

PRINCIPAL FINANCIAL GROUP INC

Form 10-Q

October 31, 2012

[Table of Contents](#)

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

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

For the quarterly period ended September 30, 2012

OR

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

---

1-16725

(Commission file number)

# PRINCIPAL FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of incorporation or organization)

**42-1520346**

(I.R.S. Employer Identification Number)

**711 High Street, Des Moines, Iowa 50392**

(Address of principal executive offices)

**(515) 247-5111**

(Registrant's telephone number, including area code)

---

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

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

The total number of shares of the registrant's Common Stock, \$0.01 par value, outstanding as of October 24, 2012, was 293,586,944.



Table of Contents

**PRINCIPAL FINANCIAL GROUP, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<u>Part I - FINANCIAL INFORMATION</u>	
<u>Item 1.</u>	
<u>Financial Statements</u>	3
<u>Consolidated Statements of Financial Position at September 30, 2012 (Unaudited) and December 31, 2011</u>	3
<u>Unaudited Consolidated Statements of Operations for the three and nine months ended September 30, 2012 and 2011</u>	4
<u>Unaudited Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2012 and 2011</u>	5
<u>Unaudited Consolidated Statements of Stockholders' Equity for the nine months ended September 30, 2012 and 2011</u>	6
<u>Unaudited Consolidated Statements of Cash Flows for the nine months ended September 30, 2012 and 2011</u>	7
<u>Notes to Unaudited Consolidated Financial Statements - September 30, 2012</u>	8
<u>Item 2.</u>	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	90
<u>Item 3.</u>	
<u>Quantitative and Qualitative Disclosures about Market Risk</u>	131
<u>Item 4.</u>	
<u>Controls and Procedures</u>	136
<u>Part II - OTHER INFORMATION</u>	
<u>Item 1.</u>	
<u>Legal Proceedings</u>	136
<u>Item 1A.</u>	
<u>Risk Factors</u>	136
<u>Item 2.</u>	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	137
<u>Item 6.</u>	
<u>Exhibits</u>	138
<u>Signature</u>	139

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

	September 30, 2012 (Unaudited)	December 31, 2011 (As adjusted)
	(in millions)	
<b>Assets</b>		
Fixed maturities, available-for-sale (2012 and 2011 include \$180.3 million and \$214.2 million related to consolidated variable interest entities)	\$ 51,533.9	\$ 49,006.7
Fixed maturities, trading (2012 and 2011 both include \$132.4 million related to consolidated variable interest entities)	808.0	971.7
Equity securities, available-for-sale	143.6	77.1
Equity securities, trading (2012 and 2011 include \$0.0 million and \$207.6 million related to consolidated variable interest entities)	237.6	404.8
Mortgage loans	11,297.9	10,727.2
Real estate	1,208.6	1,092.9
Policy loans	866.6	885.1
Other investments (2012 and 2011 include \$81.3 million and \$97.8 million related to consolidated variable interest entities and \$114.2 million and \$97.5 million measured at fair value under the fair value option)	3,172.1	2,985.8
Total investments	69,268.3	66,151.3
Cash and cash equivalents (2012 and 2011 include \$0.0 million and \$317.7 million related to consolidated variable interest entities)	2,279.0	2,833.9
Accrued investment income	614.4	615.2
Premiums due and other receivables	1,192.2	1,196.5
Deferred policy acquisition costs	2,558.5	2,428.0
Property and equipment	468.4	457.2
Goodwill	548.9	482.3
Other intangibles	927.4	890.6
Separate account assets	80,160.5	71,364.4
Other assets	1,175.7	942.3
Total assets	\$ 159,193.3	\$ 147,361.7
<b>Liabilities</b>		
Contractholder funds	\$ 37,312.2	\$ 37,676.4
Future policy benefits and claims	21,952.0	20,210.4
Other policyholder funds	720.8	548.6
Short-term debt	28.5	105.2
Long-term debt	2,180.0	1,564.8
Income taxes currently payable	6.6	3.1
Deferred income taxes	951.5	208.7
Separate account liabilities	80,160.5	71,364.4
Other liabilities (2012 and 2011 include \$312.5 million and \$565.2 million related to consolidated variable interest entities, of which \$96.4 million and \$88.4 million are	5,974.3	6,286.2

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

measured at fair value under the fair value option)

Total liabilities	<b>149,286.4</b>	137,967.8
Redeemable noncontrolling interest	<b>61.0</b>	22.2
<b>Stockholders' equity</b>		
Series A preferred stock, par value \$.01 per share with liquidation preference of \$100 per share 3.0 million shares authorized, issued and outstanding in 2012 and 2011		
Series B preferred stock, par value \$.01 per share with liquidation preference of \$25 per share 10.0 million shares authorized, issued and outstanding in 2012 and 2011	<b>0.1</b>	0.1
Common stock, par value \$.01 per share 2,500.0 million shares authorized, 453.3 million and 450.3 million shares issued, and 293.6 million and 301.1 million shares outstanding in 2012 and 2011	<b>4.5</b>	4.5
Additional paid-in capital	<b>9,712.2</b>	9,634.7
Retained earnings	<b>4,784.3</b>	4,402.3
Accumulated other comprehensive income	<b>880.8</b>	258.0
Treasury stock, at cost (159.7 million and 149.2 million shares in 2012 and 2011)	<b>(5,554.4)</b>	(5,281.7)
Total stockholders' equity attributable to Principal Financial Group, Inc.	<b>9,827.5</b>	9,017.9
Noncontrolling interest	<b>18.4</b>	353.8
Total stockholders' equity	<b>9,845.9</b>	9,371.7
Total liabilities and stockholders' equity	<b>\$ 159,193.3</b>	\$ 147,361.7

See accompanying notes.

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
(in millions, except per share data)				
<b>Revenues</b>				
Premiums and other considerations	\$ 1,158.2	\$ 672.7	\$ 2,519.3	\$ 2,221.7
Fees and other revenues	675.0	636.4	1,909.1	1,892.6
Net investment income	783.8	815.2	2,409.6	2,548.6
Net realized capital gains, excluding impairment losses on available-for-sale securities	122.1	16.9	176.4	99.6
Total other-than-temporary impairment losses on available-for-sale securities	(43.6)	(12.7)	(126.4)	(67.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income	9.2	(34.9)	31.2	(83.0)
Net impairment losses on available-for-sale securities	(34.4)	(47.6)	(95.2)	(150.6)
Net realized capital gains (losses)	87.7	(30.7)	81.2	(51.0)
Total revenues	2,704.7	2,093.6	6,919.2	6,611.9
<b>Expenses</b>				
Benefits, claims and settlement expenses	1,647.0	1,114.9	3,969.5	3,497.7
Dividends to policyholders	49.7	52.2	149.5	158.7
Operating expenses	826.6	775.4	2,106.7	2,232.7
Total expenses	2,523.3	1,942.5	6,225.7	5,889.1
Income before income taxes	181.4	151.1	693.5	722.8
Income taxes (benefits)	(9.9)	76.6	99.2	190.3
Net income	191.3	74.5	594.3	532.5
Net income (loss) attributable to noncontrolling interest	3.4	(5.6)	15.3	36.6
Net income attributable to Principal Financial Group, Inc.	187.9	80.1	579.0	495.9
Preferred stock dividends	8.2	8.2	24.7	24.7
Net income available to common stockholders	\$ 179.7	\$ 71.9	\$ 554.3	\$ 471.2
<b>Earnings per common share</b>				
Basic earnings per common share	\$ 0.61	\$ 0.23	\$ 1.86	\$ 1.48
Diluted earnings per common share	\$ 0.60	\$ 0.23	\$ 1.84	\$ 1.47

*See accompanying notes.*

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Net income	\$ 191.3	\$ 74.5	\$ 594.3	\$ 532.5
Other comprehensive income (loss), net:				
Net unrealized gains on available-for-sale securities	296.0	7.4	558.0	329.5
Noncredit component of impairment losses on fixed maturities, available-for-sale	(4.0)	18.9	(14.8)	45.2
Net unrealized gains (losses) on derivative instruments	(18.2)	32.1	27.2	19.5
Foreign currency translation adjustment	48.6	(136.4)	27.2	(64.9)
Net unrecognized postretirement benefit obligation	8.7	(201.5)	26.2	(174.2)
Other comprehensive income (loss)	331.1	(279.5)	623.8	155.1
Comprehensive income (loss)	522.4	(205.0)	1,218.1	687.6
Comprehensive income (loss) attributable to noncontrolling interest	4.2	(5.9)	16.3	36.3
Comprehensive income (loss) attributable to Principal Financial Group, Inc.	\$ 518.2	\$ (199.1)	\$ 1,201.8	\$ 651.3

*See accompanying notes.*



Table of Contents

## Principal Financial Group, Inc.

## Consolidated Statements of Stockholders' Equity

(Unaudited)

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings (in millions)	Accumulated other comprehensive income	Treasury stock	Noncontrolling interest	Total stockholders equity
<b>Balances at January 1, 2011 (as adjusted)</b>	\$	\$ 0.1	\$ 4.5	\$ 9,563.8	\$ 3,999.4	\$ 306.7	\$ (4,725.3)	\$ 157.2	\$ 9,306.4
Common stock issued				23.2					23.2
Stock-based compensation and additional related tax benefits				32.9					32.9
Treasury stock acquired, common							(456.4)		(456.4)
Dividends to preferred stockholders					(24.7)				(24.7)
Distributions to noncontrolling interest								(7.4)	(7.4)
Contributions from noncontrolling interest								127.0	127.0
Purchase of subsidiary shares from noncontrolling interest				(2.0)				(4.0)	(6.0)
Net income					495.9			36.6	532.5
Other comprehensive income						155.4		(0.3)	155.1
<b>Balances at September 30, 2011</b>	\$	\$ 0.1	\$ 4.5	\$ 9,617.9	\$ 4,470.6	\$ 462.1	\$ (5,181.7)	\$ 309.1	\$ 9,682.6
<b>Balances at January 1, 2012</b>	\$	\$ 0.1	\$ 4.5	\$ 9,634.7	\$ 4,402.3	\$ 258.0	\$ (5,281.7)	\$ 353.8	\$ 9,371.7
Common stock issued				24.7					24.7
Stock-based compensation and additional related tax benefits				52.8	(2.7)				50.1
Treasury stock acquired, common							(272.7)		(272.7)
Dividends to common stockholders					(169.6)				(169.6)
Dividends to preferred stockholders					(24.7)				(24.7)
Distributions to noncontrolling interest								(8.1)	(8.1)
Contributions from noncontrolling interest								12.1	12.1
Deconsolidation of certain variable interest entities								(353.2)	(353.2)
Net income (excludes \$1.6 million attributable to redeemable noncontrolling interest)					579.0			13.7	592.7
Other comprehensive income (excludes \$0.9 million attributable to redeemable noncontrolling interest)						622.8		0.1	622.9



Table of Contents

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

	For the nine months ended September 30,	
	2012	2011
	(in millions)	
<b>Operating activities</b>		
Net income	\$ 594.3	\$ 532.5
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred policy acquisition costs	27.4	222.9
Additions to deferred policy acquisition costs	(303.1)	(254.3)
Accrued investment income	0.8	2.4
Net cash flows for trading securities	135.3	(193.8)
Premiums due and other receivables	65.7	(99.8)
Contractholder and policyholder liabilities and dividends	1,578.8	868.7
Current and deferred income taxes (benefits)	(28.7)	39.3
Net realized capital (gains) losses	(81.2)	51.0
Depreciation and amortization expense	109.2	87.4
Mortgage loans held for sale, acquired or originated	(48.2)	(117.4)
Mortgage loans held for sale, sold or repaid, net of gain	90.1	49.9
Real estate acquired through operating activities	(25.5)	
Real estate sold through operating activities	4.1	137.8
Stock-based compensation	50.2	32.5
Other	204.5	526.3
Net adjustments	1,779.4	1,352.9
Net cash provided by operating activities	2,373.7	1,885.4
<b>Investing activities</b>		
Available-for-sale securities:		
Purchases	(6,467.5)	(5,179.4)
Sales	946.5	845.6
Maturities	4,702.7	4,350.3
Mortgage loans acquired or originated	(1,811.8)	(1,070.4)
Mortgage loans sold or repaid	1,166.7	1,269.6
Real estate acquired	(114.8)	(43.8)
Net purchases of property and equipment	(35.6)	(32.6)
Purchase of interests in subsidiaries, net of cash acquired	(62.5)	
Net change in other investments	(42.9)	(228.4)
Net cash used in investing activities	(1,719.2)	(89.1)
<b>Financing activities</b>		
Issuance of common stock	24.7	23.2
Acquisition of treasury stock	(272.7)	(456.4)
Proceeds from financing element derivatives	51.6	74.7
Payments for financing element derivatives	(38.3)	(38.6)
Excess tax benefits from share-based payment arrangements	9.8	2.0
Dividends to common stockholders	(169.6)	
Dividends to preferred stockholders	(16.5)	(24.7)
Issuance of long-term debt	602.9	2.6
Principal repayments of long-term debt	(2.1)	(4.3)
Net repayments of short-term borrowings	(81.0)	(30.7)
Investment contract deposits	4,798.7	4,067.3

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

Investment contract withdrawals	(6,126.0)	(5,836.3)
Net increase (decrease) in banking operation deposits	14.9	(15.2)
Other	(5.8)	(3.1)
Net cash used in financing activities	(1,209.4)	(2,239.5)
Net decrease in cash and cash equivalents	(554.9)	(443.2)
Cash and cash equivalents at beginning of period	2,833.9	1,877.4
Cash and cash equivalents at end of period	\$ 2,279.0	\$ 1,434.2

See accompanying notes.

Table of Contents

**Principal Financial Group, Inc.**

**Notes to Consolidated Financial Statements**

**September 30, 2012**

**(Unaudited)**

**1. Nature of Operations and Significant Accounting Policies**

**Basis of Presentation**

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. ( PFG ), its majority-owned subsidiaries and its consolidated variable interest entities ( VIEs ), have been prepared in conformity with accounting principles generally accepted in the U.S. ( U.S. GAAP ) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2012, are not necessarily indicative of the results that may be expected for the year ended December 31, 2012. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2011, included in our Form 10-K for the year ended December 31, 2011, filed with the United States Securities and Exchange Commission ( SEC ). The accompanying consolidated statement of financial position as of December 31, 2011, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Reclassifications have been made to prior period financial statements to conform to the September 30, 2012, presentation.

**Accounting Changes**

In October 2010, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that modifies the definition of the types of costs incurred by insurance entities that can be capitalized in the successful acquisition of new or renewal insurance contracts. Capitalized costs should include incremental direct costs of contract acquisition, as well as certain costs related directly to acquisition activities such as underwriting, policy issuance and processing, medical and inspection and sales force contract selling. This guidance was effective for us on January 1, 2012, and we adopted the guidance retrospectively.

Effective January 1, 2012, we voluntarily changed our method of accounting for the cost of long duration universal life and variable universal life reinsurance contracts. In conjunction with this change, we also changed our accounting policy for estimated gross profits ( EGPs ). These changes are collectively referred to as the Reinsurance Accounting Change . Under our previous method, we recognized all reinsurance cash flows as part of the net cost of reinsurance and amortized this balance over the estimated lives of the underlying policies in proportion to the pattern of EGPs on the underlying policies. Under the new method, any difference between actual and expected reinsurance cash flows are

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

recognized in earnings immediately instead of being deferred and amortized over the life of the underlying policies. In conjunction with this change, we also changed our policy for determining EGPs relating to these contracts to include the difference between actual and expected reinsurance cash flows, where previously these effects had not been included. We adopted the new policies because we believe that they better reflect the economics of our reinsurance transactions by accounting for direct claims and related reinsurance recoveries in the same period. In addition, the new policies are consistent with our intent to purchase reinsurance to protect us against large and unexpected claims.

Comparative amounts from prior periods have been adjusted to apply the new deferred policy acquisition cost ( DPAC ) guidance ( DPAC Guidance ) and the Reinsurance Accounting Change retrospectively in these financial statements.

Our retrospective adoption of the DPAC Guidance and the Reinsurance Accounting Change resulted in reductions to the opening balances of retained earnings and accumulated other comprehensive income ( AOCI ) as of January 1, 2011, as shown in the following table.

	<b>Impact on opening balance as of January 1, 2011</b>		<b>Attributed to DPAC Guidance (in millions)</b>		<b>Attributed to Reinsurance Accounting Change</b>
Retained earnings	\$ (612.9)	\$	(631.7)	\$	18.8
Accumulated other comprehensive income	34.3		29.5		4.8

The following tables show the prior period financial statement line items that were affected by the DPAC Guidance and the Reinsurance Accounting Change.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Consolidated Statements of Financial Position**

	December 31, 2011				
	As adjusted	As originally reported	Effect of change (in millions)	DPAC Guidance	Change attributed to Reinsurance Accounting Change
<b>Assets</b>					
Other investments	\$ 2,985.8	\$ 2,988.0	\$ (2.2)	\$ (2.2)	\$
Premiums due and other receivables	1,196.5	1,245.2	(48.7)		(48.7)
Deferred policy acquisition costs	2,428.0	3,313.5	(885.5)	(884.4)	(1.1)
<b>Liabilities</b>					
Future policy benefits and claims	20,210.4	20,207.9	2.5		2.5
Other policyholder funds	548.6	543.7	4.9	7.0	(2.1)
Deferred income taxes	208.7	533.4	(324.7)	(307.1)	(17.6)
<b>Stockholders equity</b>					
Retained earnings	4,402.3	5,077.5	(675.2)	(642.0)	(33.2)
Accumulated other comprehensive income	258.0	201.9	56.1	55.5	0.6

**Consolidated Statements of Operations**

	For the three months ended September 30, 2011				
	As adjusted	As originally reported	Effect of change (in millions, except per share data)	DPAC Guidance (1)	Change attributed to Reinsurance Accounting Change
<b>Revenue</b>					
Fees and other revenues	\$ 636.4	\$ 631.5	\$ 4.9	\$ 0.5	\$ 4.4
Net investment income	815.2	815.3	(0.1)	(0.1)	
<b>Expenses</b>					
Benefits, claims and settlement expenses	1,114.9	1,131.8	(16.9)	(0.1)	(16.8)
Operating expenses	775.4	766.6	8.8	(5.3)	14.1
Income before income taxes	151.1	138.2	12.9	5.8	7.1
Income taxes	76.6	71.9	4.7	2.1	2.6
Net income	\$ 74.5	\$ 66.3	\$ 8.2	\$ 3.7	\$ 4.5
Net income available to common stockholders	\$ 71.9	\$ 63.7	\$ 8.2	\$ 3.7	\$ 4.5

**Earnings per common share**

Basic earnings per common share	\$	0.23	\$	0.20	\$	0.03	\$	0.01	\$	0.02
Diluted earnings per common share	\$	0.23	\$	0.20	\$	0.03	\$	0.01	\$	0.02



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Consolidated Statements of Operations**

	For the nine months ended September 30, 2011					
	As adjusted	As originally reported	Effect of change	DPAC Guidance (1)	Change attributed to Reinsurance Accounting Change (2)	
	(in millions, except per share data)					
<b>Revenue</b>						
Fees and other revenues	\$ 1,892.6	\$ 1,930.9	\$ (38.3)	\$ 0.7	\$ (39.0)	
Net investment income	2,548.6	2,549.0	(0.4)	(0.4)		
<b>Expenses</b>						
Benefits, claims and settlement expenses	3,497.7	3,337.0	160.7	(0.1)	160.8	
Operating expenses	2,232.7	2,360.9	(128.2)	(7.0)	(121.2)	
Income before income taxes	722.8	794.0	(71.2)	7.4	(78.6)	
Income taxes	190.3	214.7	(24.4)	3.0	(27.4)	
Net income	\$ 532.5	\$ 579.3	\$ (46.8)	\$ 4.4	\$ (51.2)	
Net income available to common stockholders	\$ 471.2	\$ 518.0	\$ (46.8)	\$ 4.4	\$ (51.2)	
<b>Earnings per common share</b>						
Basic earnings per common share	\$ 1.48	\$ 1.63	\$ (0.15)	\$ 0.01	\$ (0.16)	
Diluted earnings per common share	\$ 1.47	\$ 1.61	\$ (0.14)	\$ 0.01	\$ (0.15)	

(1) In general as a result of the adoption of the DPAC Guidance we capitalize fewer expenses, which lowers earnings. During 2011, we made routine model and assumption refinements that resulted in a write-down of our DPAC asset. The DPAC Guidance was applied to a lower DPAC asset, which reduced the DPAC write-off associated with the model and assumption refinements. This positive impact to earnings more than offset the negative impact of lower capitalization during the period.

(2) In the second quarter of 2011, we made various routine adjustments to our model and assumptions in our individual life insurance business. When we updated our actuarial models for the Reinsurance Accounting Change, several of the components of our integrated insurance accounting model were impacted, resulting in changes to various balance sheet and income statement line items. While the same model and assumptions were used to derive both the as originally reported and as adjusted balances, the financial statement impacts of the model and assumption changes upon adjustment were different than previously reported because of changes to the pattern of EGPs caused by the application of our Reinsurance Accounting Change.



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

The following tables show the impact of the Reinsurance Accounting Change on the current period financial statements.

**Consolidated Statements of Financial Position**

	New reinsurance accounting method	September 30, 2012 Former reinsurance accounting method (in millions)	Effect of Reinsurance Accounting Change
<b>Assets</b>			
Premiums due and other receivables	\$ 1,192.2	\$ 1,263.3	\$ (71.1)
Deferred policy acquisition costs	2,558.5	2,540.4	18.1
<b>Liabilities</b>			
Future policy benefits and claims	21,952.0	21,952.4	(0.4)
Other policyholder funds	720.8	714.5	6.3
Deferred income taxes	951.5	974.2	(22.7)
<b>Stockholders equity</b>			
Retained earnings	4,784.3	4,828.7	(44.4)
Accumulated other comprehensive income	880.8	882.7	(1.9)

**Consolidated Statements of Operations**

	For the three months ended September 30, 2012		
	New reinsurance accounting method	Former reinsurance accounting method	Effect of Reinsurance Accounting Change
	(in millions, except per share data)		
<b>Revenue</b>			
Fees and other revenues	\$ 675.0	\$ 674.4	\$ 0.6
<b>Expenses</b>			
Benefits, claims and settlement expenses	1,647.0	1,641.5	5.5
Operating expenses	826.6	827.6	(1.0)
Income before income taxes	181.4	198.2	(16.8)
Income tax benefits	(9.9)	(3.6)	(6.3)
Net income	\$ 191.3	\$ 201.8	\$ (10.5)

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

Net income available to common stockholders	\$	179.7	\$	190.2	\$	(10.5)
<b>Earnings per common share</b>						
Basic earnings per common share	\$	0.61	\$	0.65	\$	(0.04)
Diluted earnings per common share	\$	0.60	\$	0.64	\$	(0.04)

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Consolidated Statements of Operations**

	For the nine months ended September 30, 2012		
	New reinsurance accounting method	Former reinsurance accounting method	Effect of Reinsurance Accounting Change
(in millions, except per share data)			
<b>Revenue</b>			
Fees and other revenues	\$ 1,909.1	\$ 1,917.5	\$ (8.4)
<b>Expenses</b>			
Benefits, claims and settlement expenses	3,969.5	3,950.0	19.5
Operating expenses	2,106.7	2,129.7	(23.0)
Income before income taxes	693.5	711.3	(17.8)
Income taxes	99.2	105.8	(6.6)
Net income	\$ 594.3	\$ 605.5	\$ (11.2)
Net income available to common stockholders	\$ 554.3	\$ 565.5	\$ (11.2)
<b>Earnings per common share</b>			
Basic earnings per common share	\$ 1.86	\$ 1.89	\$ (0.03)
Diluted earnings per common share	\$ 1.84	\$ 1.88	\$ (0.04)

Certain of the current and prior period line items in the consolidated statements of cash flows and consolidated statements of stockholders' equity were affected by the DPAC Guidance and the Reinsurance Accounting Change. All of the line item changes in the consolidated statements of cash flows were included in the operating activities section and the changes in the consolidated statements of stockholders' equity have largely been addressed through the preceding disclosures.

Our accounting policy for DPAC follows, which has been updated from our Form 10-K for the year ended December 31, 2011, to reflect this change.

**Deferred Policy Acquisition Costs**

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 operations as incurred.

DPAC for universal life-type insurance contracts, participating life insurance policies and certain investment contracts are being amortized over the lives of the policies and contracts in relation to the emergence of EGPs or, in certain circumstances, estimated gross revenues. This amortization is adjusted in the current period when EGPs or estimated gross revenues are revised. 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 method (reversion to the mean assumption), a common industry practice, to determine the future domestic equity market growth assumption used for the amortization of DPAC. The DPAC of nonparticipating term life insurance and individual disability policies are being amortized over the premium-paying period of the related policies using assumptions consistent with those used in computing policyholder liabilities.

DPAC 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 is necessary, DPAC would be written off to the extent that it is determined that future policy premiums and investment income or gross profits are not adequate to cover related losses and expenses.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Recent Accounting Pronouncements**

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

In December 2011, the FASB issued authoritative guidance related to balance sheet offsetting. The new guidance requires disclosures about assets and liabilities that are offset or have the potential to be offset. These disclosures are intended to address differences in the asset and liability offsetting requirements under U.S. GAAP and International Financial Reporting Standards. This new guidance will be effective for us for interim and annual reporting periods beginning January 1, 2013, with retrospective application required and is not expected to have a material impact on our consolidated financial statements.

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

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

In June 2011, the FASB issued authoritative guidance that changes the presentation of comprehensive income in the financial statements. The new guidance eliminates the presentation options contained in current guidance and instead requires entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements that show the components of net income and other comprehensive income (OCI), including adjustments for items that are reclassified from OCI to net income. The guidance does not change the items that must be reported in OCI or when an item of OCI must be reclassified to net income. In December 2011, the FASB issued a final standard to defer the new requirement to present classification adjustments out of OCI to net income on the face of the financial statements. All other requirements contained in the original statement on comprehensive income are still effective. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. The required disclosures are included in our consolidated financial statements. See Note 9, Stockholders' Equity, for further details.

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

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

In April 2011, the FASB issued authoritative guidance that modifies the criteria for determining when repurchase agreements would be accounted for as secured borrowings as opposed to sales. The guidance was effective for us on January 1, 2012, for new transfers and modifications to existing transactions and did not have a material impact on our consolidated financial statements.

Also in April 2011, the FASB issued authoritative guidance which clarifies when creditors should classify a loan modification as a troubled debt restructuring ( TDR ). A TDR occurs when a creditor grants a concession to a debtor experiencing financial difficulties. Loans denoted as a TDR are considered impaired and are specifically reserved for when calculating the allowance for credit losses. This guidance also ends the indefinite deferral issued in January 2011 surrounding new disclosures on loans classified as a TDR required as part of the credit quality disclosures guidance issued in July 2010. This guidance was effective for us on July 1, 2011, and was applied retrospectively to restructurings occurring on or after January 1, 2011. This guidance did not have a material impact on our consolidated financial statements. See Note 3, Investments, for further detail.

In July 2010, the FASB issued authoritative guidance that requires new and expanded disclosures related to the credit quality of financing receivables and the allowance for credit losses. Reporting entities are required to provide qualitative and quantitative disclosures on the allowance for credit losses, credit quality, impaired loans, modifications and nonaccrual and past due financing receivables. The disclosures are required to be presented on a disaggregated basis by portfolio segment and class of financing receivable. Disclosures required by the guidance that relate to the end of a reporting period were effective for us in our December 31,



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

2010, consolidated financial statements. Disclosures required by the guidance that relate to an activity that occurs during a reporting period were effective for us on January 1, 2011, and did not have a material impact on our consolidated financial statements. See Note 3, Investments, for further details.

In April 2010, the FASB issued authoritative guidance addressing how investments held through the separate accounts of an insurance entity affect the entity's consolidation analysis. This guidance clarifies that an insurance entity should not consider any separate account interests held for the benefit of policyholders in an investment to be the insurer's interests and should not combine those interests with its general account interest in the same investment when assessing the investment for consolidation. This guidance was effective for us on January 1, 2011, and did not have a material impact on our consolidated financial statements.

In January 2010, the FASB issued authoritative guidance that requires new disclosures related to fair value measurements and clarifies existing disclosure requirements about the level of disaggregation, inputs and valuation techniques. Specifically, reporting entities now must disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and describe the reasons for the transfers. In addition, in the reconciliation for Level 3 fair value measurements, a reporting entity should present separately information about purchases, sales, issuances and settlements. The guidance clarifies that a reporting entity needs to use judgment in determining the appropriate classes of assets and liabilities for disclosure of fair value measurement, considering the level of disaggregated information required by other applicable U.S. GAAP guidance and should also provide disclosures about the valuation techniques and inputs used to measure fair value for each class of assets and liabilities. This guidance was effective for us on January 1, 2010, except for the disclosures about purchases, sales, issuances and settlements in the reconciliation for Level 3 fair value measurements, which were effective for us on January 1, 2011. This guidance did not have a material impact on our consolidated financial statements. See Note 10, Fair Value Measurements, for further details.

**Separate Accounts**

At September 30, 2012 and December 31, 2011, the separate accounts include a separate account valued at \$145.9 million and \$146.5 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

**2. Variable Interest Entities**

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

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

### **Consolidated Variable Interest Entities**

#### *Grantor Trusts*

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

***Collateralized Private Investment Vehicles***

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

***Commercial Mortgage-Backed Securities***

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

***Hedge Funds***

We are a general partner with insignificant equity ownership in various hedge funds. These entities were deemed VIEs due to the equity owners not having decision-making ability. We determined we were the primary beneficiary of these entities due to our control through our management relationships, related party ownership and our fee structure in certain of these funds.

In the second quarter of 2012, the hedge funds were no longer consolidated. We determined we were no longer the primary beneficiary due to the increase in external ownership in the funds. As a result of deconsolidation, total assets decreased \$587.2 million and liabilities and noncontrolling interest decreased \$586.1 million.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	Grantor trusts	Collateralized private investment vehicles	CMBS (in millions)	Hedge funds (2)	Total
<b>September 30, 2012</b>					
Fixed maturities, available-for-sale	\$ 180.3	\$	\$	\$	\$ 180.3
Fixed maturities, trading		132.4			132.4
Other investments			81.3		81.3
Accrued investment income	0.5		0.6		1.1
Premiums due and other receivables	0.1				0.1
<b>Total assets</b>	<b>\$ 180.9</b>	<b>\$ 132.4</b>	<b>\$ 81.9</b>	<b>\$</b>	<b>\$ 395.2</b>
Deferred income taxes	1.9				1.9
Other liabilities (1)	137.4	126.7	48.4		312.5
<b>Total liabilities</b>	<b>\$ 139.3</b>	<b>\$ 126.7</b>	<b>\$ 48.4</b>	<b>\$</b>	<b>\$ 314.4</b>
<b>December 31, 2011</b>					
Fixed maturities, available-for-sale	\$ 199.2	\$ 15.0	\$	\$	214.2
Fixed maturities, trading		132.4			132.4
Equity securities, trading				207.6	207.6
Other investments			97.5	0.3	97.8
Cash and cash equivalents				317.7	317.7
Accrued investment income	1.2	0.1	0.6		1.9
Premiums due and other receivables				39.1	39.1
<b>Total assets</b>	<b>\$ 200.4</b>	<b>\$ 147.5</b>	<b>\$ 98.1</b>	<b>\$ 564.7</b>	<b>\$ 1,010.7</b>
Deferred income taxes	2.2				2.2
Other liabilities (1)	136.9	143.8	64.5	220.0	565.2
<b>Total liabilities</b>	<b>\$ 139.1</b>	<b>\$ 143.8</b>	<b>\$ 64.5</b>	<b>\$ 220.0</b>	<b>\$ 567.4</b>

(1) Grantor trusts contain an embedded derivative of a forecasted transaction to deliver the underlying securities; collateralized private investment vehicles include derivative liabilities and obligation to redeem notes at maturity or termination of the trust; CMBS includes obligation to the bondholders; and hedge funds include liabilities to securities brokers.

(2) The consolidated statements of financial position included a \$343.6 million noncontrolling interest for hedge funds as of December 31, 2011.

We did not provide financial or other support to investees designated as VIEs for the nine months ended September 30, 2012 and 2011.

**Unconsolidated Variable Interest Entities**

*Invested Securities*

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

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

As previously discussed, we invest in several types of collateralized private investment vehicles, which are VIEs. These include cash and synthetic structures that we do not manage. We have determined we are not the primary beneficiary of these

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

collateralized private investment vehicles primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

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

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

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

	Asset carrying value	Maximum exposure to loss (1)
	(in millions)	
<b>September 30, 2012</b>		
Fixed maturities, available-for-sale:		
Corporate	\$ 484.8	\$ 400.9
Residential mortgage-backed pass-through securities	3,265.3	3,034.6
Commercial mortgage-backed securities	3,838.4	4,115.9
Collateralized debt obligations	380.8	439.9
Other debt obligations	3,749.7	3,745.6
Fixed maturities, trading:		
Residential mortgage-backed pass-through securities	96.4	96.4
Commercial mortgage-backed securities	2.8	2.8
Collateralized debt obligations	55.7	55.7
Other debt obligations	17.4	17.4
Other investments:		
Other limited partnership interests	126.0	126.0
<b>December 31, 2011</b>		
Fixed maturities, available-for-sale:		
Corporate	\$ 544.0	\$ 392.6
Residential mortgage-backed pass-through securities	3,343.0	3,155.8
Commercial mortgage-backed securities	3,413.7	3,894.3
Collateralized debt obligations	338.8	399.7
Other debt obligations	3,570.2	3,606.9
Fixed maturities, trading:		

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

Residential mortgage-backed pass-through securities	105.6	105.6
Commercial mortgage-backed securities	12.0	12.0
Collateralized debt obligations	51.4	51.4
Other debt obligations	64.9	64.9
Other investments:		
Other limited partnership interests	122.1	122.1

---

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

### *Sponsored Investment Funds*

We are the investment manager for certain money market mutual funds that are deemed to be VIEs. We are not the primary beneficiary of these VIEs since our involvement is limited primarily to being a service provider, and our variable interest does not absorb the majority of the variability of the entities' net assets. As of September 30, 2012 and December 31, 2011, these VIEs held \$1.4 billion and \$1.7 billion in total assets, respectively. We have no contractual obligation to contribute to the funds.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

**3. Investments**

**Fixed Maturities and Equity Securities**

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock and nonredeemable preferred stock. We classify fixed maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 10, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders' equity, net of adjustments related to DPAC, sales inducements, unearned revenue reserves, policyholder liabilities, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). We also have a minimal amount of assets within trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. Mark-to-market adjustments related to these trading securities are reflected in net investment income.

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



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	Amortized cost	Gross unrealized gains (1)	Gross unrealized losses (1) (in millions)	Other-than- temporary impairments in AOCI (2)	Fair value
<b>September 30, 2012</b>					
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 935.6	\$ 38.0	\$	\$	\$ 973.6
Non-U.S. government and agencies	975.3	227.9	1.6		1,201.6
States and political subdivisions	2,999.9	251.0	2.8		3,248.1
Corporate	32,210.4	3,076.1	390.6	19.5	34,876.4
Residential mortgage-backed pass-through securities	3,034.6	230.8	0.1		3,265.3
Commercial mortgage-backed securities	4,115.9	211.7	287.8	201.4	3,838.4
Collateralized debt obligations	439.9	4.7	57.1	6.7	380.8
Other debt obligations	3,745.6	69.8	(22.6)	88.3	3,749.7
Total fixed maturities, available-for-sale	\$ 48,457.2	\$ 4,110.0	\$ 717.4	\$ 315.9	\$ 51,533.9
Total equity securities, available-for-sale	\$ 140.3	\$ 13.3	\$ 10.0		\$ 143.6
<b>December 31, 2011</b>					
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 772.3	\$ 32.8	\$	\$	\$ 805.1
Non-U.S. government and agencies	917.6	180.5	1.4		1,096.7
States and political subdivisions	2,670.0	218.2	5.5		2,882.7
Corporate	31,954.2	2,321.3	699.5	19.5	33,556.5
Residential mortgage-backed pass-through securities	3,155.8	187.9	0.7		3,343.0
Commercial mortgage-backed securities	3,894.3	117.0	429.4	168.2	3,413.7
Collateralized debt obligations	399.7	1.9	55.8	7.0	338.8
Other debt obligations	3,606.9	100.3	47.0	90.0	3,570.2
Total fixed maturities, available-for-sale	\$ 47,370.8	\$ 3,159.9	\$ 1,239.3	\$ 284.7	\$ 49,006.7
Total equity securities, available-for-sale	\$ 75.2	\$ 8.4	\$ 6.5		\$ 77.1

(1) Includes increases and decreases in asset values subsequent to an other-than-temporary impairment when a portion of the loss was recorded in AOCI.

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

(2) Excludes \$66.0 million and \$28.9 million as of September 30, 2012 and December 31, 2011, respectively, of net unrealized gains on impaired fixed maturities, available-for-sale related to changes in fair value subsequent to the impairment date.

The amortized cost and fair value of fixed maturities available-for-sale at September 30, 2012, by expected maturity, were as follows:

	Amortized cost	Fair value
	(in millions)	
Due in one year or less	\$ 3,829.6	\$ 3,892.5
Due after one year through five years	12,706.2	13,387.2
Due after five years through ten years	9,289.4	10,410.0
Due after ten years	11,296.0	12,610.0
Subtotal	37,121.2	40,299.7
Mortgage-backed and other asset-backed securities	11,336.0	11,234.2
Total	\$ 48,457.2	\$ 51,533.9

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

#### Net Realized Capital Gains and Losses

Net realized capital gains and losses on sales of investments are determined on the basis of specific identification. In general, in addition to realized capital gains and losses on investment sales and periodic settlements on derivatives not designated as hedges, we report gains and losses related to the following in net realized capital gains (losses): other-than-temporary impairments of securities and

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

subsequent realized recoveries, mark-to-market adjustments on certain trading securities, mark-to-market adjustments on certain seed money investments, fair value hedge and cash flow hedge ineffectiveness, mark-to-market adjustments on derivatives not designated as hedges, changes in the mortgage loan valuation allowance provision and impairments of real estate held for investment. Investment gains and losses on sales of certain real estate held for sale, which do not meet the criteria for classification as a discontinued operation and mark-to-market adjustments on trading securities that support investment strategies that involve the active and frequent purchase and sale of fixed maturities are reported as net investment income and are excluded from net realized capital gains (losses). The major components of net realized capital gains (losses) on investments are summarized as follows:

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Fixed maturities, available-for-sale:				
Gross gains	\$ 3.0	\$ 5.4	\$ 22.7	\$ 23.6
Gross losses	(44.1)	(13.3)	(131.0)	(74.5)
Other-than-temporary impairment losses reclassified to (from) OCI	9.2	(34.9)	31.2	(83.0)
Hedging, net	1.0	110.1	7.7	139.6
Fixed maturities, trading	4.7	(11.2)	5.7	(12.5)
Equity securities, available-for-sale:				
Gross gains	0.5	0.1	0.6	2.3
Gross losses	(0.6)		(0.6)	(4.5)
Equity securities, trading	(0.1)	(35.8)	30.6	20.8
Mortgage loans	(23.3)	(13.0)	(44.6)	(35.0)
Derivatives	(50.5)	(105.7)	(20.1)	(161.4)
Other	187.9	67.6	179.0	133.6
Net realized capital gains (losses)	\$ 87.7	\$ (30.7)	\$ 81.2	\$ (51.0)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were \$0.3 billion and \$0.1 billion for the three months ended September 30, 2012 and 2011, and \$1.0 billion and \$0.8 billion for the nine months ended September 30, 2012 and 2011, respectively.

**Other-Than-Temporary Impairments**

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

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

recognition of the other-than-temporary impairment is bifurcated. We recognize the credit loss portion in net income and the noncredit loss portion in OCI ( bifurcated OTTI ).

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Fixed maturities, available-for-sale	\$ (43.5)	\$ (12.8)	\$ (126.3)	\$ (65.4)
Equity securities, available-for-sale	(0.1)	0.1	(0.1)	(2.2)
Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities	(43.6)	(12.7)	(126.4)	(67.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) OCI (1)	9.2	(34.9)	31.2	(83.0)
Net impairment losses on available-for-sale securities	\$ (34.4)	\$ (47.6)	\$ (95.2)	\$ (150.6)

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

We estimate the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The ABS cash flow estimates are based on security specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate security cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or liquidations using bond specific facts and circumstances including timing, security interests and loss severity.

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



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Beginning balance	\$ (375.5)	\$ (359.7)	\$ (434.9)	\$ (325.7)
Credit losses for which an other-than-temporary impairment was not previously recognized	(2.2)	(9.1)	(19.1)	(24.1)
Credit losses for which an other-than-temporary impairment was previously recognized	(20.9)	(35.3)	(60.8)	(104.0)
Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold	32.4	11.6	146.3	63.3
Net reduction (increase) for positive changes in cash flows expected to be collected and amortization (1)	2.8	(0.9)	5.1	(2.9)
Ending balance	\$ (363.4)	\$ (393.4)	\$ (363.4)	\$ (393.4)

(1) Amounts are recognized in net investment income.

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

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

	Less than twelve months		September 30, 2012 Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
U.S. government and agencies	\$ 16.0	\$	\$	\$	\$ 16.0	\$
Non-U.S. governments	35.0	1.6	0.4	0.9	35.4	1.6
States and political subdivisions	196.1	1.9	13.8	0.9	209.9	2.8
Corporate	737.0	18.2	2,573.4	391.9	3,310.4	410.1
Residential mortgage-backed pass-through securities	6.5		2.4	0.1	8.9	0.1

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

Commercial mortgage-backed securities	113.5	4.0	840.6	485.2	954.1	489.2
Collateralized debt obligations	69.9	1.9	150.7	61.9	220.6	63.8
Other debt obligations	169.9	1.7	500.0	64.0	669.9	65.7
Total fixed maturities, available-for-sale	\$ 1,343.9	\$ 29.3	\$ 4,081.3	\$ 1,004.0	\$ 5,425.2	\$ 1,033.3
Total equity securities, available-for-sale	\$ 5.0	\$ 0.1	\$ 51.5	\$ 9.9	\$ 56.5	\$ 10.0

Of the total amounts, Principal Life's consolidated portfolio represented \$4,964.4 million in available-for-sale fixed maturities with gross unrealized losses of \$978.6 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 70% were investment grade (rated AAA through BBB-) with an average price of 84 (carrying value/amortized cost) at September 30, 2012. Gross unrealized losses in our fixed maturities portfolio decreased during the nine months ended September 30, 2012, due to a tightening of credit spreads, primarily in the corporate and commercial mortgage-backed securities sectors.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life's consolidated portfolio held 183 securities with a carrying value of \$1,071.2 million and unrealized losses of \$17.4 million reflecting an average price of 98 at September 30, 2012. Of this portfolio, 87% was investment grade (rated AAA through BBB-) at September 30,



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

2012, with associated unrealized losses of \$13.8 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life's consolidated portfolio held 554 securities with a carrying value of \$3,893.2 million and unrealized losses of \$961.2 million. The average rating of this portfolio was BBB- with an average price of 80 at September 30, 2012. Of the \$961.2 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$485.2 million in unrealized losses with an average price of 63 and an average credit rating of BB+. The remaining unrealized losses consist primarily of \$349.0 million within the corporate sector at September 30, 2012. The average price of the corporate sector was 87 and the average credit rating was BBB. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at September 30, 2012.

	Less than twelve months		December 31, 2011 Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
Non-U.S. governments	\$ 68.5	\$ 1.4	\$ 0.3	\$ 5.4	\$ 68.8	\$ 1.4
States and political subdivisions	5.7	0.1	51.7	5.4	57.4	5.5
Corporate	3,445.6	140.9	2,403.9	578.1	5,849.5	719.0
Residential mortgage-backed pass-through securities	77.8	0.5	3.7	0.2	81.5	0.7
Commercial mortgage-backed securities	608.4	57.3	858.9	540.3	1,467.3	597.6
Collateralized debt obligations	107.2	2.5	204.4	60.3	311.6	62.8
Other debt obligations	708.1	13.0	508.1	124.0	1,216.2	137.0
Total fixed maturities, available-for-sale	\$ 5,021.3	\$ 215.7	\$ 4,031.0	\$ 1,308.3	\$ 9,052.3	\$ 1,524.0
Total equity securities, available-for-sale	\$ 14.3	\$ 3.2	\$ 15.6	\$ 3.3	\$ 29.9	\$ 6.5

Of the total amounts, Principal Life's consolidated portfolio represented \$8,540.7 million in available-for-sale fixed maturities with gross unrealized losses of \$1,470.3 million. Of those fixed maturity securities in Principal Life's consolidated portfolio with a gross unrealized loss position, 76% were investment grade (rated AAA through BBB-) with an average price of 85 (carrying value/amortized cost) at December 31,

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

2011. Gross unrealized losses in our fixed maturities portfolio increased slightly during the year ended December 31, 2011, due to a widening of credit spreads primarily in the corporate and commercial mortgage-backed securities sectors.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life's consolidated portfolio held 477 securities with a carrying value of \$4,573.6 million and unrealized losses of \$198.7 million reflecting an average price of 96 at December 31, 2011. Of this portfolio, 86% was investment grade (rated AAA through BBB-) at December 31, 2011, with associated unrealized losses of \$128.5 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life's consolidated portfolio held 628 securities with a carrying value of \$3,967.1 million and unrealized losses of \$1,271.6 million. The average rating of this portfolio was BBB with an average price of 76 at December 31, 2011. Of the \$1,271.6 million in unrealized losses, the commercial mortgage-backed securities sector accounts for \$540.3 million in unrealized losses with an average price of 61 and an average credit rating of BBB-. The remaining unrealized losses consist primarily of \$541.4 million within the corporate sector at December 31, 2011. The average price of the corporate sector was 81 and the average credit rating was BBB. The unrealized losses on

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at December 31, 2011.

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

The net unrealized gains and losses on investments in fixed maturities available-for-sale, equity securities available-for-sale and derivative instruments are reported as a separate component of stockholders' equity. The cumulative amount of net unrealized gains and losses on available-for-sale securities and derivative instruments net of adjustments related to DPAC, sales inducements, unearned revenue reserves, changes in policyholder liabilities and applicable income taxes was as follows:

	September 30, 2012	(in millions)	December 31, 2011
Net unrealized gains on fixed maturities, available-for-sale (1)	\$ 3,407.6		\$ 1,920.6
Noncredit component of impairment losses on fixed maturities, available-for-sale	(315.9)		(284.7)
Net unrealized gains on equity securities, available-for-sale	3.3		1.9
Adjustments for assumed changes in amortization patterns	(566.6)		(376.1)
Adjustments for assumed changes in policyholder liabilities	(916.8)		(442.7)
Net unrealized gains on derivative instruments	129.0		113.2
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments	195.1		150.3
Provision for deferred income taxes	(636.9)		(354.1)
Net unrealized gains on available-for-sale securities and derivative instruments	\$ 1,298.8		\$ 728.4

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

**Mortgage Loans**

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

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

	September 30, 2012	(in millions)	December 31, 2011
Commercial mortgage loans	\$ 9,988.1		\$ 9,461.4
Residential mortgage loans	1,405.5		1,367.9
Total amortized cost	<b>11,393.6</b>		10,829.3
Valuation allowance	<b>(95.7)</b>		(102.1)
Total carrying value	<b>\$ 11,297.9</b>		\$ 10,727.2

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. We purchased \$59.5 million and \$5.4 million of residential mortgage loans during the three months ended September 30, 2012 and 2011, and \$121.8 million and \$35.4 million during the nine months ended September 30, 2012 and 2011, respectively. We sold \$2.2 million and \$6.1 million of residential mortgage loans during the three months ended September 30, 2012 and 2011, and \$14.3 million and \$14.4 million during the nine months ended September 30, 2012 and 2011, respectively. We sold \$27.1 million of commercial mortgage loans during the three months ended September 30, 2012, and \$31.1 million during the nine months ended September 30, 2012.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	September 30, 2012		December 31, 2011	
	Amortized cost	Percent of total	Amortized cost	Percent of total
(in millions)				
<b>Geographic distribution</b>				
New England	\$ 480.3	4.8%	\$ 454.0	4.8%
Middle Atlantic	2,143.3	21.5	1,744.4	18.4
East North Central	649.3	6.5	774.8	8.2
West North Central	402.1	4.0	407.8	4.3
South Atlantic	2,149.1	21.5	2,099.8	22.2
East South Central	248.5	2.5	231.8	2.4
West South Central	797.4	8.0	648.6	6.9
Mountain	744.3	7.5	643.2	6.8
Pacific	2,360.5	23.6	2,446.4	25.9
International	13.3	0.1	10.6	0.1
Total	\$ 9,988.1	100.0%	\$ 9,461.4	100.0%
<b>Property type distribution</b>				
Office	\$ 2,945.6	29.5%	\$ 2,753.8	29.1%
Retail	2,850.5	28.5	2,580.2	27.3
Industrial	1,804.2	18.1	2,070.7	21.9
Apartments	1,629.7	16.3	1,242.9	13.1
Hotel	449.7	4.5	467.7	4.9
Mixed use/other	308.4	3.1	346.1	3.7
Total	\$ 9,988.1	100.0%	\$ 9,461.4	100.0%

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of \$519.5 million and \$611.0 million and first lien mortgages with an amortized cost of \$886.0 million and \$756.9 million as of September 30, 2012 and December 31, 2011, respectively. Most of our residential home equity mortgages are concentrated in the United States and are generally second lien mortgages comprised of closed-end loans and lines of credit. The majority of our first lien loans are concentrated in the Chilean market.

**Mortgage Loan Credit Monitoring***Commercial Credit Risk Profile Based on Internal Rating*

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

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	Brick and mortar	September 30, 2012 CTL (in millions)	Total
A- and above	\$ 6,874.2	\$ 236.0	\$ 7,110.2
BBB+ thru BBB-	1,911.5	288.6	2,200.1
BB+ thru BB-	321.1	16.6	337.7
B+ and below	337.7	2.4	340.1
Total	\$ 9,444.5	\$ 543.6	\$ 9,988.1

	Brick and mortar	December 31, 2011 CTL (in millions)	Total
A- and above	\$ 5,682.5	\$ 308.6	\$ 5,991.1
BBB+ thru BBB-	2,112.3	238.8	2,351.1
BB+ thru BB-	403.7	16.4	420.1
B+ and below	693.3	5.8	699.1
Total	\$ 8,891.8	\$ 569.6	\$ 9,461.4

*Residential Credit Risk Profile Based on Performance Status*

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

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

	Home equity	September 30, 2012 First liens (in millions)	Total
Performing	\$ 494.0	\$ 863.9	\$ 1,357.9
Nonperforming	25.5	22.1	47.6
Total	\$ 519.5	\$ 886.0	\$ 1,405.5

	Home equity	December 31, 2011		
		First liens		Total
		(in millions)		
Performing	\$ 597.8	\$ 733.7	\$	1,331.5
Nonperforming	13.2	23.2		36.4
Total	\$ 611.0	\$ 756.9	\$	1,367.9

#### Non-Accrual Mortgage Loans

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



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	September 30, 2012	December 31, 2011
	(in millions)	
<b>Commercial:</b>		
Brick and mortar	\$ 31.1	\$ 46.8
<b>Residential:</b>		
Home equity	25.5	13.2
First liens	14.6	15.7
<b>Total</b>	<b>\$ 71.2</b>	<b>\$ 75.7</b>

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

	September 30, 2012					Recorded investment 90 days or more and accruing
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due (in millions)	Current	
Commercial-brick and mortar	\$	\$	\$ 2.4	\$ 2.4	\$ 9,442.1	\$ 9,444.5
Commercial-CTL					543.6	543.6
Residential-home equity	8.7	3.1	3.6	15.4	504.1	519.5
Residential-first liens	24.4	5.4	21.1	50.9	835.1	7.5
<b>Total</b>	<b>\$ 33.1</b>	<b>\$ 8.5</b>	<b>\$ 27.1</b>	<b>\$ 68.7</b>	<b>\$ 11,324.9</b>	<b>\$ 11,393.6</b>

	December 31, 2011					Recorded investment 90 days or more and accruing
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due (in millions)	Current	
Commercial-brick and mortar	\$ 61.4	\$ 4.4	\$ 22.5	\$ 88.3	\$ 8,803.5	\$ 8,891.8
Commercial-CTL					569.6	569.6
Residential-home equity	7.8	2.6	6.2	16.6	594.4	611.0
Residential-first liens	15.8	6.0	22.2	44.0	712.9	7.5
<b>Total</b>	<b>\$ 85.0</b>	<b>\$ 13.0</b>	<b>\$ 50.9</b>	<b>\$ 148.9</b>	<b>\$ 10,680.4</b>	<b>\$ 10,829.3</b>

**Mortgage Loan Valuation Allowance**

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

portfolio, adverse situations that may affect a borrower's ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, portfolio delinquency information, underwriting standards, peer group information, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component is subjective, as it requires the estimation of timing and amount of future cash flows expected to be received on impaired loans.

We review our commercial mortgage loan portfolio and analyze the need for a valuation allowance for any loan that is delinquent for 60 days or more, in process of foreclosure, restructured, on the internal watch list or that currently has a valuation allowance. In addition to establishing allowance levels for specifically identified impaired commercial mortgage loans, management determines an allowance for all other loans in the portfolio for which historical experience and current economic conditions indicate certain losses exist. These loans are segregated by major product type and/or risk level with an estimated loss ratio applied against each product type and/or risk level. The loss ratio is generally based upon historic loss experience for each loan type as adjusted for certain environmental factors management believes to be relevant.

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

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

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

	For the nine months ended September 30, 2012		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 64.8	\$ 37.3	\$ 102.1
Provision	14.3	32.2	46.5
Charge-offs	(26.7)	(28.9)	(55.6)
Recoveries		2.6	2.6

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

Effect of exchange rates			<b>0.1</b>		<b>0.1</b>	
Ending balance	\$	<b>52.4</b>	\$	<b>43.3</b>	\$	<b>95.7</b>
Allowance ending balance by basis of impairment method:						
Individually evaluated for impairment	\$	<b>4.8</b>	\$	<b>7.8</b>	\$	<b>12.6</b>
Collectively evaluated for impairment		<b>47.6</b>		<b>35.5</b>		<b>83.1</b>
Allowance ending balance	\$	<b>52.4</b>	\$	<b>43.3</b>	\$	<b>95.7</b>
Loan balance by basis of impairment method:						
Individually evaluated for impairment	\$	<b>28.7</b>	\$	<b>35.3</b>	\$	<b>64.0</b>
Collectively evaluated for impairment		<b>9,959.4</b>		<b>1,370.2</b>		<b>11,329.6</b>
Loan ending balance	\$	<b>9,988.1</b>	\$	<b>1,405.5</b>	\$	<b>11,393.6</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	For the three months ended September 30, 2011		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 75.6	\$ 38.7	\$ 114.3
Provision	0.4	7.4	7.8
Charge-offs	(4.2)	(7.6)	(11.8)
Recoveries		1.1	1.1
Effect of exchange rates		(0.2)	(0.2)
Ending balance	\$ 71.8	\$ 39.4	\$ 111.2

	For the nine months ended September 30, 2011		
	Commercial	Residential (in millions)	Total
Beginning balance	\$ 80.6	\$ 40.5	\$ 121.1
Provision	13.5	21.3	34.8
Charge-offs	(22.4)	(24.8)	(47.2)
Recoveries	0.1	2.6	2.7
Effect of exchange rates		(0.2)	(0.2)
Ending balance	\$ 71.8	\$ 39.4	\$ 111.2
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	\$ 4.1	\$ 3.8	\$ 7.9
Collectively evaluated for impairment	67.7	35.6	103.3
Allowance ending balance	\$ 71.8	\$ 39.4	\$ 111.2
Loan balance by basis of impairment method:			
Individually evaluated for impairment	\$ 19.1	\$ 25.8	\$ 44.9
Collectively evaluated for impairment	9,557.1	1,369.6	10,926.7
Loan ending balance	\$ 9,576.2	\$ 1,395.4	\$ 10,971.6

**Impaired Mortgage Loans**

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

	September 30, 2012	
Recorded investment	Unpaid principal balance (in millions)	Related allowance

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

With no related allowance recorded:					
Commercial-brick and mortar	\$	10.6	\$	10.9	\$
Residential-first liens		4.9		4.8	
With an allowance recorded:					
Commercial-brick and mortar		18.1		20.3	4.8
Residential-home equity		22.9		22.6	6.7
Residential-first liens		7.5		7.5	1.1
Total:					
Commercial	\$	28.7	\$	31.2	\$ 4.8
Residential	\$	35.3	\$	34.9	\$ 7.8

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	Recorded investment	December 31, 2011 Unpaid principal balance (in millions)	Related allowance
With no related allowance recorded:			
Commercial-brick and mortar	\$	\$ 0.3	\$
Residential-first liens	4.4	4.2	
With an allowance recorded:			
Commercial-brick and mortar	114.0	114.0	16.3
Residential-home equity	14.5	14.2	1.9
Residential-first liens	8.5	8.5	1.3
Total:			
Commercial	\$ 114.0	\$ 114.3	\$ 16.3
Residential	\$ 27.4	\$ 26.9	\$ 3.2

	For the three months ended September 30, 2012		For the nine months ended September 30, 2012	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
	(in millions)			
With no related allowance recorded:				
Commercial-brick and mortar	\$ 27.0	\$ 0.1	\$ 5.3	\$ 1.1
Residential-first liens	5.2		4.6	
With an allowance recorded:				
Commercial-brick and mortar	20.2	0.5	22.2	1.5
Residential-home equity	20.2	0.2	18.7	0.7
Residential-first liens	8.1		8.2	0.1
Total:				
Commercial	\$ 47.2	\$ 0.6	\$ 27.5	\$ 2.6
Residential	\$ 33.5	\$ 0.2	\$ 31.5	\$ 0.8

	For the three months ended September 30, 2011		For the nine months ended September 30, 2011	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
	(in millions)			
With no related allowance recorded:				
Commercial-brick and mortar	\$ 45.0	\$ 0.2	\$ 31.6	\$ 0.7
Residential-first liens	4.0		4.5	
With an allowance recorded:				
Commercial-brick and mortar	22.4	0.3	28.5	0.9

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

Residential-home equity		12.6		0.2		12.4		0.5
Residential-first liens		9.5				9.7		0.1
Total:								
Commercial	\$	67.4	\$	0.5	\$	60.1	\$	1.6
Residential	\$	26.1	\$	0.2	\$	26.6	\$	0.6

**Mortgage Loan Modifications**

Our commercial and residential mortgage loan portfolios include loans that have been modified. We assess loan modifications on a case-by-case basis to evaluate whether a TDR has occurred. The commercial mortgage loan TDRs were modified to delay or reduce principal payments and to increase, reduce or delay interest payments. For these TDR assessments, we have determined



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

the loan rates are now considered below market based on current circumstances. The commercial mortgage loan modifications resulted in delayed cash receipts and a decrease in interest income. The residential mortgage loan TDRs include modifications of interest-only payment periods, delays in principal balloon payments, and interest rate reductions. Residential mortgage loan modifications resulted in delayed or decreased cash receipts and a decrease in interest income.

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

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

	Number of Contracts	For the three months ended September 30, 2011		TDRs in payment default	
		TDRs Recorded investment (in millions)		Number of Contracts	Recorded investment (in millions)
Residential-home equity	20	\$ 0.8	1	\$	
Residential-first liens	1	0.2	1		0.3
Total	21	\$ 1.0	2	\$	0.3

	Number of Contracts	For the nine months ended September 30, 2012		TDRs in payment default	
		TDRs Recorded investment (in millions)		Number of Contracts	Recorded investment (in millions)
Commercial-brick and mortar	3	\$ 22.0		\$	
Residential-home equity	237	10.8	4		
Total	240	\$ 32.8	4	\$	

	Number of Contracts	For the nine months ended September 30, 2011		TDRs in payment default	
		TDRs Recorded investment (in millions)		Number of Contracts	Recorded investment (in millions)
Commercial-brick and mortar	4	\$ 28.5	2	\$	17.6

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

Residential-home equity	80		4.1		4	
Residential-first liens	5		1.3		1	0.3
Total	89	\$	33.9		7	\$ 17.9

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Securities Posted as Collateral**

We posted \$1,371.0 million in fixed maturities, available-for-sale securities at September 30, 2012, to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements and our obligation under funding agreements with the Federal Home Loan Bank of Des Moines ( FHLB Des Moines ). In addition, we posted \$1,672.5 million in commercial mortgage loans as of September 30, 2012, to satisfy collateral requirements associated with our obligation under funding agreements with the FHLB Des Moines. Since we did not relinquish ownership rights on these instruments, they are reported as fixed maturities, available-for-sale and mortgage loans, respectively, on our consolidated statements of financial position.

**4. Derivative Financial Instruments**

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

**Types of Derivative Instruments**

*Interest Rate Contracts*

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

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by either party. Cash is paid or received based on the terms of the swap. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty at each due date. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities and to mitigate the risks arising from timing mismatches between assets and liabilities (including duration mismatches). We also use interest rate swaps to hedge against changes in the value of assets we anticipate acquiring and other anticipated transactions and commitments. Interest rate swaps are used to hedge against changes in the value of the guaranteed minimum withdrawal benefit ( GMWB ) liability. The GMWB rider on

our variable annuity products provides for guaranteed minimum withdrawal benefits regardless of the actual performance of various equity and/or fixed income funds available with the product.

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

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

***Foreign Exchange Contracts***

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

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

Currency forwards are contracts in which we agree with other parties to deliver a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell. We have also used currency forwards to hedge the currency risk associated with net investments in foreign operations. We did not use any currency forwards during 2012 or 2011 to hedge our net investment in foreign operations.

***Equity Contracts***

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

We may sell an investment-type insurance contract with attributes tied to market indices (an embedded derivative as noted below), in which case we write an equity call option to convert the overall contract into a fixed-rate liability, essentially eliminating the equity component altogether. We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity products that credit interest based on changes in an external equity index. We use exchange-traded futures and equity put options to hedge against changes in the value of the GMWB liability related to the GMWB rider on our variable annuity product, as previously explained. The premium associated with certain options is paid quarterly over the life of the option contract.

*Credit Contracts*

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

***Other Contracts***

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

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

We offer group benefit plan contracts that have guaranteed separate accounts as an investment option. We also offer a guaranteed fund as an investment option in our defined contribution plans in Hong Kong.

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

We have fixed deferred annuities that credit interest based on changes in an external equity index. We also have certain variable annuity products with a GMWB rider, which provides that the contractholder will receive at least their principal deposit back through withdrawals of up to a specified annual amount, even if the account value is reduced to zero. Declines in the equity markets may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these annuity contracts, as previously explained.

**Exposure**

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

Our derivative transactions are generally documented under International Swaps and Derivatives Association, Inc. ( ISDA ) Master Agreements. Management believes that such agreements provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, we are permitted to set off our receivable from a counterparty against our payables to the same counterparty arising out of all included transactions. For reporting purposes, we do not offset fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements.

We posted \$362.4 million and \$502.4 million in cash and securities under collateral arrangements as of September 30, 2012 and December 31, 2011, respectively, to satisfy collateral requirements associated with our derivative credit support agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the rating on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of September 30, 2012 and December 31, 2011, was \$1,337.1 million and \$1,484.0 million, respectively. With respect to these derivatives, we posted collateral of \$362.4 million and \$502.4 million as of September 30, 2012 and December 31, 2011, respectively, in the normal course of business, which reflects netting under derivative credit support annex agreements. If the credit-risk-related contingent features underlying these agreements were triggered on September 30, 2012, we would be required to post an additional \$74.2 million of collateral to our counterparties.



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

As of September 30, 2012 and December 31, 2011, we had received \$223.8 million and \$237.0 million, respectively, of cash collateral associated with our derivative credit support annex agreements, for which we recorded a corresponding liability reflecting our obligation to return the collateral.

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

	September 30, 2012	December 31, 2011
	(in millions)	
<b>Notional amounts of derivative instruments</b>		
<b>Interest rate contracts:</b>		
Interest rate swaps	\$ 18,817.9	\$ 19,498.3
Interest rate collars	500.0	500.0
Swaptions	325.0	68.5
Futures	70.5	522.0
<b>Foreign exchange contracts:</b>		
Foreign currency swaps	3,603.9	3,919.8
Currency forwards	243.6	147.3
<b>Equity contracts:</b>		
Options	1,806.0	1,608.4
Futures	374.3	270.3
<b>Credit contracts:</b>		
Credit default swaps	1,473.3	1,530.3
Total return swaps	100.0	15.0
<b>Other contracts:</b>		
Embedded derivative financial instruments	5,948.8	4,921.7
Total notional amounts at end of period	\$ 33,263.3	\$ 33,001.6
<b>Credit exposure of derivative instruments</b>		
<b>Interest rate contracts:</b>		
Interest rate swaps	\$ 785.2	\$ 752.2
Interest rate collars	48.8	38.5
Swaptions	1.0	
<b>Foreign exchange contracts:</b>		
Foreign currency swaps	250.7	318.6
Currency forwards	14.7	1.5
<b>Equity contracts:</b>		
Options	85.6	120.3
<b>Credit contracts:</b>		
Credit default swaps	6.3	14.0
Total gross credit exposure	1,192.3	1,245.1

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

Less: collateral received		<b>269.6</b>		237.0
Net credit exposure	\$	<b>922.7</b>	\$	1,008.1

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	Derivative assets (1)		Derivative liabilities (2)	
	September 30, 2012	December 31, 2011	September 30, 2012	December 31, 2011
(in millions)				
<b>Derivatives designated as hedging instruments</b>				
Interest rate contracts	\$ 14.1	\$ 0.2	\$ 478.8	\$ 500.9
Foreign exchange contracts	202.0	267.2	137.2	158.4
Total derivatives designated as hedging instruments	\$ 216.1	\$ 267.4	\$ 616.0	\$ 659.3
<b>Derivatives not designated as hedging instruments</b>				
Interest rate contracts	\$ 758.1	\$ 730.9	\$ 571.8	\$ 651.5
Foreign exchange contracts	61.3	38.5	33.5	42.7
Equity contracts	85.6	120.3	14.7	0.8
Credit contracts	6.3	14.0	114.2	169.7
Other contracts			364.2	336.0
Total derivatives not designated as hedging instruments	911.3	903.7	1,098.4	1,200.7
Total derivative instruments	\$ 1,127.4	\$ 1,171.1	\$ 1,714.4	\$ 1,860.0

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

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statement of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of \$221.7 million and \$195.8 million as of September 30, 2012 and December 31, 2011, respectively, are reported with contractholder funds on the consolidated statements of financial position.

**Credit Derivatives Sold**

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

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by \$20.0 million as of September 30, 2012 and \$20.0 million as of December 31, 2011. These purchased credit derivative transactions had a net asset (liability) fair value of \$0.2 million as of September 30, 2012 and zero as of December 31, 2011. In certain circumstances, our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	September 30, 2012			Weighted average expected life (in years)
	Notional amount	Fair value (in millions)	Maximum future payments	
<b>Single name credit default swaps</b>				
Corporate debt				
AA	\$ 70.0	\$ (0.2)	\$ 70.0	2.7
A	612.0	2.1	612.0	2.5
BBB	200.0	(2.7)	200.0	3.3
Structured finance				
Near default	11.1	(11.1)	11.1	8.7
Total single name credit default swaps	893.1	(11.9)	893.1	2.8
<b>Basket and index credit default swaps</b>				
Corporate debt				
Near default	132.4	(78.5)	132.4	4.5
Government/municipalities				
AA	30.0	(8.7)	30.0	5.0
Structured finance				
BBB	25.0	(7.0)	25.0	4.8
Total basket and index credit default swaps	187.4	(94.2)	187.4	4.6
Total credit default swap protection sold	\$ 1,080.5	\$ (106.1)	\$ 1,080.5	3.1

	December 31, 2011			Weighted average expected life (in years)
	Notional amount	Fair value (in millions)	Maximum future payments	
<b>Single name credit default swaps</b>				
Corporate debt				
AA	\$ 85.0	\$ (1.0)	\$ 85.0	4.0
A	483.0	(1.4)	483.0	2.5
BBB	110.0	(0.3)	110.0	1.7
CCC	10.0	(0.1)	10.0	0.2
Structured finance				
C	10.0	(8.9)	10.0	10.1

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

Near default	12.9	(12.8)	12.9	1.2
Total single name credit default swaps	710.9	(24.5)	710.9	2.6
<b>Basket and index credit default swaps</b>				
Corporate debt				
CCC	132.4	(104.7)	132.4	5.2
CC	15.0	(14.8)	15.0	1.0
Government/municipalities				
A	40.0	(10.5)	40.0	4.4
Structured finance				
BBB	25.0	(11.0)	25.0	5.5
Total basket and index credit default swaps	212.4	(141.0)	212.4	4.8
Total credit default swap protection sold	\$ 923.3	\$ (165.5)	\$ 923.3	3.1

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	September 30, 2012		Weighted average expected life (in years)
	Amortized cost	Carrying value (in millions)	
<b>Corporate debt</b>			
BBB	\$ 19.0	\$ 19.0	4.3
B	25.0	24.4	0.8
Total corporate debt	44.0	43.4	2.3
<b>Structured finance</b>			
AA	6.4	6.4	7.5
BB	43.5	40.7	3.2
CCC	16.9	17.4	5.9
CC	0.3	0.3	19.4
C			4.2
Total structured finance	67.1	64.8	4.4
Total fixed maturities with credit derivatives	\$ 111.1	\$ 108.2	3.5

	December 31, 2011		Weighted average expected life (in years)
	Amortized cost	Carrying value (in millions)	
<b>Corporate debt</b>			
BB	\$ 14.7	\$ 14.7	5.0
CCC	25.0	20.8	1.5
CC	3.7	0.7	4.0
Total corporate debt	43.4	36.2	2.9
<b>Structured finance</b>			
AA	9.3	9.3	6.4
BBB	27.4	24.5	4.5
BB	15.0	13.9	2.5

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

B		11.2		11.2	5.4
CCC		3.5		3.6	4.8
CC		0.7		0.7	5.3
C		0.2		0.1	8.2
Near default		0.2		0.2	4.7
Total structured finance		67.5		63.5	4.5
Total fixed maturities with credit derivatives	\$	110.9	\$	99.7	3.9



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Fair Value Hedges**

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

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

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

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

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

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

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30, (1)		Hedged items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the three months ended September 30, (1)	
	2012	2011		2012	2011
	(in millions)			(in millions)	
Interest rate contracts	\$ 0.7	\$ (114.8)	Fixed maturities, available-for-sale	\$	\$ 109.2
Interest rate contracts		(0.1)	Investment-type insurance contracts		

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

Foreign exchange contracts	(0.3)	3.0	Fixed maturities, available-for-sale	0.8	(3.3)
Foreign exchange contracts			Investment-type insurance		
	21.0	(26.3)	contracts	(24.7)	28.2
<b>Total</b>	<b>\$ 21.4</b>	<b>\$ (138.2)</b>	<b>Total</b>	<b>\$ (23.9)</b>	<b>\$ 134.1</b>

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30, (1)		Hedging items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the nine months ended September 30, (1)	
	2012	2011		2012	2011
	(in millions)			(in millions)	
Interest rate contracts	\$ 7.3	\$ (126.1)	Fixed maturities, available-for-sale	\$ (3.9)	\$ 121.1
			Investment-type insurance		
Interest rate contracts		(2.3)	contracts		2.4
Foreign exchange contracts	1.3	(0.3)	Fixed maturities, available-for-sale	(0.3)	0.3
			Investment-type insurance		
Foreign exchange contracts	14.0	(11.9)	contracts	(17.4)	14.1
<b>Total</b>	<b>\$ 22.6</b>	<b>\$ (140.6)</b>	<b>Total</b>	<b>\$ (21.6)</b>	<b>\$ 137.9</b>

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

Hedged Item	Amount of gain (loss) for the three months ended September 30,		Amount of gain (loss) for the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Fixed maturities, available-for-sale (1)	\$ (32.6)	\$ (40.2)	\$ (101.7)	\$ (120.3)
Investment-type insurance contracts (2)	9.2	11.0	27.1	33.6

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

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

**Cash Flow Hedges**

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

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

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

The maximum length of time we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 7.7 years. At September 30, 2012, we had \$130.7 million of net gains reported in AOCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from OCI into net income. No amounts were reclassified from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring during the three and nine months ended September 30, 2012 and 2011.

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three months ended September 30,		Location of gain (loss) reclassified from AOCI into net income (effective portion)	Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the three months ended September 30,	
		2012	2011		2012	2011
		(in millions)		(in millions)		
Interest rate contracts	Fixed maturities, available-for-sale	\$ 3.6	\$ 95.2	Net investment income	\$ 2.3	\$ 1.8
Interest rate contracts	Investment-type insurance contracts	0.6	(3.7)	Benefits, claims and settlement expenses		(0.1)
Interest rate contracts	Debt			Operating expense	(1.5)	(1.3)
Foreign exchange contracts	Fixed maturities, available-for-sale	(25.2)	87.5	Net realized capital gains (losses)	(0.3)	0.3
Foreign exchange contracts	Investment-type insurance contracts	(1.4)	9.0	Benefits, claims and settlement expenses		
Total		\$ (22.4)	\$ 188.0	Total	\$ 0.5	\$ 0.7

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the nine months ended September 30,		Location of gain (loss) reclassified from AOCI into net income (effective portion)	Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the nine months ended September 30,	
		2012	2011		2012	2011
		(in millions)		(in millions)		
Interest rate contracts	Fixed maturities, available-for-sale	\$ 29.5	\$ 97.8	Net investment income	\$ 6.4	\$ 5.4
Interest rate contracts	Investment-type insurance contracts	1.2	(1.4)	Benefits, claims and settlement expenses		(0.6)
Interest rate contracts	Debt			Operating expense	(4.4)	(3.9)
Foreign exchange contracts	Fixed maturities, available-for-sale	3.2	20.1	Net realized capital losses	(12.2)	(13.7)
Foreign exchange contracts	Investment-type insurance contracts	(4.2)	(7.9)	Benefits, claims and settlement expenses		(1.7)
Total		\$ 29.7	\$ 108.6	Total	\$ (10.2)	\$ (14.5)

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

Hedged Item	Amount of gain (loss) for the three months ended September 30,		Amount of gain (loss) for the nine months ended September 30,	
	2012	2011	2012	2011
(in millions)				
Fixed maturities, available-for-sale (1)	\$ 2.0	\$ 1.9	\$ 5.9	\$ 7.3
Investment-type insurance contracts (2)	(3.4)	(3.3)	(9.8)	(9.6)

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

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

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.1 million and \$0.1 million for the three months ended September 30, 2012 and 2011, respectively. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was \$0.4 million and \$0.3 million for the nine months ended September 30, 2012 and 2011, respectively.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

We expect to reclassify net losses of \$(1.2) million from AOCI into net income in the next 12 months, which includes both net deferred gains on discontinued hedges and net losses on periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

**Derivatives Not Designated as Hedging Instruments**

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

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

Derivatives not designated as hedging instruments	Amount of gain (loss) recognized in net income on derivatives for the three months ended September 30,		Amount of gain (loss) recognized in net income on derivatives for the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Interest rate contracts	\$ (13.8)	\$ 62.2	\$ 12.4	\$ 78.2
Foreign exchange contracts	26.4	(34.5)	40.0	(45.5)
Equity contracts	(36.7)	73.2	(59.0)	60.5
Credit contracts	9.6	(8.1)	19.1	(5.1)
Other contracts	(37.1)	(115.9)	(14.9)	(171.9)
Total	\$ (51.6)	\$ (23.1)	\$ (2.4)	\$ (83.8)

**5. Long-Term Debt**

The components of long-term debt were as follows:

	September 30, 2012	December 31, 2011
	(in millions)	
7.875% notes payable, due 2014	\$ 400.0	\$ 400.0

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

3.76% notes payable, due 2015	<b>99.6</b>	89.8
8.875% notes payable, due 2019	<b>350.0</b>	350.0
3.3% notes payable, due 2022	<b>298.9</b>	
6.05% notes payable, due 2036	<b>601.7</b>	601.7
4.625% notes payable, due 2042	<b>299.5</b>	
8% surplus notes payable, due 2044	<b>99.3</b>	99.3
Non-recourse mortgages and notes payable	<b>31.0</b>	24.0
Total long-term debt	<b>\$ 2,180.0</b>	<b>\$ 1,564.8</b>

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

On September 5, 2012, we issued \$600.0 million of senior notes. We issued a \$300.0 million series of notes that bear interest at 3.3% and will mature in 2022 and a \$300.0 million series of notes that bear interest at 4.625% and will mature in 2042. Interest on the notes is payable semi-annually on March 15 and September 15 each year, beginning on March 15, 2013. The proceeds will be used for general corporate purposes, which may include the repayment of debt (including \$400.0 million aggregate principal amount of notes due in 2014), partially funding our acquisition of AFP Cuprum S.A. and organic growth.



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**6. Income Taxes**

The effective income tax rate for the three months ended September 30, 2012, was lower than the U.S. corporate income tax rate of 35% ( U.S. statutory rate ) primarily due to income tax deductions allowed for corporate dividends received, tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc. and a third quarter adjustment to reflect a decrease in our estimated annual effective income tax rate.

The effective income tax rate for the nine months ended September 30, 2012, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and tax benefits associated with a contribution of appreciated stock made to The Principal Financial Group Foundation, Inc.

The effective income tax rate for the three months ended September 30, 2011, was higher than the U.S. statutory rate primarily due to the impact of a court ruling on some uncertain tax positions, which was partially offset by income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the interest exclusion from taxable income.

The effective income tax rate for the nine months ended September 30, 2011, was lower than the U.S. statutory rate primarily due to income tax deductions allowed for corporate dividends received, the presentation of taxes on our share of earnings generated from equity method investments in net investment income and the interest inclusion from taxable income, which were partially offset by the impact of a court ruling on some uncertain tax positions.

We are a U.S. shareholder in various foreign entities classified as controlled foreign corporations ( CFCs ) for U.S. tax purposes. U.S. shareholders of CFCs are generally required to take into account as gross income in the U.S. certain passive income earned by the CFCs ( Subpart F income ) even if the income is not currently distributed. A temporary exception (the active financing exception ) was applicable for tax years beginning before January 1, 2012 to avoid the current recognition of Subpart F income derived in the active conduct of a banking, financing, insurance or similar business. The U.S. Congress and the President have yet to enact extenders legislation for 2012 as of September 30, 2012. Therefore, current tax expense has increased by an immaterial amount associated with the U.S. recognition of Subpart F income from our foreign operations. We will reverse any tax expense subject to the active financing exception during the fourth quarter should extenders legislation be enacted during 2012, assuming the legislation is retroactive to January 1, 2012.

The Internal Revenue Service ( IRS ) has completed examination of our consolidated federal income tax returns for years prior to 2004. We are contesting certain issues and have filed suit in the Court of Federal Claims, requesting refunds for the years 1995-2003. We do not expect the litigation to be resolved within the next twelve months. The IRS also completed its examinations of tax years 2004 through 2005 and 2006

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

through 2008 resulting in receipt of notices of deficiency, which were paid in 2011. We filed claims for refund for 2004 and 2005 relating to disputed adjustments during the second quarter of 2012. We expect to file claims for refund for 2006 through 2008 in the next twelve months. The IRS commenced audit of our federal income tax return for 2009 and 2010 in 2011 and in 2012, respectively. We do not expect the results of these audits or developments in other tax areas for all open tax years to significantly change the possible increase in the amount of unrecognized tax benefits, but the outcome of tax reviews is uncertain and unforeseen results can occur.

The U.S. District Court for the Southern District of Iowa issued a decision in the case of Pritired 1, LLC ( Pritired ), and Principal Life Insurance Co. v. United States on September 30, 2011. The court ruled the securities Pritired held should be characterized as debt, not equity, and thus Principal Life was not entitled to foreign tax credits for the years 2002 and 2003. The decision regarding whether to appeal this ruling has not yet been made. Pritired and Principal Life received favorable clarification from the court on September 12, 2012, that the partnership income was to also be reduced.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	Pension benefits		Other postretirement benefits	
	For the three months ended September 30,		For the three months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Service cost	\$ 11.7	\$ 10.7	\$ 0.3	\$ 0.3
Interest cost	27.3	27.3	2.0	2.3
Expected return on plan assets	(28.6)	(29.7)	(8.3)	(8.8)
Amortization of prior service benefit	(2.4)	(2.4)	(7.2)	(7.3)
Recognized net actuarial loss	22.7	14.0	0.3	0.1
Amounts recognized due to special events		(0.3)		(1.1)
Net periodic benefit cost (income)	\$ 30.7	\$ 19.6	\$ (12.9)	\$ (14.5)

	Pension benefits		Other postretirement benefits	
	For the nine months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
Service cost	\$ 35.2	\$ 32.5	\$ 1.0	\$ 0.9
Interest cost	81.8	81.3	6.1	6.7
Expected return on plan assets	(85.9)	(87.2)	(25.1)	(26.1)
Amortization of prior service benefit	(7.0)	(7.4)	(21.5)	(22.1)
Recognized net actuarial loss	68.1	43.0	0.7	0.3
Amounts recognized due to special events		(1.0)		(4.0)
Net periodic benefit cost (income)	\$ 92.2	\$ 61.2	\$ (38.8)	\$ (44.3)

**Contributions**

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act ( ERISA ) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. The minimum annual contribution for 2012 will be zero so we will not be required to fund our qualified pension plan during 2012. However, it is possible that we may fund the qualified and nonqualified pension plans in 2012 for a combined total of \$69.0 million to \$110.0 million. During the three and nine months ended September 30, 2012, we contributed \$23.0 million

and \$69.0 million to these plans, respectively.

## **8. Contingencies, Guarantees and Indemnifications**

### **Litigation and Regulatory Contingencies**

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

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

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

On December 2, 2009 and December 4, 2009, two plaintiffs, Cruise and Mullaney, each filed putative class action lawsuits in the United States District Court for the Southern District of New York against us; Principal Life; Principal Global Investors, LLC; and Principal Real Estate Investors, LLC (the Cruise/Mullaney Defendants). The lawsuits alleged the Cruise/Mullaney Defendants failed to manage the Principal U.S. Property Separate Account ( PUSPSA ) in the best interests of investors, improperly imposed a withdrawal freeze on September 26, 2008, and instituted a withdrawal queue to honor withdrawal requests as sufficient liquidity became available. Plaintiffs allege these actions constitute a breach of fiduciary duties under ERISA. Plaintiffs seek to certify a class including all qualified ERISA plans and the participants of those plans that invested in PUSPSA between September 26, 2008, and the present that have suffered losses caused by the queue. The two lawsuits, as well as two subsequently filed complaints asserting similar claims, have been consolidated and are now known as In re Principal U.S. Property Account Litigation. On April 22, 2010, an order was entered granting the motion made by the Cruise/Mullaney Defendants for change of venue to the United States District Court for the Southern District of Iowa. Plaintiffs filed an Amended Consolidated Complaint adding five new plaintiffs on November 22, 2010, and the Cruise/Mullaney Defendants moved to dismiss the amended complaint. The court denied the Cruise/Mullaney Defendants' motion to dismiss on May 17, 2011. The Cruise/Mullaney Defendants are aggressively defending the lawsuit.

Principal Life received approximately \$440.0 million in connection with the termination of certain structured transactions and the resulting prepayment of Principal Life's investment in those transactions. The transactions involved Lehman Brothers Special Financing Inc. and Lehman

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

Brothers Holdings Inc. (collectively, Lehman ) in various capacities. Subsequent to Lehman's September 2008, bankruptcy filing, its bankruptcy estate has sought to recover from numerous sources significant amounts to which it claims entitlement under various theories. The estate is attempting to recover from us an unspecified amount, but possibly up to the amount paid to us, plus interest. We are one of numerous defendants to this action, which has been stayed by the bankruptcy court. We believe that we have meritorious defenses to Lehman's claims and intend to aggressively defend against them once the stay is lifted and we are allowed to do so.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any such matter will have a material adverse effect on our business or financial position. As of September 30, 2012, there were no estimated losses accrued related to the legal matters discussed above because we believe the loss from these matters is not probable and cannot be reasonably estimated.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts that we could not estimate at September 30, 2012.

**Guarantees and Indemnifications**

In the normal course of business, we have provided guarantees to third parties primarily related to a former subsidiary and joint ventures. These agreements generally expire through 2019. The maximum exposure under these agreements as of September 30, 2012, was approximately \$270.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event that performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. While the likelihood is remote, such outcomes could materially affect net income in a particular quarter or annual period.

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

**9. Stockholders Equity**

**Common Stock**

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

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

### Reconciliation of Outstanding Shares

	Series A preferred stock	Series B preferred stock (in millions)	Common stock
Outstanding shares at January 1, 2011	3.0	10.0	320.4
Shares issued			1.7
Treasury stock acquired			(17.0)
Outstanding shares at September 30, 2011	3.0	10.0	305.1
Outstanding shares at January 1, 2012	<b>3.0</b>	<b>10.0</b>	<b>301.1</b>
Shares issued			<b>3.0</b>
Treasury stock acquired			<b>(10.5)</b>
Outstanding shares at September 30, 2012	<b>3.0</b>	<b>10.0</b>	<b>293.6</b>



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

In May 2011, our Board of Directors reinstated the November 2007 share repurchase program. In July 2011, we completed this program. In August 2011, our Board of Directors authorized a share repurchase program of up to \$200.0 million of our outstanding common stock. We completed this program in September 2011. In November 2011, our Board of Directors authorized a share repurchase program of up to \$100.0 million of our outstanding common stock. We completed this program in December 2011. In February 2012, our Board of Directors authorized a share repurchase program of up to \$100.0 million of our outstanding common stock. We completed this program in May 2012. In May 2012, our Board of Directors authorized a share repurchase program of up to \$200.0 million of our outstanding common stock.

Our Board of Directors has authorized various repurchase programs under which we are allowed to purchase shares of our outstanding common stock. Shares repurchased under these programs are accounted for as treasury stock, carried at cost and reflected as a reduction to stockholders equity.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Other Comprehensive Income**

	For the three months ended September 30, 2012			For the nine months ended September 30, 2012		
	Pre-Tax	Tax	After-Tax	Pre-Tax	Tax	After-Tax
	(in millions)					
Net unrealized gains on available-for-sale securities during the period	\$ 810.7	\$ (273.5)	\$ 537.2	\$ 1,436.7	\$ (468.9)	\$ 967.8
Reclassification adjustment for losses included in net income	56.4	(20.3)	36.1	96.5	(34.3)	62.2
Adjustments for assumed changes in amortization patterns	(145.8)	51.1	(94.7)	(225.4)	78.9	(146.5)
Adjustments for assumed changes in policyholder liabilities	(271.5)	88.9	(182.6)	(474.1)	148.6	(325.5)
Net unrealized gains on available-for-sale securities	449.8	(153.8)	296.0	833.7	(275.7)	558.0
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	(9.2)	3.2	(6.0)	(31.2)	10.9	(20.3)
Adjustments for assumed changes in amortization patterns	3.0	(1.0)	2.0	8.5	(3.0)	5.5
Noncredit component of impairment losses on fixed maturities, available-for-sale (1)	(6.2)	2.2	(4.0)	(22.7)	7.9	(14.8)
Net unrealized gains (losses) on derivative instruments during the period	(23.9)	8.3	(15.6)	5.6	(2.0)	3.6
Reclassification adjustment for (gains) losses included in net income	(0.5)	0.2	(0.3)	10.2	(3.7)	6.5
Adjustments for assumed changes in amortization patterns	(3.5)	1.2	(2.3)	26.4	(9.3)	17.1
Net unrealized gains (losses) on derivative instruments	(27.9)	9.7	(18.2)	42.2	(15.0)	27.2
Foreign currency translation adjustment	49.2	(0.6)	48.6	11.2	16.0	27.2

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

Unrecognized postretirement  
benefit obligation during the  
period

Amortization of prior service cost and actuarial loss included in net periodic benefit cost	<b>13.4</b>	<b>(4.7)</b>	<b>8.7</b>	<b>40.3</b>	<b>(14.1)</b>	<b>26.2</b>
Net unrecognized postretirement benefit obligation	<b>13.4</b>	<b>(4.7)</b>	<b>8.7</b>	<b>40.3</b>	<b>(14.1)</b>	<b>26.2</b>
Other comprehensive income	<b>\$ 478.3</b>	<b>\$ (147.2)</b>	<b>\$ 331.1</b>	<b>\$ 904.7</b>	<b>\$ (280.9)</b>	<b>\$ 623.8</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	For the three months ended September 30, 2011			For the nine months ended September 30, 2011		
	Pre-Tax	Tax	After-Tax	Pre-Tax	Tax	After-Tax
	(in millions)					
Net unrealized gains on available- for-sale securities during the period	\$ 58.9	\$ (2.8)	\$ 56.1	\$ 605.8	\$ (207.0)	\$ 398.8
Reclassification adjustment for losses included in net income	7.4	(4.4)	3.0	34.5	(12.5)	22.0
Adjustments for assumed changes in amortization patterns	21.6	(7.6)	14.0	(98.6)	34.5	(64.1)
Adjustments for assumed changes in policyholder liabilities	(71.8)	6.1	(65.7)	(33.3)	6.1	(27.2)
Net unrealized gains on available- for-sale securities	16.1	(8.7)	7.4	508.4	(178.9)	329.5
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	35.4	(12.3)	23.1	83.5	(29.9)	53.6
Adjustments for assumed changes in amortization patterns	(6.4)	2.2	(4.2)	(12.9)	4.5	(8.4)
Noncredit component of impairment losses on fixed maturities, available-for-sale (1)	29.0	(10.1)	18.9	70.6	(25.4)	45.2
Net unrealized gains on derivative instruments during the period	73.0	(25.5)	47.5	40.0	(14.0)	26.0
Reclassification adjustment for (gains) losses included in net income	(0.8)	0.2	(0.6)	14.2	(5.1)	9.1
Adjustments for assumed changes in amortization patterns	(22.8)	8.0	(14.8)	(24.0)	8.4	(15.6)
Net unrealized gains on derivative instruments	49.4	(17.3)	32.1	30.2	(10.7)	19.5
Foreign currency translation adjustment	(138.5)	2.1	(136.4)	(46.0)	(18.9)	(64.9)
Unrecognized postretirement benefit obligation during the period (2)	(312.9)	109.5	(203.4)	(276.8)	96.9	(179.9)

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

Amortization of prior service cost and actuarial loss included in net periodic benefit cost	3.0	(1.1)	1.9	8.8	(3.1)	5.7
Net unrecognized postretirement benefit obligation	(309.9)	108.4	(201.5)	(268.0)	93.8	(174.2)
Other comprehensive income (loss)	\$ (353.9)	\$ 74.4	\$ (279.5)	\$ 295.2	\$ (140.1)	\$ 155.1

(1) Represents the net impact of (1) unrealized gains resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold and (2) unrealized losses resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI.

(2) Includes the impact of the quarterly remeasurement of plan assets and liabilities in 2011 resulting from curtailment accounting associated with our exited group medical insurance business.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Accumulated Other Comprehensive Income**

	Net unrealized gains on available-for-sale securities	Noncredit component of impairment losses on fixed maturities available-for-sale	Net unrealized gains on derivative instruments (in millions)	Foreign currency translation adjustment	Unrecognized postretirement benefit obligation	Accumulated other comprehensive income
<b>Balances at January 1, 2011</b>	\$ 652.1	\$ (198.2)	\$ 11.3	\$ 29.7	\$ (188.2)	\$ 306.7
Other comprehensive income	329.5	45.2	19.5	(64.6)	(174.2)	155.4
<b>Balances at September 30, 2011</b>	\$ 981.6	\$ (153.0)	\$ 30.8	\$ (34.9)	\$ (362.4)	\$ 462.1
<b>Balances at January 1, 2012</b>	\$ 860.7	\$ (167.2)	\$ 34.9	\$ (109.3)	\$ (361.1)	\$ 258.0
Other comprehensive income	558.0	(14.8)	27.2	26.2	26.2	622.8
<b>Balances at September 30, 2012</b>	\$ 1,418.7	\$ (182.0)	\$ 62.1	\$ (83.1)	\$ (334.9)	\$ 880.8

**Noncontrolling Interest**

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

The noncontrolling interest holders in certain of our subsidiaries maintain an equity interest that is redeemable at the option of the holder, which may be exercised on varying dates beginning in 2014. Since redemption of the noncontrolling interest is outside of our control, this interest is presented on the consolidated statements of financial position line item titled Redeemable noncontrolling interest. If the interest were to be redeemed, we would be required to purchase such interest at a redemption value based on a formula that management intended to reasonably approximate fair value based on a fixed multiple of earnings over a measurement period. As such, the carrying value of the redeemable noncontrolling interest is compared to the redemption value at each reporting period. Any adjustments to the carrying amount of the redeemable noncontrolling interest for changes in redemption value prior to exercise of the redemption option are determined after the attribution of net income or loss of the subsidiary and are recorded in retained earnings.

Following is a reconciliation of the changes in the redeemable noncontrolling interest for the nine months ended September 30, 2012 (in millions):

<b>Balance at January 1, 2012</b>	<b>\$</b>	<b>22.2</b>
Net income attributable to redeemable noncontrolling interest		<b>1.6</b>
Redeemable noncontrolling interest assumed related to acquisition		<b>37.6</b>
Distributions to redeemable noncontrolling interest		<b>(1.3)</b>
Foreign currency translation adjustment		<b>0.9</b>
<b>Balance at September 30, 2012</b>	<b>\$</b>	<b>61.0</b>

## 10. Fair Value Measurements

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

### Valuation Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety considering factors specific to the asset or liability.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

**Determination of Fair Value**

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

Fair value estimates are made based on available market information and judgments about the financial instrument at a specific point in time. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during 2012.

***Fixed Maturities***

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



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

If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to the asset class, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available and where at least one significant unobservable input is utilized, which are reflected in Level 3 and can include fixed maturities across all asset classes. As of September 30, 2012, less than 1% of our fixed maturities were valued using internal pricing models, which were classified as Level 3 assets accordingly.

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

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

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

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

***Equity Securities***

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

***Derivatives***

The fair values of exchange-traded derivatives are determined through quoted market prices, which are reflected in Level 1. Exchange-traded derivatives include interest rate and equity futures that are settled daily such that their fair value is not reflected in the consolidated statements of financial position. The fair values of over-the-counter derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The majority of our over-the-counter derivatives are valued with models that use market observable inputs, which are reflected in Level 2. Significant inputs include contractual terms, interest rates, currency exchange rates, credit spread curves, equity prices, and volatilities. These valuation models consider projected discounted cash flows, relevant swap curves, and appropriate implied

volatilities. Certain over-the-counter derivatives utilize unobservable market data, primarily independent broker quotes that are nonbinding quotes based on models that do not reflect the result of market transactions, which are reflected in Level 3.

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

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

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

***Other Investments***

Other investments reported at fair value primarily include seed money investments, for which the fair value is determined using the net asset value of the fund. The net asset value of the fund represents the price at which we feel we would be able to initiate a transaction. Seed money investments in mutual funds for which the net asset value is published are reflected in Level 1. Seed money investments in mutual funds or other investment funds in markets that do not have a published net asset value are reflected in Level 2.

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

***Cash and Cash Equivalents***

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

***Separate Account Assets***

Separate account assets include equity securities, debt securities and derivative instruments, for which fair values are determined as previously described, and are reflected in Level 1, Level 2 and Level 3. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of

the loans. The market clearing spreads vary based on mortgage type, weighted average life, rating and liquidity. These are reflected in Level 3. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. In addition, each property is appraised annually by an independent appraiser. The real estate included in separate account assets is recorded net of related mortgage encumbrances for which the fair value is estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. The real estate within the separate accounts is reflected in Level 3.

#### *Investment-Type Insurance Contracts*

Certain annuity contracts and other investment-type insurance contracts include embedded derivatives that have been bifurcated from the host contract and that are measured at fair value on a recurring basis, which are reflected in Level 3. The key assumptions for calculating the fair value of the embedded derivative liabilities are market assumptions (such as equity market returns, interest rate levels, market volatility and correlations) and policyholder behavior assumptions (such as lapse, mortality, utilization and withdrawal patterns). They are valued using a combination of historical data and actuarial judgment. Stochastic models are used to value the embedded derivatives that incorporate a spread reflecting our own creditworthiness and risk margins.

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

#### *Other Liabilities*

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

Additionally, obligations of consolidated VIEs for which the fair value option was elected are included in other liabilities. These obligations are valued either based on prices obtained from third party pricing vendors as utilized and described in our discussion of how fair value is determined for fixed maturities, which are reflected in Level 2, or broker quotes, which are reflected in Level 3.

**Assets and Liabilities Measured at Fair Value on a Recurring Basis**

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

	Assets/ (liabilities) measured at fair value	As of September 30, 2012			
		Level 1	Fair value hierarchy level		Level 3
			Level 2	(in millions)	
<b>Assets</b>					
Fixed maturities, available-for-sale:					
U.S. government and agencies	\$ 973.6	\$ 205.8	\$ 767.8	\$	
Non-U.S. governments	1,201.6		1,155.7	45.9	
States and political subdivisions	3,248.1		3,246.1	2.0	
Corporate	34,876.4	90.9	34,595.8	189.7	
Residential mortgage-backed securities	3,265.3		3,265.3		
Commercial mortgage-backed securities	3,838.4		3,838.4		
Collateralized debt obligations	380.8		304.0	76.8	
Other debt obligations	3,749.7		3,733.8	15.9	
Total fixed maturities, available-for-sale	51,533.9	296.7	50,906.9	330.3	
Fixed maturities, trading	808.0	148.1	469.1	190.8	
Equity securities, available-for-sale	143.6	62.9	64.0	16.7	
Equity securities, trading	237.6	96.4	141.2		
Derivative assets (1)	1,127.4		1,057.4	70.0	
Other investments (2)	259.4	22.5	122.7	114.2	
Cash equivalents (3)	1,400.7	183.6	1,217.1		
Sub-total excluding separate account assets	55,510.6	810.2	53,978.4	722.0	

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

Separate account assets		<b>80,160.5</b>		<b>52,867.9</b>		<b>22,772.7</b>		<b>4,519.9</b>
<b>Total assets</b>	<b>\$</b>	<b>135,671.1</b>	<b>\$</b>	<b>53,678.1</b>	<b>\$</b>	<b>76,751.1</b>	<b>\$</b>	<b>5,241.9</b>
<b>Liabilities</b>								
Investments-type insurance contracts								
(4)	\$	(221.7)	\$		\$		\$	(221.7)
Derivative liabilities (1)		(1,355.3)				(1,235.6)		(119.7)
Other liabilities (4)		(233.8)				(185.5)		(48.3)
<b>Total liabilities</b>	<b>\$</b>	<b>(1,810.8)</b>	<b>\$</b>	<b></b>	<b>\$</b>	<b>(1,421.1)</b>	<b>\$</b>	<b>(389.7)</b>
<b>Net assets (liabilities)</b>	<b>\$</b>	<b>133,860.3</b>	<b>\$</b>	<b>53,678.1</b>	<b>\$</b>	<b>75,330.0</b>	<b>\$</b>	<b>4,852.2</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

As of December 31, 2011

	Assets/ (liabilities) measured at fair value	Fair value hierarchy level		
		Level 1	Level 2	Level 3
(in millions)				
<b>Assets</b>				
Fixed maturities, available-for-sale:				
U.S. government and agencies	\$ 805.1	\$ 57.5	\$ 747.6	\$ 22.9
Non-U.S. governments	1,096.7		1,073.8	22.9
States and political subdivisions	2,882.7		2,882.7	
Corporate	33,556.5	87.5	33,172.0	297.0
Residential mortgage-backed securities	3,343.0		3,343.0	
Commercial mortgage-backed securities	3,413.7		3,413.7	
Collateralized debt obligations	338.8		236.3	102.5
Other debt obligations	3,570.2		3,542.9	27.3
Total fixed maturities, available-for-sale	49,006.7	145.0	48,412.0	449.7
Fixed maturities, trading	971.7	199.6	551.3	220.8
Equity securities, available-for-sale	77.1	56.5	2.6	18.0
Equity securities, trading	404.8	291.6	113.2	
Derivative assets (1)	1,171.1		1,110.9	60.2
Other investments (2)	213.3	17.6	98.2	97.5
Cash equivalents (3)	1,659.8	677.3	982.5	
Sub-total excluding separate account assets	53,504.5	1,387.6	51,270.7	846.2
Separate account assets	71,364.4	49,477.1	17,689.1	4,198.2
<b>Total assets</b>	<b>\$ 124,868.9</b>	<b>\$ 50,864.7</b>	<b>\$ 68,959.8</b>	<b>\$ 5,044.4</b>
<b>Liabilities</b>				
Investments-type insurance contracts (4)	\$ (195.8)	\$	\$	\$ (195.8)
Derivative liabilities (1)	(1,527.3)		(1,350.2)	(177.1)
Other liabilities (4)	(225.3)		(201.1)	(24.2)
<b>Total liabilities</b>	<b>\$ (1,948.4)</b>	<b>\$</b>	<b>\$ (1,551.3)</b>	<b>\$ (397.1)</b>
<b>Net assets (liabilities)</b>	<b>\$ 122,920.5</b>	<b>\$ 50,864.7</b>	<b>\$ 67,408.5</b>	<b>\$ 4,647.3</b>

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

(2) Primarily includes seed money investments, commercial mortgage loans of consolidated VIEs and, beginning in 2012, an equity method investment reported at fair value.

(3) Includes money market instruments and short-term investments with a maturity date of three months or less when purchased.



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

(4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported. Other liabilities also include obligations of consolidated VIEs reported at fair value.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Changes in Level 3 Fair Value Measurements**

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

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**

**September 30, 2012**  
**(Unaudited)**

	Beginning asset/ (liability) balance as of June 30, 2011	For the three months ended September 30, 2011				Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of September 30, 2011	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net purchases, sales, issuances and settlements (4)	(in millions)				
<b>Assets</b>									
Fixed maturities, available-for-sale:									
Non-U.S. governments	\$ 23.3	\$	\$ 0.3	\$ (0.9)	\$	\$	\$ 22.7	\$	
Corporate	534.6	0.1	(13.9)	(7.9)	10.0	(264.0)	258.9	(0.1)	
Commercial mortgage-backed securities	11.3	(3.7)	2.8	(10.4)					
Collateralized debt obligations	110.9	(7.2)	(5.2)	0.4			98.9	(7.2)	
Other debt obligations	37.1	0.1	(1.1)	(0.2)	0.4	(7.9)	28.4		
Total fixed maturities, available-for-sale	717.2	(10.7)	(17.1)	(19.0)	10.4	(271.9)	408.9	(7.3)	
Fixed maturities, trading	221.5	(19.1)		(0.2)	20.5	(5.6)	217.1	(19.1)	
Equity securities, available-for-sale	48.4		1.4	(27.6)		(16.1)	6.1		
Derivative assets	33.7	26.6	0.1	5.7			66.1	24.0	
Other investments	107.4	0.6		(3.5)			104.5	0.6	
Separate account assets (2)	3,904.4	100.1	(0.1)	79.0	10.4	(36.8)	4,057.0	105.0	
<b>Liabilities</b>									
Investment-type insurance contracts	(49.2)	(122.0)		5.1			(166.1)	(123.9)	
Derivative liabilities	(178.8)	(20.7)	(2.2)	(2.5)			(204.2)	(24.6)	
Other liabilities (3)	(178.8)	5.1	22.4	(4.7)			(156.0)	(1.0)	

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	Beginning asset/ (liability) balance as of December 31, 2011	For the nine months ended September 30, 2012					Ending asset/ (liability) balance as of September 30, 2012	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net Purchases, sales, issuances and settlements (4)	Transfers into Level 3	Transfers out of Level 3		
<b>Assets</b>								
Fixed maturities, available-for-sale:								
Non-U.S. governments	\$ 22.9	\$	\$	\$ 8.5	\$ 14.5	\$	\$ 45.9	\$
States and political subdivisions			0.2		1.8		2.0	
Corporate	297.0	(6.9)	13.4	(70.3)	54.8	(98.3)	189.7	(3.0)
Collateralized debt obligations	102.5	(3.7)	4.1	5.1		(31.2)	76.8	(0.2)
Other debt obligations	27.3	(2.2)	1.3	(25.8)	15.3		15.9	(2.2)
Total fixed maturities, available-for-sale	449.7	(12.8)	19.0	(82.5)	86.4	(129.5)	330.3	(5.4)
Fixed maturities, trading	220.8	3.6		(43.1)	9.5		190.8	4.3
Equity securities, available-for-sale	18.0		(1.3)				16.7	
Derivative assets	60.2	6.9		2.9			70.0	8.0
Other investments	97.5	(0.8)		17.5			114.2	(0.8)
Separate account assets (2)	4,198.2	318.4	0.3	3.2	1.6	(1.8)	4,519.9	307.1
<b>Liabilities</b>								
Investments-type insurance contracts	(195.8)	(14.6)	(0.1)	(11.2)			(221.7)	(16.8)
Derivative liabilities	(177.1)	32.4	0.7	24.3			(119.7)	34.9
Other liabilities (3)	(24.2)	(24.1)					(48.3)	(24.1)

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	Beginning asset/ (liability) balance as of December 31, 2010	For the nine months ended September 30, 2011					Ending asset/ (liability) balance as of September 30, 2011	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
		Total realized/unrealized gains (losses) Included in net income (1)	Included in other comprehensive income	Net Purchases, sales, issuances and settlements (4)	Transfers into Level 3	Transfers out of Level 3		
<b>Assets</b>								
Fixed maturities, available-for-sale:								
Non-U.S. governments	\$ 24.5	\$	\$ 0.5	\$ (2.3)	\$	\$ 22.7	\$	
Corporate	552.1	(8.8)	(13.8)	(42.5)	55.9	(284.0)	258.9	(3.8)
Commercial mortgage-backed securities	16.2	(3.7)	5.1	(10.5)		(7.1)		
Collateralized debt obligations	109.3	(18.3)	10.1	(0.9)		(1.3)	98.9	(7.9)
Other debt obligations	88.8	0.1	(0.2)	(30.3)	9.0	(39.0)	28.4	0.1
Total fixed maturities, available-for-sale	790.9	(30.7)	1.7	(86.5)	64.9	(331.4)	408.9	(11.6)
Fixed maturities, trading	269.1	(23.5)		(24.0)	20.5	(25.0)	217.1	(22.6)
Equity securities, available-for-sale	43.2	(4.5)	11.1	(27.6)		(16.1)	6.1	
Derivative assets	33.3	38.6	(0.1)	(5.7)			66.1	33.3
Other investments	128.3	(1.5)		(22.3)			104.5	(1.5)
Separate account assets (2)	3,771.5	335.7	(0.2)	9.4	13.5	(72.9)	4,057.0	338.9
<b>Liabilities</b>								
Investments-type insurance contracts	(6.6)	(178.4)		18.9			(166.1)	(178.5)
Derivative liabilities	(181.5)	(13.8)	0.2	(9.1)			(204.2)	(14.5)
Other liabilities (3)	(156.8)	3.4	13.3	(15.9)			(156.0)	3.4

- (1) Both realized gains (losses) and mark-to-market unrealized gains (losses) are generally reported in net realized capital gains (losses) within the consolidated statements of operations. Realized and unrealized gains (losses) on certain fixed maturities, trading and certain derivatives used in relation to certain trading portfolios are reported in net investment income within the consolidated statements of operation.
- (2) Gains and losses for separate account assets do not impact net income as the change in value of separate account assets is offset by a change in value of separate account liabilities. Foreign currency translation adjustments related to the Principal International segment separate account assets are recorded in AOCI and are offset by foreign currency translation adjustments of the corresponding separate account liabilities.
- (3) Certain embedded derivatives reported in other liabilities are part of a cash flow hedge, with the effective portion of the unrealized gains (losses) recorded in AOCI.
- (4) Gross purchases, sales, issuances and settlements were:

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

For the three months ended September 30, 2012

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

For the three months ended September 30, 2011

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 0.6	\$ (1.5)	\$	\$	\$ (0.9)
Corporate	1.4	(1.3)		(8.0)	(7.9)
Commercial mortgage-backed securities		(10.5)		0.1	(10.4)
Collateralized debt obligations	0.1			0.3	0.4
Other debt obligations				(0.2)	(0.2)
Total fixed maturities, available-for-sale	2.1	(13.3)		(7.8)	(19.0)
Fixed maturities, trading				(0.2)	(0.2)
Equity securities, available-for-sale		(27.6)			(27.6)
Derivative assets	16.2	(10.5)			5.7
Other investments				(3.5)	(3.5)
Separate account assets	122.7	(40.7)		(3.0)	79.0
<b>Liabilities</b>					
Investment-type insurance contracts			(0.3)	5.4	5.1
Derivative liabilities	(1.2)	(1.3)			(2.5)
Other liabilities				(4.7)	(4.7)

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

For the nine months ended September 30, 2012

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

For the nine months ended September 30, 2011

	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. government	\$ 3.1	\$ (5.4)	\$	\$	\$ (2.3)
Corporate	9.8	(17.8)		(34.5)	(42.5)
Commercial mortgage-backed securities		(10.5)			(10.5)
Collateralized debt obligations	0.4	(0.4)		(0.9)	(0.9)
Other debt obligations				(30.3)	(30.3)
Total fixed maturities, available-for-sale	13.3	(34.1)		(65.7)	(86.5)
Fixed maturities, trading	10.0	(5.7)		(28.3)	(24.0)
Equity securities, available-for-sale		(27.6)			(27.6)
Derivative assets	17.0	(22.7)			(5.7)
Other investments				(22.3)	(22.3)
Separate account assets	196.1	(165.3)	2.3	(23.7)	9.4
<b>Liabilities</b>					
Investment-type insurance contracts			11.7	7.2	18.9
Derivative liabilities	(11.1)	2.0			(9.1)
Other liabilities	(2.1)			(13.8)	(15.9)

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





Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Transfers**

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

	For the three months ended September 30, 2012					
	Transfers out of Level 1 into Level 2	Transfers out of Level 1 into Level 3	Transfers out of Level 2 into Level 1	Transfers out of Level 2 into Level 3	Transfers out of Level 3 into Level 1	Transfers out of Level 3 into Level 2
	(in millions)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						
State and political subdivisions	\$	\$	\$	\$ 1.8	\$	\$
Corporate				28.8		2.8
Collateralized debt obligations						4.2
Other debt obligations				9.3		
Total fixed maturities, available-for-sale				39.9		7.0
Separate account assets	7.8		0.3			

	For the nine months ended September 30, 2012					
	Transfers out of Level 1 into Level 2	Transfers out of Level 1 into Level 3	Transfers out of Level 2 into Level 1	Transfers out of Level 2 into Level 3	Transfers out of Level 3 into Level 1	Transfers out of Level 3 into Level 2
	(in millions)					
<b>Assets</b>						
Fixed maturities, available-for-sale:						
Non-U.S. governments	\$	\$	\$	\$ 14.5	\$	\$
State and political subdivisions				1.8		
Corporate				54.8		98.3
Collateralized debt obligations						31.2
Other debt obligations				15.3		
Total fixed maturities, available-for-sale				86.4		129.5
Fixed maturities, trading				9.5		
Separate account assets	3,230.6	0.3	0.3	1.3		1.8

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

During the three and nine months ended September 30, 2011, \$39.4 million and \$3,591.4 million, respectively, of separate account assets transferred out of Level 1 into Level 2. Separate account assets transferred between Level 1 and Level 2 during the three and nine months ended September 30, 2012 and 2011, primarily related to foreign equity securities. When these securities are valued at the local close price of the exchange where the assets traded, they are reflected in Level 1. When events materially affecting the value occur between the close of the local exchange and the New York Stock Exchange, we use adjusted prices determined by a third party pricing vendor to update the foreign market closing prices and the fair value is reflected in Level 2.

Assets transferred into Level 3 during the three and nine months ended September 30, 2012 and 2011, primarily included those assets for which we are now unable to obtain pricing from a recognized third party pricing vendor as well as assets that were previously priced using a matrix valuation approach that may no longer be relevant when applied to asset-specific situations. The majority of assets transferred into level 3 have been priced based on a broker quote.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

Assets transferred out of Level 3 during the three and nine months ended September 30, 2012 and 2011, included those for which we are now able to obtain pricing from a recognized third party pricing vendor or from internal models using substantially all market observable information.

**Quantitative Information about Level 3 Fair Value Measurements**

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

As of September 30, 2012					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
<b>Assets</b>					
Fixed maturities, available-for-sale:					
Non-U.S. governments	\$ 13.5	Discounted cash flow	Discount rate (1) Illiquidity premium	1.7% 50 basis points ( bps )	1.7% 50bps
Corporate	61.5	Discounted cash flow	Discount rate (1) Illiquidity premium Earnings before interest, taxes, depreciation and amortization multiple Probability of default Potential loss severity	1.7%-34.0% 0bps-100bps  0x-4.4x 0%-100% 0%-60%	9.4% 40bps  1x 13.3% 6.3%
Collateralized debt obligations	38.4	Discounted cash flow	Discount rate (1) Illiquidity premium	1.1%-20.7% 400bps-1,000bps	13.8% 792bps
Other debt obligations	15.9	Discounted cash flow	Discount rate (1) Illiquidity premium	6.8%-20.0% 0bps-50bps	12.5% 28bps



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

As of September 30, 2012					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
Fixed maturities, trading	39.4	Discounted cash flow	Discount rate (1)	1.3%-72.2%	4.9%
			Illiquidity premium	0bps-1,400bps	360bps
			Earnings before interest, taxes, depreciation and amortization multiple	0x-4.4x	0.3x
			Potential loss severity	0%-66%	14.9%
	<b>132.4</b>	See note (2)			
Other investments		Discounted cash flow - commercial mortgage loans of consolidated			
	81.3	VIEs	Discount rate (1)	3.3%	3.3%
			Illiquidity premium	417bps	417bps
		Discounted cash flow - equity method real estate investment	Discount rate (1)	12.5%	12.5%
	32.8		Terminal capitalization rate	5.5%	5.5%
			Average market rent growth rate	5.4%	5.4%
Separate account assets		Discounted cash flow - mortgage loans	Discount rate (1)	0.8%-12.5%	4.0%
	4,359.4		Illiquidity premium	0bps-50bps	
			Credit spread rate	62bps-1,230bps	340bps
		Discounted cash flow - real estate	Discount rate (1)	6.5%-10.5%	8.2%
			Terminal capitalization rate	4.8%-9.5%	7.3%
			Average market rent growth rate	2.3%-5.7%	3.4%

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

As of September 30, 2012					
	Assets / (liabilities) measured at fair value (in millions)	Valuation technique(s)	Unobservable input description	Input/range of inputs	Weighted average
<b>Liabilities</b>					
Investment-type insurance contracts	(221.7)	Discounted cash flow	Long duration interest rate	2.5%-2.6% (3)	See note (3)
			Long-term equity market volatility	16.1%-42.3%	
			Non-performance risk	0.5%-1.5%	
			Utilization rate	See note (4)	See note (4)
			Lapse rate	0.5%-16.0%	
			Mortality rate	See note (5)	See note (5)
Derivative liabilities	(78.4)	See note (2)			
Other liabilities	(48.3)	See note (2)			

- (1) Represents market comparable interest rate or an index adjusted rate used as the base rate in the discounted cash flow analysis prior to any credit spread, illiquidity or other adjustments, where applicable.
- (2) Relates to a consolidated collateralized private investment vehicle that is a VIE. Fixed maturity, trading represents the underlying collateral of the investment structure and consists of high-grade fixed maturity investments, which are over-collateralized based on outstanding notes priced at par. The derivative liability represents credit default swaps that are valued using a correlation model to the credit default swap ( CDS ) Index ( CDX ) and inputs to the valuation are based on observable market data such as the end of period swap curve, CDS constituents of the index and spread levels of the index, as well as CDX tranche spreads. The other liabilities represent obligations to third party note holders due at maturity or termination of the trust. The value of the obligations reflect the third parties' interest in the investment structure.
- (3) Represents the range of rate curves used in the valuation analysis that we have determined market participants would use when pricing the instrument. Derived from interpolation between observable 20 and 30-year swap rates.
- (4) This input factor is the number of contractholders taking withdrawals as well as the amount and timing of the withdrawals and a range does not provide a meaningful presentation.
- (5) This input is based on an appropriate industry mortality table and a range does not provide a meaningful presentation.

Market comparable discount rates are used as the base rate in the discounted cash flows used to determine the fair value of certain assets. Increases or decreases in the credit spreads on the comparable assets could cause the fair value of the assets to significantly decrease or increase, respectively. Additionally, we may adjust the base discount rate or the modeled price by applying an illiquidity premium given the highly structured nature of certain assets. Increases or decreases in this illiquidity premium could cause significant decreases or increases, respectively, in the fair value of the asset.

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

increase or decrease, respectively. Increases or decreases in our own credit risks, which impact the rates used to discount future cash flows, could significantly increase or decrease, respectively, the fair value of the embedded derivative. All of these changes in fair value would impact net income.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

**Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis**

Certain assets are measured at fair value on a nonrecurring basis. During the nine months ended September 30, 2012, certain mortgage loans had been marked to fair value of \$172.5 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$3.1 million and \$14.4 million for the three and nine months ended September 30, 2012, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs. The fair value of the underlying collateral is determined based on a discounted cash flow valuation either from an external broker opinion of value or an internal model. Significant inputs used in the discounted cash flow calculation include: a discount rate, terminal capitalization rate and average market rent growth. The ranges of inputs used in the fair value measurements for the mortgage loans marked to fair value during the nine months ended September 30, 2012, were:

Discount rate = 8.0% - 20.0%

Terminal capitalization rate = 6.3% - 10.5%

Average market rent growth = 3.0% - 8.0%

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



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

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

During the nine months ended September 30, 2011, certain mortgage loans had been marked to fair value of \$104.4 million. The net impact of impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of \$2.1 million and \$16.1 million for the three months and nine ended September 30, 2011, respectively, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During the nine months ended September 30, 2011, certain mortgage servicing rights had been written down to fair value of \$4.9 million. The net impact of impairments and improvements in estimated fair value of previously impaired mortgage servicing rights resulted in a net loss of \$0.9 million and \$1.0 million for the three months and nine ended September 30, 2011, that was recorded in operating expenses. These mortgage servicing rights are a Level 3 fair value measurement, as fair value is determined by calculating the present value of the future servicing cash flows from the underlying mortgage loans.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Fair Value Option**

As a result of our implementation of new authoritative guidance related to the accounting for VIEs effective January 1, 2010, we elected fair value accounting for certain assets and liabilities of newly consolidated VIEs for which it was not practicable for us to determine the carrying value. The fair value option was elected for commercial mortgage loans reported with other investments and obligations reported with other liabilities in the consolidated statements of financial position. The changes in fair value of these items are reported in net realized capital gains (losses) on the consolidated statements of operations.

The fair value and aggregate contractual principal amounts of commercial mortgage loans for which the fair value option has been elected were \$81.4 million and \$80.3 million as of September 30, 2012, and \$97.5 million and \$96.1 million as of December 31, 2011, respectively. The change in fair value of the loans resulted in a \$0.3 million and \$0.6 million pre-tax gain (loss) for the three months ended September 30, 2012 and 2011, respectively, and a (\$0.3) million and (\$1.5) million pre-tax gain (loss) for the nine months ended September 30, 2012 and 2011, respectively, none of which related to instrument-specific credit risk. None of these loans were more than 90 days past due or in nonaccrual status. Interest income on these commercial mortgage loans is included in net investment income on the consolidated statements of operations and is recorded based on the effective interest rates as determined at the closing of the loan. Interest income recorded on these commercial mortgage loans was \$1.6 million and \$2.1 million for the three months ended September 30, 2012 and 2011, respectively, and \$5.1 million and \$6.7 million for the nine months ended September 30, 2012 and 2011, respectively.

The fair value and aggregate unpaid principal amounts of obligations for which the fair value option has been elected were \$96.4 million and \$212.7 million as of September 30, 2012, and \$88.4 million and \$169.8 million as of December 31, 2011, respectively. For the three months ended September 30, 2012 and 2011, the change in fair value of the obligations resulted in a pre-tax gain (loss) of (\$14.7) million and \$4.4 million, which includes a pre-tax gain (loss) of (\$14.7) million and \$5.1 million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. For the nine months ended September 30, 2012 and 2011, the change in fair value of the obligations resulted in a pre-tax gain (loss) of (\$23.2) million and \$4.6 million, which includes a pre-tax gain (loss) of (\$24.1) million and \$3.4 million related to instrument-specific credit risk that is estimated based on credit spreads and quality ratings, respectively. Interest expense recorded on these obligations is included in operating expenses on the consolidated statements of operations and was \$1.2 million and \$1.6 million for the three months ended September 30, 2012 and 2011, respectively, and \$3.9 million and \$5.2 million for the nine months ended September 30, 2012 and 2011, respectively.

We invest in real estate ventures for the purpose of earning investment returns and for capital appreciation. We elected the fair value option for a venture entered into during the third quarter of 2012 that is subject to the equity method of accounting because the nature of the investment is to add value to the property and generate income from the operations of the property. Other equity method real estate investments are not fair valued because the investments mainly generate income from the operations of the underlying properties. This investment is reported with other investments in the consolidated statements of financial position. The change in fair value is reported in net investment income on the consolidated statements of operations. The fair value of the equity method investment for which the fair value option has been elected was \$32.8 million as of September 30, 2012. The change in fair value of the investment resulted in a \$0.5 million pre-tax loss for both the three and nine months ended September 30, 2012.



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Financial Instruments Not Reported at Fair Value**

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

	September 30, 2012				
	Carrying amount	Fair value	Level 1 (in millions)	Fair value hierarchy level Level 2	Level 3
<b>Assets (liabilities)</b>					
Mortgage loans	\$ 11,297.9	\$ 11,880.4			\$ 11,880.4
Policy loans	866.6	1,080.4			1,080.4
Other investments	250.1	251.1		163.7	87.4
Cash and cash equivalents	878.3	878.3	878.3		
Investments-type insurance contracts	(31,633.5)	(32,139.6)		(7,421.2)	(24,718.4)
Short-term debt	(28.5)	(28.5)		(28.5)	
Long-term debt	(2,180.0)	(2,499.9)		(2,470.3)	(29.6)
Separate account liabilities	(71,784.0)	(70,867.3)			(70,867.3)
Bank deposits	(2,157.7)	(2,162.7)	(1,364.8)	(797.9)	
Cash collateral payable	(226.8)	(226.8)	(226.8)		

	December 31, 2011	
	Carrying amount (in millions)	Fair value
<b>Assets (liabilities)</b>		
Mortgage loans	\$ 10,727.2	\$ 11,223.4
Policy loans	885.1	1,343.4
Other investments	165.6	165.6
Cash and cash equivalents	1,174.1	1,174.1
Investments-type insurance contracts	(32,408.5)	(32,234.0)
Short-term debt	(105.2)	(105.2)
Long-term debt	(1,564.8)	(1,750.7)
Separate account liabilities	(64,016.2)	(62,906.9)
Bank deposits	(2,142.8)	(2,150.2)
Cash collateral payable	(234.0)	(234.0)

**Mortgage Loans**

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

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

### *Policy Loans*

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

### *Other Investments*

The fair value of commercial loans and certain consumer loans included in other investments is calculated by discounting scheduled cash flows through the estimated maturity date using market interest rates that reflect the credit and interest rate risk inherent in the loans. The estimate of term to maturity is based on historical experience, adjusted as required, for current economic and lending conditions. The effect of nonperforming loans is considered in assessing the credit risk inherent in the fair value estimate. These are reflected in Level 3. The carrying value of the remaining investments reported in this line item approximate their fair value and are of a short-term nature. These are reflected in Level 2.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

***Cash and Cash Equivalents***

The carrying amounts of cash and cash equivalents that are not reported at fair value on a recurring basis approximate their fair value, which are reflected in Level 1 given the nature of cash.

***Investment-Type Insurance Contracts***

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

***Short-Term Debt***

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

***Long-Term Debt***

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

***Separate Account Liabilities***

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

***Bank Deposits***

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

***Cash Collateral Payable***

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**11. Segment Information**

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

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

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

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

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

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

Management uses segment operating earnings in goal setting, as a basis for determining employee compensation and in evaluating performance on a basis comparable to that used by securities analysts. We determine segment operating earnings by adjusting U.S. GAAP net income for net realized capital gains (losses), as adjusted, and other after-tax adjustments which management believes are not indicative of overall operating trends. Net realized capital gains (losses), as adjusted, are net of income taxes, related changes in the amortization pattern of DPAC and sales inducements, recognition of deferred front-end fee revenues for sales charges on retirement and life insurance products and services, amortization of hedge accounting book value adjustments for certain discontinued hedges, net realized capital gains and losses distributed, noncontrolling interest capital gains and losses and certain market value adjustments to fee revenues. Net realized capital gains (losses), as



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

adjusted, exclude periodic settlements and accruals on derivative instruments not designated as hedging instruments and exclude certain market value adjustments of embedded derivatives and realized capital gains (losses) associated with our exited group medical insurance business. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on derivatives not designated as hedging instruments), including their impact on recognition of front-end fee revenues, certain market value adjustments to fee revenues and amortization of hedge accounting book value adjustments for certain discontinued hedges, and revenue from our exited group medical insurance business. Segment operating revenues include operating revenues from real estate properties that qualify for discontinued operations. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment operating earnings enhances the understanding of our results of operations by highlighting earnings attributable to the normal, ongoing operations of the business.

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	September 30, 2012	December 31, 2011
	(in millions)	
<b>Assets:</b>		
Retirement and Investor Services	\$ 116,138.7	\$ 108,998.0
Principal Global Investors	1,265.1	1,833.3
Principal International	18,849.7	15,612.1
U.S. Insurance Solutions	18,682.3	17,389.1
Corporate	4,257.5	3,529.2
Total consolidated assets	\$ 159,193.3	\$ 147,361.7

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
<b>Operating revenues by segment:</b>				
Retirement and Investor Services	\$ 1,570.7	\$ 996.0	\$ 3,707.0	\$ 3,058.1
Principal Global Investors	144.0	132.9	423.2	394.5
Principal International	203.8	220.1	676.9	653.4
U.S. Insurance Solutions	766.5	739.3	2,215.0	2,202.0
Corporate	(46.4)	(56.6)	(139.8)	(130.3)
Total segment operating revenues	2,638.6	2,031.7	6,882.3	6,177.7
Net realized capital gains (losses), net of related revenue adjustments	64.9	(55.8)	12.8	(124.1)
Exited group medical insurance business	1.2	117.7	24.1	553.4
Assumption change within our Individual Life business				4.9
Total revenues per consolidated statements of operations	\$ 2,704.7	\$ 2,093.6	\$ 6,919.2	\$ 6,611.9
<b>Operating earnings (loss) by segment, net of related income taxes:</b>				
Retirement and Investor Services	\$ 137.5	\$ 129.6	\$ 422.8	\$ 438.4
Principal Global Investors	20.6	19.1	55.0	56.5
Principal International	29.5	35.3	108.2	99.4
U.S. Insurance Solutions	(21.6)	49.1	78.8	151.5
Corporate	(31.2)	(39.9)	(100.7)	(103.8)
Total segment operating earnings, net of related income taxes	134.8	193.2	564.1	642.0
Net realized capital gains (losses), as adjusted (1)	88.8	(56.8)	39.6	(88.2)
Other after-tax adjustments (2)	(43.9)	(64.5)	(49.4)	(82.6)
Net income available to common stockholders per consolidated statements of operations	\$ 179.7	\$ 71.9	\$ 554.3	\$ 471.2



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
<b>Net realized capital gains (losses):</b>				
Net realized capital gains (losses)	\$ 87.7	\$ (30.7)	\$ 81.2	\$ (51.0)
Certain derivative and hedging-related adjustments	(22.7)	(25.4)	(68.4)	(73.2)
Certain market value adjustments to fee revenues				(0.1)
Recognition of front-end fee revenue	(0.1)	0.3		0.2
Net realized capital gains (losses), net of related revenue adjustments	64.9	(55.8)	12.8	(124.1)
Amortization of deferred policy acquisition and sales inducement costs	30.5	(43.8)	34.7	(37.5)
Capital (gains) losses distributed	(6.8)	9.7	(8.7)	(2.0)
Certain market value adjustments of embedded derivatives		0.9	(1.4)	64.7
Net realized capital (gains) losses associated with exited group medical insurance business			0.2	(0.2)
Noncontrolling interest capital (gains) losses		6.4	(8.2)	(30.4)
Income tax effect	0.2	25.8	10.2	41.3
Net realized capital gains (losses), as adjusted	\$ 88.8	\$ (56.8)	\$ 39.6	\$ (88.2)

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

For the three months ended September 30, 2011, other after-tax adjustments included (1) the negative effect of (a) the impact of a court ruling on some uncertain tax positions (\$68.9 million) and (b) our estimated obligation associated with Executive Life of New York's liquidation petition (\$10.5 million) and (2) the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP (\$14.9 million).

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

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

For the nine months ended September 30, 2011, other after-tax adjustments included (1) the negative effect of (a) the impact of a court ruling on some uncertain tax positions (\$68.9 million); (b) an assumption change in our Individual Life business (\$34.5 million); (c) a contribution made to The Principal Financial Group Foundation, Inc. (\$19.5 million) and (d) our estimated obligation associated with Executive Life of New York's liquidation petition (\$10.5 million) and (2) the positive effect of gains associated with our exited group medical insurance business that does not yet qualify for discontinued operations accounting treatment under U.S. GAAP (\$50.8 million).

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
	(in millions)			
<b>Retirement and Investor Services:</b>				
Full service accumulation	\$ 339.0	\$ 332.3	\$ 1,006.1	\$ 1,018.0
Principal Funds	156.8	138.8	453.0	424.6
Individual annuities	302.1	278.2	864.0	840.6
Bank and trust services	26.1	26.0	75.9	74.4
Eliminations	(30.4)	(27.7)	(88.6)	(85.1)
Total Accumulation	793.6	747.6	2,310.4	2,272.5
Investment only	105.2	123.1	328.8	386.5
Full service payout	671.9	125.3	1,067.8	399.1
Total Guaranteed	777.1	248.4	1,396.6	785.6
Total Retirement and Investor Services	1,570.7	996.0	3,707.0	3,058.1
Principal Global Investors (1)	144.0	132.9	423.2	394.5
Principal International	203.8	220.1	676.9	653.4
<b>U.S. Insurance Solutions:</b>				
Individual life insurance	372.6	362.9	1,044.8	1,074.7
Specialty benefits insurance	393.9	376.4	1,170.2	1,127.3
Total U.S. Insurance Solutions	766.5	739.3	2,215.0	2,202.0
Corporate	(46.4)	(56.6)	(139.8)	(130.3)
Total operating revenues	\$ 2,638.6	\$ 2,031.7	\$ 6,882.3	\$ 6,177.7
Total operating revenues	\$ 2,638.6	\$ 2,031.7	\$ 6,882.3	\$ 6,177.7
Net realized capital gains (losses), net of related revenue adjustments	64.9	(55.8)	12.8	(124.1)
Exited group medical insurance business	1.2	117.7	24.1	553.4
Assumption change within our Individual Life business				4.9
Total revenues per consolidated statements of operations	\$ 2,704.7	\$ 2,093.6	\$ 6,919.2	\$ 6,611.9

(1) Reflects inter-segment revenues of \$54.1 million and \$54.0 million for the three months ended September 30, 2012 and 2011, respectively, and \$160.0 million and \$161.5 million for the nine months ended September 30, 2012 and 2011, respectively.

## 12. Stock-Based Compensation Plans

As of September 30, 2012, we have the Amended and Restated 2010 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan, the Directors Stock Plan and the Long-Term Performance Plan ( Stock-Based Compensation Plans ). As of May 17, 2005, no new grants will be made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan. Under the terms of the Amended and Restated 2010 Stock Incentive Plan, grants may be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units or other stock-based awards. The 2005 Directors Stock Plan provides for the grant of nonqualified stock options,

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

restricted stock, restricted stock units or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock or performance units.

As of September 30, 2012, the maximum number of new shares of common stock that were available for grant under the Amended and Restated 2010 Stock Incentive Plan and the 2005 Directors Stock Plan was 8.6 million.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

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

	For the nine months ended September 30,	
	2012	2011
	(in millions)	
Compensation cost	\$ 40.3	\$ 35.1
Related income tax benefit	13.3	12.2
Capitalized as part of an asset	1.8	1.7

**Nonqualified Stock Options**

Nonqualified stock options were granted to certain employees under the Amended and Restated 2010 Stock Incentive Plan. Total options granted were 0.8 million for the nine months ended September 30, 2012. The fair value of these options was determined using the Black-Scholes option valuation model assuming a weighted-average dividend yield of 2.6 percent, a weighted-average expected volatility of 70.0 percent, a weighted-average risk-free interest rate of 1.1 percent and a weighted-average expected term of 6 years. The weighted-average estimated fair value of stock options granted during the nine months ended September 30, 2012, was \$13.95 per share.

As of September 30, 2012, there were \$5.8 million of total unrecognized compensation costs related to nonvested stock options. The costs are expected to be recognized over a weighted-average service period of approximately 1.6 years.

**Performance Share Awards**

Performance share awards were granted to certain employees under the Amended and Restated 2010 Stock Incentive Plan. Total performance share awards granted were 0.4 million for the nine months ended September 30, 2012. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance objective to be determined at the end of the performance period. The actual number of shares to be awarded at the end of each performance period will range between 0% and 150% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was \$27.46 per common share.

As of September 30, 2012, there were \$7.5 million of total unrecognized compensation costs related to nonvested performance share awards granted. The costs are expected to be recognized over a weighted-average service period of approximately 1.5 years.



**Restricted Stock Units**

Restricted stock units were issued to certain employees and agents pursuant to the Amended and Restated 2010 Stock Incentive Plan and non-employee directors pursuant to the 2005 Directors Stock Plan. Total restricted stock units granted were 1.1 million for the nine months ended September 30, 2012. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was \$27.33 per common share.

As of September 30, 2012, there were \$39.4 million of total unrecognized compensation costs related to nonvested restricted stock unit awards granted. The costs are expected to be recognized over a weighted-average period of approximately 1.9 years.

**Employee Stock Purchase Plan**

Under the Employee Stock Purchase Plan, employees purchased 0.5 million shares for the nine months ended September 30, 2012. The weighted average fair value of the discount on the stock purchased was \$4.76 per share.

As of September 30, 2012, a total of 6.4 million of new shares are available to be made issuable by us for this plan.

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**13. Earnings Per Common Share**

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

	For the three months ended September 30,		For the nine months ended September 30,	
	2012	2011	2012	2011
(in millions, except per share data)				
Net income	\$ 191.3	\$ 74.5	\$ 594.3	\$ 532.5
Subtract:				
Net income (loss) attributable to noncontrolling interest	3.4	(5.6)	15.3	36.6
Preferred stock dividends	8.2	8.2	24.7	24.7
Net income available to common stockholders	\$ 179.7	\$ 71.9	\$ 554.3	\$ 471.2
Weighted-average shares outstanding:				
Basic	294.7	311.9	298.6	317.7
Dilutive effects:				
Stock options	1.0	1.0	1.0	1.3
Restricted stock units	1.5	1.5	1.4	1.5
Performance share awards	0.3	0.4	0.4	0.4
Diluted	297.5	314.8	301.4	320.9
Net income per common share:				
Basic	\$ 0.61	\$ 0.23	\$ 1.86	\$ 1.48
Diluted	\$ 0.60	\$ 0.23	\$ 1.84	\$ 1.47

The calculation of diluted earnings per share for the three and nine months ended September 30, 2012 and 2011, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

**14. Condensed Consolidating Financial Information**

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

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

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) Principal Life, (iii) Principal Financial Services, Inc. ( PFS ) and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2012 and December 31, 2011, and for the nine months ended September 30, 2012 and 2011.

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

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

September 30, 2012

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$ 45,306.8	\$ 6,580.0	\$ (352.9)	\$ 51,533.9
Fixed maturities, trading	173.7	295.5	338.8		808.0
Equity securities, available-for-sale		138.4	5.2		143.6
Equity securities, trading		0.3	237.3		237.6
Mortgage loans		9,839.8	1,805.4	(347.3)	11,297.9
Real estate		8.9	1,199.7		1,208.6
Policy loans		836.8	29.8		866.6
Investment in unconsolidated entities	10,588.7	3,125.2	5,147.6	(18,023.8)	837.7
Other investments	6.0	2,463.1	1,095.4	(1,230.1)	2,334.4
Cash and cash equivalents	975.2	527.2	756.3	20.3	2,279.0
Accrued investment income	0.2	542.8	68.4	3.0	614.4
Premiums due and other receivables	30.1	988.9	1,129.8	(956.6)	1,192.2
Deferred policy acquisition costs		2,289.0	269.5		2,558.5
Property and equipment		405.2	63.2		468.4
Goodwill		54.2	494.7		548.9
Other intangibles		28.2	899.2		927.4
Separate account assets		68,098.3	12,062.2		80,160.5
Other assets	56.5	1,145.4	1,260.5	(1,286.7)	1,175.7
Total assets	\$ 11,830.4	\$ 136,094.0	\$ 33,443.0	\$ (22,174.1)	\$ 159,193.3
<b>Liabilities</b>					
Contractholder funds	\$	\$ 36,730.4	\$ 857.6	\$ (275.8)	\$ 37,312.2
Future policy benefits and claims		17,484.7	4,624.3	(157.0)	21,952.0
Other policyholder funds		685.0	36.1	(0.3)	720.8
Short-term debt			28.5		28.5
Long-term debt	1,950.1	99.4	477.8	(347.3)	2,180.0
Income taxes currently payable			135.3	(128.7)	6.6
Deferred income taxes		624.3	426.2	(99.0)	951.5
Separate account liabilities		68,098.3	12,062.2		80,160.5
Other liabilities	52.8	4,633.0	4,122.3	(2,833.8)	5,974.3
Total liabilities	2,002.9	128,355.1	22,770.3	(3,841.9)	149,286.4
Redeemable noncontrolling interest			61.0		61.0
<b>Stockholders equity</b>					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	4.5	2.5		(2.5)	4.5

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

Additional paid-in capital	<b>9,712.2</b>	<b>5,738.2</b>	<b>7,906.0</b>	<b>(13,644.2)</b>	<b>9,712.2</b>
Retained earnings	<b>4,784.3</b>	<b>1,124.4</b>	<b>1,765.2</b>	<b>(2,889.6)</b>	<b>4,784.3</b>
Accumulated other comprehensive income	<b>880.8</b>	<b>873.8</b>	<b>917.5</b>	<b>(1,791.3)</b>	<b>880.8</b>
Treasury stock, at cost	<b>(5,554.4)</b>				<b>(5,554.4)</b>
Total stockholders' equity attributable to PFG	<b>9,827.5</b>	<b>7,738.9</b>	<b>10,588.7</b>	<b>(18,327.6)</b>	<b>9,827.5</b>
Noncontrolling interest			<b>23.0</b>	<b>(4.6)</b>	<b>18.4</b>
Total stockholders' equity	<b>9,827.5</b>	<b>7,738.9</b>	<b>10,611.7</b>	<b>(18,332.2)</b>	<b>9,845.9</b>
Total liabilities and stockholders' equity \$	<b>11,830.4</b>	<b>\$ 136,094.0</b>	<b>\$ 33,443.0</b>	<b>\$ (22,174.1)</b>	<b>\$ 159,193.3</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2011**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$ 43,285.3	\$ 6,082.4	\$ (361.0)	\$ 49,006.7
Fixed maturities, trading	268.7	374.8	328.2		971.7
Equity securities, available-for-sale		73.4	3.7		77.1
Equity securities, trading		0.3	404.5		404.8
Mortgage loans		9,271.5	1,831.8	(376.1)	10,727.2
Real estate		9.2	1,084.9	(1.2)	1,092.9
Policy loans		859.3	25.8		885.1
Investment in unconsolidated entities	9,828.0	3,115.7	4,718.4	(16,834.8)	827.3
Other investments	7.0	2,559.0	925.3	(1,332.8)	2,158.5
Cash and cash equivalents	226.7	1,344.5	1,277.6	(14.9)	2,833.9
Accrued investment income	1.8	551.1	66.6	(4.3)	615.2
Premiums due and other receivables		969.1	827.7	(600.3)	1,196.5
Deferred policy acquisition costs		2,197.4	230.6		2,428.0
Property and equipment		395.9	61.3		457.2
Goodwill		54.3	428.0		482.3
Other intangibles		29.2	861.4		890.6
Separate account assets		61,615.1	9,749.3		71,364.4
Other assets	14.8	668.9	994.7	(736.1)	942.3
<b>Total assets</b>	<b>\$ 10,347.0</b>	<b>\$ 127,374.0</b>	<b>\$ 29,902.2</b>	<b>\$ (20,261.5)</b>	<b>\$ 147,361.7</b>
<b>Liabilities</b>					
Contractholder funds	\$	\$ 37,356.8	\$ 586.7	\$ (267.1)	\$ 37,676.4
Future policy benefits and claims		16,373.3	3,937.9	(100.8)	20,210.4
Other policyholder funds		519.7	29.0	(0.1)	548.6
Short-term debt			105.2		105.2
Long-term debt	1,351.7	99.4	504.8	(391.1)	1,564.8
Income taxes currently payable	(18.6)	(218.4)	34.3	205.8	3.1
Deferred income taxes	(22.5)	90.6	155.2	(14.6)	208.7
Separate account liabilities		61,615.1	9,749.3		71,364.4
Other liabilities	18.5	4,293.3	4,591.5	(2,617.1)	6,286.2
<b>Total liabilities</b>	<b>1,329.1</b>	<b>120,129.8</b>	<b>19,693.9</b>	<b>(3,185.0)</b>	<b>137,967.8</b>
Redeemable noncontrolling interest			22.2		22.2
<b>Stockholders equity</b>					
Series A preferred stock					
Series B preferred stock	0.1				0.1
Common stock	4.5	2.5		(2.5)	4.5

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

Additional paid-in capital	9,634.7	5,718.1	7,870.2	(13,588.3)	9,634.7
Retained earnings	4,402.3	1,195.0	1,660.3	(2,855.3)	4,402.3
Accumulated other comprehensive income	258.0	328.6	297.5	(626.1)	258.0
Treasury stock, at cost	(5,281.7)				(5,281.7)
Total stockholders' equity attributable to PFG	9,017.9	7,244.2	9,828.0	(17,072.2)	9,017.9
Noncontrolling interest			358.1	(4.3)	353.8
Total stockholders' equity	9,017.9	7,244.2	10,186.1	(17,076.5)	9,371.7
Total liabilities and stockholders' equity \$	10,347.0	\$ 127,374.0	\$ 29,902.2	\$ (20,261.5)	\$ 147,361.7

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

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

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$	\$	2,265.7	\$	\$
Fees and other revenues	0.3	1,115.0	1,018.9	(225.1)	1,909.1
Net investment income	2.7	1,869.8	521.9	15.2	2,409.6
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		(296.9)	496.8	(23.5)	176.4
Total other-than-temporary impairment losses on available-for-sale securities		(111.5)	(14.8)	(0.1)	(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income		27.1	4.1		31.2
Net impairment losses on available-for-sale securities		(84.4)	(10.7)	(0.1)	(95.2)
Net realized capital gains (losses)		(381.3)	486.1	(23.6)	81.2
Total revenues	3.0	4,869.2	2,280.5	(233.5)	6,919.2
<b>Expenses</b>					
Benefits, claims and settlement expenses		3,542.3	436.7	(9.5)	3,969.5
Dividends to policyholders		149.5			149.5
Operating expenses	90.8	1,286.3	925.8	(196.2)	2,106.7
Total expenses	90.8	4,978.1	1,362.5	(205.7)	6,225.7
Income (loss) before income taxes	(87.8)	(108.9)	918.0	(27.8)	693.5
Income taxes (benefits)	(34.4)	(126.4)	260.5	(0.5)	99.2
Equity in the net income (loss) of subsidiaries	632.4	438.6	(9.7)	(1,061.3)	
Net income	579.0	456.1	647.8	(1,088.6)	594.3
Net income attributable to noncontrolling interest			15.4	(0.1)	15.3
Net income attributable to PFG	579.0	456.1	632.4	(1,088.5)	579.0
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$	\$	\$	\$	\$
	554.3	456.1	632.4	(1,088.5)	554.3
Net income	\$	\$	\$	\$	\$
	579.0	456.1	647.8	(1,088.6)	594.3
Other comprehensive income	570.3	546.2	110.4	(603.1)	623.8
Comprehensive income	\$	\$	\$	\$	\$
	1,149.3	1,002.3	758.2	(1,691.7)	1,218.1





Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations****For the nine months ended September 30, 2011**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$	\$	1,993.2	\$	\$
Fees and other revenues	0.1	1,190.4	928.8	(226.7)	1,892.6
Net investment income	1.5	1,961.0	562.4	23.7	2,548.6
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		482.0	(386.2)	3.8	99.6
Total other-than-temporary impairment losses on available-for-sale securities		(51.8)	(15.8)		(67.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income		(90.0)	7.0		(83.0)
Net impairment losses on available-for-sale securities		(141.8)	(8.8)		(150.6)
Net realized capital gains (losses)		340.2	(395.0)	3.8	(51.0)
Total revenues	1.6	5,484.8	1,324.7	(199.2)	6,611.9
<b>Expenses</b>					
Benefits, claims and settlement expenses		3,065.3	442.4	(10.0)	3,497.7
Dividends to policyholders		158.7			158.7
Operating expenses	86.4	1,511.1	827.2	(192.0)	2,232.7
Total expenses	86.4	4,735.1	1,269.6	(202.0)	5,889.1
Income (loss) before income taxes	(84.8)	749.7	55.1	2.8	722.8
Income taxes (benefits)	(32.4)	263.1	(39.2)	(1.2)	190.3
Equity in the net income (loss) of subsidiaries	548.3	(63.0)	490.7	(976.0)	
Net income	495.9	423.6	585.0	(972.0)	532.5
Net income attributable to noncontrolling interest			36.7	(0.1)	36.6
Net income attributable to PFG	495.9	423.6	548.3	(971.9)	495.9
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$	\$	\$	\$	\$
	471.2	423.6	548.3	(971.9)	471.2
Net income	\$	\$	\$	\$	\$
	495.9	423.6	585.0	(972.0)	532.5
Other comprehensive income (loss)	175.8	239.7	(89.9)	(170.5)	155.1
Comprehensive income	\$	\$	\$	\$	\$
	671.7	663.3	495.1	(1,142.5)	687.6



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

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

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ 49.2	\$ 2,369.3	\$ (204.2)	\$ 159.4	\$ 2,373.7
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases		(5,753.7)	(739.5)	25.7	(6,467.5)
Sales		862.7	98.8	(15.0)	946.5
Maturities		4,058.9	643.8		4,702.7
Mortgage loans acquired or originated		(1,687.2)	(177.4)	52.8	(1,811.8)
Mortgage loans sold or repaid		1,104.6	280.3	(218.2)	1,166.7
Real estate acquired			(114.8)		(114.8)
Net purchases of property and equipment		(22.4)	(13.2)		(35.6)
Purchases of interests in subsidiaries, net of cash acquired			(62.5)		(62.5)
Dividends and returns of capital received from unconsolidated entities	539.8	435.0	539.8	(1,514.6)	
Net change in other investments	(0.2)	(14.8)	(14.8)	(13.1)	(42.9)
Net cash provided by (used in) investing activities	539.6	(1,016.9)	440.5	(1,682.4)	(1,719.2)
<b>Financing activities</b>					
Issuance of common stock	24.7				24.7
Acquisition of treasury stock	(272.7)				(272.7)
Proceeds from financing element derivatives		51.6			51.6
Payments for financing element derivatives		(38.3)			(38.3)
Excess tax benefits from share-based payment arrangements		4.7	5.1		9.8
Dividends to common stockholders	(169.6)				(169.6)
Dividends to preferred stockholders	(16.5)				(16.5)
Issuance of long-term debt	593.8		9.1		602.9
Principal repayments of long-term debt			(45.7)	43.6	(2.1)
Net repayments of short-term borrowings			(81.0)		(81.0)
Dividends and capital paid to parent		(539.8)	(974.8)	1,514.6	
Investment contract deposits		4,481.7	317.0		4,798.7
Investment contract withdrawals		(6,123.8)	(2.2)		(6,126.0)

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

Net increase in banking operation deposits				<b>14.9</b>		<b>14.9</b>
Other		<b>(5.8)</b>				<b>(5.8)</b>
Net cash provided by (used in) financing activities	<b>159.7</b>	<b>(2,169.7)</b>		<b>(757.6)</b>	<b>1,558.2</b>	<b>(1,209.4)</b>
Net increase (decrease) in cash and cash equivalents	<b>748.5</b>	<b>(817.3)</b>		<b>(521.3)</b>	<b>35.2</b>	<b>(554.9)</b>
Cash and cash equivalents at beginning of period	<b>226.7</b>	<b>1,344.5</b>		<b>1,277.6</b>	<b>(14.9)</b>	<b>2,833.9</b>
Cash and cash equivalents at end of period	<b>\$ 975.2</b>	<b>\$ 527.2</b>		<b>\$ 756.3</b>	<b>\$ 20.3</b>	<b>\$ 2,279.0</b>

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

**For the nine months ended September 30, 2011**

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ (249.2)	\$ 1,983.6	\$ 447.8	\$ (296.8)	\$ 1,885.4
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases	(4.4)	(4,697.5)	(480.4)	2.9	(5,179.4)
Sales	200.0	545.0	110.1	(9.5)	845.6
Maturities	4.4	3,825.7	520.2		4,350.3
Mortgage loans acquired or originated		(989.0)	(114.2)	32.8	(1,070.4)
Mortgage loans sold or repaid		1,106.6	242.1	(79.1)	1,269.6
Real estate acquired			(43.8)		(43.8)
Net purchases of property and equipment		(27.0)	(5.6)		(32.6)
Dividends and returns of capital received from unconsolidated entities	506.3	224.4	506.4	(1,237.1)	
Net change in other investments	(0.2)	(51.4)	(164.1)	(12.7)	(228.4)
Net cash provided by (used in) investing activities	706.1	(63.2)	570.7	(1,302.7)	(89.1)
<b>Financing activities</b>					
Issuance of common stock	23.2				23.2
Acquisition of treasury stock	(456.4)				(456.4)
Proceeds from financing element derivatives		74.7			74.7
Payments for financing element derivatives		(38.6)			(38.6)
Excess tax benefits from share-based payment arrangements		0.8	1.2		2.0
Dividends to preferred stockholders	(24.7)				(24.7)
Issuance of long-term debt			2.6		2.6
Principal repayments of long-term debt			(55.8)	51.5	(4.3)
Net repayments of short-term borrowings			(30.7)		(30.7)
Dividends and capital paid to parent		(506.4)	(730.7)	1,237.1	
Investment contract deposits		3,746.8	320.5		4,067.3
Investment contract withdrawals		(5,834.3)	(2.0)		(5,836.3)
Net decrease in banking operation deposits			(15.2)		(15.2)
Other		(3.1)			(3.1)

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

Net cash used in financing activities	(457.9)	(2,560.1)	(510.1)	1,288.6	(2,239.5)
Net increase (decrease) in cash and cash equivalents	(1.0)	(639.7)	508.4	(310.9)	(443.2)
Cash and cash equivalents at beginning of period	370.9	699.8	719.9	86.8	1,877.4
Cash and cash equivalents at end of period	\$ 369.9	\$ 60.1	\$ 1,228.3	\$ (224.1)	\$ 1,434.2

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

On May 24, 2011, our shelf registration statement was filed with the SEC and became effective. The shelf registration replaces the shelf registration that had been in effect since June 2008, as it was scheduled to expire in June 2011. Under our current shelf registration, we have the ability to issue unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration statement.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) PFS, (iii) Principal Life and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of September 30, 2012 and December 31, 2011, and for the nine months ended September 30, 2012 and 2011.

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



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

September 30, 2012

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$	\$ 51,533.9	\$	\$ 51,533.9
Fixed maturities, trading	173.7		634.3		808.0
Equity securities, available-for-sale			143.6		143.6
Equity securities, trading			237.6		237.6
Mortgage loans			11,297.9		11,297.9
Real estate			1,208.6		1,208.6
Policy loans			866.6		866.6
Investment in unconsolidated entities	10,588.7	10,488.8	837.7	(21,077.5)	837.7
Other investments	6.0	29.0	2,299.4		2,334.4
Cash and cash equivalents	975.2	459.5	1,558.9	(714.6)	2,279.0
Accrued investment income	0.2		614.2		614.4
Premiums due and other receivables	30.1		1,161.8	0.3	1,192.2
Deferred policy acquisition costs			2,558.5		2,558.5
Property and equipment			468.4		468.4
Goodwill			548.9		548.9
Other intangibles			927.4		927.4
Separate account assets			80,160.5		80,160.5
Other assets	56.5	49.2	1,207.0	(137.0)	1,175.7
Total assets	\$ 11,830.4	\$ 11,026.5	\$ 158,265.2	\$ (21,928.8)	\$ 159,193.3
<b>Liabilities</b>					
Contractholder funds	\$	\$	\$ 37,312.2	\$	\$ 37,312.2
Future policy benefits and claims			21,952.0		21,952.0
Other policyholder funds			720.8		720.8
Short-term debt			309.6	(281.1)	28.5
Long-term debt	1,950.1		229.9		2,180.0
Income taxes currently payable		2.1	42.5	(38.0)	6.6
Deferred income taxes			1,035.1	(83.6)	951.5
Separate account liabilities			80,160.5		80,160.5
Other liabilities	52.8	435.7	5,934.4	(448.6)	5,974.3
Total liabilities	2,002.9	437.8	147,697.0	(851.3)	149,286.4
Redeemable noncontrolling interest			61.0		61.0
<b>Stockholders equity</b>					
Series A preferred stock					
Series B preferred stock	0.1				0.1

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

Common stock	4.5		17.8	(17.8)	4.5
Additional paid-in capital	9,712.2	7,906.0	7,901.5	(15,807.5)	9,712.2
Retained earnings	4,784.3	1,765.2	1,692.3	(3,457.5)	4,784.3
Accumulated other comprehensive income	880.8	917.5	879.2	(1,796.7)	880.8
Treasury stock, at cost	(5,554.4)		(2.0)	2.0	(5,554.4)
Total stockholders' equity attributable to PFG	9,827.5	10,588.7	10,488.8	(21,077.5)	9,827.5
Noncontrolling interest			18.4		18.4
Total stockholders' equity	9,827.5	10,588.7	10,507.2	(21,077.5)	9,845.9
Total liabilities and stockholders' equity	\$ 11,830.4	\$ 11,026.5	\$ 158,265.2	\$ (21,928.8)	\$ 159,193.3

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Financial Position**

**December 31, 2011**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Assets</b>					
Fixed maturities, available-for-sale	\$	\$	\$ 49,006.7	\$	\$ 49,006.7
Fixed maturities, trading	268.7		703.0		971.7
Equity securities, available-for-sale			77.1		77.1
Equity securities, trading			404.8		404.8
Mortgage loans			10,727.2		10,727.2
Real estate			1,092.9		1,092.9
Policy loans			885.1		885.1
Investment in unconsolidated entities	9,828.0	9,762.9	827.2	(19,590.8)	827.3
Other investments	7.0	3.0	2,148.5		2,158.5
Cash and cash equivalents	226.7	702.4	2,787.9	(883.1)	2,833.9
Accrued investment income	1.8		613.4		615.2
Premiums due and other receivables			1,195.2	1.3	1,196.5
Deferred policy acquisition costs			2,428.0		2,428.0
Property and equipment			457.2		457.2
Goodwill			482.3		482.3
Other intangibles			890.6		890.6
Separate account assets			71,364.4		71,364.4
Other assets	14.8	10.4	926.1	(9.0)	942.3
<b>Total assets</b>	<b>\$ 10,347.0</b>	<b>\$ 10,478.7</b>	<b>\$ 147,017.6</b>	<b>\$ (20,481.6)</b>	<b>\$ 147,361.7</b>
<b>Liabilities</b>					
Contractholder funds	\$	\$	\$ 37,676.4	\$	\$ 37,676.4
Future policy benefits and claims			20,210.4		20,210.4
Other policyholder funds			548.6		548.6
Short-term debt		50.0	318.9	(263.7)	105.2
Long-term debt	1,351.7		213.1		1,564.8
Income taxes currently payable	(18.6)	(0.9)	12.0	10.6	3.1
Deferred income taxes	(22.5)	(22.9)	270.8	(16.7)	208.7
Separate account liabilities			71,364.4		71,364.4
Other liabilities	18.5	624.5	6,264.1	(620.9)	6,286.2
<b>Total liabilities</b>	<b>1,329.1</b>	<b>650.7</b>	<b>136,878.7</b>	<b>(890.7)</b>	<b>137,967.8</b>
Redeemable noncontrolling interest			22.2		22.2
<b>Stockholders equity</b>					
Series A preferred stock					
Series B preferred stock	0.1				0.1

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

Common stock	4.5		17.8	(17.8)	4.5
Additional paid-in capital	9,634.7	7,870.2	7,543.4	(15,413.6)	9,634.7
Retained earnings	4,402.3	1,660.3	1,907.5	(3,567.8)	4,402.3
Accumulated other comprehensive income	258.0	297.5	296.2	(593.7)	258.0
Treasury stock, at cost	(5,281.7)		(2.0)	2.0	(5,281.7)
Total stockholders' equity attributable to PFG	9,017.9	9,828.0	9,762.9	(19,590.9)	9,017.9
Noncontrolling interest			353.8		353.8
Total stockholders' equity	9,017.9	9,828.0	10,116.7	(19,590.9)	9,371.7
Total liabilities and stockholders' equity	\$ 10,347.0	\$ 10,478.7	\$ 147,017.6	\$ (20,481.6)	\$ 147,361.7

Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

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

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$	\$	\$ 2,519.3	\$	\$ 2,519.3
Fees and other revenues	0.3		1,909.6	(0.8)	1,909.1
Net investment income	2.7	0.1	2,406.4	0.4	2,409.6
Net realized capital gains, excluding impairment losses on available-for-sale securities		1.0	175.4		176.4
Total other-than-temporary impairment losses on available-for-sale securities			(126.4)		(126.4)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income			31.2		31.2
Net impairment losses on available-for-sale securities			(95.2)		(95.2)
Net realized capital gains		1.0	80.2		81.2
Total revenues	3.0	1.1	6,915.5	(0.4)	6,919.2
<b>Expenses</b>					
Benefits, claims and settlement expenses			3,969.5		3,969.5
Dividends to policyholders			149.5		149.5
Operating expenses	90.8	4.4	2,011.9	(0.4)	2,106.7
Total expenses	90.8	4.4	6,130.9	(0.4)	6,225.7
Income (loss) before income taxes	(87.8)	(3.3)	784.6		693.5
Income taxes (benefits)	(34.4)	(4.7)	138.3		99.2
Equity in the net income of subsidiaries	632.4	631.0		(1,263.4)	
Net income	579.0	632.4	646.3	(1,263.4)	594.3
Net income attributable to noncontrolling interest			15.3		15.3
Net income attributable to PFG	579.0	632.4	631.0	(1,263.4)	579.0
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 554.3	\$ 632.4	\$ 631.0	\$ (1,263.4)	\$ 554.3
Net income	\$ 579.0	\$ 632.4	\$ 646.3	\$ (1,263.4)	\$ 594.3
Other comprehensive income	570.3	621.1	584.0	(1,151.6)	623.8
Comprehensive income	\$ 1,149.3	\$ 1,253.5	\$ 1,230.3	\$ (2,415.0)	\$ 1,218.1



Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Operations**

**For the nine months ended September 30, 2011**

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Revenues</b>					
Premiums and other considerations	\$	\$	\$ 2,221.7	\$	\$ 2,221.7
Fees and other revenues	0.1		1,895.3	(2.8)	1,892.6
Net investment income (loss)	1.5	(3.2)	2,547.5	2.8	2,548.6
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		(0.1)	99.7		99.6
Total other-than-temporary impairment losses on available-for-sale securities			(67.6)		(67.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income			(83.0)		(83.0)
Net impairment losses on available-for-sale securities			(150.6)		(150.6)
Net realized capital losses		(0.1)	(50.9)		(51.0)
Total revenues	1.6	(3.3)	6,613.6		6,611.9
<b>Expenses</b>					
Benefits, claims and settlement expenses			3,497.7		3,497.7
Dividends to policyholders			158.7		158.7
Operating expenses	86.4	1.2	2,145.1		2,232.7
Total expenses	86.4	1.2	5,801.5		5,889.1
Income (loss) before income taxes	(84.8)	(4.5)	812.1		722.8
Income taxes (benefits)	(32.4)	(8.3)	231.0		190.3
Equity in the net income of subsidiaries	548.3	544.5		(1,092.8)	
Net income	495.9	548.3	581.1	(1,092.8)	532.5
Net income attributable to noncontrolling interest			36.6		36.6
Net income attributable to PFG	495.9	548.3	544.5	(1,092.8)	495.9
Preferred stock dividends	24.7				24.7
Net income available to common stockholders	\$ 471.2	\$ 548.3	\$ 544.5	\$ (1,092.8)	\$ 471.2
Net income	\$ 495.9	\$ 548.3	\$ 581.1	\$ (1,092.8)	\$ 532.5
Other comprehensive income	175.8	152.7	163.6	(337.0)	155.1
Comprehensive income	\$ 671.7	\$ 701.0	\$ 744.7	\$ (1,429.8)	\$ 687.6





Table of Contents

**Principal Financial Group, Inc.**  
**Notes to Consolidated Financial Statements**  
**September 30, 2012**  
**(Unaudited)**

**Condensed Consolidating Statements of Cash Flows**

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

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined (in millions)	Eliminations	Principal Financial Group, Inc. Consolidated
<b>Operating activities</b>					
Net cash provided by (used in) operating activities	\$ 49.2	\$ (164.6)	\$ 2,303.2	\$ 185.9	\$ 2,373.7
<b>Investing activities</b>					
Available-for-sale securities:					
Purchases			(6,467.5)		(6,467.5)
Sales			946.5		946.5
Maturities			4,702.7		4,702.7
Mortgage loans acquired or originated			(1,811.8)		(1,811.8)
Mortgage loans sold or repaid			1,166.7		1,166.7