

Principal Financial Group®

3Q 2023 Earnings Call Transcript

October 27, 2023

9:00 a.m. CT

Nasdaq: PFG



Call participants

Executives

Dan Houston: Chairman, President & CEO

Deanna Strable: Executive Vice President & CFO

Amy Friedrich: President – Benefits and Protection

Pat Halter: President - Principal Asset Management

Chris Littlefield: President - Retirement & Income Solutions

Kamal Bhatia: Global Head of Investments – Principal Asset Management

Humphrey Lee: Vice President - Investor Relations

Analysts

Ryan Krueger: KBW

Jimmy Bhullar: JP Morgan

Suneet Kamath: Jefferies

Alex Scott: Goldman Sachs

Wilma Burdis: Raymond James

Wes Carmichael: Wells Fargo

Tom Gallagher: Evercore

Tracy Benguigui: Barclays

Josh Shanker: Bank of America

Presentation

Operator: Good morning, and welcome to the Principal Financial Group Third Quarter 2023 Financial Results Conference Call. There will be a question and answer period after the speakers have completed their prepared remarks. If you would like to ask a question at that time, simply press star and then the number one on your telephone keypad. A confirmation tone will indicate your line is in the question queue. We would ask that you be respectful of others and limit your questions to one and a follow up so we can get to everyone in the queue.

I would now like to turn the conference call over to Humphrey Lee, Vice President of Investor Relations.

Humphrey Lee: Thank you, and good morning. Welcome to Principal Financial Group's Third Quarter 2023 Conference Call. As always, materials related to today's call are available on our website at investors.principal.com.

Following a reading of the safe harbor provision, CEO, Dan Houston, and CFO, Deanna Strable, will deliver some prepared remarks. We will then open up the call for questions. Other members of senior management will also be available for Q&A.

Some of the comments made during this conference call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. The company does not revise or update them to reflect new information, subsequent events, or changes in strategy (ph). Risks and uncertainties that could cause actual results to differ materially from those expressed or implied are discussed in the company's most recent annual report on Form 10-K filed by the company with the U.S. Securities and Exchange Commission.

Additionally, some of the comments made during this conference call may refer to non-GAAP financial measures. Reconciliations of the non-GAAP financial measures to the most directly comparable U.S. GAAP financial measures may be found in our earnings release, financial supplement, and slide presentation.

We'll be hosting a combined fourth quarter 2023 earnings and 2024 outlook call on February 13. We will share more details earlier next year.
Dan?

Dan Houston:

Thanks, Humphrey, and welcome to everyone on the call. This morning, I'd like to share key aspects of our third quarter financial results and some notable performance highlights. Deanna will follow with additional details and an update on our current financial and capital position. Our diversified and increasingly integrated business model, as well as our leading and differentiated position in the U.S. small to midsized business market, contributed to a strong quarter. Across the enterprise, we continue to balance investing for growth in our businesses with disciplined expense management.

Starting on slide three, healthy sales growth across our businesses and strong underwriting results drove reported non-GAAP operating earnings of \$420 million or \$1.72 per diluted share in the third quarter. Excluding significant variances, earnings per share increased 14% over the third quarter of 2022. The synergies between our businesses increasingly integrated offering and the value of our distribution and joint venture partnerships continue to unlock value for our customers and shareholders.

During the quarter, we delivered on our capital deployment strategy, investing for growth in our businesses and returning more than \$350 million of capital to shareholders through share repurchases and common stock dividends. Our strong capital position enabled us to complete \$200 million of share repurchases in the third quarter and to increase our dividend.

After a strong start to the year, equity markets retreated in August and September. Foreign currency tailwinds in the first half of the year reversed in the third quarter as the U.S. dollar strengthened on growth and higher yields in the U.S., outpacing much of the rest of the world.

These macroeconomic dynamics impacted our total company-managed AUM, which ended the quarter over \$650 billion. Total company managed net cash flow improved from the second quarter, benefiting from strong net cash flow in Principal International, improved institutional flows in Principal Global Investors, and strong general account flows.

With \$2.1 billion of net outflows in the quarter, we performed better than many active asset managers as a percentage of beginning AUM. The current volatile markets are a challenge for the asset management industry and the aggressive interest rate hikes over the last 18 months have continued to make cash and money market funds highly attractive. This is evidenced by the nearly \$1 trillion of industry flows into money market funds year-to-date and approximately \$7 trillion of AUM and money market funds across the industry. We are well positioned and have the right strategies as interest rates stabilize and investors reallocate back into risk-based assets like our specialty income solutions.

Despite continued pressure in the real estate sector, we generated \$800 million of positive real estate net cash flow in the quarter as institutional investors are starting to put money to work in select real estate strategies. This was nearly double our real estate flows in the first half of the year and demonstrates the confidence our clients have in our differentiated capabilities in this asset class.

We have several real estate opportunities boosting our optimism for the coming quarters. We expect additional funding in the fourth quarter and our new data center fund and our China real estate joint venture. As discussed last quarter, we have a strong pipeline of committed yet unfunded real estate mandates, currently over \$6 billion that we'll put to work opportunistically.

Looking at asset management in total, we are aware of two large institutional outflows of similar size that will impact net cash flow by approximately \$5 billion in total. One client is planning to take the funds in-house while the other is moving to a passive option. We expect one of

the outflows to occur in the fourth quarter and the other early in the first quarter of 2024.

In Principal International, we ended the quarter with \$168 billion of total reported AUM. This reflected strong retirement net cash flow in Latin America, including \$1 billion in Brazil. Brasilrev, our joint venture with Banco do Brazil, remains the market leader in both AUM and deposits with nearly 30% market share. As a reminder, net cash flow in Brazil tends to be seasonally stronger in the first and third quarter each year.

We continue to have great confidence in the global asset management opportunity and our ability to deliver global and local investment capabilities and client support across more than 80 markets. As part of our efforts to invest for growth, we have added two new highly regarded investment leaders George Maris from Janus Henderson as CIO of Equities and Michael Goosay from Goldman Sachs as CIO fixed income. Both are proven investment leaders with specialized global expertise that complements our robust investment capabilities and will further build upon our experienced team of nearly 900 investment professionals. We will also be announcing a new leader of Latin America in the coming days, to drive our businesses across Brazil, Chile, and Mexico.

Turning to U.S. retirement, account value net cash flow was positive in the third quarter. Total RIS sales grew 30% and fee-based transfer deposits increased 78% compared to a year ago. We had two large retirement plan sales in the quarter, which contributed \$3 billion to sales and transfer deposits. As a reminder, sales and lapses in large plan segment can impact net cash flow significantly quarter-to-quarter.

Total reoccurring deposits increased over the third quarter of 2022, driven by a 7% increase in the SMB segment. This was partially offset by the impact on deposits from large plan lapses earlier this year as well as lower defined benefit planned deposits given the full funding status of these plans. The SMB segment continues to be strong and has proven resilient as employment and wages remain healthy.

Looking ahead, we expect elevated lapses and negative net cash flow in the fourth quarter, consistent with historical trends. We typically see plans change providers at year-end, while we generally onboard new plans in the first quarter.

On a full year basis, we expect sales and transfer deposits to be higher than 2022 levels and we have good momentum heading into 2024. We remain focused on driving profitable growth in RIS, leveraging our leading market position and full suite of retirement and workplace solutions.

In specialty benefits strong sales, retention, employment, and wage growth contributed to an 8% growth in premium and fees over the third quarter of 2022. Attractive segments within the SMB market remain underpenetrated and we are confident in our ability to target these segments with a meaningful value proposition to aid and continuing to deliver above market growth.

In Life, our strategy is working as business market premium and fees grew 24% over the third quarter of 2022 and outpaced the runoff of the legacy business.

I'm excited about the growth opportunities across the enterprise and confident that our focus on high-growth markets, combined with our integrated product suite and distinct set of distribution partnerships will continue to drive value for our customers and our shareholders. At our core, we're focused on providing individuals, businesses, communities, and markets with access to financial tools and products and guidance. And today, we know the demand for this kind of knowledge and support is significant.

To stay in touch with customer trends around the globe, we regularly take a step back and consider the state of the foundation upon which our industry has built. One example of trends we're seeing comes to life in the Global Financial Inclusion Index, a global study sponsored by Principal, assessing the state of financial inclusion worldwide. We released our second year finding earlier this month, identifying a

continued and persistent need for financial service companies, employers, and governments to continue to work together to help more people feel prepared to fully participate in building long-term financial security.

Before turning it over to Deanna, I'd like to highlight some recognition we recently received. Forbes recently recognized Principal on its list of best employers for women in the U.S. and one of America's most cybersecure companies. We also achieved the top score on the 2023 Disability Equality Index from Disability:IN. And in Chile, most innovative companies, a local innovation consulting group recently awarded Cuprum and Principal as the most innovative company in both the AFP and asset management categories. Recognition like this helps us benchmark progress, attract and retain talent, and stand out in the marketplace.

Deanna?

Deanna Strable: Thanks, Dan. Good morning to everyone on the call. This morning I will share the key contributors to financial performance for the quarter, details of our current financial and capital position, and an update on our commercial mortgage loan portfolio.

We reported net income of \$1.2 billion in the third quarter, reflecting more than \$700 million of income from exited businesses. This benefit was primarily due to a change in the fair value of the funds withheld embedded derivative, which doesn't impact our capital or free cash flow and can be extremely volatile quarter-to-quarter.

Excluding the income from exited businesses, net income was \$544 million with minimal credit losses of \$6 million. We also had minimal impacts from credit drift in the third quarter. Year-to-date, total credit drift and losses were a manageable \$41 million, which is better than our expectation at the beginning of the year.

Excluding significant variances, third quarter non-GAAP operating earnings were \$446 million or \$1.83 per diluted share. EPS increased 14%

over the third quarter of 2022, demonstrating the strength and resiliency of our diversified business model.

On a year-to-date basis, EPS excluding significant variances, has increased 5% over 2022 compared to our 3% to 6% guided range. As detailed on slide 11, significant variances impacted our third quarter non-GAAP operating earnings by a net positive \$40 million pretax, a net negative \$27 million after tax, and \$0.11 per diluted share.

The significant variances included impacts from the actuarial assumption review, lower-than-expected variable investment income in RIS Life and Corporate, as well as impacts in Principal International, including lower-than-expected encaje performance and better-than-expected impacts of inflation.

The assumption review had a net positive \$63 million impact on pretax operating earnings. This was primarily driven by experience adjustments in RIS and Specialty Benefits, including updates to PRT mortality assumptions, group and individual disability morbidity assumptions, as well as model refinements in life. The after-tax impact was a negative \$6 million as the pretax benefit was more than offset by a one-time tax impact resulting from a PRT tax reserve methodology change. RIS in life's third quarter pretax operating earnings, excluding significant variances, reflect the run rate impacts from the assumption review. There are no material run rate impacts in Specialty Benefits.

In total, variable investment income was positive for the quarter and improved from the first half of the year, but it was lower than our run rate expectations. While VII benefited from improvement in real estate sales and alternative investment returns, prepayment fees remain immaterial.

Looking at macroeconomics in the third quarter, the S&P 500 daily average increased 6% from the second quarter and 12% from the third quarter of 2022, benefiting third quarter results in our fee-based businesses. While the daily average increased, markets retreated in the second half of the quarter. The S&P 500 closed nearly 4% lower than the

second quarter and fixed income returns were negative as well. This impacts revenue, earnings, and margins for our fee-based businesses.

Foreign exchange rates were a slight headwind on a quarterly basis relative to the second quarter, a slight tailwind compared to the third quarter of 2022 and immaterial on a trailing 12-month basis. In RIS, benefits from strong expense management as well as favorable equity market performance and higher interest rates were partially offset by fee compression.

Excluding significant variances, net revenue increased 4% compared to a year ago and margin was strong at 39%. PGI benefited from real estate performance fees in the quarter, driving a 6% increase in revenue over the third quarter of 2022 and improved the margin to 39%.

Specialty Benefits pretax operating earnings, excluding significant variances, increased 32% over the year ago quarter. This was fueled by growth in the business, strong long-term disability underwriting experience, and lower group life mortality.

The third quarter adjusted margin was strong at over 17%, which was more than 300 basis points higher than the third quarter of 2022. As we look to the fourth quarter, I want to remind you that our enterprise compensation and other expenses are typically higher due to the seasonality of certain expenses. We expect less of an impact this fourth quarter than the typical 7% to 10% as we're focused on managing expenses in the challenging and volatile macro environment.

Shifting to our investment portfolio, it remains high quality, aligned with our liability profile and well positioned for a variety of economic conditions. We revalued the office real estate portfolio again in the third quarter. The commercial mortgage loan portfolio remains healthy. The current loan-to-value and debt service coverage ratios are strong at 47% and 2.5x. Specific to our office exposure in the CML portfolio, all year-to-date maturities are resolved and we are confident in the outcome of the one small remaining office loan maturing in the fourth quarter.

Looking ahead to 2024 office maturities, the underlying metrics are strong with a 63% loan-to-value and debt service coverage ratio of 3.8x. We are confident in the outcome of the 11 maturities in 2024, of which only three are slated for the first half of the year.

Turning to capital and liquidity, we are in a strong position with \$1.4 billion of excess and available capital, which reflects the benefit of negative IMR and includes approximately \$940 million at the holding company, which is above our \$800 million targeted level, \$360 million in our subsidiaries, and \$50 million in excess of our targeted 400% risk-based capital ratio.

We returned more than \$350 million to shareholders in the third quarter, including \$200 million of share repurchases and \$156 million of common stock dividends. Last night, we announced a \$0.67 common stock dividend payable in the fourth quarter. This is a \$0.02 increase and aligns with our targeted 40% dividend payout ratio.

Given our current capital position and strong free capital flow, we are increasing our full year share repurchase expectation to approximately \$700 million, \$100 million higher than previously expected. Combined with common stock dividends, we now expect to return \$1.3 billion of capital to shareholders for the full year.

We remain focused on maintaining our capital and liquidity targets at both the life company and the holding company, and we'll continue a balanced and disciplined approach to capital deployment. We are committed to maximizing our growth drivers of retirement, global asset management, and benefits and protection, which will continue to deliver long-term growth for the enterprise and long-term shareholder value.

This concludes our prepared remarks. Operator, please open the call for questions.

Operator:

Thank you. At this time, I would like to remind everyone that, to ask a question, press star and then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Our first questions come from the line of Ryan Krueger with KBW. Please proceed with your questions.

Ryan Krueger: Hey, thanks. Good morning. My first question was on real estate. And you mentioned a couple of real estate opportunities that you have some visibility on. I just -- I guess my question is you did \$800 million in real estate flows in the quarter. Do you think that type of pace is more reasonable now as we move forward? Or can you give any more color on your expectations there?

Dan Houston: Yes, Ryan, good morning. Thanks for the question. I'm going to have Pat respond to that in just a minute here, but I also want to let everyone know that we've invited Kamal Bhatia to join us for our Q&A. Kamal is Global Head of Investments for Principal Asset Management. He reports directly to Pat and will also participate in responding to questions on PGI on earnings calls going forward. So with that, Pat, would you like to take that question, please?

Pat Halter: Yes. Ryan, thanks for the question. As you highlighted, third quarter, we did have a \$800 million net cash flow in real estate. That was from predominantly the institutional marketplace and that was double the prior quarter in terms of net cash flow. To your question, we continue to see an active pipeline and an active opportunity to selectively deploy the \$6 billion of committed capital that has not been invested yet in our pipeline as we look forward. And I would expect in the fourth quarter to continue to see a very consistent pace like we saw in the third quarter in terms of the real estate net cash flow, Ryan.

Ryan Krueger: Great. Thanks. And then on the two outflows totaling \$5 billion that you mentioned, what type of funds or what type of asset classes are those in?

Dan Houston: Please, Pat.

Pat Halter: Yeah. Thanks, Ryan. As Dan mentioned, we do have two large onetime outflows that we expect to see in the late fourth quarter of 2023 and in the early first quarter of 2024. The first one is a preferred securities mandate, who is with a large client who is merging multiple strategies into one larger sort of a portfolio.

The second is a very large-cap equity mandate with a client that has opted to move to a passive strategy. Just in terms of probably the natural question is what is the sort of the combined earnings loss impact of these two large mandates. It's approximately \$10 million without offsetting any expense adjustments we would be considering as we go forward.

We've also taken a look, Ryan, at our just overall portfolio, if there are any other onetime outflows we expect as we look forward into 2024. And we have not noted any other ones at this point in time as we reviewed the overall portfolio and our client base.

Dan Houston: So Ryan and Pat, the only thing I might add to that. On that preferred securities mandate, they took that in-house in spite of very strong performance from our preferred spectrum asset management. So again, it was a tough loss for us, especially considering the strong performance.

Next question, operator.

Operator: Thank you. Our next questions come from the line of Jimmy Bhullar with JPMorgan. Please proceed with your questions.

Jimmy Bhullar: Hey, good morning. So first for Pat, PGI performance fees were very strong in the third quarter. And if you could just give us some color on what drove that and what your outlook is either over the next quarter or over the next year? Because I would have thought that performance would have suffered in this type of an environment, but obviously, the quarterly number was very good.

Dan Houston: Thanks, Jimmy, for the question. Pat?

Pat Halter: Yeah, Jimmy, thanks for the question. As you've heard me in prior comments, we always have a large pipeline of different investments that are at different stages of maturity in terms of harvesting gains or performance fees. And as you can imagine, performance fees are relatively lumpy depending on market conditions and when we can optimize the actual sort of hopefully alpha generation that we see in the real estate portfolios that we're managing. We did have a \$22 million gross performance fee in the third quarter. Those are in two different transactions.

As we look forward, we probably think that the first half of the year where we saw performance fees which were muted, we'll probably see that in the fourth quarter. But I would suggest to you that as we look into 2024, if the market conditions provide an opportunity for us, we still have confidence that as we've indicated in past discussions that we should expect performance fees to be in the \$30-plus million range which has been a consistent guidance and a consistent realization of where we've seen performance fees. Probably in the second half of 2024 versus the first half of 2024, but we continue to believe we have a diverse portfolio of different investment strategies that can be harvested in the future years.

Jimmy Bhullar: Okay. Thanks. And then secondly, on RIS net flows in the fee business. You saw some high lapses this quarter. I think you mentioned large cap lapses on the wealth platform you bought. The acquisition happened several years ago. So I would have thought that by now those shock lapses would have been over. But is it part -- is it that or is it competition? What's really causing the weak flows in the fee-based business?

Dan Houston: And Jimmy, let me make just a couple of really quick comments before handing it over to Chris. First thing I want to do is thank Chris for his leadership in advancing our domestic retirement strategy. It's a challenging environment out there. He's done an amazing job recruiting talent from the industry and leveraging our existing talent.

Our focus still remains on small, mid, and large plans. Each one of those have different characteristics that can be volatile. But most importantly, our continued doubling down on our abilities to create a unique TRS solution for defined benefit, defined contribution, ESOP, and nonqualified. And certainly, we've seen some volatility in these businesses, but I'd like to think that in large part the integration has taken place and Chris is growing it from here. So Chris, can you please respond?

Chris Littlefield: Yes. No, thanks for the question, Jimmy. I think what you have to keep in mind is that as a result of the pandemic and some of the market volatility that has probably dampened some of the bid activity, and we certainly have seen an uptick in bid activity across the industry as we've gotten into '23. So I don't think it's something that's going to continue to create a lot of pressure. And in fact, we see a very significant and meaningful moderation in contract losses heading into '24.

But yes, we definitely are working through that. I mean from a perspective of flows, we had a positive quarter, and we're starting to see the pickup in sales and transfer deposits. I mean if you look at 78% increase in transfer deposits in the quarter. SMB was up mid-double digits. All of that is really positive, and we continue to see those trends continue in the fourth quarter. So I think, yes, we are seeing some lag from more pandemic activity and some of the market volatility that it's really hard to move plans when the market's really volatile. So I think that's going to pretty much sort out here over the next quarter or so.

Jimmy Bhullar: Thank you.

Dan Houston: Thanks, Jimmy.

Operator: Thank you. Our next questions come from the line of Suneet Kamath with Jefferies. Please proceed with your questions.

Suneet Kamath: Thanks. Good morning. Just for Deanna to start on the assumption review. Any sort of ongoing GAAP impacts that we should expect? And then similarly, is there any sort of either statutory impact from the

review or implications for taxes based on that negative item that showed up in the tax rate?

Deanna Strable: Yes. Thanks, Suneet, for the question. From a run rate perspective, it does cause a slight benefit in RIS, a slight pressure in life, no impact in SBD. I think it is of note though that those would be reflected in the third quarter run rate operating earnings that we gave you on a pretax basis. So those have all been kind of factored in.

As we move to capital, the tax item did cause a capital hit. And so that was unknown, and we had slightly positive offsetting -- modest positive capital impact that offset a portion of that from the AAR. But ultimately, those would be the moving pieces. From a tax perspective, no ongoing impact. That was a onetime impact that really trued up and reversed some credits that we had taken in previous years. And so no impact as we go forward.

Suneet Kamath: Got it. Okay. Thanks. And then, I guess, maybe for Amy. On the disability business, we continue to see really good results, not only from you guys, but other companies. And I guess I'm just trying to understand or like to understand how quickly you think this strong -- these strong results will be sort of factored into pricing? I would imagine that would occur at some point, but I just want to get a sense of, from a timing perspective, what the glide path looks like. Thanks.

Dan Houston: Amy, please.

Amy Friedrich: Yeah. Yeah. So let me -- I'll give you my perspective on this. It's going to vary a bit by kind of how your block is made up. But if you have most of your block, which we do in an ability to kind of annually rerate. I think that those -- the reratable nature of that business is going to mean that we pass on that good performance relatively quickly.

I will say we're pretty committed to making sure that when we've got good performance, we're putting that back into our rates. We know that that's good for our customers. We know more income protection

products out there in the industry and in the economy are good for the economy. And we know that it's good for our future growth rates if we continue to put that in.

So what I would say though is it does take a little bit of time for that to catch up. You do something differently with your in-force block versus your new business pricing. So I would guess as we come out through '23 and into 2024, you would still see even us slowly kind of moving that into our in-force or new case pricing. But it will -- I mean, in a well run business, it will get back into pricing so that it can benefit the growth of the whole industry.

The other point I would say, though, is that you do -- it does matter the composition of your block. So for example, our block is about 70% what we would consider knowledge workers. So those knowledge workers are going to have really great options in terms of when you think of claims recovery in terms of hybrid or remote working options. So if you've got more of your block of business in those knowledge industries, your ability to consistently move that into your block, the benefits of that into your pricing and into your results are going to be higher than if you have a lot more in like retail or manufacturing sectors. So the composition of your block matters, the reratable nature whether you've locked in multiyear rate guarantees matters, and it's going to factor into everybody's ability to grow.

Dan Houston: That help, Suneet?

Suneet Kamath: It does. Thank you so much.

Dan Houston: I appreciate the question.

Operator: Thank you. Our next questions come from the line of Alex Scott with Goldman Sachs. Please proceed with your questions.

Alex Scott: Hi. I wanted to see if you could talk a bit about the margins and just the sustainability of margins that are running at a pretty nice level just partly

probably driven by the recovery in some AUM over the last couple of quarters or a few quarters. And how should we think about your ability to hold on to some of that and kind of keep the flexibility versus some of the pressures from inflation, obviously, ongoing and so forth. Any way to think through that in terms of the more short-term targets that you guys communicated?

Dan Houston:

Yes, Alex, it was a little garbled there towards the end. But certainly, I appreciate the question around margins, our ability to maintain those margins. And the first thing I'll say before handing it over to Deanna is we have an ongoing vigilance around aligning our expenses with our revenues to make sure that we're protecting margin for our investors. In extreme markets, it's more challenging. But again, we do try to anticipate this to some degree and to make sure that we are again, being focused appropriately on growing our businesses and making the appropriate investments while at the same time taking out unnecessary expenses. So Deanna, maybe you can sort of anticipate and frame the margins on a go-forward basis.

Deanna Strable:

Yes. I'll frame it in total. And then Alex, if you have some specific businesses that you want to go into a little bit deeper, you can bring that up and we can pass on to the appropriate president. It was a very strong margin quarter across almost all of our businesses. I'd say we obviously were benefiting relative to outlook from some of the early in the year market strength. And as you know, some of that did retreat as we went through the third quarter and in to the fourth quarter.

The other thing I would say is that we did mention on the prepared remarks that we do have some seasonality in our expenses. We do expect that to be less than typical, but you will see some impact on fourth quarter margins from that as well. That does impact all businesses with a slightly larger impact in our retirement business.

But I think the good news is bringing us back to the full year, we do still feel really good about our targeted margins. And ultimately, we will be laying out kind of our expectations for 2024 in the February outlook call,

but we continue to be very targeted and focused on maintaining those margins and doing what we need to do to keep us in those levels.

Dan Houston: You have a follow-up, Alex?

Alex Scott: Yeah. The follow-up I had is on PGI. I wanted to ask about just the broad industry pressure that active asset management is facing. And what are the strategies that you all are deploying to be able to sort of resist some of those pressures? And anything -- nuance that you're working on there to help flows?

Dan Houston: Well, one thing we all know, Alex, is there's no shortage of challenges out there in terms of geopolitical risk and economic volatility and extreme interest rates and certainly inflation. And I think the right person to tackle this one is Kamal. So Kamal, do you want to provide some insights, please?

Kamal Bhatia: Sure. Thanks, Alex. Yes. I'll give you a perspective, Alex, on where we see client engagement and client sentiment because that's the best measure of where we see the industry going. I would probably highlight for you two dimensions here.

One, I think, as Dan talked about, most investors have been very well rewarded and they've been smart, particularly when it comes to achieving their goals by taking less risk and focusing on coupon yields. As you know, we are getting a lot of interest on our specialty income capabilities. And the reason we are seeing more and more of that recently is because a lot of investors are now focusing on total return solutions rather than simply looking at the coupon yield. Most of these institutions and including some of our wealth management partners really realize that we are probably at an early dawn of a long cycle with a total return capability would probably benefit them, and that is certainly something we have great performance and great capability on.

The second piece, as you've seen, is we continue to do extremely well in our real estate franchise, but we tend to have a lot more conversations

on private markets. And one of the things that's driving that continued engagement and our confidence in future success is we have some very, very long tenured strategic relationships. And as we go through this market cycle where there is a desire to work with partners that have experience through transition and discovery, Principal Asset Management is well positioned and there are a couple of reasons for it.

One is we have this amazing capability to work across public and private markets, which is important during these times. We also have a true understanding between debt and equity and we can offer a full service solution to them. And I would highlight that we have had a continuing excellent culture of client service with some of these large relationships that continues to benefit us. So as you highlighted, the active management space is stressed, but we do have some capabilities that give us high confidence from that perspective.

Dan Houston: Did that help, Alex?

Alex Scott: Yep. Thank you for all the detail.

Dan Houston: Thank you.

Operator: Thank you. Our next questions come from the line of Wilma Burdis with Raymond James. Please proceed with your questions.

Wilma Burdis: Hey. Good morning. Could you discuss the favorable impact of mortality on the pension risk transfer business in the quarter? And whether this is something you would expect to continue?

Dan Houston: Yeah. And I'll have Deanna take that one. Thanks.

Deanna Strable: Yeah. So obviously, over the past few years, we went through the COVID, where we did see some benefit of mortality. But ultimately, as we do every third quarter, we step back and we look at all of our actuarial

assumptions and make sure that we are reflecting that in our reserve levels.

New this year under LDTI is the fact that this annual actuarial review also applies to Fast 60 products, which includes our pension risk transfer products. And so again, that wouldn't have been something we would have reflected historically in our AAR, but now are reflecting that.

One of the things that we have seen is that ultimately, we are not seeing the expected mortality improvement that we had factored into our assumptions. And so we tried that up and ultimately then increase the mortality expectations on those PRT lives. And that led to that slightly over \$50 million benefit in the PRT. We aren't changing our future mortality assumptions. There is a slight benefit in the run rate expectations for AAR, but that was really the driver of what happened.

Wilma Burdis: Okay. And then the adjusted benefit ratio in Specialty Benefits was 58%, which was better than your targets and improved 4 points year-over-year. It sounds like the group disability could continue to outperform in the near term, but could you go into the other drivers and what we should expect in the coming quarters?

Dan Houston: Excellent. Thanks, Wilma. Amy, please.

Amy Friedrich: Yeah. So Wilma, as you've noted, the group disability one is probably one of the bigger drivers that's giving us that overall result. And again, as we've talked a little bit about, some of that will continue. I do think that third quarter is not repeatable in terms of when you adjust out the AAR, you're looking at that almost 46% loss ratio. That's not something that will continue, but we will see some improvement from those historical levels.

The other piece I'd say is group life is continuing to perform really, really well. I made a point in an earlier question to talk a little bit about our focus on those knowledge industries. I do think that tends to have a little bit of impact in group life as well. So the type of business that you've

built over time and the type of patterns you see against that business really do matter. And so I would expect group life to continue to perform pretty well.

Dental has been one that we have been seeing a little bit more utilization and severity over the last year, year and a half since COVID. It's been one of those we're trying to kind of find that next normal pattern. I do see it beginning to kind of slowly return to those patterns that we used to see prior to COVID. We're always willing to make some modest pricing adjustments to make sure we're continuing to be good stewards of that line of business, but I would expect to see that to continue to have probably even a little bit better performance than we saw in the trailing 12-month number from that.

And then our supplemental health line, I would continue to expect to see the type of performance that we've seen from that in the past and then individual disability could also see some of those benefits we've talked about, but I would continue to see it performing consistent with some of those historical levels.

Dan Houston: Hopefully, that helps, Wilma.

Wilma Burdis: Thank you.

Operator: Thank you. Our next questions come from the line of Wesley Carmichael with Wells Fargo. Please proceed with your questions.

Wes Carmichael: Hey, good morning. So last quarter, I think you talked about you expected variable investment income to be a little bit below normal levels for the remainder of 2023. And are you still expecting that into the fourth quarter? And maybe just if you think that could persist into 2024 or when you expect that to turn around?

Dan Houston: Thanks, Wes. I'll have Deanna take that one.

Deanna Strable: Yes. I think when you look at 3Q relative to what we saw in first quarter and second quarter. The real improvement came because we did see

some real estate sales in the quarter that then transferred into that variable investment income. As I look forward to the fourth quarter, I think you probably -- it is hard to predict, especially given the volatile market that we have, but probably expect to see fourth quarter be closer to 1Q and 2Q levels as we sit here today.

For 2024, I'll defer to more detail on the February outlook call. But I do think it is obvious to understand that as the interest rates continue at this high level, we're going to continue to see ongoing pressure from prepaids. And it's really the other alts and the real estate that can be volatile quarter-to-quarter.

Wes Carmichael: Thanks. And maybe as a follow-up. In the Individual Life business, it seems like that maybe came in a little bit below your expectations, maybe even for the last couple of quarters or so. So just wondering if there is an impact related to mortality or what's driving a little bit of the pressure there?

Dan Houston: Yeah. The only thing I just want to say before Amy delves into this is what an outstanding job she and her team have done in pivoting from that retail franchise with the divested businesses, the reinsurance agreements. And there is going to be a little volatility there, but the business owner executive solutions and NQ business has really been powerful for the organization and really complementary to the entire platform. But Amy, you want to take on the loss ratios here?

Amy Friedrich: Yeah. Dan, you've hit one of the points I would make about that is that I would say that life business sort of refocus has been meeting or exceeding our expectations in terms of getting ourselves focused on those business owner -- really meaningful business owner relationships. About 50% of the business that we do in nonqualified in any given quarter is going to be tied into the life insurance business now. And when we look at those business owner offerings, they tend to not only purchase life insurance products, but they tend to deepen the relationship across our retirement and asset management franchise as

well. And so those are really nice small business relationships for us to be building.

You've hit the point in terms of the question, which is there have been some things in the last couple of quarters in terms of mortality that we've seen a little bit more. It's not on the incident side. We're not seeing the number of claims, but the severity has been running a little bit hotter than we've seen historically, but that really does attribute the whole difference that is the severity.

Wes Carmichael: Thank you.

Dan Houston: Thank you, Wes.

Operator: Thank you. Our next questions come from the line of Tom Gallagher with Evercore ISI. Please proceed with your questions.

Tom Gallagher: Good morning. A few questions on RIS for me. Dan you had highlighted you expected net outflows in RIS in Q4. And I think part of that is just seasonal, the way the business works. Now last year, you guys had outsized, I think it was \$7 billion of outflows in Q4. I just want to make sure we're all level set here. Would you expect another outsized quarter directionally similar to \$7 billion or just more down, something a lot better than that, still outflows, but not some of the unusual large jumbo outflows?

Dan Houston: Yeah. Tom, I appreciate the question. I'll have Chris take that one on.

Chris Littlefield: Yes. Thanks, Tom. So again, as we see in the third quarter, we're seeing really good quality pipeline and well positioned for a strong double-digit growth in sales and transfer deposit growth across SMBs and large throughout the full year. But as Dan mentioned, we do expect to see some elevated lapse activity.

I think the hard part about the fourth quarter is it's really difficult to predict, Tom. It's an active quarter for planned transitions and planned

lineup changes. And you're going to have plans transition move from December to January. So it's really hard for us to give a lot of clear guidance on that. But we expect it to be negative, but we do expect it to be less negative than the year ago, both in terms of dollars and in terms of the withdrawal percentages. So again, that would give you some directional view.

As we continue to look forward into the fourth quarter and first quarter, we continue to see strong transfer deposits, solid recurring deposit growth, and a meaningful moderation in our contract lapse rate, all consistent with how we're really managing the business, which is for profitable growth. And despite all of this activity, we expect to be within our guidance range for revenue for the full year and in the upper half of margin for the full year. So we had some pressure, but certainly don't see as much as we did a year ago.

Dan Houston: Did that help, Tom?

Tom Gallagher: That's helpful, Chris and Dan. Thanks. My follow-up is just a fee question on RIS. If I -- the calculation I'm doing is probably overly simplified, but if I look at the average increase in monthly assets, it's 3% to 4%, and you should have gotten an extra fee day in Q3. And then I look at essentially flat fees for the quarter in Q3 versus 2Q, that would suggest, I would say, somewhat higher-than-normal fee compression or fee pressure. Is there -- are you seeing more fee pressure than normal? Or is there maybe something with the calculation that we need to adjust? Thanks.

Chris Littlefield: No. Thanks, Tom. No, again, I think throughout the year, we've definitely benefited from equity markets that's pushed our fee rate around 40 bps the last few quarters. But as we're seeing the compression emerge, it's emerging in line with our guidance. We've historically guided that we expect to see compression annually to be at sort of the 2 to 3 bps reduction a year, which is driven by competitive market dynamics, both acquiring new business, retaining existing customers, having higher price plans, lapse versus and newer ones coming in at lower fee rates.

So that's the compression that we sort of put in that 2 bps to 3 bps a year reduction. This year -- this quarter, it was about 2 bps versus a year ago. So that's what you're seeing. And while the fee revenue rate is down a bit, keep in mind that how we manage this business, we also have lower expenses and we're delivering higher margins, consistent with how we're really managing this business for the future.

Dan Houston: Yeah, Chris, the only thing I might add to that list is also the investment management shift. So to the extent there's more money that goes to a passive option as opposed to active, you're going to see a negative impact on the revenues as well.

Tom Gallagher: That makes sense. Thanks, guys.

Dan Houston: Appreciate it, Tom.

Operator: Thank you. Our next questions come from the line of Tracy Benguigui with Barclays. Please proceed with your questions.

Tracy Benguigui: Thank you. Your office CML LTV is healthy at 63%, but it's worse than 57% last quarter. I feel like office pressures will take time to materialize. How do you see your office CML LTV trending going forward? Is it too simplistic to think about low to mid-single-digit deterioration every quarter? I'm just wondering if there's a certain level where you feel less comfortable.

Dan Houston: Pat, any insights here?

Pat Halter: Yes. Thanks for the question, Tracy. So as Deanna mentioned, we actually do rewriting on our office portfolio on a quarterly basis. And just a reminder, again, we have about \$3.1 billion worth of office in our general account. That's a 57% loan-to-value, 2.6x debt service coverage. It's 89% occupied. 75% of buildings we consider to be Class A, really strong, high-quality buildings, sort of a A quality in terms of our sort of expectation on the rating performance.

But we do every quarter, an analysis of the cash flow streams of each office property, the terminal cap rates, the discount rates that we want to apply to come up with a valuation. I think one of the things that I really think is important that we've been very aggressive on adjusting our cap rates on a quarter-to-quarter basis. to make sure we're staying abreast of what we're hearing, what we're seeing in terms of investor expectations in terms of where trades are being consummated in the marketplace.

And I'll suggest to you that our cap rates continue to be significantly conservative relative to NCREIF, which is the index that most institutional investors look at in the private market space. And our cap rates for office are 17% higher. So we're very conservative relative to where NCREIF cap rates are and those NCREIF cap rates just came out in the last day.

And so we continue to be very thoughtful about market conditions, reflecting those market conditions in our quarterly assessments. And so we want to make sure we're giving you real time data and real-time expectations as to where we see those debt service coverage and loan to values.

Dan Houston: Does that help, Tracy?

Tracy Benguigui: It helps for sure because it feels like then your LTV is probably more realistic and less stale than maybe what others report given that diligence. But just wondering where that 63% could go from here if I look at the next few quarters.

Deanna Strable: Well, Tracy, I'm not sure what -- where the 63% is. I actually think that's the loan to value on our '24 maturities. So the actual total office portfolio is what Pat mentioned as is 57%. And then the other thing I would make note of on the '24 maturities is even though the LTV is 63%, the debt service coverage is 3.8%, and we have a 94% occupancy. So ultimately, for those loans that are maturing in '24, we feel good that those are attractive loans that will be maturing next year.

Tracy Benguigui: Got it. We're seeing traditional life and annuity insurers borrowing a page from the playbook of alternative asset managers and they're creating these side cars in Bermuda by making an equity stake alongside consortium of investors as a way to accumulate assets and earn fee income. I'm wondering what your thoughts are given you do have large asset management capabilities.

Dan Houston: Yeah. It really came in garbled, Tracy, on your question, but I believe it's whether or not there's an offshore solution that would help in capital relief for some of our spread businesses. Deanna, do you want to frame that for us?

Deanna Strable: Yes. Tracy, good question. We always evaluate opportunities to create value for our customers and opportunities and look at what our competitors are doing relative to that. We have been exploring whether we should set up a Bermuda entity specifically focused on PRT and term. Our focus will be on new sales as we go forward. And we won't -- we aren't considering a side car arrangement relative to that. One, given the size of our portfolio, the size of our new sales, and our ability to manage that in-house relative to that. So there'll be more to come on that as we go forward, but I always want to be mindful to make sure that we are being as capital efficient as we can in creating value for our shareholders.

Dan Houston: Thank you.

Tracy Benguigui: Thank you.

Operator: Thank you. Our last questions will come from the line of Josh Shanker with Bank of America. Please proceed with your questions.

Josh Shanker: Yeah. Thank you. So the timing of the \$0.02 dividend rate also comes in concert with a \$100 million increase to the buyback expectations. It seems that you were a bit surprised by just how much cash flow you're generating. To what extent are you -- is that a number that should

generally be forecastable for you over time? And can you go through some of the history when you did the Talcott deal about how much it reduced your cash flow by and when you recover to the levels where you're going to be raising dividends again?

Dan Houston:

Yes. So it's a good question. The first thing I would say is you have to look at the last two years for Principal and know that forecasting some of these has been challenging given some of the changes that we've made. We do have a very strong capital position. We anticipated that in the post strategic review when we were doing our analysis. We wanted to use a fair amount of judgment of not having perfect clarity to what this might look like, but as we said during the strategic reviews outcome, we're committed to returning capital through both share buyback, through increased dividends and targeting our 40% payout ratio, but also investing in these organic businesses, knowing that most of those businesses deployments would be in our fee businesses. And having said that, we still look for opportunities in spread where it's appropriate. But I'll have Deanna add some additional comments.

Deanna Strable:

Yeah. Thanks, Josh, for the question. We came out of the strategic review and really committed to that 75% to 85% free cash flow ratio and we managed to make sure that we're within that. We were happy to be able to raise our dividend \$0.01 last quarter and \$0.02 this quarter. And as you're aware, that has been on pause since our strategic review as we wanted to understand the impact on our earnings level. And then, as you know, also in 2022, the markets were pretty negative. And so we needed to understand how we could get through that as well.

We did have a few one-timers in the quarter that did help our free capital flow. They netted to about \$100 million positive impact. The two most notable one is the admittance of the negative IMR, but that was partially offset by the AAR tax impact that we talked about. And so again, feel really good about the ability to increase our common stock dividend, increase our share buyback expectations, and put us on track for a \$1.3 billion of capital return to our shareholders for the full year of 2023. I

don't think what we're seeing this year is an anomaly and ultimately still stay focused on that 75% to 85% free cash flow conversion.

Josh Shanker: And if I think a lot of times people think that equity markets or equity businesses compounded a 7% to 8% annual compounding rate. If I apply that to growing your cash flow, I assume you don't think you're going to be worse than. I know things don't move in a straight line, but it's not unreasonable, I guess, to think about that in most quarters, we should see a dividend hike if things are working the way you hope they will. Is that a wrong way to think about things?

Deanna Strable: 8 Yeah. I mean, obviously, the markets can have some fluctuation on that. But I think you can even go back to prior to the transaction and look at our trend of dividend increases. And we did have a consistent pattern of increases.

The other thing I would say is we have high-growth operations in our Specialty Benefits business. We have high growth expectations in our international business. And I come back to the fact that we have -- we think we can deliver 9% to 12% EPS growth. That won't always be at that level. There'll be some years where it's slightly lower, some years where you might benefit more from macro.

But again, I come back to strong free cash flow. We are committed to being a growing company, and we are committed to returning that growth back to our shareholders. And ultimately, in pressured time because of our diversified model relative to pure asset managers, we're actually able to have consistent dividends versus a lot of volatility. So I like the pattern and the consistency. And as you say, over the long term, you're right, we should be able to increase that dividend and return to our shareholders.

Dan Houston: Thanks for the questions, Josh.

Operator: Thank you. We have reached the end of our Q&A. Mr. Houston, your closing comments, please.

Dan Houston: I apologize. It sounds like we may have a bad line here. All these questions didn't come in perfectly clear today. But just a reminder on something Humphrey had mentioned, which is we will have a combined earnings call in 2024 on February 13. It will also include the outlook at that point in time.

There's no shortage of macroeconomic and geopolitical risk out there today. It remains top of mind for us as we continue to keep our customers in line of sight, our individual employer and institutional customers. We want to continue to align our expenses with our revenues, while also investing and innovating to better meet the needs of our customers. The bottom line, I still remain very optimistic about our ability to create value for our customers and shareholders on a go-forward basis. Appreciate your time today. Thank you.

Operator: Thank you. This does conclude today's conference call. You may disconnect your lines at this time, and we thank you for your participation.

[About Principal](#)^{®1}

Principal Financial Group[®] (Nasdaq: PFG) is a global financial company with approximately 19,500 employees² passionate about improving the wealth and well-being of people and businesses. In business for more than 140 years, we're helping approximately 61 million customers² plan, insure, invest, and retire, while working to improve our planet, support the communities where we do business, and build a diverse, inclusive workforce. Principal[®] is proud to be recognized as one of the 2023 World's Most Ethical Companies³, a member of the Bloomberg Gender Equality Index, and a Top 10 "Best Places to Work in Money Management"⁴. Learn more about Principal and our commitment to sustainability, inclusion, and purpose at [principal.com](https://www.principal.com).

¹ Principal, Principal and symbol design and Principal Financial Group are trademarks and service marks of Principal Financial Services, Inc., a member of the Principal Financial Group.

² As of September 30, 2023

³ Ethisphere, 2023

⁴ Pensions & Investments, 2022