PRINCIPAL FINANCIAL GROUP INC
Form 10-Q
July 31, 2013
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

---

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

For the quarterly period ended June 30, 2013

OR

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

1-16725

(Commission file number)

PRINCIPAL FINANCIAL GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware	**42-1520346**
(State or other jurisdiction of incorporation or organization)	(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 x No o

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 x No o

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 x	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The total number of shares of the registrant s Common Stock, $0.01 par value, outstanding as of July 24, 2013, was 294,349,361.

Table of Contents

PRINCIPAL FINANCIAL GROUP, INC.

TABLE OF CONTENTS

		Page
Part I - FINANCIAL INFORMATION		
Item 1.	Financial Statements	3
	Consolidated Statements of Financial Position at June 30, 2013 (Unaudited) and December 31, 2012	3
	Unaudited Consolidated Statements of Operations for the three and six months ended June 30, 2013 and 2012	4
	Unaudited Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2013 and 2012	5
	Unaudited Consolidated Statements of Stockholders Equity for the six months ended June 30, 2013 and 2012	6
	Unaudited Consolidated Statements of Cash Flows for the six months ended June 30, 2013 and 2012	7
	Notes to Unaudited Consolidated Financial Statements June 30, 2013	8
Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	89
Item 3.	Quantitative and Qualitative Disclosures about Market Risk	126
Item 4.	Controls and Procedures	132
Part II OTHER INFORMATION		
Item 1.	Legal Proceedings	133
Item 1A.	Risk Factors	133
Item 2.	Unregistered Sales of Equity Securities and Use of Proceeds	133
Item 6.	Exhibits	134
Signature		135

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Principal Financial Group, Inc.

Consolidated Statements of Financial Position

	June 30, 2013 (Unaudited)	December 31, 2012 (As adjusted)
	(in millions)	
Assets		
Fixed maturities, available-for-sale (2013 and 2012 include $232.8 million and $194.6 million related to consolidated variable interest entities)	$ **49,191.6**	$ 50,939.3
Fixed maturities, trading (2013 and 2012 both include $110.4 million related to consolidated variable interest entities)	**589.8**	626.7
Equity securities, available-for-sale	**135.3**	136.5
Equity securities, trading	**636.7**	252.8
Mortgage loans	**12,121.7**	11,519.7
Real estate	**1,264.8**	1,180.3
Policy loans	**865.3**	864.9
Other investments (2013 and 2012 include $76.6 million and $80.3 million related to consolidated variable interest entities and $116.5 million and $113.9 million measured at fair value under the fair value option)	**2,976.3**	3,291.1
Total investments	**67,781.5**	68,811.3
Cash and cash equivalents	**1,110.5**	4,177.2
Accrued investment income	**565.4**	584.4
Premiums due and other receivables	**1,219.0**	1,084.4
Deferred acquisition costs	**2,925.4**	2,590.0
Property and equipment	**476.4**	464.2
Goodwill	**1,138.5**	543.4
Other intangibles	**1,517.3**	914.7
Separate account assets (2013 includes $33,179.6 million related to consolidated variable interest entities)	**118,740.2**	81,653.8
Other assets	**1,038.5**	1,006.8
Total assets	$ **196,512.7**	$ 161,830.2
Liabilities		
Contractholder funds	$ **36,269.7**	$ 37,786.5
Future policy benefits and claims	**22,129.5**	22,436.2
Other policyholder funds	**739.5**	716.4
Short-term debt	**175.3**	40.8
Long-term debt	**2,578.6**	2,671.3
Income taxes currently payable	**7.2**	15.3
Deferred income taxes	**578.7**	600.0
Separate account liabilities (2013 includes $33,179.6 million related to consolidated variable interest entities)	**118,740.2**	81,653.8
Other liabilities (2013 and 2012 include $314.4 million and $302.9 million related to consolidated variable interest entities, of which $98.9 million and $85.0 million are measured at fair value under the fair value option)	**5,831.5**	6,146.1
Total liabilities	**187,050.2**	152,066.4

Redeemable noncontrolling interest		**53.6**		60.4
Stockholders equity				
Series A preferred stock, par value $.01 per share with liquidation preference of $100 per share 3.0 million shares authorized, issued and outstanding in 2013 and 2012				
Series B preferred stock, par value $.01 per share with liquidation preference of $25 per share 10.0 million shares authorized, issued and outstanding in 2013 and 2012		**0.1**		0.1
Common stock, par value $.01 per share 2,500.0 million shares authorized, 456.5 million and 453.5 million shares issued, and 293.9 million and 293.8 million shares outstanding in 2013 and 2012		**4.6**		4.5
Additional paid-in capital		**9,819.8**		9,730.9
Retained earnings		**5,125.2**		4,862.0
Accumulated other comprehensive income (loss)		**(0.5)**		640.3
Treasury stock, at cost (162.6 million and 159.7 million shares in 2013 and 2012)		**(5,645.8)**		(5,554.4)
Total stockholders equity attributable to Principal Financial Group, Inc.		**9,303.4**		9,683.4
Noncontrolling interest		**105.5**		20.0
Total stockholders equity		**9,408.9**		9,703.4
Total liabilities and stockholders equity	**$**	**196,512.7**	$	161,830.2

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Operations

(Unaudited)

	For the three months ended June 30,		For the six months ended June 30,	
	2013	**2012**	**2013**	**2012**
	(in millions, except per share data)			
Revenues				
Premiums and other considerations	**$ 737.2**	$ 681.3	**$ 1,431.9**	$ 1,361.1
Fees and other revenues	**803.8**	636.1	**1,537.4**	1,234.1
Net investment income	**749.7**	801.0	**1,539.0**	1,625.8
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities	**(53.4)**	32.2	**(79.8)**	54.3
Total other-than-temporary impairment losses on available-for- sale securities	**(24.6)**	(49.1)	**(69.3)**	(82.8)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income	**(2.1)**	17.1	**18.1**	22.0
Net impairment losses on available-for-sale securities	**(26.7)**	(32.0)	**(51.2)**	(60.8)
Net realized capital gains (losses)	**(80.1)**	0.2	**(131.0)**	(6.5)
Total revenues	**2,210.6**	2,118.6	**4,377.3**	4,214.5
Expenses				
Benefits, claims and settlement expenses	**1,095.7**	1,110.0	**2,190.2**	2,322.5
Dividends to policyholders	**47.5**	49.5	**95.8**	99.8
Operating expenses	**801.8**	729.6	**1,597.5**	1,284.7
Total expenses	**1,945.0**	1,889.1	**3,883.5**	3,707.0
Income before income taxes	**265.6**	229.5	**493.8**	507.5
Income taxes	**29.0**	50.9	**67.2**	107.6
Net income	**236.6**	178.6	**426.6**	399.9
Net income attributable to noncontrolling interest	**6.0**	2.7	**9.5**	11.9
Net income attributable to Principal Financial Group, Inc.	**230.6**	175.9	**417.1**	388.0
Preferred stock dividends	**8.3**	8.3	**16.5**	16.5
Net income available to common stockholders	**$ 222.3**	$ 167.6	**$ 400.6**	$ 371.5
Earnings per common share				
Basic earnings per common share	**$ 0.76**	$ 0.56	**$ 1.36**	$ 1.24
Diluted earnings per common share	**$ 0.75**	$ 0.56	**$ 1.35**	$ 1.22

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Comprehensive Income

(Unaudited)

	For the three months ended June 30, 2013	For the three months ended June 30, 2012	For the six months ended June 30, 2013	For the six months ended June 30, 2012
	(in millions)			
Net income	**$ 236.6**	$ 178.6	**$ 426.6**	$ 399.9
Other comprehensive income (loss), net:				
Net unrealized gains (losses) on available-for-sale securities	**(453.7)**	100.7	**(553.0)**	262.0
Noncredit component of impairment losses on fixed maturities, available-for-sale	**0.7**	(9.9)	**(10.6)**	(10.8)
Net unrealized gains (losses) on derivative instruments	**(0.3)**	48.9	**21.7**	45.4
Foreign currency translation adjustment	**(190.4)**	(83.5)	**(136.0)**	(23.9)
Net unrecognized postretirement benefit obligation	**13.8**	8.8	**27.6**	17.5
Other comprehensive income (loss)	**(629.9)**	65.0	**(650.3)**	290.2
Comprehensive income (loss)	**(393.3)**	243.6	**(223.7)**	690.1
Comprehensive income (loss) attributable to noncontrolling interest	**(2.4)**	2.1		12.1
Comprehensive income (loss) attributable to Principal Financial Group, Inc.	**$ (390.9)**	$ 241.5	**$ (223.7)**	$ 678.0

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Stockholders Equity

(Unaudited)

	Series A preferred stock	Series B preferred stock	Common stock	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income (loss)	Treasury stock	Noncontrolling interest	Total stockholders equity
					(in millions)				
Balances at January 1, 2012 (as adjusted)	$	$ 0.1	$ 4.5	$ 9,634.7	$ 4,323.4	$ 271.4	$ (5,281.7)	$ 353.8	$ 9,306.2
Common stock issued				11.7					11.7
Stock-based compensation and additional related tax benefits				39.0	(1.8)				37.2
Treasury stock acquired, common							(203.2)		(203.2)
Dividends to common stockholders					(108.0)				(108.0)
Dividends to preferred stockholders					(16.5)				(16.5)
Distributions to noncontrolling interest								(5.7)	(5.7)
Contributions from noncontrolling interest								6.2	6.2
Deconsolidation of certain variable interest entities								(353.2)	(353.2)
Net income (excludes $0.7 million attributable to redeemable noncontrolling interest)					388.0			11.2	399.2
Other comprehensive income (excludes $0.3 million attributable to redeemable noncontrolling interest)						290.0		(0.1)	289.9
Balances at June 30, 2012	$	$ 0.1	$ 4.5	$ 9,685.4	$ 4,585.1	$ 561.4	$ (5,484.9)	$ 12.2	$ 9,363.8
Balances at January 1, 2013	**$**	**$ 0.1**	**$ 4.5**	**$ 9,730.9**	**$ 4,862.0**	**$ 640.3**	**$ (5,554.4)**	**$ 20.0**	**$ 9,703.4**
Common stock issued			**0.1**	**37.7**					**37.8**
Stock-based compensation and additional related tax benefits				**38.1**	**(2.2)**				**35.9**
Treasury stock acquired, common							**(91.4)**		**(91.4)**
Dividends to common stockholders					**(135.2)**				**(135.2)**
Dividends to preferred stockholders					**(16.5)**				**(16.5)**
Distributions to noncontrolling interest								**(6.4)**	**(6.4)**
Contributions from noncontrolling interest								**115.9**	**115.9**
Purchase of subsidiary shares from noncontrolling interest				**1.6**				**(47.2)**	**(45.6)**

Sale of subsidiary shares to noncontrolling interest				**11.5**				**20.3**	**31.8**
Net income (excludes $1.1 million attributable to redeemable noncontrolling interest)					**417.1**			**8.4**	**425.5**
Other comprehensive loss (excludes $(4.0) million attributable to redeemable noncontrolling interest)						**(640.8)**		**(5.5)**	**(646.3)**
Balances at June 30, 2013	**$**	**$ 0.1**	**$ 4.6**	**$ 9,819.8**	**$ 5,125.2**	**$ (0.5)**	**$ (5,645.8)**	**$ 105.5**	**$ 9,408.9**

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the six months ended June 30,	
	2013	2012
	(in millions)	
Operating activities		
Net income	$ **426.6**	$ 399.9
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred acquisition costs	**101.6**	(56.4)
Additions to deferred acquisition costs	**(236.6)**	(197.7)
Accrued investment income	**19.0**	25.7
Net cash flows for trading securities	**(27.4)**	81.2
Premiums due and other receivables	**(44.5)**	82.4
Contractholder and policyholder liabilities and dividends	**461.6**	806.3
Current and deferred income taxes (benefits)	**136.3**	(18.4)
Net realized capital losses	**131.0**	6.5
Depreciation and amortization expense	**75.2**	66.2
Mortgage loans held for sale, acquired or originated		(42.9)
Mortgage loans held for sale, sold or repaid, net of gain	**0.2**	60.6
Real estate acquired through operating activities	**(54.3)**	(14.5)
Real estate sold through operating activities	**11.6**	2.0
Stock-based compensation	**36.2**	37.5
Other	**(252.9)**	263.6
Net adjustments	**357.0**	1,102.1
Net cash provided by operating activities	**783.6**	1,502.0
Investing activities		
Available-for-sale securities:		
Purchases	**(4,921.6)**	(3,911.8)
Sales	**1,099.4**	695.1
Maturities	**3,955.4**	3,102.3
Mortgage loans acquired or originated	**(1,778.4)**	(1,310.9)
Mortgage loans sold or repaid	**1,079.9**	816.0
Real estate acquired	**(46.9)**	(39.8)
Net purchases of property and equipment	**(11.9)**	(24.7)
Purchase of interests in subsidiaries, net of cash acquired	**(1,268.3)**	(62.5)
Net change in other investments	**(30.2)**	(90.5)
Net cash used in investing activities	**(1,922.6)**	(826.8)
Financing activities		
Issuance of common stock	**37.8**	11.7
Acquisition of treasury stock	**(91.4)**	(203.2)
Proceeds from financing element derivatives	**14.6**	20.8
Payments for financing element derivatives	**(24.3)**	(26.4)
Excess tax benefits from share-based payment arrangements	**6.8**	10.7
Purchase of subsidiary shares from noncontrolling interest	**(47.2)**	
Sale of subsidiary shares to noncontrolling interest	**31.8**	
Dividends to common stockholders	**(135.2)**	(108.0)
Dividends to preferred stockholders	**(8.2)**	(8.2)
Issuance of long-term debt	**9.1**	9.1
Principal repayments of long-term debt	**(211.9)**	(1.5)

Net proceeds from short-term borrowings		**131.7**		155.5
Investment contract deposits		**3,157.3**		2,886.7
Investment contract withdrawals		**(4,771.4)**		(4,595.4)
Net decrease in banking operation deposits		**(23.8)**		(10.6)
Other		**(3.4)**		(3.7)
Net cash used in financing activities		**(1,927.7)**		(1,862.5)
Net decrease in cash and cash equivalents		**(3,066.7)**		(1,187.3)
Cash and cash equivalents at beginning of period		**4,177.2**		2,833.9
Cash and cash equivalents at end of period	**$**	**1,110.5**	$	1,646.6

See accompanying notes.

Table of Contents

Principal Financial Group, Inc.

Notes to Consolidated Financial Statements

June 30, 2013

(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (PFG), its majority-owned subsidiaries and its consolidated variable interest entities (VIEs), have been prepared in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and six months ended June 30, 2013, are not necessarily indicative of the results that may be expected for the year ended December 31, 2013. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2012, included in our Form 10-K for the year ended December 31, 2012, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2012, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Reclassifications have been made to prior period financial statements to conform to the June 30, 2013, presentation.

Revisions of Previously Issued Financial Statements

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

(a) Fewer acquisition costs are capitalized. Specifically, we expense as incurred salary and related costs associated with the successful efforts of our proprietary sales force and sales support staff. All direct and incremental costs such as commissions will continue to be deferred.

(b) Deferred costs are amortized on a straight line basis over the expected contract life rather than based on estimated gross profits. The amortization method change also impacts purchased customer intangible assets.

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

Recent Accounting Pronouncements

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

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

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

In February 2013, the FASB issued authoritative guidance that requires entities to disclose additional information about items reclassified out of accumulated other comprehensive income (AOCI). Entities are required to disclose information regarding changes in AOCI balances by component and significant items reclassified out of AOCI by component either on the face of the

Table of Contents

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

income statement or as a separate footnote to the financial statements. This guidance was effective for us beginning January 1, 2013, and did not have a material impact on our consolidated financial statements. This guidance did not impact the requirements for reporting of comprehensive income under FASB guidance issued in June 2011, which changed the presentation of comprehensive income in the financial statements. The guidance eliminated the presentation options contained in previous guidance and instead required entities to report components of comprehensive income in either a continuous statement of comprehensive income or two separate but consecutive statements that show the components of net income and other comprehensive income (OCI), including adjustments for items that are reclassified from OCI to net income. The guidance did not change the items that must be reported in OCI or when an item of OCI must be reclassified to net income. This guidance was effective for us on January 1, 2012, and did not have a material impact on our consolidated financial statements. See Note 9, Stockholders Equity, for further details.

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

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

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

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

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

statements. See Note 10, Fair Value Measurements, for further details.

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

Separate Accounts

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

Table of Contents

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

At June 30, 2013 and December 31, 2012, the separate account assets include a separate account valued at $181.6 million and $148.3 million, respectively, which primarily includes shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

2. Acquisition

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

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

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

Net assets acquired	$	**1,263.5**

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

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

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

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

Table of Contents

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

	For the three months ended, June 30, 2013	2012	For the six months ended, June 30, 2013	2012
	(in millions, except per share data)			
Total revenues	**$ 2,210.6**	$ 2,157.7	**$ 4,427.3**	$ 4,316.8
Net income	**236.6**	205.5	**447.1**	455.7
Basic earnings per common share	**0.76**	0.69	**1.52**	1.52
Diluted earnings per common share	**0.75**	0.68	**1.51**	1.50

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

	For the three months ended, June 30, 2013	For the six months ended, June 30, 2013
	(in millions)	
Total revenues	**$ 58.4**	**$ 76.7**
Net income	**26.1**	**35.4**

3. Variable Interest Entities

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

Consolidated Variable Interest Entities

Grantor Trusts

We contributed undated subordinated floating rate notes to three grantor trusts. The trusts separated the cash flows by issuing an interest-only certificate and a residual certificate related to each note contributed. Each interest-only certificate entitles the holder to interest on the stated note for a specified term, while the residual certificate entitles the holder to interest payments subsequent to the term of the interest-only certificate

and to all principal payments. We retained the interest-only certificates and the residual certificates were subsequently sold to third parties. We have determined these grantor trusts are VIEs due to insufficient equity to sustain them. We determined we are the primary beneficiary as a result of our contribution of securities into the trusts and our continuing interest in the trusts.

Collateralized Private Investment Vehicle

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

Table of Contents

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

Commercial Mortgage-Backed Securities

In September 2000, we sold commercial mortgage loans to a real estate mortgage investment conduit trust. The trust issued various commercial mortgage-backed securities (CMBS) certificates using the cash flows of the underlying commercial mortgages it purchased. This is considered a VIE due to insufficient equity to sustain itself. We have determined we are the primary beneficiary as we retained the special servicing role for the assets within the trust as well as the ownership of the bond class that controls the unilateral kick out rights of the special servicer.

Mandatory Retirement Savings

As a result of our first quarter 2013 acquisition of Cuprum, we hold an equity interest in mandatory privatized social security funds in which we provide asset management services. We determined that the mandatory privatized social security funds, which include contributors for voluntary pension savings, voluntary non-pension savings and compensation savings accounts, are VIEs. This is because the equity holders as a group lack the power, due to voting rights or similar rights, to direct the activities of the entity that most significantly impact the entity s economic performance and also because equity investors are protected from below-average market investment returns relative to the industry s return, due to a regulatory guarantee that we provide. Further we concluded that we are the primary beneficiary through our power to make decisions and our variable interest in the funds. The purpose of the funds, which reside in legally segregated entities, is to provide long-term retirement savings. The obligation to the client is directly related to the assets held in the funds and, as such, we present the assets as separate account assets and the obligation as separate account liabilities within our consolidated statements of financial position.

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

	Grantor trusts	Collateralized private investment vehicle	CMBS (in millions)	Mandatory retirement savings	Total
June 30, 2013					
Fixed maturities, available-for-sale	$ 232.8	$	$	$	$ 232.8
Fixed maturities, trading		110.4			110.4
Other investments			76.6		76.6
Accrued investment income	0.4		0.5		0.9
Separate account assets				33,179.6	33,179.6
Total assets	$ 233.2	$ 110.4	$ 77.1	$ 33,179.6	$ 33,600.3
Deferred income taxes	$ 1.7	$	$	$	$ 1.7
Separate account liabilities				33,179.6	33,179.6
Other liabilities (1)	176.6	98.3	39.5		314.4

Total liabilities	**$**	**178.3**	**$**	**98.3**	**$**	**39.5**	**$**	**33,179.6**	**$**	**33,495.7**
December 31, 2012										
Fixed maturities, available-for-sale	$	194.6	$		$		$		$	194.6
Fixed maturities, trading				110.4						110.4
Other investments						80.3				80.3
Accrued investment income		0.5				0.6				1.1
Total assets	$	195.1	$	110.4	$	80.9	$		$	386.4
Deferred income taxes	$	1.8	$		$		$		$	1.8
Other liabilities (1)		152.4		104.8		45.7				302.9
Total liabilities	$	154.2	$	104.8	$	45.7	$		$	304.7

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

Table of Contents

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

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

Unconsolidated Variable Interest Entities

Invested Securities

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

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

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

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

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

Table of Contents

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

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

	Asset carrying value	Maximum exposure to loss (1)
	(in millions)	
June 30, 2013		
Fixed maturities, available-for-sale:		
Corporate	**$ 500.4**	**$ 412.3**
Residential mortgage-backed pass-through securities	**2,939.4**	**2,849.5**
Commercial mortgage-backed securities	**3,953.3**	**4,087.6**
Collateralized debt obligations	**355.4**	**383.6**
Other debt obligations	**3,916.0**	**3,914.8**
Fixed maturities, trading:		
Residential mortgage-backed pass-through securities	**60.8**	**60.8**
Commercial mortgage-backed securities	**2.0**	**2.0**
Collateralized debt obligations	**60.3**	**60.3**
Other debt obligations	**1.7**	**1.7**
Other investments:		
Other limited partnership interests	**128.6**	**128.6**
December 31, 2012		
Fixed maturities, available-for-sale:		
Corporate	$ 523.2	$ 403.7
Residential mortgage-backed pass-through securities	3,226.7	3,022.7
Commercial mortgage-backed securities	3,897.4	4,094.8
Collateralized debt obligations	379.2	428.8
Other debt obligations	3,779.2	3,756.9
Fixed maturities, trading:		
Residential mortgage-backed pass-through securities	77.7	77.7
Commercial mortgage-backed securities	2.8	2.8
Collateralized debt obligations	56.4	56.4
Other debt obligations	3.2	3.2
Other investments:		
Other limited partnership interests	136.2	136.2

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

Sponsored Investment Funds

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 June 30, 2013 and December 31, 2012, these VIEs held $1.6 billion and $1.5 billion in total assets, respectively. We have no contractual obligation to contribute to the funds.

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

4. Investments

Fixed Maturities and Equity Securities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain nonredeemable preferred stock. Equity securities include mutual funds, common stock, nonredeemable preferred stock and mandatory regulatory required investments. We classify fixed

Table of Contents

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

maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 10, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders equity, net of adjustments related to deferred acquisition costs (DAC), sales inducements, unearned revenue reserves, policyholder liabilities, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). We also have a minimal amount of assets within trading securities portfolios that support investment strategies that involve the active and frequent purchase and sale of fixed maturities. In addition, we have assets within the trading securities portfolio that represent mandatory regulatory required investments. Mark-to-market adjustments related to these trading securities are reflected in net investment income.

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

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

	Amortized cost	Gross unrealized gains	Gross unrealized losses (in millions)	Fair value	Other-than-temporary impairments in AOCI (1)
June 30, 2013					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 800.8	$ 18.4	$ 26.8	$ 792.4	$
Non-U.S. government and agencies	882.3	176.4	7.2	1,051.5	
States and political subdivisions	3,349.0	138.6	59.4	3,428.2	
Corporate	31,070.7	2,083.1	398.4	32,755.4	17.0
Residential mortgage-backed pass-through securities	2,849.5	118.4	28.5	2,939.4	
Commercial mortgage-backed securities	4,087.6	191.9	326.2	3,953.3	221.1
Collateralized debt obligations	383.6	8.6	36.8	355.4	3.5
Other debt obligations	3,914.8	52.2	51.0	3,916.0	78.5
Total fixed maturities, available-for-sale	$ 47,338.3	$ 2,787.6	$ 934.3	$ 49,191.6	$ 320.1
Total equity securities, available-for-sale	$ 132.4	$ 12.2	$ 9.3	$ 135.3	

December 31, 2012					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 911.4	$ 33.2	$ 0.3	$ 944.3	$
Non-U.S. government and agencies	944.9	264.3	0.9	1,208.3	
States and political subdivisions	2,940.4	241.1	2.7	3,178.8	
Corporate	31,615.4	3,029.9	319.9	34,325.4	19.5
Residential mortgage-backed pass-through securities	3,022.7	204.4	0.4	3,226.7	
Commercial mortgage-backed securities	4,094.8	241.7	439.1	3,897.4	195.4
Collateralized debt obligations	428.8	7.0	56.6	379.2	4.3
Other debt obligations	3,756.9	73.5	51.2	3,779.2	82.8
Total fixed maturities, available-for-sale	$ 47,715.3	$ 4,095.1	$ 871.1	$ 50,939.3	$ 302.0
Total equity securities, available-for-sale	$ 132.4	$ 12.6	$ 8.5	$ 136.5	

---

(1) Excludes $135.9 million and $95.0 million as of June 30, 2013 and December 31, 2012, respectively, of net unrealized gains on impaired fixed maturities, available-for-sale related to changes in fair value subsequent to the impairment date, which are included in gross unrealized gains and gross unrealized losses.

Table of Contents

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

The amortized cost and fair value of fixed maturities available-for-sale at June 30, 2013, by expected maturity, were as follows:

	Amortized cost	Fair value
	(in millions)	
Due in one year or less	**$ 3,129.8**	**$ 3,175.7**
Due after one year through five years	**13,183.6**	**13,775.2**
Due after five years through ten years	**8,615.9**	**9,141.5**
Due after ten years	**11,173.5**	**11,935.1**
Subtotal	**36,102.8**	**38,027.5**
Mortgage-backed and other asset-backed securities	**11,235.5**	**11,164.1**
Total	**$ 47,338.3**	**$ 49,191.6**

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

Net Realized Capital Gains and Losses

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

	For the three months ended June 30,		For the six months ended June 30,	
	2013	2012	2013	2012
	(in millions)			
Fixed maturities, available-for-sale:				
Gross gains	**$ 6.3**	$ 4.4	**$ 21.8**	$ 19.7
Gross losses	**(29.7)**	(50.8)	**(80.4)**	(86.9)
Other-than-temporary impairment losses reclassified to (from) OCI	**(2.1)**	17.1	**18.1**	22.0
Hedging, net	**(60.8)**	23.4	**(89.8)**	6.7
Fixed maturities, trading	**(6.3)**	(2.0)	**(6.2)**	1.0

Equity securities, available-for-sale:								
Gross gains		**0.1**				**0.1**		0.1
Gross losses		**(0.1)**				**(0.1)**		
Equity securities, trading		**5.2**		(3.5)		**11.5**		30.7
Mortgage loans		**(10.8)**		(10.2)		**(17.0)**		(21.3)
Derivatives		**11.8**		2.8		**30.0**		30.4
Other		**6.3**		19.0		**(19.0)**		(8.9)
Net realized capital gains (losses)	**$**	**(80.1)**	$	0.2	**$**	**(131.0)**	$	(6.5)

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were $540.2 million and $285.9 million for the three months ended June 30, 2013 and 2012, and $1,100.3 million and $716.1 million for the six months ended June 30, 2013 and 2012, respectively.

Table of Contents

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

Other-Than-Temporary Impairments

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

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

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

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

	For the three months ended June 30,		For the six months ended June 30,	
	2013	**2012**	**2013**	**2012**
		(in millions)		
Fixed maturities, available-for-sale	**$ (24.5)**	$ (49.1)	**$ (69.2)**	$ (82.8)
Equity securities, available-for-sale	**(0.1)**		**(0.1)**	
Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities	**(24.6)**	(49.1)	**(69.3)**	(82.8)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from)	**(2.1)**	17.1	**18.1**	22.0

OCI (1)								
Net impairment losses on available-for-sale securities	**$**	**(26.7)**	$	(32.0)	**$**	**(51.2)**	$	(60.8)

---

(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

Table of Contents

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

characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate security cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or liquidations using bond specific facts and circumstances including timing, security interests and loss severity.

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

	For the three months ended June 30, 2013	For the three months ended June 30, 2012	For the six months ended June 30, 2013	For the six months ended June 30, 2012
	(in millions)			
Beginning balance	**$ (318.6)**	$ (404.7)	**$ (335.2)**	$ (434.8)
Credit losses for which an other-than-temporary impairment was not previously recognized	**(1.9)**	(9.5)	**(6.2)**	(16.9)
Credit losses for which an other-than-temporary impairment was previously recognized	**(16.8)**	(19.1)	**(35.1)**	(39.9)
Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold	**32.7**	56.5	**68.5**	113.8
Net reduction for positive changes in cash flows expected to be collected and amortization (1)	**3.1**	1.3	**6.5**	2.3
Ending balance	**$ (301.5)**	$ (375.5)	**$ (301.5)**	$ (375.5)

(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:

June 30, 2013		
Less than twelve months	**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	$ 415.0	$ 26.8	$	$	$ 415.0	$ 26.8
Non-U.S. governments	95.7	4.1	17.5	3.1	113.2	7.2
States and political subdivisions	1,195.5	57.0	16.0	2.4	1,211.5	59.4
Corporate	4,359.6	154.4	1,465.3	244.0	5,824.9	398.4
Residential mortgage-backed pass-through securities	923.9	28.4	2.1	0.1	926.0	28.5
Commercial mortgage-backed securities	611.3	14.3	569.1	311.9	1,180.4	326.2
Collateralized debt obligations	58.9	0.4	47.1	36.4	106.0	36.8
Other debt obligations	1,421.4	20.0	266.5	31.0	1,687.9	51.0
Total fixed maturities, available-for-sale	$ 9,081.3	$ 305.4	$ 2,383.6	$ 628.9	$ 11,464.9	$ 934.3
Total equity securities, available-for-sale	$ 12.4	$ 0.1	$ 52.0	$ 9.2	$ 64.4	$ 9.3

Table of Contents

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

Of the total amounts, Principal Life Insurance Company s (Principal Life) consolidated portfolio represented $10,926.2 million in available-for-sale fixed maturities with gross unrealized losses of $885.5 million. Of those fixed maturity securities in Principal Life s consolidated portfolio with a gross unrealized loss position, 85% were investment grade (rated AAA through BBB-) with an average price of 93 (carrying value/amortized cost) at June 30, 2013. Gross unrealized losses in our fixed maturities portfolio increased slightly during the six months ended June 30, 2013, due to an increase in interest rates.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 1,141 securities with a carrying value of $8,777.9 million and unrealized losses of $292.4 million reflecting an average price of 97 at June 30, 2013. Of this portfolio, 92% was investment grade (rated AAA through BBB-) at June 30, 2013, with associated unrealized losses of $275.6 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 379 securities with a carrying value of $2,148.3 million and unrealized losses of $593.1 million. The average rating of this portfolio was BBB- with an average price of 78 at June 30, 2013. Of the $593.1 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $311.9 million in unrealized losses with an average price of 65 and an average credit rating of BB-. The remaining unrealized losses consist primarily of $211.4 million within the corporate sector at June 30, 2013. The average price of the corporate sector was 86 and the average credit rating was BBB+. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at June 30, 2013.

	December 31, 2012					
	Less than twelve months		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	$ 115.4	$ 0.3	$	$	$ 115.4	$ 0.3
Non-U.S. governments	17.3	0.2	13.4	0.7	30.7	0.9
States and political subdivisions	235.3	2.1	8.8	0.6	244.1	2.7
Corporate	831.8	10.6	1,961.7	309.3	2,793.5	319.9

Residential mortgage-backed pass-through securities	70.4	0.3	2.4	0.1	72.8	0.4
Commercial mortgage-backed securities	98.9	3.3	785.0	435.8	883.9	439.1
Collateralized debt obligations	72.2	1.0	133.8	55.6	206.0	56.6
Other debt obligations	235.6	2.0	414.9	49.2	650.5	51.2
Total fixed maturities, available-for-sale	$ 1,676.9	$ 19.8	$ 3,320.0	$ 851.3	$ 4,996.9	$ 871.1
Total equity securities, available-for-sale	$ 5.8	$ 0.1	$ 52.9	$ 8.4	$ 58.7	$ 8.5

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

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 224 securities with a carrying value of $1,382.1 million and unrealized losses of $16.2 million reflecting an average price of 99 at December 31, 2012. Of this portfolio, 89% was investment grade (rated AAA through BBB-) at December 31, 2012, with associated unrealized losses of $13.3 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Table of Contents

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

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 488 securities with a carrying value of $3,037.3 million and unrealized losses of $809.5 million. The average rating of this portfolio was BBB- with an average price of 79 at December 31, 2012. Of the $809.5 million in unrealized losses, the commercial mortgage-backed securities sector accounts for $435.8 million in unrealized losses with an average price of 64 and an average credit rating of BB+. The remaining unrealized losses consist primarily of $268.1 million within the corporate sector at December 31, 2012. The average price of the corporate sector was 86 and the average credit rating was BBB. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired at December 31, 2012.

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

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

	June 30, 2013	December 31, 2012
	(in millions)	
Net unrealized gains on fixed maturities, available-for-sale (1)	**$ 2,163.9**	$ 3,562.5
Noncredit component of impairment losses on fixed maturities, available-for-sale	**(320.1)**	(302.0)
Net unrealized gains on equity securities, available-for-sale	**2.9**	4.1
Adjustments for assumed changes in amortization patterns	**(296.9)**	(515.2)
Adjustments for assumed changes in policyholder liabilities	**(733.5)**	(1,198.7)
Net unrealized gains on derivative instruments	**104.4**	90.7
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments	**112.0**	191.3
Provision for deferred income taxes	**(338.9)**	(597.0)
Net unrealized gains on available-for-sale securities and derivative instruments	**$ 693.8**	$ 1,235.7

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

Mortgage Loans

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

	June 30, 2013	December 31, 2012
	(in millions)	
Commercial mortgage loans	**$ 10,918.7**	$ 10,235.1
Residential mortgage loans	**1,297.9**	1,382.0
Total amortized cost	**12,216.6**	11,617.1
Valuation allowance	**(94.9)**	(97.4)
Total carrying value	**$ 12,121.7**	$ 11,519.7

Table of Contents

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

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. We purchased $22.5 million and $50.9 million of residential mortgage loans during the three months ended June 30, 2013 and 2012, and $71.0 million and $62.3 million during the six months ended June 30, 2013 and 2012, respectively. We sold $0.0 million and $6.3 million of residential mortgage loans during the three months ended June 30, 2013 and 2012, and $0.0 million and $12.1 million during the six months ended June 30, 2013 and 2012, respectively. We purchased $141.1 million and $30.4 million of commercial mortgage loans during the three months ended June 30, 2013 and 2012, and $141.1 million and $61.4 million during the six months ended June 30, 2013 and 2012, respectively. We sold $0.0 million and $4.0 million of commercial mortgage loans during the three months ended June 30, 2013 and 2012, and $13.0 million and $4.0 million during the six months ended June 30, 2013 and 2012, respectively.

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

	June 30, 2013		December 31, 2012	
	Amortized cost	Percent of total	Amortized cost	Percent of total
	($ in millions)			
Geographic distribution				
New England	**$ 557.4**	**5.1%**	$ 536.6	5.2%
Middle Atlantic	**2,550.4**	**23.4**	2,233.4	21.8
East North Central	**592.5**	**5.4**	635.6	6.2
West North Central	**326.7**	**3.0**	377.3	3.7
South Atlantic	**2,132.4**	**19.5**	2,135.0	20.9
East South Central	**196.9**	**1.8**	244.8	2.4
West South Central	**848.0**	**7.8**	767.9	7.5
Mountain	**850.2**	**7.8**	726.6	7.1
Pacific	**2,842.2**	**26.0**	2,562.3	25.0
International	**22.0**	**0.2**	15.6	0.2
Total	**$ 10,918.7**	**100.0%**	$ 10,235.1	100.0%
Property type distribution				
Office	**$ 3,636.2**	**33.3%**	$ 3,078.8	30.1%
Retail	**2,813.9**	**25.8**	2,928.3	28.6
Industrial	**1,844.1**	**16.9**	1,765.5	17.2
Apartments	**1,860.7**	**17.0**	1,685.9	16.5
Hotel	**436.0**	**4.0**	445.8	4.4
Mixed use/other	**327.8**	**3.0**	330.8	3.2
Total	**$ 10,918.7**	**100.0%**	$ 10,235.1	100.0%

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of $441.9 million and $495.7 million and first lien mortgages with an amortized cost of $856.0 million and $886.3 million as of June 30, 2013 and December 31, 2012, 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

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 .

Table of Contents

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

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

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

	June 30, 2013		
	Brick and mortar	CTL	Total
		(in millions)	
A- and above	**$ 8,210.0**	**$ 207.8**	**$ 8,417.8**
BBB+ thru BBB-	**1,758.9**	**271.1**	**2,030.0**
BB+ thru BB-	**217.3**	**1.0**	**218.3**
B+ and below	**250.4**	**2.2**	**252.6**
Total	**$ 10,436.6**	**$ 482.1**	**$ 10,918.7**

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

Residential Credit Risk Profile Based on Performance Status

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

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

June 30, 2013

	Home equity	First liens (in millions)	Total
Performing	**$ 421.1**	**$ 834.5**	**$ 1,255.6**
Nonperforming	**20.8**	**21.5**	**42.3**
Total	**$ 441.9**	**$ 856.0**	**$ 1,297.9**

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

Non-Accrual Mortgage Loans

Commercial and residential mortgage loans are placed on non-accrual status if we have concern regarding the collectability of future payments or if a loan has matured without being paid off or extended. Factors considered may include conversations with the borrower, loss of major tenant, bankruptcy of borrower or major tenant, decreased property cash flow for commercial mortgage loans or number of days past due and other circumstances for residential mortgage loans. Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of

Table of Contents

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

the loan. When a loan is placed on nonaccrual status, the accrued unpaid interest receivable is reversed against interest income. Accrual of interest resumes after factors resulting in doubts about collectability have improved. Residential first lien mortgages in the Chilean market are carried on accrual for a longer period of delinquency than domestic loans, as assessment of collectability is based on the nature of the loans and collection practices in that market.

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

	June 30, 2013	December 31, 2012
	(in millions)	
Commercial:		
Brick and mortar	**$ 32.3**	$ 44.5
Residential:		
Home equity	**20.8**	23.1
First liens	**13.3**	13.2
Total	**$ 66.4**	$ 80.8

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

	June 30, 2013						
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due	Current	Total loans	Recorded investment 90 days or more and accruing
				(in millions)			
Commercial-brick and mortar	**$**	**$**	**$ 19.7**	**$ 19.7**	**$ 10,416.9**	**$ 10,436.6**	**$**
Commercial-CTL					**482.1**	**482.1**	
Residential-home equity	**4.1**	**1.5**	**2.8**	**8.4**	**433.5**	**441.9**	
Residential-first liens	**31.3**	**8.3**	**19.2**	**58.8**	**797.2**	**856.0**	**8.2**
Total	**$ 35.4**	**$ 9.8**	**$ 41.7**	**$ 86.9**	**$ 12,129.7**	**$ 12,216.6**	**$ 8.2**

	December 31, 2012						
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due	Current	Total loans	Recorded investment 90 days or more and accruing
				(in millions)			
	$ 32.8	$ 13.7	$	$ 46.5	$ 9,658.5	$ 9,705.0	$

Commercial-brick and mortar							
Commercial-CTL					530.1	530.1	
Residential-home equity	5.7	2.8	3.9	12.4	483.3	495.7	
Residential-first liens	22.3	5.1	19.8	47.2	839.1	886.3	8.1
Total	$ 60.8	$ 21.6	$ 23.7	$ 106.1	$ 11,511.0	$ 11,617.1	$ 8.1

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

Table of Contents

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

allowance. The change in the valuation allowance provision is included in net realized capital gains (losses) on our consolidated statements of operations.

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

We review our commercial mortgage loan portfolio and analyze the need for a valuation allowance for any loan that is delinquent for 60 days or more, in process of foreclosure, restructured, on the internal watch list or that currently has a valuation allowance. In addition to establishing allowance levels for specifically identified impaired commercial mortgage loans, management determines an allowance for all other loans in the portfolio for which historical experience and current economic conditions indicate certain losses exist. These loans are segregated by 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 June 30, 2013		
	Commercial	**Residential**	**Total**
		(in millions)	
Beginning balance	**$ 41.8**	**$ 47.7**	**$ 89.5**
Provision	**6.5**	**4.3**	**10.8**
Charge-offs	**(1.2)**	**(5.4)**	**(6.6)**
Recoveries	**0.6**	**0.7**	**1.3**
Effect of exchange rates		**(0.1)**	**(0.1)**
Ending balance	**$ 47.7**	**$ 47.2**	**$ 94.9**

	For the six months ended June 30, 2013		
	Commercial	Residential	Total
		(in millions)	
Beginning balance	$ 51.8	$ 45.6	$ 97.4
Provision	6.0	11.3	17.3
Charge-offs	(10.7)	(11.3)	(22.0)
Recoveries	0.6	1.7	2.3
Effect of exchange rates		(0.1)	(0.1)
Ending balance	$ 47.7	$ 47.2	$ 94.9
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	$ 10.3	$ 10.7	$ 21.0
Collectively evaluated for impairment	37.4	36.5	73.9
Allowance ending balance	$ 47.7	$ 47.2	$ 94.9
Loan balance by basis of impairment method:			
Individually evaluated for impairment	$ 28.6	$ 36.8	$ 65.4
Collectively evaluated for impairment	10,890.1	1,261.1	12,151.2
Loan ending balance	$ 10,918.7	$ 1,297.9	$ 12,216.6

Table of Contents

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

	For the three months ended June 30, 2012		
	Commercial	Residential (in millions)	Total
Beginning balance	$ 52.4	$ 36.9	$ 89.3
Provision	3.4	6.6	10.0
Charge-offs	(6.5)	(7.3)	(13.8)
Recoveries		0.8	0.8
Effect of exchange rates		(0.1)	(0.1)
Ending balance	$ 49.3	$ 36.9	$ 86.2

	For the six months ended June 30, 2012		
	Commercial	Residential (in millions)	Total
Beginning balance	$ 64.8	$ 37.3	$ 102.1
Provision	10.4	13.2	23.6
Charge-offs	(25.9)	(15.6)	(41.5)
Recoveries		2.0	2.0
Ending balance	$ 49.3	$ 36.9	$ 86.2
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	$ 5.7	$ 4.6	$ 10.3
Collectively evaluated for impairment	43.6	32.3	75.9
Allowance ending balance	$ 49.3	$ 36.9	$ 86.2
Loan balance by basis of impairment method:			
Individually evaluated for impairment	$ 37.9	$ 31.6	$ 69.5
Collectively evaluated for impairment	9,836.1	1,339.2	11,175.3
Loan ending balance	$ 9,874.0	$ 1,370.8	$ 11,244.8

Impaired Mortgage Loans

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

	June 30, 2013		
	Recorded investment	Unpaid principal balance (in millions)	Related allowance

With no related allowance recorded:			
Commercial-brick and mortar	$ **3.4**	$ **5.0**	$
Residential-first liens	**6.4**	**6.4**	
With an allowance recorded:			
Commercial-brick and mortar	**26.1**	**26.1**	**10.3**
Residential-home equity	**20.6**	**20.6**	**9.5**
Residential-first liens	**9.8**	**9.8**	**1.2**
Total:			
Commercial	$ **29.5**	$ **31.1**	$ **10.3**
Residential	$ **36.8**	$ **36.8**	$ **10.7**

Table of Contents

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

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

	For the three months ended June 30, 2013		For the six months ended June 30, 2013	
	Average recorded investment	Interest income recognized	Average recorded investment	Interest income recognized
	(in millions)			
With no related allowance recorded:				
Commercial-brick and mortar	**$ 27.5**	**$**	**$ 13.1**	**$ 0.1**
Residential-first liens	**5.8**		**8.1**	
With an allowance recorded:				
Commercial-brick and mortar	**17.3**	**0.1**	**15.3**	**0.1**
Residential-home equity	**20.5**	**0.2**	**20.7**	**0.4**
Residential-first liens	**9.6**	**0.1**	**9.4**	**0.1**
Total:				
Commercial	**$ 44.8**	**$ 0.1**	**$ 28.4**	**$ 0.2**
Residential	**$ 35.9**	**$ 0.3**	**$ 38.2**	**$ 0.5**

	For the three months ended June 30, 2012		For the six months ended June 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	$ 69.4	$ 0.4	$ 21.7	$ 1.0
Residential-first liens	5.9		5.0	
With an allowance recorded:				
Commercial-brick and mortar	31.3	0.5	68.1	1.0
Residential-home equity	17.0	0.2	16.0	0.5
Residential-first liens	8.5	0.1	8.5	0.1
Total:				
Commercial	$ 100.7	$ 0.9	$ 89.8	$ 2.0

Residential	$	31.4	$	0.3	$	29.5	$	0.6

Mortgage Loan Modifications

Our commercial and residential mortgage loan portfolios include loans that have been modified. We assess loan modifications on a case-by-case basis to evaluate whether a TDR has occurred. The commercial mortgage loan TDRs were modified to delay or reduce principal payments and to increase, reduce or delay interest payments. For these TDR assessments, we have determined the loan rates are now considered below market based on current circumstances. The commercial mortgage loan modifications resulted in

Table of Contents

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

delayed cash receipts and a decrease in interest income. The residential mortgage loan TDRs include modifications of interest-only payment periods, delays in principal balloon payments, and interest rate reductions. Residential mortgage loan modifications resulted in delayed or decreased cash receipts and a decrease in interest income.

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

	For the three months ended June 30, 2013			
	TDRs		TDRs in payment default	
	Number of contracts	Recorded investment (in millions)	Number of contracts	Recorded investment (in millions)
Commercial-brick and mortar	**1**	**$ 0.2**		**$**
Residential-home equity	**21**	**0.8**	**1**	
Residential-first liens	**1**	**0.2**	**2**	**0.7**
Total	**23**	**$ 1.2**	**3**	**$ 0.7**

	For the three months ended June 30, 2012			
	TDRs		TDRs in payment default	
	Number of contracts	Recorded investment (in millions)	Number of contracts	Recorded investment (in millions)
Commercial-brick and mortar	2	$ 41.4		$
Residential-home equity	54	2.2	1	
Total	56	$ 43.6	1	$

	For the six months ended June 30, 2013			
	TDRs		TDRs in payment default	
	Number of contracts	Recorded investment (in millions)	Number of contracts	Recorded investment (in millions)
Commercial-brick and mortar	**2**	**$ 0.9**		**$**
Residential-home equity	**53**	**2.8**	**13**	
Residential-first liens	**3**	**0.6**	**2**	**0.7**
Total	**58**	**$ 4.3**	**15**	**$ 0.7**

	For the six months ended June 30, 2012			
	TDRs		TDRs in payment default	
	Number of contracts	Recorded investment (in millions)	Number of contracts	Recorded investment (in millions)

Commercial-brick and mortar	3	$	45.8		$
Residential-home equity	103		4.5	3	
Total	106	$	50.3	3	$

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
June 30, 2013
(Unaudited)

Securities Posted as Collateral

We posted $1,600.8 million in fixed maturities, available-for-sale securities at June 30, 2013, to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements, Futures Commission Merchant (FCM) agreements and our obligation under funding agreements with the Federal Home Loan Bank of Des Moines (FHLB Des Moines). In addition, we posted $1,882.0 million in commercial mortgage loans as of June 30, 2013, to satisfy collateral requirements associated with our obligation under funding agreements with the FHLB Des Moines. Since we did not relinquish ownership rights on these instruments, they are reported as fixed maturities, available-for-sale and mortgage loans, respectively, on our consolidated statements of financial position.

Balance Sheet Offsetting

We have financial instruments that are subject to master netting agreements or similar agreements. Financial assets subject to master netting agreements or similar agreements were as follows:

	Gross amount of recognized assets (1)	Gross amounts not offset in the Statement of Financial Position		Net amount
		Financial instruments (2)	Collateral received	
		(in millions)		
June 30, 2013				
Derivative assets	**$ 706.4**	**$ (621.7)**	**$ (75.7)**	**$ 9.0**
Reverse repurchase agreements	**46.4**		**(46.4)**	
Total	**$ 752.8**	**$ (621.7)**	**$ (122.1)**	**$ 9.0**
December 31, 2012				
Derivative assets	$ 1,016.3	$ (779.3)	$ (225.5)	$ 11.5
Reverse repurchase agreements	148.2		(148.2)	
Total	$ 1,164.5	$ (779.3)	$ (373.7)	$ 11.5

(1) The gross amount of recognized derivative and reverse repurchase agreement assets are reported with other investments on the consolidated statements of financial position. The above excludes $0.2 million and $0.4 million of derivative assets as of June 30, 2013 and December 31, 2012, respectively, that are not subject to master netting agreements or similar agreements. The gross amounts of derivative and reverse repurchase agreement assets are not netted against offsetting liabilities for presentation on the consolidated statements of financial position.

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

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

	Gross amount of recognized liabilities (1)	Gross amounts not offset in the Statement of Financial Position		Net amount
		Financial instruments (2)	Collateral pledged	
		(in millions)		
June 30, 2013				
Derivative liabilities	**$ 1,122.4**	**$ (621.7)**	**$ (384.4)**	**$ 116.3**
December 31, 2012				
Derivative liabilities	$ 1,198.2	$ (779.3)	$ (279.1)	$ 139.8

(1) The gross amount of recognized derivative liabilities are reported with other liabilities and contractholder funds on the consolidated statements of financial position. The above excludes $253.4 million and $329.8 million of derivative liabilities as of June 30, 2013 and December 31, 2012, respectively, which are primarily embedded derivatives that are not subject to master netting agreements or similar agreements. The gross amount of recognized repurchase agreement liabilities are reported with

Table of Contents

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

short-term debt on the consolidated statements of financial position. The gross amounts of derivative and repurchase agreement liabilities are not netted against offsetting assets for presentation on the consolidated statements of financial position.

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

The financial instruments that are subject to master netting agreements or similar agreements include right of setoff provisions. Derivative instruments include provisions to setoff positions covered under the agreements with the same counterparties and provisions to setoff positions outside of the agreements with the same counterparties in the event of default by one of the parties. Derivative instruments also include collateral provisions. Collateral received and pledged is generally settled daily with each counterparty. See Note 5, Derivative Financial Instruments, for further details.

Repurchase and reverse repurchase agreements include provisions to setoff other repurchase and reverse repurchase balances with the same counterparty. Repurchase and reverse repurchase agreements also include collateral provisions with the counterparties. For reverse repurchase agreements we require the counterparties to pledge collateral with a value greater than the amount of cash transferred. We have the right but do not sell or repledge collateral received in reverse repurchase agreements. Repurchase agreements are structured as secured borrowings for all counterparties. We pledge fixed maturities available-for-sale, which the counterparties have the right to sell or repledge. Interest incurred on repurchase agreements is reported as part of operating expense on the consolidated statements of operations. Net proceeds related to repurchase agreements are reported as a component of financing activities on the consolidated statements of cash flows. We did not have any outstanding repurchase agreements as of June 30, 2013 and December 31, 2012.

5. Derivative Financial Instruments

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

Types of Derivative Instruments

Interest Rate Contracts

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

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by any party. Cash is paid or received based on the terms of the swap. 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 options include interest rate caps and interest rate floors, which can be combined to form interest rate collars, are contracts that entitle the purchaser to pay or receive the amounts, if any, by which a specified market rate exceeds a cap strike interest rate, or falls below a floor strike interest rate, respectively, at specified dates. We use interest rate collars to manage interest rate risk related to guaranteed minimum interest rate liabilities in our individual annuities contracts and lapse risk associated with higher interest rates.

A swaption is an option to enter into an interest rate swap at a future date. We purchase swaptions to offset or modify existing exposures. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility

Table of Contents

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

to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

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

Foreign Exchange Contracts

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

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

Currency forwards are contracts in which we agree with other parties to deliver or receive a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell and to hedge the currency risk associated with a business combination. We have also used currency forwards to hedge the currency risk associated with net investments in foreign operations. We did not use any currency forwards during 2013 or 2012 to hedge our net investment in foreign operations.

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

strike price. We have used currency options to manage the foreign currency risk associated with a business combination.

Equity Contracts

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

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

Table of Contents

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

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

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

Other Contracts

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

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

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

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

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

Exposure

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

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

Table of Contents

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

We posted $407.6 million and $296.9 million in cash and securities under collateral arrangements as of June 30, 2013 and December 31, 2012, respectively, to satisfy collateral requirements associated with our derivative credit support agreements and FCM agreements. Beginning in the second quarter 2013, these amounts include initial margin requirements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the ratings on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of June 30, 2013 and December 31, 2012, was $1,119.6 million and $1,205.4 million, respectively. Cleared derivatives have contingent features that require us to post excess margin as required by the FCM. The terms surrounding excess margin vary by FCM agreement. With respect to derivatives containing collateral triggers, we posted collateral and initial margin of $407.6 million and $296.9 million as of June 30, 2013 and December 31, 2012, respectively, in the normal course of business, which reflects netting under derivative agreements. If the credit-risk-related contingent features underlying these agreements were triggered on June 30, 2013, we would be required to post an additional $70.8 million of collateral to our counterparties.

As of June 30, 2013 and December 31, 2012, we had received $54.5 million and $207.8 million, respectively, of cash collateral associated with our derivative credit support annex agreements and FCM agreements, for which we recorded a corresponding liability reflecting our obligation to return the collateral.

Table of Contents

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

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:

	June 30, 2013	December 31, 2012
	(in millions)	
Notional amounts of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 19,314.6**	$ 18,381.2
Interest rate options	**1,500.0**	500.0
Swaptions	**325.0**	325.0
Interest rate futures	**166.0**	82.0
Foreign exchange contracts:		
Currency swaps	**3,228.9**	3,454.1
Currency forwards	**265.0**	557.2
Currency options		1,400.0
Equity contracts:		
Equity options	**1,879.1**	1,811.8
Equity futures	**305.9**	373.6
Credit contracts:		
Credit default swaps	**1,131.8**	1,378.3
Total return swaps	**100.0**	100.0
Other contracts:		
Embedded derivative financial instruments	**6,414.9**	5,893.2
Total notional amounts at end of period	**$ 34,631.2**	$ 34,256.4
Credit exposure of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 507.1**	$ 683.9
Interest rate options	**34.5**	48.5
Swaptions	**1.3**	0.7
Foreign exchange contracts:		
Currency swaps	**147.9**	263.8
Currency forwards	**0.4**	6.8
Currency options		1.9
Equity contracts:		
Equity options	**45.1**	74.3
Credit contracts:		
Credit default swaps	**7.5**	6.8
Total return swaps	**2.1**	
Total gross credit exposure	**745.9**	1,086.7
Less: collateral received	**86.2**	248.0
Net credit exposure	**$ 659.7**	$ 838.7

Table of Contents

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

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

	Derivative assets (1)		Derivative liabilities (2)	
	June 30, 2013	December 31, 2012	June 30, 2013	December 31, 2012
	(in millions)			
Derivatives designated as hedging instruments				
Interest rate contracts	**$ 0.2**	$ 10.3	**$ 350.5**	$ 440.5
Foreign exchange contracts	**101.8**	190.0	**161.1**	127.2
Total derivatives designated as hedging instruments	**$ 102.0**	$ 200.3	**$ 511.6**	$ 567.7
Derivatives not designated as hedging instruments				
Interest rate contracts	**$ 506.4**	$ 677.1	**$ 449.0**	$ 493.9
Foreign exchange contracts	**43.5**	58.2	**23.7**	14.3
Equity contracts	**45.1**	74.3	**77.2**	27.7
Credit contracts	**9.6**	6.8	**63.4**	96.6
Other contracts			**250.9**	327.8
Total derivatives not designated as hedging instruments	**604.6**	816.4	**864.2**	960.3
Total derivative instruments	**$ 706.6**	$ 1,016.7	**$ 1,375.8**	$ 1,528.0

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

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of $74.2 million and $170.5 million as of June 30, 2013 and December 31, 2012, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

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

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. The effect of this purchased protection would reduce our total maximum future payments by $34.9 million as of June 30, 2013 and $15.0 million as of December 31, 2012. These purchased credit derivative transactions had a net asset (liability) fair value of $(0.2) million as of June 30, 2013 and $0.2 million as of December 31, 2012. In certain circumstances, our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

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

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

Table of Contents

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

	June 30, 2013			
	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
		(in millions)		
Single name credit default swaps				
Corporate debt				
AA	**$ 40.0**	**$**	**$ 40.0**	**4.9**
A	**366.5**	**3.4**	**366.5**	**4.0**
BBB	**195.0**	**(3.4)**	**195.0**	**4.8**
Structured finance				
Near default	**5.6**	**(5.6)**	**5.6**	**0.1**
Total single name credit default swaps	**607.1**	**(5.6)**	**607.1**	**4.3**
Basket and index credit default swaps				
Corporate debt				
Near default	**110.4**	**(38.7)**	**110.4**	**3.7**
Government/municipalities				
AA	**30.0**	**(4.8)**	**30.0**	**4.2**
Structured finance				
BBB	**25.0**	**(4.3)**	**25.0**	**4.0**
Total basket and index credit default swaps	**165.4**	**(47.8)**	**165.4**	**3.9**
Total credit default swap protection sold	**$ 772.5**	**$ (53.4)**	**$ 772.5**	**4.2**

	December 31, 2012			
	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
		(in millions)		
Single name credit default swaps				
Corporate debt				
AA	$ 70.0	$ (0.2)	$ 70.0	2.5
A	572.0	2.4	572.0	2.4
BBB	200.0	(1.6)	200.0	3.0
Structured finance				
Near default	11.1	(11.0)	11.1	8.5
Total single name credit default swaps	853.1	(10.4)	853.1	2.6
Basket and index credit default swaps				
Corporate debt				
Near default	110.4	(65.2)	110.4	4.2
Government/municipalities				
AA	30.0	(7.3)	30.0	4.7
Structured finance				
BBB	25.0	(5.6)	25.0	4.5
Total basket and index credit default swaps	165.4	(78.1)	165.4	4.4

Total credit default swap protection sold	$	1,018.5	$	(88.5)	$	1,018.5	2.9

We also have invested in fixed maturities classified as available-for-sale that contain credit default swaps that do not require bifurcation and fixed maturities classified as trading that contain credit default swaps. These securities are subject to the credit risk of the issuer, normally a special purpose vehicle, which consists of the underlying credit default swaps and high quality fixed maturities that serve as collateral. A default event occurs if the cumulative losses exceed a specified attachment point, which is typically not the first loss of the portfolio. If a default event occurs that exceeds the specified attachment point, our investment may not be fully returned. We would

Table of Contents

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

have no future potential payments under these investments. The following tables show, by the types of referenced/underlying asset class and external rating, our fixed maturities with embedded credit derivatives.

	June 30, 2013		
	Amortized cost	Carrying value (in millions)	Weighted average expected life (in years)
Corporate debt			
BBB	**$ 21.5**	**$ 21.5**	**3.5**
Total corporate debt	**21.5**	**21.5**	**3.5**
Structured finance			
A	**6.3**	**6.3**	**16.9**
BB	**20.6**	**19.0**	**3.2**
B	**4.1**	**4.1**	**3.6**
CCC	**22.9**	**22.9**	**5.1**
Total structured finance	**53.9**	**52.3**	**5.6**
Total fixed maturities with credit derivatives	**$ 75.4**	**$ 73.8**	**5.0**

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

Fair Value Hedges

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

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

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

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

Table of Contents

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

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

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

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the three months ended June 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 June 30, (1)	
	2013	**2012**		**2013**	**2012**
	(in millions)			**(in millions)**	
Interest rate contracts	**$ 65.9**	$ (25.1)	Fixed maturities, available-for-sale	**$ (62.7)**	$ 24.3
Foreign exchange contracts		2.4	Fixed maturities, available-for-sale	**0.1**	(2.4)
Foreign exchange contracts	**(10.0)**	(23.2)	Investment-type insurance contracts	**9.9**	22.1
Total	**$ 55.9**	$ (45.9)	Total	**$ (52.7)**	$ 44.0

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the six months ended June 30, (1)		Hedging items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the six months ended June 30, (1)	
	2013	**2012**		**2013**	**2012**
	(in millions)			**(in millions)**	
Interest rate contracts	**$ 96.3**	$ 6.6	Fixed maturities, available-for-sale	**$ (91.3)**	$ (3.9)
Foreign exchange contracts	**1.3**	1.6	Fixed maturities, available-for-sale	**(1.2)**	(1.1)
Foreign exchange contracts	**(74.1)**	(7.0)	Investment-type insurance contracts	**73.6**	7.3
Total	**$ 23.5**	$ 1.2	Total	**$ (18.9)**	$ 2.3

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

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

Hedged Item	Amount of gain (loss) for the three months ended June 30, 2013	2012	Amount of gain (loss) for the six months ended June 30, 2013	2012
		(in millions)		
Fixed maturities, available-for-sale (1)	**$ (29.7)**	$ (33.6)	**$ (61.2)**	$ (69.1)
Investment-type insurance contracts (2)	**10.0**	9.1	**19.3**	17.9

(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.

Table of Contents

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

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 7.0 years. At June 30, 2013, we had $81.2 million of net gains reported in AOCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from OCI into net income. We reclassified $0.2 million and $0.0 million from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring during the six months ended June 30, 2013 and 2012, respectively.

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

Derivatives in cash flow hedging relationships	**Related hedged item**	**Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three months ended June 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 June 30,**	
		2013	**2012**		**2013**	**2012**
		(in millions)			**(in millions)**	
Interest rate contracts	Fixed maturities, available-for-sale	$ **(17.5)**	$ 28.0	Net investment income	$ **2.9**	$ 2.2
Interest rate contracts	Investment-type insurance contracts	**0.1**	(1.1)	Benefits, claims and settlement expenses		
Interest rate contracts	Debt			Operating expense	**(1.6)**	(1.5)
Foreign exchange contracts	Fixed maturities, available-for-sale	**0.6**	47.9	Net realized capital losses	**(1.5)**	(1.7)
Foreign exchange contracts	Investment-type insurance contracts	**3.0**	1.1	Benefits, claims and settlement expenses		
Total		$ **(13.8)**	$ 75.9	Total	$ **(0.2)**	$ (1.0)

Derivatives in cash		**Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the six months ended**	**Location of gain (loss) reclassified from AOCI**	**Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the six months ended**

flow hedging relationships	Related hedged item	June 30, 2013	2012	into net income (effective portion)	June 30, 2013	2012
		(in millions)			(in millions)	
Interest rate contracts	Fixed maturities, available-for-sale	**$ (41.2)**	$ 25.9	Net investment income	**$ 5.6**	$ 4.1
Interest rate contracts	Investment-type insurance contracts	**1.1**	0.6	Benefits, claims and settlement expenses		
Interest rate contracts	Debt			Operating expense	**(3.2)**	(2.9)
Foreign exchange contracts						