment, provides guidance for establishing reserves.

Future policy benefits and claims include reserves for individual traditional and group life insurance, disability, medical and long-term care insurance and individual and group annuities that provide periodic income payments. These reserves are computed using assumptions of mortality, morbidity, lapse, investment performance and expense. These assumptions are based on our experience, industry results, emerging trends and future expectations. For long-duration insurance contracts, once these assumptions are made for a given policy or group of policies, they will not be changed over the life of the policy. However, significant changes in experience or assumptions may require us to provide for expected future losses on a product by establishing premium deficiency reserves. Premium deficiency reserves may also be established for short-duration contracts to provide for expected future losses. Our reserve levels are reviewed throughout the year using internal analysis including, among other things, experience studies, claim development analysis and annual loss recognition analysis. To the extent experience indicates potential loss recognition, we recognize losses on certain lines of business. The ultimate accuracy of the assumptions on these long-tailed insurance products cannot be determined until the obligation of the entire block of business on which the assumptions were made is extinguished. Short-term variances of actual results from the assumptions used in the computation of the reserves are reflected in current period net income and can impact quarter-to-quarter net income.

Future policy benefits and claims also include reserves for incurred but unreported disability, medical, dental, vision, critical illness and life insurance claims. We recognize claims costs in the period the service was provided to our policyholders. However, claims costs incurred in a particular period are not known with certainty until after we receive, process and pay the claims. We determine the amount of this liability using actuarial methods based on historical claim payment patterns as well as emerging cost trends, where applicable, to determine our estimate of claim liabilities. We also look back to assess how our prior periods' estimates developed. To the extent appropriate, changes in such development are recorded as a change to current period claim expense. Historically, the amount of the claim reserve adjustment made in subsequent reporting periods for prior period estimates have been within a reasonable range given our normal claim fluctuations.

We periodically review and update actuarial assumptions that are used to compute reserves. For more information see "Transactions Affecting Comparability of Results of Operations Other Actuarial Assumption Updates."

**Benefit Plans**

The reported expense and liability associated with pension and OPEB plans requires the use of assumptions. Numerous assumptions are made regarding the discount rate, expected long-term rate of return on plan assets, turnover, expected compensation increases, health care claim costs, health care cost trends, retirement rates and mortality. The discount rate and the expected return on plan assets have the most significant impact on the level of expense.

The assumed discount rate is determined by projecting future benefit payments inherent in the Projected Benefit Obligation and discounting those cash flows using a spot yield curve for high quality corporate bonds. Our assumed discount rates were 3.60% for our pension plans and 3.35% for our OPEB plans as of December 31, 2017. Typically, a 0.25% decrease in the discount rate would increase the pension benefits Projected Benefit Obligation and the Net Periodic Pension Cost ("NPPC") by approximately \$128.7 million and \$5.3 million, respectively. Typically, a 0.25% decrease in the discount rate would increase the OPEB accumulated postretirement benefit obligation by approximately \$2.5 million and would have a nominal impact on the Net Periodic Benefit Cost ("NPBC"). Typically, a 0.25% increase in the discount rate would result in decreases in benefit obligations and expenses at a level generally commensurate with those noted above.

The assumed long-term rate of return on plan assets is set at the long-term rate expected to be earned based on the long-term investment policy of the plans and the various classes of the invested funds. Historical and future expected returns of multiple asset classes were analyzed to develop a risk-free real rate of return and risk premiums for each asset class. The overall long-term rate for each asset class was developed by combining a long-term inflation component, the real risk-free rate of return and the associated risk premium. A weighted average rate was developed based on long-term returns for each asset class, the plan's target asset allocation policy and the tax structure of the trusts. For the 2017 NPPC and 2017 NPBC, a 6.70% and 4.40% weighted average long-term rate of return was used, respectively. For the 2018 NPPC and 2018 NPBC, a 6.30% and 4.85% weighted average long-term rate of return assumption, respectively, will be used. Typically, a 0.25% decrease in the assumed long-term rate of return would increase the NPPC by approximately \$6.2 million and the NPBC by approximately \$1.7 million. Typically, a 0.25% increase in this rate would result in a decrease to expense at the same levels. The assumed return on plan assets is based on the fair market value of plan assets as of December 31, 2017.

The compensation increase assumption is generally set at a rate consistent with current and expected long-term compensation and salary policy, including inflation.

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

Actuarial gains and losses are amortized using a straight-line amortization method over the average remaining service period of employees, which is approximately 10 years for pension costs and approximately 4 years for OPEB costs.

Table of Contents

The qualified pension plan does not utilize the allowable corridor, while the nonqualified pension plan and OPEB plans utilize the 10% corridor. Prior service costs are amortized on a weighted average basis over approximately 7 years for pension costs and 2 years for OPEB costs. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 11, Employee and Agent Benefits" for further discussion.

***Income Taxes***

We provide for income taxes based on our estimate of the liability for taxes due. Our tax accounting represents management's best estimate of various events and transactions, such as completion of tax audits or establishment of, or changes to, a valuation allowance associated with certain deferred tax assets, which could affect our estimates and effective income tax rate in a particular quarter or annual period. Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates expected to be in effect during the years in which the basis differences reverse. We are required to evaluate the recoverability of our deferred tax assets each quarter and establish a valuation allowance, if necessary, to reduce our deferred tax assets to an amount that is more-likely-than-not to be realizable. In determining the need for a valuation allowance, we consider many factors, including future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in prior carryback years and implementation of any feasible and prudent tax planning strategies management would employ to realize the tax benefit.

U.S. federal and state deferred income taxes have not been provided on approximately \$1,331.2 million and \$1,088.4 million of accumulated but undistributed earnings from operations of foreign subsidiaries as of December 31, 2017 and 2016, respectively. We do not record U.S. federal and state deferred income taxes on foreign earnings not expected to be distributed to the U.S. We apply an exception to the general rule, which under U.S. GAAP otherwise requires the recording of U.S. deferred income taxes on the anticipated repatriation of foreign earnings as recognized for financial reporting purposes. The exception permits us to not record a U.S. deferred income tax liability on foreign earnings we expect to be indefinitely reinvested in our foreign operations. The related deferred income taxes will be recorded in the period it becomes apparent we can no longer positively assert some or all the undistributed earnings will remain invested into the foreseeable future.

Inherent in the provision for income taxes are estimates and our expectations regarding the deductibility of certain items, the timing of income and expense recognition, future performance and the current or future realization of operating losses, capital losses and certain tax credits. We regularly evaluate the capital needs of our domestic and foreign operations considering all available information, including operating and capital plans, regulatory capital requirements, parent company financing and cash flow needs, as well as tax laws applicable to our domestic and foreign subsidiaries. In the event these estimates differ from our prior estimates due to the receipt of new information, we may be required to significantly change the provision for income taxes recorded in the consolidated financial statements. Any such change could significantly affect the amounts reported in the consolidated financial statements in the year these estimates change. A significant decline in value of financial assets could lead to establishment of a valuation allowance on deferred tax assets having an adverse effect on current and future results. In management's judgment, total deferred income tax assets are more-likely-than-not to be realized.

In addition, the amount of income taxes paid is subject to audits in the U.S. as well as various state and foreign jurisdictions. Tax benefits are recognized for book purposes when the more-likely-than-not threshold is met with regard to the validity of an uncertain tax position. Once this threshold is met, for each uncertain tax position we recognize in earnings the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement with the Internal Revenue Service or other income taxing authorities for audits ongoing or not yet commenced.

We had \$231.8 million and \$242.9 million of current income tax receivables associated with outstanding audit issues reported as other assets in our consolidated statements of financial position as of December 31, 2017 and 2016, respectively. We believe there are adequate defenses against, or sufficient provisions for, the contested issues, but final resolution of contested issues could take several years while legal remedies are pursued. Consequently, we do not anticipate the ultimate resolution of audits ongoing or not yet commenced to have a material impact on our net income.

The effects of tax legislation are recognized in the period of enactment. The effects of the U.S. tax reform were reflected in the 2017 financial statements as determined or as reasonably estimated provisional amounts based on available information subject to interpretation in accordance with the SEC's Staff Accounting Bulletin No. 118 ("SAB 118"). SAB 118 provides guidance on accounting for the effects of the U.S. tax reform where our determinations are incomplete but we are able to determine a reasonable estimate. A final determination is required to be made within a measurement period not to extend beyond one year from the enactment date of the U.S. tax reform. The provisional amount is primarily associated with estimation of the one-time deemed repatriation tax considering complexity as well as limited and changing technical tax guidance. Further, the provisional amount also applies in regard to other potential technical interpretations of accounting and taxing authorities related to elements of the U.S. tax reform subject to change. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes" for further discussion.



Table of Contents

**Recent Events**

***MetLife Afore***

On October 26, 2017, we announced an agreement to acquire full ownership of MetLife Afore, MetLife, Inc.'s mandatory pension business in Mexico, subject to regulatory approvals. The acquisition grows the scale of our existing AFORE operations within the Principal International segment by increasing AUM by approximately \$3.7 billion and adding 0.7 million customers. The combined AFORE business is expected to be the 5th largest in terms of AUM and 6th largest in terms of customers in Mexico. We expect the transaction to close in the first half of 2018.

***INTERNOS***

On November 30, 2017, we announced an expansion of both our European business and our global real estate capabilities through the acquisition of INTERNOS, a London-based European real estate investment manager with \$3.25 billion in AUM as of September 30, 2017, and more than 100 full-time employees across eight European countries. The acquisition is expected to close in the first half of 2018, subject to regulatory approval. Once approved, INTERNOS will become Principal Real Estate Investors Europe and operate as our dedicated European real estate private equity investment boutique. Principal Real Estate Investors Europe will be reported within the Principal Global Investors segment.

***CIMB Joint Ventures***

On January 11, 2018, we and CIMB announced a realignment of our ownership stakes in our joint ventures, CPAM and CPIAM. Once complete, we will increase our ownership stake to 60% with CIMB retaining 40% ownership and co-management of both CPAM and CPIAM. Our investment in both entities will continue to be reported within the Principal International segment upon completion of the agreement. We expect the transaction to close in the second quarter of 2018 subject to regulatory approvals across the region.

**Transactions Affecting Comparability of Results of Operations**

***Acquisition***

We entered into an acquisition agreement for the following business.

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

***Other***

***Tax Cuts and Jobs Act.*** U.S. tax reform made broad and complex changes to the U.S. Internal Revenue Code applicable to us. The primary impact on our 2017 financial results was associated with the effect of reducing the U.S. statutory tax rate from 35% to 21% on our deferred tax balances as of December 31, 2017, and a one-time deemed repatriation tax on certain unremitted earnings of foreign subsidiaries. Other provisions of U.S. tax reform not effective until January 1, 2018, include, but are not limited to: 1) provisions reducing the dividends received deduction; 2) essentially eliminating U.S. federal income taxes on dividends from foreign subsidiaries; 3) retaining an element of current inclusion of certain earnings of controlled foreign corporations; 4) eliminating the corporate alternative minimum tax ("AMT") and 5) changing how existing AMT credits will be realized. Net income attributable to Principal Financial Group, Inc. for the year ended December 31, 2017, benefited \$568.3 million from the impact of the U.S. tax reform.

***Actuarial Assumption Updates.*** We periodically review and update actuarial assumptions that are inputs to the models for DAC and other actuarial balances and make model refinements as necessary. During the third quarter of 2017, assumption updates and model refinements were made resulting in an unlocking of DAC and other actuarial balances that decreased total company net income by \$26.6 million for the year ended December 31, 2017. The pre-tax operating earnings impact was \$(32.8) million for our U.S. Insurance Solutions segment, \$(21.8) million for our Retirement and Income Solutions segment and \$(11.8) million for our Principal International segment for the year ended December 31, 2017.

During the third quarter of 2016, assumption updates and model refinements were made resulting in an unlocking of DAC and other actuarial balances that decreased total company net income by \$68.8 million for the year ended December 31, 2016. The pre-tax operating earnings impact was \$(33.2) million for our U.S. Insurance Solutions segment, \$(31.6) million for our Retirement and Income Solutions segment

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

and \$(8.9) million for our Principal International segment for the year ended December 31, 2016.

During the third quarter of 2015, assumption updates and model refinements were made resulting in an unlocking of DAC and other actuarial balances that increased total company net income by \$26.2 million for the year ended December 31, 2015. The pre-tax operating earnings impact was \$76.8 million for our U.S. Insurance Solutions segment and \$(28.7) million for our Retirement and Income Solutions segment for the year ended December 31, 2015.



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

### Table of Contents

The individual life insurance business actuarial assumption updates and model refinements had the most significant impact and affected several line items within our income statement. The following table presents the increase (decrease) on the individual life insurance income statement line items for the years ended December 31, 2017, 2016 and 2015.

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<i>(in millions)</i>		
Pre-tax operating earnings (losses)	\$ (47.0)	\$ (43.2)	\$ 64.6
Fee revenues	14.2	(9.5)	(3.0)
Benefits, claims and settlement expenses	18.5	53.6	(43.5)
Dividends to policyholders		8.2	
Operating expenses	42.7	(28.1)	(24.1)

### ***Real Estate Transactions***

In an effort to adjust the concentration of our real estate holdings in Southern California, improve the liquidity of our real estate portfolio and gain control of certain properties that were jointly owned, we entered an exchange agreement to exit certain real estate joint ventures in September 2017. The transaction resulted in us transferring our interest in certain real estate properties in exchange for our joint venture partner's interest in certain other real estate properties. In a subsequent transaction we sold certain of these real estate properties to a third party. Both transactions closed in September 2017.

We recognized a \$690.9 million net pre-tax realized capital gain (\$410.8 million net after-tax realized capital gain) for the year ended December 31, 2017, as a result of these transactions. For additional information related to these transactions, see Item 1. "Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments" under the caption, "Real Estate Transactions."

### ***Chilean Legal Entity Merger***

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

### **Other Factors Affecting Comparability**

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

Fluctuations in foreign currency to U.S. dollar exchange rates for locations 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. The most significant impact occurs within our Principal International segment where pre-tax operating earnings were positively impacted \$12.6 million and negatively impacted \$25.3 million for the years ended December 31, 2017 and 2016, respectively, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. This impact was calculated by comparing (a) the difference between current year results and prior year results to (b) the difference between current year results and prior year results translated using current year exchange rates for both periods. We use this approach to calculate the impact of exchange rates on all revenue and expense line items. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 7A. "Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk."

#### ***Effects of Inflation***

The impact of inflation has not had a material effect on our annual consolidated results of operations over the past three years. However, we may be materially affected by inflation in the future.

#### ***Variable Investment Income***

Variable investment income includes certain types of investment returns such as prepayment fees and income (loss) from certain elements of our other alternative asset classes, including results of value-add real estate sales activity. Due to its unpredictable nature, variable investment

income may or may not be material to our financial results for a given reporting period and may create variances when comparing different reporting periods. For additional information, see "Investment Results."

Table of Contents**Recent Regulatory Changes**

On June 9, 2017, most provisions of the DOL fiduciary rule became applicable. The regulation broadens the definition of a fiduciary under ERISA to include persons providing investment advice to an employee benefit plan or an IRA for a fee or other compensation. The DOL also released two new prohibited transaction class exemptions and amendments to current prohibited transaction exemptions. Broker-dealers and advisors continue to work through the implications of the regulations on business models, and how they proceed could impact our business. Even with this fluid environment, our assessment of the regulation's impact to our business and future financial results indicates the costs will not have a significant effect on our financial condition or results of operations.

The final applicability date for certain provisions of the DOL fiduciary rule, such as the Best Interest Contract Exemption, was originally scheduled for January 1, 2018. However, in November 2017, the DOL delayed the applicability date of these provisions to July 1, 2019. The delay in the applicability date will provide additional time for the DOL and the SEC to evaluate the rule's impact on access to financial information and advice. This evaluation may result in revisions to, or potentially rescission of, the rule.

**Recent Accounting Changes**

For recent accounting changes, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies" under the caption, "Recent Accounting Pronouncements."

**Results of Operations**

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

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Revenues:					
Premiums and other considerations	\$ 6,217.4	\$ 5,299.1	\$ 5,310.3	\$ 918.3	\$ (11.2)
Fees and other revenues	3,892.3	3,627.4	3,653.1	264.9	(25.7)
Net investment income	3,459.3	3,296.5	3,052.1	162.8	244.4
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	606.0	269.5	(20.9)	336.5	290.4
Net other-than-temporary impairment losses on available-for-sale securities	(28.7)	(98.8)	(0.8)	70.1	(98.0)
Other-than-temporary impairment losses on fixed maturities available-for-sale reclassified to (from) other comprehensive income	(53.1)	0.4	(29.4)	(53.5)	29.8
Net impairment losses on available-for-sale securities	(81.8)	(98.4)	(30.2)	16.6	(68.2)
Net realized capital gains (losses)	524.2	171.1	(51.1)	353.1	222.2
Total revenues	14,093.2	12,394.1	11,964.4	1,699.1	429.7
Expenses:					
Benefits, claims and settlement expenses	7,822.6	6,913.2	6,697.7	909.4	215.5
Dividends to policyholders	124.6	156.6	163.5	(32.0)	(6.9)
Operating expenses	3,893.8	3,732.6	3,672.4	161.2	60.2
Total expenses	11,841.0	10,802.4	10,533.6	1,038.6	268.8
Income before income taxes	2,252.2	1,591.7	1,430.8	660.5	160.9
Income taxes (benefits)	(72.3)	229.9	177.6	(302.2)	52.3
Net income	2,324.5	1,361.8	1,253.2	962.7	108.6
Net income attributable to noncontrolling interest	14.1	45.3	19.2	(31.2)	26.1
Net income attributable to Principal Financial Group, Inc.	2,310.4	1,316.5	1,234.0	993.9	82.5
Less:					
Preferred stock dividends			16.5		(16.5)

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

Excess of redemption value over carrying value of preferred shares redeemed				8.2				(8.2)		
Net income available to common stockholders	\$	<b>2,310.4</b>	\$	1,316.5	\$	1,209.3	\$	993.9	\$	107.2

Table of Contents

*Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

**Net Income Attributable to Principal Financial Group, Inc.**

Net income attributable to Principal Financial Group, Inc. increased \$568.3 million related to the U.S. tax reform and \$410.8 million due to after-tax net realized capital gains resulting from real estate transactions in 2017.

**Total Revenues**

Premiums increased \$810.2 million for the Retirement and Income Solutions segment primarily due to higher sales of single premium group and individual annuities with life contingencies. The single premium group annuity 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.

Fees and other revenues increased \$92.1 million for the Retirement and Income Solutions segment primarily due to higher fees stemming from an increase in mean account values, which resulted from an increase in the daily average equity markets since 2016. Fees and other revenues increased \$79.9 million for the U.S. Insurance Solutions segment primarily due to growth in the business. Fees and other revenues increased \$61.1 million for the Principal Global Investors segment primarily due to an increase in management fee revenue resulting from higher AUM.

Net investment income increased primarily due to higher average invested assets in our U.S. operations. For additional information, see "Investment Results – Net Investment Income."

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. Net realized capital gains increased primarily due to \$690.9 million in net gains resulting from real estate transactions in 2017 as described in "Transactions Affecting Comparability of Results of Operations – Real Estate Transactions." This increase was partially offset by a \$347.1 million change in derivatives not designated as hedging instruments that had losses in 2017 versus gains in 2016. For additional information, see "Investment Results – Net Realized Capital Gains (Losses)."

**Total Expenses**

Benefits, claims and settlement expenses increased \$864.3 million for the Retirement and Income Solutions segment primarily due to an increase in reserves resulting from higher sales of single premium group and individual annuities with life contingencies.

Operating expenses increased for the U.S. Insurance Solutions segment primarily due to an \$82.9 million increase resulting from an unfavorable impact associated with actuarial assumption updates and model refinements in 2017 as compared to a favorable impact in 2016 and a \$72.2 million increase associated with growth in the business.

**Income Taxes**

The effective income tax rates were (3)% and 14% for the years ended December 31, 2017 and 2016, respectively. The effective income tax rate decreased to (3)% for the year ended December 31, 2017, from 14% for the year ended December 31, 2016, primarily due to a 36% benefit from the impact of the U.S. tax reform, partially offset by a 16% increase in pre-tax income with no proportionate increase in permanent tax adjustments and a 4% increase in state income taxes. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes – Effective Income Tax Rate" for further discussion.

*Year Ended December 31, 2016 Compared to Year Ended December 31, 2015*

**Net Income Attributable to Principal Financial Group, Inc.**

Net income attributable to Principal Financial Group, Inc. increased \$158.4 million as a result of after-tax net realized capital gains in 2016 as compared to after-tax net realized capital losses in 2015 primarily related to derivatives not designated as hedging instruments. In addition, net income attributable to Principal Financial Group, Inc. increased due to a \$128.8 million increase in after-tax net investment income attributable to higher average invested assets in our U.S. operations and a \$45.6 million increase in after-tax variable investment income. These increases were partially offset by a \$105.2 million benefit from a change in deferred tax balances related to the merger of two of our Chilean legal entities in 2015 and a \$95.0 million after-tax decrease related to actuarial assumption updates and model refinements that had an unfavorable impact on net income in 2016 as compared to a favorable impact in 2015. Additionally, these increases were partially offset by a \$49.1 million decrease attributable to lower investment yields on invested assets in our U.S. operations.

**Total Revenues**

Premiums decreased \$150.5 million for the Retirement and Income Solutions segment primarily due to lower sales of individual annuities with life contingencies. Premiums increased \$117.7 million for the U.S. Insurance Solutions segment primarily resulting from growth in the business. Premiums increased for the Principal International segment

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

### Table of Contents

primarily in Latin America due to \$28.0 million higher sales of single premium annuities with life contingencies in Chile partially offset by \$6.3 million weakening of the Chilean peso against the U.S. dollar.

Fees and other revenues decreased \$75.8 million for the Corporate segment primarily due to income on a tax indemnification recognized in 2015. Fees and other revenues decreased \$35.5 million for the Retirement and Income Solutions segment primarily due to challenging equity market performance. Fees and other revenues increased \$42.3 million for the U.S. Insurance Solutions segment primarily resulting from growth in the business. Fees and other revenues increased \$37.7 million for the Principal Global Investors segment primarily due to increased AUM.

Net investment income increased primarily due to \$198.1 million attributable to higher average invested assets in our U.S. operations and a \$70.1 million increase in variable investment income. These increases were partially offset by a \$75.6 million decrease attributable to lower investment yields on invested assets in our U.S. operations. For additional information, see "Investment Results Net Investment Income."

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 gains in 2016 as compared to net realized capital losses in 2015 primarily due to change in derivatives not designated as hedging instruments. For additional information, see "Investment Results Net Realized Capital Gains (Losses)."

### **Total Expenses**

Benefits, claims and settlement expenses increased for the U.S. Insurance Solutions segment primarily due to a \$117.3 million increase resulting from an unfavorable unlocking impact associated with actuarial assumption updates and model refinements in 2016 as compared to a favorable unlocking impact in 2015. Additionally, benefits, claims and settlement expenses increased \$90.1 million for the U.S. Insurance Solutions segment resulting from growth in our specialty benefits insurance business.

Operating expenses increased for the Corporate segment primarily due to \$86.4 million of one-time costs incurred to extinguish long-term debt in 2016 and \$10.0 million higher interest expense in 2016 associated with the issuance of long-term debt in 2015. These increases were partially offset by a \$42.8 million negative impact of a court ruling on some uncertain tax positions in 2015.

### **Income Taxes**

The effective income tax rates were 14% and 12% for the years ended December 31, 2016 and 2015, respectively. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes Effective Income Tax Rate" for further discussion.

### **Results of Operations by Segment**

For results of operations by segment see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 16, Segment Information."

### **Retirement and Income Solutions Segment**

#### ***Retirement and Income Solutions Trends***

Several key factors impact revenue and earnings growth in the Retirement and Income Solutions segment. These factors include: the ability of our distribution channels to generate new sales and retain existing business; pricing decisions that take account of competitive conditions, persistency, investment returns, mortality trends, and operating expense levels; investment management performance; equity market returns and interest rate changes. Profitability ultimately depends on our ability to price products and invest assets 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.

Net revenue is a key metric used to understand Retirement and Income Solutions earnings growth. Net revenue is defined as operating revenues less benefits, claims and settlement expenses less dividends to policyholders. Net revenue from Retirement and Income Solutions Fee is primarily fee based and is impacted by changes in the equity markets. Net revenue from Retirement and Income Solutions Spread is driven by the difference between investment income earned on the underlying general account assets and the interest rate credited to the contracts.

The following table presents the Retirement and Income Solutions segment net revenue for the years indicated:

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

		For the year ended December 31,			Increase (decrease)	
		2017	2016	2015	2017 vs. 2016	2016 vs. 2015
		<i>(in millions)</i>				
Retirement and Income Solutions	Fee	\$ 1,594.3	\$ 1,511.1	\$ 1,573.5	\$ 83.2	\$ (62.4)
Retirement and Income Solutions	Spread	544.2	491.5	437.6	52.7	53.9
Total Retirement and Income Solutions		\$ 2,138.5	\$ 2,002.6	\$ 2,011.1	\$ 135.9	\$ (8.5)



Table of Contents**Retirement and Income Solutions Segment Summary Financial Data**

The following table presents certain summary financial data relating to the Retirement and Income Solutions segment for the years indicated:

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Operating revenues:					
Premiums and other considerations	\$ 3,671.1	\$ 2,860.9	\$ 3,011.4	\$ 810.2	\$ (150.5)
Fees and other revenues	1,394.4	1,304.7	1,338.8	89.7	(34.1)
Net investment income	2,100.1	1,985.1	1,816.7	115.0	168.4
<b>Total operating revenues</b>	<b>7,165.6</b>	<b>6,150.7</b>	<b>6,166.9</b>	<b>1,014.9</b>	<b>(16.2)</b>
Expenses:					
Benefits, claims and settlement expenses, including dividends to policyholders	5,027.1	4,148.1	4,155.8	879.0	(7.7)
Operating expenses	1,238.7	1,208.1	1,271.0	30.6	(62.9)
<b>Total expenses</b>	<b>6,265.8</b>	<b>5,356.2</b>	<b>5,426.8</b>	<b>909.6</b>	<b>(70.6)</b>
Pre-tax operating earnings	\$ 899.8	\$ 794.5	\$ 740.1	\$ 105.3	\$ 54.4

**Year Ended December 31, 2017 Compared to Year Ended December 31, 2016****Pre-Tax Operating Earnings**

Pre-tax operating earnings increased \$33.4 million in our Fee business primarily due to higher fees stemming from an increase in mean account values, which resulted from an increase in the daily average equity markets since 2016. Pre-tax operating earnings increased in our Spread business primarily due to a \$54.4 million increase attributed to higher mean account values stemming from growth in the business and a \$24.6 million favorable impact associated with actuarial assumption updates and model refinements in 2017 compared to 2016.

**Net Revenue**

Net revenue increased \$83.2 million in our Fee business primarily due to higher fees stemming from an increase in mean account values, which resulted from an increase in the daily average equity markets since 2016. Net revenue increased in our Spread business primarily due to a \$54.4 million increase attributed to higher mean account values stemming from growth in the business.

**Operating Expenses**

Operating expenses increased in our Fee business primarily due to a \$24.4 million increase in staff related costs and a \$15.1 million increase in non-deferrable commission expense and investment management fee expense related to an increase in mean account values, which resulted from an increase in the daily average equity markets since 2016. Operating expenses decreased in our Spread business primarily due to a \$20.7 million decrease in DAC amortization expense resulting from a favorable impact associated with actuarial assumption updates and model refinements in 2017 compared to 2016.

**Year Ended December 31, 2016 Compared to Year Ended December 31, 2015****Pre-Tax Operating Earnings**

Pre-tax operating earnings increased in our Spread business primarily due to a \$31.6 million increase due to higher mean account values stemming from growth in the business and a \$23.5 million increase in variable investment income. In addition, the segment continues to diligently manage expenses and focus on achieving operational efficiencies where possible.

**Net Revenue**

Net revenue decreased in our Fee business primarily due to a \$41.0 million unfavorable impact associated with actuarial assumption updates and model refinements in 2016 and \$39.0 million due to challenging equity market performance, partially offset by an \$11.5 million increase in variable investment income. Net revenue increased in our Spread business primarily due to a \$31.6 million increase due to higher mean account values stemming from growth in the business and a \$23.5 million increase in variable investment income.

Table of Contents**Operating Expenses**

Operating expenses decreased in our Fee business primarily due to \$51.3 million lower DAC unlocking amortization expense resulting from actuarial assumption updates and model refinements in 2016 compared to 2015 and a \$16.8 million third quarter 2015 DAC amortization expense true-up stemming from a decline in market performance. In addition, the segment continues to diligently manage expenses and focus on achieving operational efficiencies where possible.

**Principal Global Investors Segment***Principal Global Investors Trends*

Our overall AUM increased \$40.4 billion in 2017 due to continued strong portfolio management and positive market performance. We also continue to expand our global presence and experience success in winning institutional asset management mandates and other deposits.

The following table provides a summary of AUM managed by Principal Global Investors by the business area that sourced or generated the AUM. Principal Global Investors sourced represents institutional and fund platform AUM sourced by Principal Global Investors' distribution teams. General account represents general account assets of domestic insurance companies and other balance sheet assets. Other affiliated sources represent AUM sourced by other PFG businesses (e.g., separate account assets).

As of	Principal Global Investors sourced	General account	Other affiliated sources	Total AUM
	<i>(in billions)</i>			
December 31, 2017	\$ 219.2	\$ 76.4	\$ 135.3	\$ 430.9
December 31, 2016	200.3	72.8	117.4	390.5
December 31, 2015	186.0	67.0	107.8	360.8

*Principal Global Investors Segment Summary Financial Data*

AUM is the base by which we generate management fee revenues. Market performance and net cash flow are the two main drivers of AUM growth. Market performance reflects equity, fixed income, real estate and other alternative investment performance. Net cash flow reflects client deposits and withdrawals. The fee levels on these client deposits and withdrawals are increasingly becoming the more important factor to revenue growth and will vary widely based on 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 year ended December 31,		
	2017	2016	2015
	<i>(in billions)</i>		
AUM, beginning of period	\$ 390.5	\$ 360.8	\$ 342.7
Net cash flow (1)	(2.7)	9.0	15.5
Investment performance (2)	43.1	21.7	0.6
Operations acquired (3)			1.9
Other (4)		(1.0)	0.1
AUM, end of period	\$ 430.9	\$ 390.5	\$ 360.8

(1) Negative 2017 net cash flows were primarily driven by the loss of a few large low-fee mandates. Positive 2016 and 2015 net cash flows were primarily due to strong distribution results.

(2)

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

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

- (3) Reflects assets managed by Principal Global Investors resulting from the acquisition of AXA's MPF and ORSO pension business in September 2015.
- (4) Primarily reflects the transfer of assets between managers and the effect of exchange rates.

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

## Table of Contents

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

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
<b>Operating revenues:</b>					
Fees and other revenues	\$ 1,434.2	\$ 1,373.1	\$ 1,335.4	\$ 61.1	\$ 37.7
Net investment income	10.2	14.0	8.1	(3.8)	5.9
<b>Total operating revenues</b>	<b>1,444.4</b>	1,387.1	1,343.5	57.3	43.6
<b>Total expenses</b>	<b>969.0</b>	937.4	950.6	31.6	(13.2)
Pre-tax operating earnings attributable to noncontrolling interest	5.7	5.9	4.4	(0.2)	1.5
<b>Pre-tax operating earnings</b>	<b>\$ 469.7</b>	\$ 443.8	\$ 388.5	\$ 25.9	\$ 55.3

### *Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

#### **Pre-Tax Operating Earnings**

Pre-tax operating earnings increased due to a \$96.9 million increase in management fee revenue as a result of increased AUM partially offset by a \$39.2 million decrease in performance fee revenue largely due to a prior year triennial performance fee in our real estate business. Additionally, expenses supporting the business increased \$31.6 million.

### *Year Ended December 31, 2016 Compared to Year Ended December 31, 2015*

#### **Pre-Tax Operating Earnings**

Pre-tax operating earnings increased due to a \$31.0 million increase in management fee revenue as a result of increased AUM and a \$19.1 million increase in performance fee revenue largely in our real estate business.

## **Principal International Segment**

### *Principal International Trends*

Our Principal International businesses focus on locations with growing middle classes, favorable demographics and increasing long-term savings, ideally with voluntary or mandatory pension markets. With variations depending upon the specific location, we have targeted these markets for sales of retirement and related products and services, including mutual funds, asset management, income annuities and life insurance accumulation products to businesses and individuals.

We have pursued our international strategy through a combination of acquisitions, start-up operations and joint ventures, which require infusions of capital consistent with our strategy of long-term growth and profitability.

### *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 locations 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.

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

## Table of Contents

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

	For the year ended December 31,		
	2017	2016	2015
	<i>(in billions)</i>		
AUM, beginning of period	\$ 137.1	\$ 109.9	\$ 114.6
Net cash flow	6.3	9.1	9.3
Investment performance (1)	13.3	9.9	7.7
Operations acquired (2)			4.0
Effect of exchange rates	4.3	9.1	(27.3)
Other (3)	(0.3)	(0.9)	1.6
<b>AUM, end of period</b>	<b>\$ 160.7</b>	<b>\$ 137.1</b>	<b>\$ 109.9</b>

- (1) Variations in investment performance are primarily the result of fluctuations in market performance over time.
- (2) Reflects the acquisition of AXA's MPF and ORSO pension business in September 2015 and Finansa Asset Management Limited in January 2015.
- (3) Reflects \$1.9 billion transfer of CIMB-Principal Islamic Asset Management Sdn. Bhd from Principal Global Investors in April 2015.

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 years indicated.

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Net revenue	\$ 760.1	\$ 678.0	\$ 655.6	\$ 82.1	\$ 22.4

The following table presents certain summary financial data relating to the Principal International segment for the years indicated:

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Operating revenues:					
Premiums and other considerations	\$ 218.0	\$ 274.6	\$ 252.9	\$ (56.6)	\$ 21.7
Fees and other revenues	433.5	407.4	401.8	26.1	5.6
Net investment income	600.0	570.0	565.9	30.0	4.1
<b>Total operating revenues</b>	<b>1,251.5</b>	<b>1,252.0</b>	<b>1,220.6</b>	<b>(0.5)</b>	<b>31.4</b>
Expenses:					
Benefits, claims and settlement expenses	491.4	574.0	565.0	(82.6)	9.0
Operating expenses	426.2	387.6	387.6	38.6	
<b>Total expenses</b>	<b>917.6</b>	<b>961.6</b>	<b>952.6</b>	<b>(44.0)</b>	<b>9.0</b>
Pre-tax operating earnings (losses) attributable to noncontrolling interest	3.9	2.3	(3.3)	1.6	5.6
<b>Pre-tax operating earnings</b>	<b>\$ 330.0</b>	<b>\$ 288.1</b>	<b>\$ 271.3</b>	<b>\$ 41.9</b>	<b>\$ 16.8</b>

*Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

**Pre-Tax Operating Earnings**

Pre-tax operating earnings increased \$29.1 million in Latin America primarily due to \$17.8 million of increased earnings from our equity method investment in Brasilprev, of which \$11.3 million was due to the strengthening of the Brazilian real against the U.S. dollar, and \$17.0 million was due to favorable relative market performance on our required regulatory investments relative to the year earlier period. In addition, Asia pre-tax operating earnings increased \$21.8 million due to continued growth in the business.

**Net Revenue**

Net revenue increased \$57.0 million in Latin America due to \$17.8 million of increased earnings from our equity method investment in Brasilprev, of which \$11.3 million was due to the strengthening of the Brazilian real against the U.S. dollar, and due to \$17.3 million favorable relative market performance in our required regulatory investments. Net revenue in Asia increased \$25.2 million due to continued growth in the business.



Table of Contents**Year Ended December 31, 2016 Compared to Year Ended December 31, 2015****Pre-Tax Operating Earnings**

Pre-tax operating earnings increased in Asia due to \$22.4 million from higher earnings from our equity method investment in China. Pre-tax operating earnings decreased in Latin America due to \$23.8 million from weakening of currencies against the U.S. dollar. This decrease was partially offset by \$22.0 million higher earnings from our equity method investment in Brazil.

**Net Revenue**

Net revenue increased in Asia due to \$24.6 million from higher revenues in Hong Kong following the AXA acquisition in September 2015 and \$22.4 million higher earnings from our equity method investment in China. Net revenue in Latin America decreased due to \$36.4 million weakening of currencies against the U.S. dollar and a \$7.4 million unfavorable 2016 impact associated with assumption updates and model refinements in Mexico. These decreases were partially offset by \$22.0 million higher earnings from our equity method investment in Brazil.

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

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

In our specialty benefits insurance business, premium and fees growth is a result of strong retention and sales, as well as continued in-group growth. In our individual life insurance business, premium and fees growth is driven by strong sales with a focus on maintaining a balanced product portfolio.

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

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Specialty benefits insurance	\$ 2,021.1	\$ 1,862.3	\$ 1,732.6	\$ 158.8	\$ 129.7
Individual life insurance	1,082.3	996.1	966.1	86.2	30.0

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

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Operating revenues:					
Premiums and other considerations	\$ 2,328.3	\$ 2,163.6	\$ 2,045.9	\$ 164.7	\$ 117.7
Fees and other revenues (1)	774.9	694.6	652.6	80.3	42.0
Net investment income	799.4	779.1	742.1	20.3	37.0
Total operating revenues	3,902.6	3,637.3	3,440.6	265.3	196.7
Expenses:					
Benefits, claims and settlement expenses (1)	2,346.3	2,220.5	1,964.1	125.8	256.4
Dividends to policyholders (1)	124.4	156.2	163.2	(31.8)	(7.0)
Operating expenses (1)	1,047.2	899.4	883.8	147.8	15.6
Total expenses	3,517.9	3,276.1	3,011.1	241.8	265.0
Pre-tax operating earnings (1)	\$ 384.7	\$ 361.2	\$ 429.5	\$ 23.5	\$ (68.3)

- 
- (1) For further details related to the impact associated with actuarial assumption updates and model refinements on results for 2017, 2016 and 2015, see "Transactions Affecting Comparability of Results of Operations - Other - Actuarial Assumption Updates."

***Year Ended December 31, 2017 Compared to Year Ended December 31, 2016***

**Pre-Tax Operating Earnings**

Pre-tax operating earnings increased primarily due to growth in the business.

Table of Contents

**Operating Revenues**

Premium and fees increased primarily due to growth in the business.

**Total Expenses**

Benefits, claims and settlement expenses increased \$91.1 million in our specialty benefits insurance business primarily due to growth in the business. Benefits, claims and settlement expenses increased in our individual life insurance business primarily due to a \$61.5 million increase associated with growth in the business, partially offset by a \$35.1 million decrease resulting from a less unfavorable unlocking associated with actuarial assumption updates and model refinements in 2017 as compared to 2016.

Operating expenses increased in our specialty benefits insurance business primarily due to a \$50.7 million increase associated with growth in the business and a \$12.1 million increase resulting from a favorable impact associated with actuarial assumption updates and model refinements in 2016 and no impact in 2017. Operating expenses increased \$83.1 million in our individual life insurance business primarily resulting from an unfavorable impact associated with actuarial assumption updates and model refinements in 2017 as compared to a favorable impact in 2016.

***Year Ended December 31, 2016 Compared to Year Ended December 31, 2015***

**Pre-Tax Operating Earnings**

Pre-tax operating earnings increased in our specialty benefits insurance business primarily due to \$16.2 million associated with growth in the business and \$13.6 million related to expense management. Pre-tax operating earnings decreased \$98.8 million in our individual life insurance business primarily due to an unfavorable unlocking associated with actuarial assumption updates and model refinements in 2016 as compared to a favorable unlocking in 2015.

**Operating Revenues**

Premium and fees increased \$129.7 million in our specialty benefits insurance business primarily due to growth in the business.

**Total Expenses**

Benefits, claims and settlement expenses increased \$98.9 million in our specialty benefits insurance business primarily due to growth in the business. Benefits, claims and settlement expenses increased in our individual life insurance business primarily due to a \$97.1 million increase resulting from unfavorable unlocking impacts associated with actuarial assumption updates and model refinements in 2016 as compared to favorable unlocking impacts in 2015 and a \$35.3 million increase due to growth in the business.

Operating expenses increased in our specialty benefits insurance business primarily due to a \$32.6 million increase associated with growth in the business, partially offset by a \$12.1 million favorable impact from actuarial assumption updates and model refinements in 2016 and a \$6.7 million decrease related to a reimbursement of a reinsurance expense allowance in 2015.

**Corporate Segment**

***Corporate Segment Summary Financial Data***

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

	For the year ended December 31,			Increase (decrease)	
	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Total operating revenues	\$ (60.8)	\$ (46.3)	\$ (50.5)	\$ (14.5)	\$ 4.2
Total expenses	148.8	150.1	134.7	(1.3)	15.4
Pre-tax operating earnings attributable to noncontrolling interest	0.9	22.5	7.1	(21.6)	15.4

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

Pre-tax operating losses	\$	(210.5)	\$	(218.9)	\$	(192.3)	\$	8.4	\$	(26.6)
--------------------------	----	---------	----	---------	----	---------	----	-----	----	--------

*Year Ended December 31, 2017 Compared to Year Ended December 31, 2016*

**Pre-Tax Operating Losses**

Pre-tax operating losses decreased primarily due to a \$17.1 million reduction in financing activities and a \$14.7 million reduction in pension and OPEB expense. These were partially offset by a \$20.0 million fee resulting from our election to discontinue an arrangement with one of our financing counterparties in the first quarter of 2017.

Table of Contents*Year Ended December 31, 2016 Compared to Year Ended December 31, 2015***Pre-Tax Operating Losses**

Pre-tax operating losses increased primarily due to an increase in costs associated with financing activities.

**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.

**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 the 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, we believe to be adequate to meet anticipated short-term and long-term payment obligations. We will continue our prudent capital management practice of regularly exploring options available to us to maximize capital flexibility, including accessing the capital markets and careful attention to and management of expenses.

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

We also manage liquidity risk by limiting the sales of liabilities with features such as puts or other options that can be exercised at inopportune times. For example, as of December 31, 2017, approximately \$9.3 billion, or 99%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. Our individual annuity liabilities also contain surrender charges and other provisions limiting early surrenders.

The following table summarizes the withdrawal characteristics of our domestic general account investment contracts as of December 31, 2017.

	Contractholder funds	Percentage
	<i>(in millions)</i>	
Not subject to discretionary withdrawal	\$ 10,293.6	33.9%
Subject to discretionary withdrawal with adjustments:		
Specified surrender charges	7,119.9	23.5
Market value adjustments	6,625.2	21.8
Subject to discretionary withdrawal without adjustments	6,304.6	20.8

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

Total domestic investment contracts	\$	30,343.3	100.0%
-------------------------------------	----	----------	--------

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

As of December 31, 2017 and December 31, 2016, we had short-term credit facilities with various financial institutions in an aggregate amount of \$905.0 million and \$1,005.0 million, respectively. As of December 31, 2017 and

Table of Contents

December 31, 2016, we had \$39.5 million and \$51.4 million, respectively, of outstanding borrowings, with no assets pledged as support. During the first quarter of 2017, we extended or renewed \$789.0 million of our revolving credit facilities. The facilities and their new maturity dates include a \$600.0 million 5-year facility, with PFG, PFS and Principal Life as co-borrowers that matures March 2022 and a \$200.0 million 5-year credit facility, with PFG, PFS, Principal Life and Principal Financial Services V (UK) LTD as co-borrowers, of which \$11.0 million matures March 2020 and \$189.0 million matures March 2022. The revolving credit facilities are committed and available for general corporate purposes. The \$600.0 million facility is supported by seventeen banks and the \$200.0 million facility is supported by fifteen banks through March 2020, reduced to \$189.0 million supported by fourteen banks thereafter. Most of the banks have other relationships with us. In addition to the revolving credit facilities, Principal International Chile has the capacity to access up to \$60.0 million in unsecured lines of credit offered by Chilean financial institutions and Principal Life has a \$45.0 million unsecured line of credit. Due to the financial strength and the strong relationships we have with these providers, we are comfortable we have 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. No significant restrictions limit the payment of dividends by PFG, except those generally applicable to corporations incorporated in Delaware.

Dividends from Principal Life, our primary subsidiary, are limited by Iowa law. Under Iowa law, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Insurance Commissioner of the State of Iowa (the "Commissioner") to pay stockholder dividends or make any other distribution if such distributions would exceed certain statutory limitations. Iowa law gives the Commissioner discretion to disapprove requests for distributions in excess of these limits. Extraordinary dividends include those made within the preceding twelve months that exceed the greater of (i) 10% of Principal Life's statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year. Based on statutory results for the year ended December 31, 2017, the dividend limitation for Principal Life is approximately \$1,122.4 million in 2018.

On May 1, 2017, Principal Life sold its ownership interest in Principal Global Investors, LLC to Principal Life's direct parent, PFS, in connection with a corporate reorganization designed to better utilize and allocate capital internally. Subsequent to the sale, Principal Life paid an extraordinary dividend of \$1,068.4 million to its parent, which was approved by the Commissioner, primarily from proceeds received from the sale.

Total stockholder dividends paid by Principal Life to its parent in 2017, including distribution of the proceeds from the sale, were \$1,818.4 million, all of which was extraordinary and approved by the Commissioner. As of December 31, 2017, we had \$2,171.3 million of cash and liquid assets held in our holding companies and other subsidiaries, which is available for corporate purposes. Corporate balances held in foreign holding companies meet the indefinite reinvestment exception (see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes"). We recorded a one-time deemed repatriation tax on certain accumulated foreign earnings as a result of the U.S. tax reform; however, we have not had a change in the indefinite reinvestment assertion as we still have plans in place to use cash offshore.

In 2016, total stockholder dividends paid by Principal Life to its parent were \$1,175.0 million, of which \$650.0 million was extraordinary and approved by the Commissioner.

In 2015, total stockholder dividends paid by Principal Life to its parent were \$504.4 million, all of which was extraordinary and approved by the Commissioner.

**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 and strategies, see "Investments."

**Cash Flows.** All cash flow 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.

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

Net cash provided by operating activities was \$4,188.0 million, \$3,857.8 million and \$4,377.1 for the years ended December 31, 2017, 2016 and 2015, respectively. Our insurance businesses typically generate positive cash flows from operating activities, as premiums collected from our insurance products and income received from our investments



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

## Table of Contents

exceed acquisition costs, benefits paid, redemptions and operating expenses. These positive cash flows are then invested to support the obligations of our insurance and investment products and required capital supporting these products. Our cash flows from operating activities are affected by the timing of premiums, fees and investment income received and benefits and expenses paid. The increase in cash provided by operating activities in 2017 compared to 2016 was the result of fluctuations in receivables and payables associated with the timing of settlements. The increase was partially offset by net outflows from trading securities. The decrease in cash provided by operating activities in 2016 compared to 2015 was the result of fluctuations in receivables and payables associated with the timing of settlements.

Net cash used in investing activities was \$4,052.8 million, \$5,153.9 million and \$3,167.6 million for the years ended December 31, 2017, 2016 and 2015, respectively. The decrease in cash used in investing activities in 2017 compared to 2016 was driven by decreased net purchases of available-for-sale securities and the net sale of real estate. The increase in cash used in investing activities in 2016 compared to 2015 was the result of increased purchases of available-for-sale securities primarily in our Spread business.

Net cash used in financing activities was \$384.0 million and \$508.6 million for the years ended December 31, 2017 and 2015, respectively, compared to net cash provided by financing activities of \$1,450.9 million for the year ended December 31, 2016. The increase in cash used in financing activities in 2017 compared to 2016 was the result of lower net investment contract deposits primarily in the investment only business. The increase in cash provided by financing activities in 2016 compared to 2015 was the result of net investment contract deposits in 2016 as compared to net investment contract withdrawals in 2015 primarily due to new issuances in the investment only business in 2016. The increase was partially offset by the net redemption of long-term debt in 2016 as compared to the net issuance of long-term debt in 2015. The proceeds of the debt issuance were primarily used for the redemption of preferred stock in 2015.

**Shelf Registration.** On May 3, 2017, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaced the shelf registration that had been in effect since May 2014. 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, depositary shares, purchase contracts and purchase units of PFG. 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. For information on senior notes issued from our shelf registration, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 9, Debt."

**Short-Term Debt.** For short-term debt information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 9, Debt."

**Long-Term Debt.** On November 10, 2016, we issued \$650.0 million of senior notes, in two tranches. The proceeds from the issuance of these notes were used to redeem our notes payable due in 2017 and 2019. On November 18 and December 5, 2016, we used available cash to purchase approximately \$94.4 million in aggregate principal amount of our senior notes due in 2036. On May 7, 2015, we issued \$400.0 million of senior notes and \$400.0 million of junior subordinated notes, which are subordinated to all our senior debt. The proceeds from these notes were used primarily to redeem our series A and series B preferred stock. For additional long-term debt information regarding these debt issuances, purchases and redemptions, and all outstanding long-term debt, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 9, Debt."

**Stockholders' Equity.** On June 30, 2015, we redeemed our 3.0 million shares of series A preferred stock for \$300.0 million and our 10.0 million shares of series B preferred stock for \$250.0 million. Proceeds from the issuance of our common stock were \$162.5 million, \$37.8 million and \$76.1 million in 2017, 2016 and 2015, respectively.

The following table summarizes our return of capital to common stockholders.

	<b>For the year ended December 31,</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
	<i>(in millions)</i>		
Dividends to stockholders	\$ 540.0	\$ 464.9	\$ 441.0
Repurchase of common stock	220.4	277.3	300.6
<b>Total cash returned to stockholders</b>	<b>\$ 760.4</b>	<b>\$ 742.2</b>	<b>\$ 741.6</b>
Number of shares repurchased	3.6	6.7	6.0

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

For additional stockholders' equity information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 13, Stockholders' Equity."

Table of Contents**Capitalization**

The following table summarizes our capital structure:

	December 31, 2017	December 31, 2016
	(\$ in millions)	
Debt:		
Short-term debt	\$ 39.5	\$ 51.4
Long-term debt	3,178.4	3,125.7
Total debt	3,217.9	3,177.1
Equity excluding AOCI	12,683.8	10,902.5
Total capitalization excluding AOCI	\$ 15,901.7	\$ 14,079.6

Debt to equity excluding AOCI	25%	29%
Debt to capitalization excluding AOCI	20%	23%

**Contractual Obligations**

The following table presents payments due by period for long-term contractual obligations as of December 31, 2017.

Contractual obligations (1)	Total payments	Payments due in year ending			
		2018	2019 - 2020	2021 - 2022	2023 and thereafter
	(in millions)				
Contractholder funds (2)	\$ 89,445.2	\$ 5,562.4	\$ 12,025.6	\$ 9,618.2	\$ 62,239.0
Future policy benefits and claims (3)	53,510.4	2,968.2	5,523.0	5,194.8	39,824.4
Long-term debt (4)	3,178.4			298.2	2,880.2
Certificates of deposit (5)	556.6	240.1	201.0	113.8	1.7
Other long-term liabilities (6)	2,292.3	1,853.8	146.9	125.9	165.7
Capital leases (7)	25.8	11.5	13.1	1.0	0.2
Long-term debt interest (4)	2,794.7	143.7	284.7	269.3	2,097.0
Operating leases (8)	190.6	47.5	68.4	41.2	33.5
Purchase obligations (9)	1,062.8	1,039.1	21.8	1.9	
Total contractual obligations	\$ 153,056.8	\$ 11,866.3	\$ 18,284.5	\$ 15,664.3	\$ 107,241.7

(1) Contractual obligations exclude short-term liabilities, other policyholder funds, taxes and short-term debt as these are not long-term and/or not contractual in nature. Contractual obligations also exclude obligations under our pension and OPEB plans as we do not anticipate contributions will be needed to satisfy the minimum funding requirements of ERISA for our qualified pension plan, nor do we anticipate contributions to the OPEB plans due to the funded status of the trust. In addition, separate account liabilities are excluded. Separate account liabilities represent the fair market value of the assets of the funds that are separately administered by us. Generally, the separate account contract owner, rather than us, bears the investment risk of these funds. The separate account liabilities are legally segregated and are not subject to claims that arise out of any other business of ours. Net deposits, net investment income and realized and unrealized capital gains and losses on the separate accounts are not reflected in the consolidated statements of operations. The separate account obligations will be fully funded by cash flows from the separate account assets.

(2) Contractholder funds include GICs, funding agreements, individual fixed annuities, universal life insurance and other investment contracts. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 8, Insurance Liabilities" for additional information.

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

Amounts included in the contractholder funds line item reflect estimated cash payments to be made to policyholders. The sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount included in our consolidated statements of financial position as of December 31, 2017. The liability amount in our consolidated statements of financial position reflects either the account value (in the case of individual fixed annuities, universal life insurance and GICs) or the par value plus accrued interest and other adjustments (in the case of funding agreements and other investment contracts).

- (3) Amounts included in the future policy benefits and claims line item reflect estimated cash payments to be made to policyholders. The sum of the cash outflows shown for all years in the table exceeds the corresponding liability amount included in our consolidated statements of financial position as of December 31, 2017. The liability amount in our consolidated statements of financial position reflects estimated cash payments to policyholders, reductions for expected future premiums, assumptions with regard to the timing of cash payments and discounting for interest.
- (4) For long-term debt information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 9, Debt."
- (5) Amounts included in the certificates of deposit line item reflect estimated cash payments to be made, including expected interest payments. Certificates of deposit are reported with other liabilities on our consolidated statements of financial position.

Table of Contents

- (6) Amounts included in the other long-term liabilities line item are contractual, non-cancelable and long-term in nature. The total payments primarily relate to savings deposits as well as premium associated with purchased option contracts where payments are made over the life of the contract. This line item excludes accruals, short-term items and items not contractual in nature.
- (7) Amounts included in the capital leases line item represent future minimum lease payments due under capital leases for buildings and hardware storage equipment. For capital lease information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Contingencies, Guarantees and Indemnifications" under the caption, "Capital Leases."
- (8) Amounts included in the operating leases line item represent payments due under various operating leases for office space, data processing equipment and office furniture and equipment. For operating lease information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Contingencies, Guarantees and Indemnifications" under the caption, "Operating Leases."
- (9) Purchase obligations include material contracts where we have a non-cancelable commitment to purchase goods and services in addition to commitments to originate loans and purchase investments.

***Pension and OPEB Plan Funding***

We have defined benefit pension plans covering substantially all of our U.S. employees and certain agents. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 11, Employee and Agent Benefits" for a complete discussion of these plans and their effect on the consolidated financial statements.

We report the net funded status of our pension and OPEB plans in the consolidated statements of financial position. The net funded status represents the difference between the fair value of plan assets and the projected benefit obligation for pension and OPEB plans. The measurement of the net funded status can vary based upon the fluctuations in the fair value of the plan assets and the actuarial assumptions used for the plans as discussed below. The net underfunded status of the pension and OPEB obligation was \$253.7 million pre-tax and \$346.6 million pre-tax as of December 31, 2017 and 2016, respectively. Nonqualified pension plan assets are not included as part of the funding status mentioned above. The nonqualified pension plan assets are held in Rabbi trusts for the benefit of all nonqualified plan participants. The assets held in a Rabbi trust are available to satisfy the claims of general creditors only in the event of bankruptcy. Therefore, these assets are fully consolidated in our consolidated statements of financial position and are not reflected in our funded status as they do not qualify as plan assets under U.S. GAAP. The market value of assets held in these trusts was \$352.0 million and \$341.0 million as of December 31, 2017 and 2016, respectively.

Our funding policy for the qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contributions required under ERISA and, generally, not greater than the maximum amount that can be deducted for U.S. federal income tax purposes. We do not anticipate contributions will be needed in 2018 to satisfy the minimum funding requirements of ERISA for our qualified pension plan. We are unable to estimate the amount that may be contributed, but it is possible that we may fund the plans in 2018 up to \$125 million. This includes funding for both our qualified and nonqualified pension plans. We may contribute to our OPEB plans in 2018 pending further analysis.

***Contractual Commitments***

In connection with our banking business, we have made commitments to extend credit under home equity lines of credit, which are agreements to lend to a customer as long as there is no violation of any conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. A majority of these lines of credit are expected to expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash funding requirements. We evaluate each customer's creditworthiness on a case-by-case basis. The total commitments to fund home equity loans were \$0.5 million as of December 31, 2017.

We have made commitments to provide liquidity for certain benefit plans transitioning to us from another provider. As funds from the plans become available, they will be used to pay down outstanding balances. As of December 31, 2017, the amount of unfunded commitments was \$18.1 million.

We have made commitments to fund certain limited partnerships and other funds in which we are not the general partner or investment manager. As of December 31, 2017, the amount of unfunded commitments was \$761.3 million. We are only required to fund additional equity under these commitments when called upon to do so by the partnership or fund; therefore, these commitments are not liabilities on our consolidated statements of financial position.

*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 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 3, Variable Interest Entities." We have made commitments to fund certain limited partnerships, as previously discussed in "Contractual Commitments", some of which are classified as unconsolidated variable interest entities.

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

### Table of Contents

**Guarantees and Indemnifications.** As of December 31, 2017, no significant changes to guarantees and indemnifications have occurred since December 31, 2016. For guarantee and indemnification information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 12, Contingencies, Guarantees and Indemnifications" under the caption, "Guarantees and Indemnifications."

### **Financial Strength 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, capital levels, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), risk exposures and operating leverage.

In October 2017, Fitch affirmed the 'AA-' financial strength ratings of Principal Life and P NLIC. Fitch also affirmed PFG's long-term senior unsecured debt at 'A-'. The outlook on all ratings remains 'stable'. The rating reflects very strong and stable operating profitability and a very strong business profile, reflecting strong market position and significant operating scale focusing on small and midsize businesses in the retirement market.

In April 2017, S&P affirmed PFG's credit ratings and the financial strength ratings of Principal Life and PNLIC at 'A+'. The outlook remains 'stable' for all ratings. Principal Life's enterprise risk management rating was affirmed as 'Strong'. The rating affirmation reflects S&P's view that we have a very strong competitive position as a leader in the U.S. small to midsize 401(k) market, with strong asset management and insurance solution capabilities.

In January 2017, A.M. Best affirmed the financial strength ratings of Principal Life and PNLIC at 'A+'. The outlook remains 'stable' for all ratings. The affirmation reflects continued solid risk-adjusted capitalization, well-managed balance sheet, strong business profile and consistently favorable operating results.

In the fourth quarter of 2017, Moody's and Fitch changed their outlook on the U.S. life insurance sector to 'stable' from 'negative'. S&P continues to maintain a 'stable' outlook as well. This outlook reflects their expectation that despite ongoing concerns over evolving issues that could negatively impact the U.S. life insurance sector, insurers have shown resilience by exhibiting very strong balance sheet fundamentals and good earnings and liquidity.

A.M. Best continues to reflect a 'negative' outlook reflecting its view that a negative impact on the U.S. life insurance sector could come from pressures such as the flattening yield curve, low treasury rates and evolving regulatory issues.

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 rating is not a recommendation to buy, sell or hold securities. Such a rating may be subject to revision or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating.

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

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

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

*Impacts of Income Taxes*

For income tax information, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 10, Income Taxes."

**Fair Value Measurement**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The fair value hierarchy gives the highest priority (Level 1) to unadjusted quoted prices in active markets for identical assets or liabilities and gives the lowest priority (Level 3) to unobservable inputs. 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



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

### Table of Contents

entirety considering factors specific to the asset or liability. See Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements" for further details, including a reconciliation of changes in Level 3 fair value measurements.

As of December 31, 2017, 41% of our net assets (liabilities) were Level 1, 56% were Level 2 and 3% were Level 3. Excluding separate account assets as of December 31, 2017, 3% of our net assets (liabilities) were Level 1, 97% were Level 2 and 0% were Level 3.

As of December 31, 2016, 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, 2016, 3% of our net assets (liabilities) were Level 1, 96% 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 December 31, 2017, were \$7,791.7 million as compared to \$7,779.6 million as of December 31, 2016. The increase was primarily related to gains in our separate account assets. These gains were partially offset by net sales of our separate account assets 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 recognized third party pricing vendors or from internal models using substantially all market observable information versus relying on broker quotes or utilizing significant unobservable inputs.

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of December 31, 2016, were \$7,779.6 million as compared to \$7,318.6 million as of December 31, 2015. The increase was primarily related to gains in our separate account assets and net purchases of certain structured securities. The increase was partially offset by net sales of our separate accounts assets.

### **Investments**

We had total consolidated assets as of December 31, 2017, of \$253,941.2 million, of which \$82,102.7 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; therefore, the discussion and financial information below does not include such assets.

### **Overall Composition of Invested Assets**

Invested assets as of December 31, 2017, 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, equity securities, real estate and residential mortgage loans. In addition, policy loans are included in our invested assets.

	December 31, 2017		December 31, 2016	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Fixed maturities:				
Public	\$ 41,999.3	51%	\$ 39,170.3	52%
Private	17,955.1	22	16,074.2	21
Equity securities	1,866.6	2	1,512.3	2
Mortgage loans:				
Commercial	12,871.5	16	12,027.8	16
Residential	1,279.0	2	1,202.4	1
Real estate held for sale	212.9		130.7	
Real estate held for investment	1,523.8	2	1,238.1	2
Policy loans	808.3	1	823.8	1
Other investments	3,586.2	4	3,655.9	5
<b>Total invested assets</b>	<b>82,102.7</b>	<b>100%</b>	<b>75,835.5</b>	<b>100%</b>
Cash and cash equivalents	2,470.8		2,719.6	

Total invested assets and cash	\$	<b>84,573.5</b>	\$	78,555.1
--------------------------------	----	-----------------	----	----------

**Investment Results**

***Net Investment Income***

The following table presents the yield and investment income, excluding net realized capital gains and losses, for our invested assets for the years indicated. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period. The yields for available-for-sale fixed maturities and available-for-sale equity

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

Table of Contents

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

	For the year ended December 31,						Increase (decrease)			
	2017		2016		2015		2017 vs. 2016		2016 vs. 2015	
	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount	Yield	Amount
	(\$ in millions)									
Fixed maturities	4.3%	\$ 2,354.9	4.4%	\$ 2,274.0	4.5%	\$ 2,153.2	(0.1)%	\$ 80.9	(0.1)%	\$ 120.8
Equity securities	4.0	67.8	3.6	51.5	4.4	50.2	0.4	16.3	(0.8)	1.3
Mortgage loans commercial	4.4	544.6	4.4	513.4	4.6	505.8		31.2	(0.2)	7.6
Mortgage loans residential	4.9	61.3	5.3	60.5	6.3	69.3	(0.4)	0.8	(1.0)	(8.8)
Real estate	8.3	129.4	9.1	127.9	6.9	97.1	(0.8)	1.5	2.2	30.8
Policy loans	5.6	45.6	5.6	46.3	5.6	46.3		(0.7)		
Cash and cash equivalents	1.1	28.6	0.5	14.2	0.4	8.5	0.6	14.4	0.1	5.7
Other investments	8.7	316.4	8.5	293.1	6.1	198.7	0.2	23.3	2.4	94.4
<b>Total</b>	<b>4.5</b>	<b>3,548.6</b>	<b>4.6</b>	<b>3,380.9</b>	<b>4.5</b>	<b>3,129.1</b>	<b>(0.1)</b>	<b>167.7</b>	<b>0.1</b>	<b>251.8</b>
Investment expenses	(0.1)	(89.3)	(0.1)	(84.4)	(0.1)	(77.0)		(4.9)		(7.4)
<b>Net investment income</b>	<b>4.4%</b>	<b>\$ 3,459.3</b>	<b>4.5%</b>	<b>\$ 3,296.5</b>	<b>4.4%</b>	<b>\$ 3,052.1</b>	<b>(0.1)%</b>	<b>\$ 162.8</b>	<b>0.1%</b>	<b>\$ 244.4</b>

**Year Ended December 31, 2017 Compared to Year Ended December 31, 2016**

Net investment income from fixed maturities increased primarily due to higher average invested assets, partially offset by lower investment yields on invested assets in our U.S. operations.

Net investment income from equity securities increased primarily due to favorable relative market performance on our required regulatory investments in the pension funds of our Latin America business.

Net investment income from commercial mortgages increased primarily due to higher average invested assets and higher prepayments, partially offset by lower investment yields on invested assets in our U.S. operations.

Net investment income from other investments increased primarily due to the change in volume of interest rate swaps designated as hedging instruments and associated market impacts, partially offset by the sale of value-add joint venture real estate during 2016.

**Year Ended December 31, 2016 Compared to Year Ended December 31, 2015**

Net investment income from fixed maturities increased primarily due to higher average invested assets, partially offset by lower investment yields on invested assets in our U.S. operations.

Net investment income from real estate increased primarily due to the sale of certain value-add real estate.

Net investment income from other investments increased primarily due to the sale of value-add joint venture real estate. Additionally, net investment income increased due to the change in volume of interest rate swaps designated as hedging instruments and associated market impacts.

**Net Realized Capital Gains (Losses)**

The following table presents the contributors to net realized capital gains and losses for the years indicated.

	For the year ended December 31,	Increase (decrease)
--	------------------------------------	---------------------

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

	2017	2016	2015	2017 vs. 2016	2016 vs. 2015
	<i>(in millions)</i>				
Fixed maturities, available-for-sale credit impairments (1)	\$ (80.6)	\$ (96.5)	\$ (30.2)	\$ 15.9	\$ (66.3)
Commercial mortgages credit impairments	2.0	(1.2)	(3.4)	3.2	2.2
Other credit impairments	6.9	4.0	3.6	2.9	0.4
Fixed maturities, available-for-sale and trading noncredit	(21.6)	49.9	1.6	(71.5)	48.3
Derivatives and related hedge activities	(168.0)	179.1	(22.6)	(347.1)	201.7
Other gains (losses)	785.5	35.8	(0.1)	749.7	35.9
Net realized capital gains (losses)	\$ 524.2	\$ 171.1	\$ (51.1)	\$ 353.1	\$ 222.2

- 
- (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 hedge activities, were a net gain of \$1.1 million, \$0.2 million and \$0.3 million for the years ended December 31, 2017, 2016 and 2015, respectively.

Table of Contents

***Year Ended December 31, 2017 Compared to Year Ended December 31, 2016***

Fixed maturities, available-for-sale and trading noncredit had net losses in 2017 as compared to net gains in 2016 primarily due to the sale of a long dated structured security in 2016 and other noncredit sales at losses in 2017 versus gains in 2016.

Derivatives and related hedge activities had net losses in 2017 as compared to net gains in 2016 primarily due to losses in 2017 versus gains in 2016 on interest rate swap derivatives not designated as hedging instruments due to changes in interest rates and increased losses on the GMWB embedded derivatives, including changes in the spread reflecting our own creditworthiness, and related hedging instruments.

Other gains increased primarily due to net gains resulting from real estate transactions in 2017.

***Year Ended December 31, 2016 Compared to Year Ended December 31, 2015***

Net realized capital losses on fixed maturities, available-for-sale credit impairments increased primarily due to higher impairments on corporate fixed maturities in the energy sector and structured fixed maturities.

Net realized capital gains on fixed maturities, available-for-sale and trading noncredit increased primarily due to the sale of a long dated structured security in 2016 and gains versus losses on trading securities related to changes in interest rates and credit spreads.

Derivatives and related hedge activities had net gains in 2016 as compared to net losses in 2015 primarily due to increased gains on interest rate swap derivatives not designated as hedging instruments due to changes in interest rates. In addition, currency forwards and currency swaps had gains in 2016 versus losses in 2015 due to changes in exchange rates. Credit related derivatives also had gains in 2016 versus losses in 2015.

Other gains (losses) reflected gains in 2016 as compared to losses in 2015 primarily due to a write-off of unamortized book value on corporate owned real estate in 2015 and gains in 2016 versus losses in 2015 on equity securities, trading.

**U.S. Investment Operations**

Of our invested assets, \$74,136.4 million were held by our U.S. operations as of December 31, 2017. Our U.S. invested assets are managed primarily by our Principal Global Investors segment. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing investment policies and monitoring risk limits and tolerances. Our primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters. We seek to protect customers' benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing 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.

A dedicated committee, comprised of senior investment professional staff members, approves the credit rating for the fixed maturities we purchase. We have teams of security analysts, organized by industry and asset class, that analyze and monitor these investments. Investments held in the portfolio are monitored 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. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

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

material changes in the issuer's revenues, margins, capital structure or collateral values;

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.

We purchase credit default swaps to hedge certain credit exposures in our investment portfolio and total return swaps and futures to hedge a portion of our investment portfolio from credit losses. We economically hedged credit

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

### Table of Contents

exposure in our portfolio by purchasing credit default swaps with a notional amount of \$143.5 million and \$176.5 million as of December 31, 2017 and December 31, 2016, respectively. As of December 31, 2016, we also economically hedged credit exposure in our portfolio using total return swaps with a notional amount of \$90.0 million and futures with a notional amount of \$11.9 million. 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 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 5, Derivative Financial Instruments" under the caption, "Credit Derivatives Sold."

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

obtaining approval of all new counterparties by the Investment Committee;

establishing exposure limits that take into account non-derivative exposure we have with the counterparty as well as derivative exposure;

performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;

diversifying our risk across numerous approved counterparties;

implementing credit support annex (collateral) agreements ("CSAs") for over-the-counter derivative transactions or similar agreements with a majority of our counterparties to further limit counterparty exposures, which provide for netting of exposures;

limiting exposure to A credit or better for over-the-counter derivative counterparties without CSAs;

conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;

daily monitoring of counterparty credit ratings, exposures and associated collateral levels and

trading mandatorily cleared contracts through centralized clearinghouses.

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. For further information on derivative exposure, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 4, Investments" under the caption, "Balance Sheet Offsetting."

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage loan portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying commercial real estate, 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:

**Weighted average loan-to-value  
ratio**

**Debt service coverage ratio**

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

	December 31, 2017	December 31, 2016	December 31, 2017	December 31, 2016
New mortgages	51%	52%	2.5X	2.6X
Entire mortgage portfolio	45%	46%	2.7X	2.7X

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

The amortized cost and weighted average yield, calculated using amortized cost, of non-structured fixed maturity securities that will be callable at the option of the issuer, excluding securities with a make-whole provision, were \$2,869.7 million and 3.4%, respectively, as of December 31, 2017 and \$2,075.9 million and 3.5%, respectively, as of December 31, 2016. In addition, the amortized cost and weighted average yield of residential mortgage-backed pass-through securities, residential collateralized mortgage obligations, and asset-backed securities – home equity with material prepayment risk were \$5,538.6 million and 3.1%, respectively, as of December 31, 2017 and \$4,891.3 million and 3.2%, respectively, as of December 31, 2016.

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



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

## Table of Contents

charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 7A. "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.

	December 31, 2017		December 31, 2016	
	Carrying amount	% of total	Carrying amount	% of total
	(\$ in millions)			
Fixed maturities:				
Public	\$ 38,026.4	51%	\$ 35,524.8	52%
Private	17,943.2	24	16,065.2	23
Equity securities	411.8	1	342.6	1
Mortgage loans:				
Commercial	12,700.8	17	11,940.5	17
Residential	722.7	1	680.5	1
Real estate held for sale	210.7		128.7	
Real estate held for investment	1,522.0	2	1,236.5	2
Policy loans	783.4	1	800.7	1
Other investments	1,815.4	3	2,088.7	3
Total invested assets	74,136.4	100%	68,808.2	100%
Cash and cash equivalents	2,284.4		2,335.5	
Total invested assets and cash	\$ 76,420.8		\$ 71,143.7	

### **Fixed Maturities**

Fixed maturities include bonds, ABS, redeemable preferred stock and certain non-redeemable preferred securities. Included in the privately placed category as of December 31, 2017 and December 31, 2016, were \$12.7 billion and \$11.2 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 years indicated.

	December 31, 2017		December 31, 2016	
	Carrying amount	Percent of total	Carrying amount	Percent of total
	(\$ in millions)			
U.S. government and agencies	\$ 1,328.8	2%	\$ 1,415.7	3%
States and political subdivisions	6,793.8	12	5,625.6	11
Non-U.S. governments	528.3	1	542.0	1
Corporate public	20,679.9	37	19,117.9	37
Corporate private	13,026.8	23	12,140.2	23
Residential mortgage-backed pass-through securities	2,879.2	5	2,842.5	5
Commercial mortgage-backed securities	3,675.9	7	4,070.2	8
Residential collateralized mortgage obligations	2,483.7	5	1,827.8	4
Asset-backed securities	4,573.2	8	4,008.1	8

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

Total fixed maturities	\$	55,969.6	100%	\$	51,590.0	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.

We purchase CMBS to diversify the overall credit risks of the fixed maturities portfolio and to provide attractive returns. The primary risks in holding CMBS 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. 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

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

### Table of Contents

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 and later vintages represent a return to debt service coverage ratios and loan-to-value ratios that more closely resemble loans originated prior to 2005.

Similar to CMBS, we purchase ABS for diversification and to provide attractive returns. The primary risks in holding ABS are also structural and credit risks, which are similar to those noted above for CMBS. Our ABS portfolio is diversified by type of asset, issuer, and vintage. 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 we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we hold a diverse class of securities, which limits our exposure to any one security.

The international exposure held in our U.S. operation's fixed maturities portfolio was 20% of total fixed maturities as of December 31, 2017 and 21% as of December 31, 2016. 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 years indicated.

	December 31, 2017	December 31, 2016
	<i>(in millions)</i>	
European Union, excluding UK	\$ 3,119.1	\$ 3,419.4
United Kingdom	2,513.9	2,282.4
Asia-Pacific	1,550.7	1,517.1
Australia/New Zealand	1,511.2	1,338.4
Latin America	1,047.5	950.4
Europe, non-European Union	720.2	740.4
Middle East and Africa	455.2	365.3
Other (1)	283.6	261.7
<b>Total</b>	<b>\$ 11,201.4</b>	<b>\$ 10,875.1</b>

(1)

Includes exposure from two countries and various supranational organizations as of both December 31, 2017, and December 31, 2016.

International fixed maturities exposure is determined by the country of domicile of the parent entity of an individual asset. All international fixed maturities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturities investments and we are within those internal limits. Exposure to Canada is not included in our international exposure. As of December 31, 2017 and December 31, 2016, our investments in Canada totaled \$1,854.5 million and \$1,604.5 million, respectively.

**Fixed Maturities Credit Concentrations.** One aspect of managing credit risk is through industry, issuer and asset class diversification. Our credit concentrations are managed to established limits. The following table presents our top ten exposures as of December 31, 2017.

	Amortized cost
	<i>(in millions)</i>
Mars, Incorporated	\$ 217.2
Berkshire Hathaway Inc.	208.6
Wells Fargo & Company	203.2
Duke Energy Corporation	190.3
Comcast Corporation	187.1
Bank of America Corporation	185.5
BP p.l.c.	185.1
JPMorgan Chase & Co.	177.8
Province of Quebec	169.7
People's Republic of China	164.3

Total top ten exposures	\$	1,888.8
-------------------------	----	---------

**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 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, 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

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

### Table of Contents

list" are periodically analyzed by investment analysts or analysts that focus on troubled securities ("Workout Group"). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative and unobservable inputs.

The Securities Valuation Office ("SVO") of the NAIC monitors the bond investments of insurers for regulatory capital and reporting purposes and, when required, assigns securities to one of six categories referred to as NAIC designations. Although NAIC designations are not produced to aid the investment decision making process, NAIC designations may serve as a reasonable proxy for Nationally Recognized Statistical Rating Organizations' ("NRSRO") credit ratings for certain bonds. For most corporate bonds, NAIC designations 1 and 2 include bonds generally considered investment grade by such rating organizations. Bonds are considered investment grade when rated "Baa3" or higher by Moody's, or "BBB " or higher by S&P. NAIC designations 3 through 6 include bonds generally 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 designation is not always a reasonable indication of an NRSRO rating as described below. For CMBS and non-agency RMBS, Blackrock Solutions undertakes the modeling of those NAIC designations. 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 as of the years indicated as well as the percentage, based on fair value, that each designation comprises.

NAIC designation	December 31, 2017			December 31, 2016		
	Amortized cost	Carrying amount	Percent of carrying amount	Amortized cost	Carrying amount	Percent of carrying amount
(\$ in millions)						
1	\$ 36,314.6	\$ 37,769.0	67%	\$ 33,198.2	\$ 34,031.5	66%
2	14,766.4	15,714.7	28	13,614.9	14,155.0	27
3	1,906.8	1,987.7	4	2,578.5	2,611.8	6
4	342.6	335.4	1	640.9	604.3	1
5	142.4	126.0		148.6	120.4	
6	38.3	36.8		80.9	67.0	
Total fixed maturities	\$ 53,511.1	\$ 55,969.6	100%	\$ 50,262.0	\$ 51,590.0	100%

Fixed maturities included 44 securities with an amortized cost of \$631.3 million, gross gains of \$20.1 million, gross losses of \$3.4 million and a carrying amount of \$648.0 million as of December 31, 2017, that were still pending a review and assignment of a designation 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, we will always have securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent designation is assigned based on our fixed income analyst's assessment.

**Commercial Mortgage-Backed Securities.** As of December 31, 2017, based on amortized cost, 98% of our CMBS portfolio had an NAIC designation of 1 and 88% was issued during the more conservative underwriting periods prior to 2005 and after 2008.

The following tables present our exposure by credit quality, based on NAIC designations, and vintage for our CMBS portfolio as of the years indicated.

NAIC designation	December 31, 2017							
	2004 and prior		2005 to 2008		2009 and after		Total	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount
(in millions)								
1	\$ 66.6	\$ 69.0	\$ 370.3	\$ 365.3	\$ 3,193.0	\$ 3,176.3	\$ 3,629.9	\$ 3,610.6
2			11.7	12.4	1.2	1.2	12.9	13.6
3			33.0	32.9			33.0	32.9

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

4			13.4	6.8		13.4	6.8	
5	0.2	0.1	6.5	5.8		6.7	5.9	
6	2.5	2.2	3.0	3.9		5.5	6.1	
Total (1)	\$ 69.3	\$ 71.3	\$ 437.9	\$ 427.1	\$ 3,194.2	\$ 3,177.5	\$ 3,701.4	\$ 3,675.9

---

(1) The CMBS portfolio included agency CMBS with a \$357.6 million amortized cost and a \$355.2 million carrying amount.

Table of Contents

NAIC designation	December 31, 2016							
	2004 and prior		2005 to 2008		2009 and after		Total	
	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount
	<i>(in millions)</i>							
1	\$ 105.2	\$ 108.9	\$ 1,183.7	\$ 1,180.7	\$ 2,698.4	\$ 2,657.6	\$ 3,987.3	\$ 3,947.2
2			19.8	19.3			19.8	19.3
3			16.2	14.6			16.2	14.6
4	7.7	7.3	64.8	57.1			72.5	64.4
5	2.1	1.4	16.7	13.7			18.8	15.1
6	1.8	1.9	9.7	7.7			11.5	9.6
Total (1)	\$ 116.8	\$ 119.5	\$ 1,310.9	\$ 1,293.1	\$ 2,698.4	\$ 2,657.6	\$ 4,126.1	\$ 4,070.2

(1) The CMBS portfolio included agency CMBS with a \$393.3 million amortized cost and a \$389.0 million carrying amount.

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

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

	December 31, 2017		December 31, 2016	
	<i>(\$ in millions)</i>			
Total fixed maturities (public and private)	\$	55,969.6	\$	51,590.0
Problem fixed maturities (1)	\$	33.8	\$	74.1
Potential problem fixed maturities		35.0		154.8
Restructured fixed maturities		4.8		
Total problem, potential problem and restructured fixed maturities	\$	73.6	\$	228.9
Total problem, potential problem and restructured fixed maturities as a percent of total fixed maturities		0.13%		0.44%

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

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

**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 a security is deemed to be other than temporarily impaired, an impairment loss is recognized. For additional details, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 4, Investments."



Table of Contents

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 at 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.

A number of significant risks and uncertainties are 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 \$79.6 million, \$95.1 million, and \$30.3 million for the years ended December 31, 2017, 2016, and 2015, respectively.

Table of Contents**Fixed Maturities Available-for-Sale**

The following tables present our fixed maturities available-for-sale by industry category and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in AOCI, as of the years indicated.

		December 31, 2017			
		Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
		<i>(in millions)</i>			
Finance	Banking	\$ 4,314.2	\$ 166.7	\$ 9.6	\$ 4,471.3
Finance	Brokerage	349.0	16.9	1.6	364.3
Finance	Finance Companies	309.7	7.6	0.2	317.1
Finance	Financial Other	509.0	29.7	4.8	533.9
Finance	Insurance	2,505.9	281.2	3.5	2,783.6
Finance	REITS	1,378.8	48.4	3.8	1,423.4
Industrial	Basic Industry	1,158.8	82.9	0.9	1,240.8
Industrial	Capital Goods	2,085.2	126.2	3.4	2,208.0
Industrial	Communications	2,359.8	238.1	3.0	2,594.9
Industrial	Consumer Cyclical	1,670.2	74.6	2.3	1,742.5
Industrial	Consumer Non-Cyclical	3,748.4	217.3	9.6	3,956.1
Industrial	Energy	2,532.5	241.6	11.8	2,762.3
Industrial	Other	450.8	15.4	0.6	465.6
Industrial	Technology	1,601.2	70.2	2.4	1,669.0
Industrial	Transportation	1,459.7	70.5	4.6	1,525.6
Utility	Electric	3,228.4	219.6	13.7	3,434.3
Utility	Natural Gas	482.5	26.8	1.1	508.2
Utility	Other	270.1	16.8	0.6	286.3
Government guaranteed		1,220.1	167.4	2.4	1,385.1
Total corporate securities		31,634.3	2,117.9	79.9	33,672.3
Residential mortgage-backed pass-through securities		2,483.7	50.3	21.3	2,512.7
Commercial mortgage-backed securities		3,700.7	32.4	57.9	3,675.2
Residential collateralized mortgage obligations		2,486.0	20.5	22.8	2,483.7
Asset-backed securities Home equity (1)		202.4	15.7	4.1	214.0
Asset-backed securities All other		3,007.8	5.7	13.6	2,999.9
Collateralized debt obligations Credit		51.7		13.4	38.3
Collateralized debt obligations CMBS		0.2	0.2		0.4
Collateralized debt obligations Loans		1,320.2	2.5	2.1	1,320.6
Total mortgage-backed and other asset-backed securities		13,252.7	127.3	135.2	13,244.8
U.S. government and agencies		1,292.1	44.3	7.6	1,328.8
States and political subdivisions		6,438.3	371.4	15.9	6,793.8
Non-U.S. governments		492.1	37.3	1.1	528.3
Total fixed maturities, available-for-sale		\$ 53,109.5	\$ 2,698.2	\$ 239.7	\$ 55,568.0

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

Table of Contents

		December 31, 2016			
		Amortized	Gross	Gross	Carrying
		cost	unrealized	unrealized	amount
		(in millions)			
Finance	Banking	\$ 4,214.3	\$ 92.1	\$ 80.0	\$ 4,226.4
Finance	Brokerage	333.8	12.2	2.3	343.7
Finance	Finance Companies	283.9	5.8	0.4	289.3
Finance	Financial Other	498.2	39.9	1.6	536.5
Finance	Insurance	2,380.6	197.7	14.4	2,563.9
Finance	REITS	1,141.8	28.7	13.8	1,156.7
Industrial	Basic Industry	1,135.4	49.0	13.3	1,171.1
Industrial	Capital Goods	1,860.6	100.4	13.3	1,947.7
Industrial	Communications	2,403.5	203.7	11.7	2,595.5
Industrial	Consumer Cyclical	1,525.7	67.8	4.0	1,589.5
Industrial	Consumer Non-Cyclical	3,485.3	145.5	31.3	3,599.5
Industrial	Energy	2,722.6	178.6	47.8	2,853.4
Industrial	Other	284.9	13.7		298.6
Industrial	Technology	1,292.2	40.7	5.3	1,327.6
Industrial	Transportation	1,428.5	52.7	26.7	1,454.5
Utility	Electric	3,189.6	167.1	44.2	3,312.5
Utility	Natural Gas	322.7	13.7	2.9	333.5
Utility	Other	255.0	15.5		270.5
Government guaranteed		1,182.5	100.3	8.7	1,274.1
Total corporate securities		29,941.1	1,525.1	321.7	31,144.5
Residential mortgage-backed pass-through securities		2,786.8	66.4	30.6	2,822.6
Commercial mortgage-backed securities		4,124.2	31.1	87.0	4,068.3
Residential collateralized mortgage obligations		1,822.9	14.4	23.6	1,813.7
Asset-backed securities	Home equity (1)	247.6	14.0	8.8	252.8
Asset-backed securities	All other	2,995.3	8.6	17.3	2,986.6
Collateralized debt obligations	Credit	52.0		21.7	30.3
Collateralized debt obligations	CMBS	0.3			0.3
Collateralized debt obligations	Loans	727.3	2.8	2.6	727.5
Total mortgage-backed and other asset-backed securities		12,756.4	137.3	191.6	12,702.1
U.S. government and agencies		1,409.3	17.1	10.7	1,415.7
States and political subdivisions		5,460.4	192.4	86.9	5,565.9
Non-U.S. governments		475.0	71.7	4.7	542.0
Total fixed maturities, available-for-sale		\$ 50,042.2	\$ 1,943.6	\$ 615.6	\$ 51,370.2

(1)

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

Of the \$239.7 million in gross unrealized losses as of December 31, 2017, \$1.3 million in losses were attributed to securities scheduled to mature in one year or less, \$23.2 million attributed to securities scheduled to mature between one to five years, \$27.0 million attributed to securities scheduled to mature between five to ten years, \$53.0 million attributed to securities scheduled to mature after ten years and \$135.2 million related to mortgage-backed and other ABS that are not classified by maturity year. As of December 31, 2017, we were in a \$2,458.5 million net unrealized gain position as compared to a \$1,328.0 million net unrealized gain position as of December 31, 2016. The \$1,130.5 million increase in net unrealized gains for the year ended December 31, 2017, can primarily be attributed to tightening of credit spreads.

**Fixed Maturities Available-For-Sale Unrealized Losses.** We believe our long-term fixed maturities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of

cash flow.

We invest in privately placed fixed maturities to enhance the overall value of the portfolio, increase diversification and obtain higher yields than are possible with comparable quality public market securities. Generally, private placements provide broader access to management information, strengthened negotiated protective covenants, call protection features and, where applicable, a higher level of collateral. They are, however, generally not freely tradable because of restrictions imposed by U.S. federal and state securities laws and illiquid trading markets.

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

Table of Contents

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 AOCI, as of the years indicated.

	December 31, 2017				December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
<i>(in millions)</i>								
Investment grade:								
Public	\$ 34,596.8	\$ 1,998.4	\$ 132.4	\$ 36,462.8	\$ 32,818.8	\$ 1,347.3	\$ 368.8	\$ 33,797.3
Private	16,117.7	600.4	63.7	16,654.4	13,814.6	508.1	113.2	14,209.5
Below investment grade:								
Public	1,129.7	53.1	20.1	1,162.7	1,617.5	47.0	62.0	1,602.5
Private	1,265.3	46.3	23.5	1,288.1	1,791.3	41.2	71.6	1,760.9
Total fixed maturities, available-for-sale	\$ 53,109.5	\$ 2,698.2	\$ 239.7	\$ 55,568.0	\$ 50,042.2	\$ 1,943.6	\$ 615.6	\$ 51,370.2

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, on investment grade fixed maturities available-for-sale by aging category as of the years indicated.

	December 31, 2017					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
<i>(in millions)</i>						
Three months or less	\$ 3,012.2	\$ 11.5	\$ 2,440.0	\$ 10.3	\$ 5,452.2	\$ 21.8
Greater than three to six months	2,201.7	21.7	1,203.9	13.2	3,405.6	34.9
Greater than six to nine months	148.8	1.7	174.5	5.3	323.3	7.0
Greater than nine to twelve months	36.2	0.6	34.2	2.5	70.4	3.1
Greater than twelve to twenty-four months	2,813.9	77.8	1,050.7	21.0	3,864.6	98.8
Greater than twenty-four to thirty-six months	241.5	7.4	61.9	2.0	303.4	9.4
Greater than thirty-six months	184.3	11.7	113.7	9.4	298.0	21.1
Total fixed maturities, available-for-sale	\$ 8,638.6	\$ 132.4	\$ 5,078.9	\$ 63.7	\$ 13,717.5	\$ 196.1

	December 31, 2016					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
<i>(in millions)</i>						
Three months or less	\$ 9,056.5	\$ 230.1	\$ 3,335.5	\$ 61.9	\$ 12,392.0	\$ 292.0
Greater than three to six months	985.0	55.9	512.5	18.6	1,497.5	74.5
Greater than six to nine months	79.5	1.0	58.9	0.9	138.4	1.9
Greater than nine to twelve months	93.7	7.9	176.0	6.5	269.7	14.4
Greater than twelve to twenty-four months	512.4	17.1	292.2	5.8	804.6	22.9
Greater than twenty-four to thirty-six months	108.1	4.4	38.8	3.8	146.9	8.2

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

Greater than thirty-six months	397.7	52.4	231.5	15.7	629.2	68.1
Total fixed maturities, available-for-sale	\$ 11,232.9	\$ 368.8	\$ 4,645.4	\$ 113.2	\$ 15,878.3	\$ 482.0

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

Table of Contents

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, on below investment grade fixed maturities available-for-sale by aging category as of the years indicated.

	December 31, 2017					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	<i>(in millions)</i>					
Three months or less	\$ 38.3	\$ 0.7	\$ 65.4	\$ 0.5	\$ 103.7	\$ 1.2
Greater than three to six months			11.1	0.3	11.1	0.3
Greater than six to nine months	1.5	5.7	46.3	1.9	47.8	7.6
Greater than nine to twelve months	1.1	0.1			1.1	0.1
Greater than twelve to twenty-four months	6.0	0.1	4.5	0.1	10.5	0.2
Greater than twenty-four to thirty-six months	28.4	4.3	23.5	3.9	51.9	8.2
Greater than thirty-six months	73.0	9.2	55.9	16.8	128.9	26.0
Total fixed maturities, available-for-sale	\$ 148.3	\$ 20.1	\$ 206.7	\$ 23.5	\$ 355.0	\$ 43.6

	December 31, 2016					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	<i>(in millions)</i>					
Three months or less	\$ 88.2	\$ 2.8	\$ 168.6	\$ 2.5	\$ 256.8	\$ 5.3
Greater than three to six months	10.9	1.3	62.2	3.8	73.1	5.1
Greater than six to nine months		0.1	6.2	0.1	6.2	0.2
Greater than nine to twelve months	3.4	0.5	1.0	0.1	4.4	0.6
Greater than twelve to twenty-four months	200.6	16.8	76.0	7.8	276.6	24.6
Greater than twenty-four to thirty-six months	147.8	17.6	93.6	22.7	241.4	40.3
Greater than thirty-six months	135.4	22.9	85.8	34.6	221.2	57.5
Total fixed maturities, available-for-sale	\$ 586.3	\$ 62.0	\$ 493.4	\$ 71.6	\$ 1,079.7	\$ 133.6

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, 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 years indicated.

	December 31, 2017					
	Problem, potential problem and restructured		All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	<i>(in millions)</i>					
Three months or less	\$ 0.5	\$ 1.0	\$ 25.4	\$ 16.8	\$ 25.9	\$ 17.8
Greater than three to six months			0.1		0.1	

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

Greater than six to nine months			<b>0.5</b>	<b>0.1</b>	<b>0.5</b>	<b>0.1</b>
Greater than twelve months	<b>18.7</b>	<b>12.7</b>	<b>24.2</b>	<b>11.1</b>	<b>42.9</b>	<b>23.8</b>
Total fixed maturities, available-for-sale	<b>\$ 19.2</b>	<b>\$ 13.7</b>	<b>\$ 50.2</b>	<b>\$ 28.0</b>	<b>\$ 69.4</b>	<b>\$ 41.7</b>



Table of Contents

	Problem, potential problem and restructured		December 31, 2016 All other fixed maturity securities		Total	
	Gross		Gross		Gross	
	Carrying amount	unrealized losses	Carrying amount	unrealized losses	Carrying amount	unrealized losses
	<i>(in millions)</i>					
Three months or less	\$ 4.9	\$ 1.2	\$ 31.0	\$ 8.8	\$ 35.9	\$ 10.0
Greater than three to six months	25.8	16.2	2.2	1.2	28.0	17.4
Greater than six to nine months			0.1	0.1	0.1	0.1
Greater than nine to twelve months	4.6	2.5	0.1	0.2	4.7	2.7
Greater than twelve months	45.7	35.4	50.6	30.6	96.3	66.0
Total fixed maturities, available-for-sale	\$ 81.0	\$ 55.3	\$ 84.0	\$ 40.9	\$ 165.0	\$ 96.2

**Mortgage Loans**

Mortgage loans consist of commercial mortgage loans on real estate and residential mortgage loans. The carrying amount of our commercial mortgage loan portfolio was \$12,700.8 million and \$11,940.5 million as of December 31, 2017 and December 31, 2016, respectively. The carrying amount of our residential mortgage loan portfolio was \$722.7 million and \$680.5 million as of December 31, 2017 and December 31, 2016, respectively.

**Commercial Mortgage Loans.** We generally report commercial mortgage loans on real estate at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances.

Commercial mortgage loans play an important role in our investment strategy by:

providing strong risk-adjusted relative value in comparison to other investment alternatives;

enhancing total returns and

providing strategic portfolio diversification.

As a result, we have focused on constructing a high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages originated with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of office properties, apartments, well anchored retail properties and general-purpose industrial properties.

Our commercial mortgage loan portfolio is diversified by geography and specific collateral property type. Commercial mortgage lending in the state of California accounted for 18% of our commercial mortgage loan portfolio before valuation allowance as of both December 31, 2017 and December 31, 2016. 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 December 31, 2017 and December 31, 2016, the total number of commercial mortgage loans outstanding was 813 and 840, of which 52% and 55% were for loans with

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

principal balances less than \$10.0 million, respectively. The average loan size of our commercial mortgage portfolio was \$15.6 million and \$14.2 million as of December 31, 2017 and December 31, 2016, respectively.

***Commercial Mortgage Loan Credit Monitoring.*** For further details on monitoring and management of our commercial mortgage loan portfolio, see Item 8. "Financial Statements and Supplementary Data, Notes to 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

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

## Table of Contents

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.

We did not have problem, potential problem and restructured commercial mortgages as of December 31, 2017 and December 31, 2016.

**Commercial Mortgage Loan Valuation Allowance.** The valuation allowance for commercial mortgage loans includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. For further details on the commercial mortgage loan valuation allowance, see Item 8. "Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 4, Investments Mortgage Loan Valuation Allowance."

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

	For the year ended December 31, 2017	For the year ended December 31, 2016
	(\$ in millions)	
Balance, beginning of period	\$ 27.4	\$ 27.5
Provision	(1.6)	1.4
Charge-offs		(1.5)
Balance, end of period	\$ 25.8	\$ 27.4

Valuation allowance as % of carrying value before reserves	0.20%	0.23%
--	-------	-------

**Residential Mortgage Loans.** The residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$23.0 million and \$165.6 million and first lien mortgages with an amortized cost of \$706.1 million and \$531.9 million as of December 31, 2017 and December 31, 2016, 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 \$8.4 million and \$12.2 million as of December 31, 2017 and December 31, 2016, respectively.

We establish the residential mortgage loan valuation allowance at levels considered adequate to absorb estimated probable losses within the portfolio based on management's evaluation of the size and current risk characteristics of the portfolio. Such evaluation considers numerous factors, including, but not limited to net charge-off trends, loss forecasts, collateral values, geographic location, borrower credit scores, delinquency rates, industry condition and economic trends. The changes in the valuation allowance are reported in net realized capital gains (losses) on our consolidated statements of operations.

The residential mortgage loan valuation allowance decreased in 2017 primarily due to sales of home equity loans. The following table represents our residential mortgage loan valuation allowance for the years indicated.

	For the year ended December 31, 2017	For the year ended December 31, 2016
	(\$ in millions)	
Balance, beginning of period	\$ 17.0	\$ 23.9
Provision	(10.5)	(5.7)
Charge-offs	(5.0)	(4.8)
Recoveries	4.9	3.6
Balance, end of period	\$ 6.4	\$ 17.0

Valuation allowance as % of carrying value before reserves	0.88%	2.44%
--	-------	-------

### **Real Estate**

Real estate consists primarily of commercial equity real estate. As of December 31, 2017 and December 31, 2016, the carrying amount of our equity real estate investment was \$1,732.7 million and \$1,365.2 million, 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 \$1,522.0 million and \$1,236.5 million as of December 31, 2017 and December 31, 2016, respectively. The carrying value of real estate held for investment is generally adjusted for impairments whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized capital losses in our consolidated results of operations. Impairment adjustments recorded for the years ended December 31, 2017 and December 31, 2016, were \$1.1 million and \$0.8 million, respectively.

The carrying amount of real estate held for sale was \$210.7 million and \$128.7 million as of December 31, 2017 and December 31, 2016, respectively. Once we identify a real estate property to be sold and it is probable that it will be sold, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to

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

### Table of Contents

adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs. The change in valuation allowance for the year ended December 31, 2016, was \$4.5 million. The valuation allowance did not change for the year ended December 31, 2017.

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. As of December 31, 2017, our largest equity real estate portfolio concentration was in the Pacific (44%) region of the United States. By property type, our largest concentrations were in apartments (33%), office (31%), and industrial (26%) as of December 31, 2017.

### **Other Investments**

Our other investments totaled \$1,815.4 million as of December 31, 2017, compared to \$2,088.7 million as of December 31, 2016. Derivative assets accounted for \$250.4 million and \$871.6 million in other investments as of December 31, 2017 and December 31, 2016, respectively. The remaining invested assets are primarily related to equity method investments, which include real estate properties owned jointly with venture partners and operated by the partners and sponsored investment funds.

### **International Investment Operations**

Of our invested assets, \$7,966.3 million were held by our Principal International segment as of December 31, 2017. The assets are primarily managed by the local Principal International affiliate. Due to the regulatory constraints in each location, each company maintains its own investment policies. As shown in the following table, the major category of international invested assets is fixed maturities. The following table excludes invested assets of the separate accounts.

	December 31, 2017		December 31, 2016	
	Carrying amount	Percent of total	Carrying amount	Percent of total
	<i>(\$ in millions)</i>			
<b>Fixed maturities:</b>				
Public	\$ 3,972.9	50%	\$ 3,645.5	52%
Private	11.9		9.0	
Equity securities	1,454.8	18	1,169.7	17
<b>Mortgage loans:</b>				
Commercial	170.7	2	87.3	1
Residential	556.3	7	521.9	7
Real estate held for sale	2.2		2.0	
Real estate held for investment	1.8		1.6	
Policy loans	24.9		23.1	
<b>Other investments:</b>				
Direct financing leases	937.4	12	875.2	13
Investment in unconsolidated entities	763.8	10	634.7	9
Derivative assets and other investments	69.6	1	57.3	1
<b>Total invested assets</b>	<b>7,966.3</b>	<b>100%</b>	<b>7,027.3</b>	<b>100%</b>
Cash and cash equivalents	186.4		384.1	
<b>Total invested assets and cash</b>	<b>\$ 8,152.7</b>		<b>\$ 7,411.4</b>	