Principal Financial Group®
3Q 2021 Earnings Call Transcript

October 27, 2021
9:00 a.m. CT
Nasdaq: PFG

Call participants

Executives

Dan Houston: Chairman, President & CEO

Deanna Strable: Executive VP & CFO

Amy Friedrich: President - U.S. Insurance Solutions

Renee Schaaf: President - Retirement & Income Solutions

Pat Halter: President - Global Asset Management

John Egan: VP - Investor Relations

Analysts

Humphrey Lee: Dowling & Partners

Ryan Krueger: KBW

Josh Shanker: Bank of America

Andrew Kligerman: Credit Suisse

Tracy Benguigui: Barclays

Erik Bass: Autonomous Research

Tom Gallagher: Evercore ISI

John Barnidge: Piper Sandler

Presentation

Operator: Good morning, and welcome to the Principal Financial Group Third Quarter 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 the number one on your telephone keypad. We would ask that you be respectful of others and limit your questions to one and a follow up so that we can get to everyone in the queue. I would now like to turn the conference over to John Egan, vice president of investor relations.

John Egan: Thank you, and good morning. Welcome to Principal Financial Group's Third Quarter 2021 Conference Call. As always, materials related to today's call are available on our website at principal.com/investor. Following the reading of the safe harbor provision, CEO, Dan Houston and CFO, Deanna Strable, will deliver some prepared remarks. Then we will open up the call for questions. Others available for the Q&A session include: Renee Schaaf, Retirement Income Solutions; Pat Halter, Global Asset Management; and Amy Friedrich, US Insurance Solutions.

Some of the comments made during this conference call may contain forward-looking statements within the meaning of the Private Securities Ligation Reform Act. The company does not revise or update them to reflect new information, subsequent events or changes in strategy. 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 US 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 US GAAP financial measures may be found on our earnings release, financial supplement and slide presentation. Dan?

Daniel J. Houston: Thanks, John, and welcome to everyone on the call. This morning, I will discuss the progress we are making towards our strategic and financial targets and the key performance highlights for the third quarter. Deanna will follow with additional details of our third quarter results as well as our current capital and financial position.

Last week, Principal celebrated 20 years as a public company. Our evolution from a mutual insurance company to a global financial services provider has been remarkable. Since our IPO in 2001, we've increased our AUM by more than 8 times from $120 billion to nearly $1 trillion, and the number of customers we serve is increased nearly 4 times from 13 million to 49 million today. Over the last two decades, we have weathered through a global financial crisis, volatile financial markets and geopolitical conditions and the complexity of a global pandemic. We've deliberately evolved our portfolio, product offering and go-to-market approach to grow the business and meet the changing needs of our customers.

At the same time, we've stepped up and worked to act in a way that benefits society and the planet, guided by a robust ESG strategy that's focused on reducing our carbon footprint, strengthening our

communities and advancing access to financial security for more people and businesses.

At our Investor Day in June, we shared how our long-term strategy puts the customer at the center of what we do and leans into our competitive advantages, which are differentiated and integrated solutions, our leadership position in higher growth markets and our deep and established customer reach.

We emphasized how our focus on a higher growth, more capital-efficient enterprise through our growth drivers, Retirement in the US and select emerging markets, Global Asset Management and US Benefits and Protection positions us to win, grow and create shareholder value today and long into the future.

As shown on Slide 4, we are committed to achieving near-term financial targets. Excluding significant variances, we've delivered a 12% increase in earnings per share on a trailing 12-month basis, the high end of our 9% to 12% target range. And at nearly 14%, we're making great progress towards reaching our targeted 15% return on equity.

We're executing on our strengthened capital management strategy and on our way to return $3 billion of excess capital to shareholders by the end of 2022. With our prior announcement to exit the US retail fixed annuity business and the retail segment of our US life insurance business, we've ceased sales as of the end of the third quarter.

We're actively engaged in conversations with the counterparties of transactions for the US retail fixed annuity and universal life with

secondary guarantee blocks and are confident we'll have more to share in the coming months.

At our US individual life Insurance business, our focus is now solely on business market through business owner executive solutions and nonqualified deferred compensation offerings. In fact, IBIS and Associates recently ranked Principal the top life insurance provider in small case business market in terms of both premium and case count, underscoring the strength of our go-forward strategy. With this intense focus on executing on our strategy and serving our customers, we're already beginning to see benefits in the third quarter.

Turning to Slide 5, we reported $458 million of non-GAAP operating earnings in the third quarter. Excluding significant variances, earnings increased 7% over the third quarter of 2020, driven by growth in the business and improvement in the macroeconomic conditions, including a robust US labor market across many of our businesses.

We closed the third quarter with a total AUM of $981 billion, including $688 billion of AUM managed by Principal. Total AUM increased 34% compared to the third quarter of 2020, reflecting $17 billion of net cash flow over the trailing 12 months, strong investment performance and the migration of institutional retirement and trust retirement assets.

Total company net cash flow was a positive $4.6 billion in the third quarter, more than double the prior year quarter with positive net cash flow across all of our business units.

Third quarter results are a testament to our focus on delivering outcomes for our customers through our integrated solution and differentiated capabilities.

In Global Asset Management, third quarter PGI-managed net cash flow was a positive $2.2 billion with positive net cash flow across institutional mutual fund platforms and general account. PGI generated record-managed AUM of $535 billion and record-sourced AUM of $265 billion in the quarter.

As shown on Slide 6, we continue to deliver strong long-term investment performance as 69% of the principal mutual funds, ETFs, separate accounts and collective investment trust were above median for the 3-year period, 72% for the 5-year and 86% for the 10-year. For our Morningstar-rated funds, 73% of fund-level AUM had a 4- or 5-star rating. Longer-term performance continues to position us well to attract and retain assets.

Our flagship real estate products and yield-oriented products, including preferred securities, high yield and private assets continues to be in demand. We are expanding our direct lending capabilities and looking for opportunities to deliver ESG capabilities across a variety of product categories and investment vehicles to meet evolving client demands.

A US Retirement and Principal Super Saver study shows that despite market volatility during the pandemic, over half of these retirement participants said they have saved more in their retirement plans over the last 18 months and only 3% said they save less.

These trends are contributing to the 67% growth in recurring deposits and RIS-Fee compared to third quarter of 2020. This reflects a 20% increase in recurring deposits on our legacy block, deposits from the migrated IRT retirement participants as well as the strong increase in employer matches. Combined with strong transfer deposits and record contract retention, RIS-Fee reported positive net cash flow of approximately $1 billion in the third quarter.

Additionally, we had $2.2 billion of RIS-Spread sales in the third quarter, including $1.4 billion of MTN and GIC issuances and nearly $500 million of pension risk transfer sales. These strong sales generated more than $800 million of positive net cash flow.

Outside of the US, Principal International reported $400 million of net cash flow and $156 billion of AUM in the third quarter, a 5% increase in AUM on a constant currency basis compared to a year ago.

Despite negative cash flow in Brazil during the quarter, we continue to see growth and our multimercado funds, now which account for almost 30% of AUM in BrazilPrev. With 53 billion Brazilian Real, net cash flow year-to-date, we've captured 69% of the market through these value-added solutions for our customers that are higher revenue diversified funds.

China AUM, which is not included in the reported AUM, was $158 billion in the third quarter benefiting from positive net cash flow across all asset classes, we continue to see growth in equity net cash flow and AUM as retail investors look for higher value add products.

In US Benefits and Protection, we're seeing increased demand for benefits, robust hiring and favorable wage trends. Notably, group

benefits trailing 12-month in-group growth was a record 2.7% for the total block and nearly 5% in businesses with under 200 employees.

Turning to Slide 7. We continue to make progress on our ESG efforts. We issued our first sustainability bond during the quarter. The bond's $600 million proceeds will be used to support green and social initiatives that reinforce our ESG commitments. We also launched a municipal bond impact strategy during the quarter, our first in the US, which is primarily offered to high net worth clients as a separately managed account.

We're focused on developing new ESG products and strategies while enhancing existing products to meet the growing client demand for these products around the world. We're very optimistic about the opportunities that lie ahead as momentum continues to build in many of our businesses. We are evolving our portfolio to bring greater focus to our growth drivers and create greater value for our shareholders.

I'll now turn it over to Deanna, who will go further into how this translates and to our results. Deanna?

Deanna D. Strable: Thanks, Dan. Good morning to everyone on the call. This morning, I'll share the key contributors to our financial performance for the quarter as well as an update on our current financial and capital position.

Net income attributable to Principal was $360 million in the third quarter, including $99 million of net realized capital losses with $6 million of credit losses.

We reported $458 million of non-GAAP operating earnings in the third quarter or $1.69 per diluted share. Excluding significant variances, non-GAAP operating earnings of $444 million or $1.64 per diluted share increased 7% and 9% respectively compared to the third quarter of 2020.

Since the end of 2020, we've increased ROE 300 basis points to nearly 14% and through growth in earnings and higher levels of capital deployment. We're on track to reach our targeted 15% ROE by year-end 2023 as we deploy capital in a more purposeful manner to higher-return businesses, return excess capital to shareholders and grow earnings.

The reported non-GAAP operating earnings effective tax rate was 19.4% for the third quarter, slightly above our guided range of 16% to 19%, primarily due to higher taxes resulting from our international businesses. We expect the full year tax rate to be within the guided range.

As shown on Slide 8, we had a number of significant variances during the third quarter, a benefit from very favorable variable investment income was partially offset by a net unfavorable impact from the actuarial assumption review, COVID-related claims, IRT integration costs and lower-than-expected encaje performance in Latin America. These had a net positive impact to reported non-GAAP operating earnings of $18 million pre-tax, $14 million after tax and $0.05 per diluted share.

Variable investment income was $91 million pre-tax higher than expected in the third quarter, primarily driven by very favorable alternative investment returns and prepayment fees.

The net negative $33 million pre-tax impact from the annual assumption review was primarily driven by updates to experience and economic assumptions. Unfavorable impacts as a result of updating variable annuity lapse rate assumptions were partially offset by a favorable impact in individual life, primarily due to interest rates. While we didn't change our long-term interest rate assumptions, the starting point is approximately 40 basis points higher than where we expected rates to be a year ago.

In the third quarter, COVID impacted RIS-Spread and US Insurance Solutions with approximately 90,000 US COVID-related deaths in the quarter, the net $20 million after-tax impact was higher than our rule of thumb, primarily due to elevated group life claims in Specialty Benefits. While our COVID impacts have been volatile quarter-to-quarter, the cumulative impact since the start of the pandemic is tracking right in line with our overall rule of thumb.

Looking at macroeconomic factors in the third quarter, the S&P 500 index was flat and the daily average increased 6% compared to the second quarter. The daily average also increased 34% from the year ago quarter, benefiting revenue, AUM and account values in RIS-Fee and PGI.

Foreign exchange rates were a slight headwind compared to the second quarter, but a tailwind on a trailing 12-month basis. Impacts to reported pre-tax operating earnings included a negative $2 million compared to second quarter 2021, a positive $4 million compared to third quarter 2020 and a positive $6 million on a trailing 12-month basis.

Turning to the business units, my following comments exclude the impacts of significant variances. As a reminder, we took action in 2020 to reduce expenses due to uncertainties from the pandemic. Some of the expenses were naturally lower like travel, sales-related expenses and bonus accruals, and we intentionally reduced other expenses, including hiring, salary cost, third-party spend as well as marketing and advertising. As revenues have increased over the past year, some of these expenses have increased as well, impacting comparability of results year-over-year.

RIS-Fee pre-tax operating earnings were flat with the year ago quarter. Growth in net revenue was offset by higher expenses, including variable compensation and DAC amortization.

While we've been reporting the IRT revenue in our results since the transaction closed, the associated account value didn't fully migrate until last quarter and thus is now fully reflected in average account value. As a result, our average annualized fee rate declined approximately 25 basis points from a year ago, and we expect annual fee compression to be between 2 to 3 basis points in 2022. Our revenue mix also is now less equity market sensitive as the IRT block included more transaction-based and participant-based fees.

As a reminder, the IRT Trust and Custody business will migrate in the first quarter of 2022, later than what was assumed in our 2021 outlook. As a result, we will continue to have some TSA and integration costs as well as delayed synergies pressuring full year 2021 earnings and margins. We now expect that the full year margin to be at the lower end of our 23% to 27% guided range. Expense synergies have already started emerging, and we are confident that we'll achieve our targeted $90 million in 2023.

PGI benefited from strong management fees, performance fees and continued disciplined expense management in the third quarter, boosting growth in revenue and earnings and producing a 45% margin. Pretax operating earnings and margin benefited from a net $9 million from performance fees in the quarter.

Looking ahead to the fourth quarter, we anticipate another quarter of favorable impacts from variable investment income and PGI performance fees. I also want to remind you that our enterprise fourth quarter compensation and other expenses are typically higher than other quarters due to seasonality of certain expenses like marketing and IT. We expect the impact of seasonality will be lower this fourth quarter than our typical 7% to 10%.

Turning to capital and liquidity on Slide 9, we are focused on returning excess capital to shareholders and plan to grade down to our targeted capital levels by year-end 2022. At the end of the third quarter, we had $2.5 billion of excess and available capital, including $1.8 billion at the holding company, $1 billion higher than our target of $800 million to cover the next 12 months of obligations, $190 million in excess of our targeted 400% risk-based capital ratio estimated to be 412% and nearly $500 million of available cash in our subsidiaries. We will continue to maintain a 20% to 25% leverage ratio and expect to pay down $300 million of long-term debt when it matures in late 2022.

As shown on Slide 10, we deployed $371 million of capital during the third quarter, including $203 million of share repurchases and $168 million to common stock dividends. Since the beginning of the year, we've returned over $1 billion of capital to shareholders.

We remain committed to returning $3 billion by the end of 2022, including $1.4 billion to $1.8 billion of share repurchases and $1.3 billion to $1.4 billion in common stock dividends. This excludes any impacts of potential transactions.

Last night, we announced a $0.64 common stock dividend payable in the fourth quarter, a $0.01 or 2% increase from the dividend paid in the third quarter. Our dividend yield is approximately 4% and we're on track to achieve our targeted 40% dividend payout ratio for the full year.

Through our refined focus and strengthened capital deployment strategy, we will invest in areas where Principal has established competitive advantages and the ability to meet targeted returns. We have a clear path to becoming a high-growth, more capital-efficient company creating long-term value for shareholders. We are excited about the path forward, focusing on our growth areas with established differentiators, allowing for improved focus, returns and risk profile. This concludes our prepared remarks.

Operator, please open the call for questions.

Operator: At this time, I would like to remind everyone that to ask a question press star and the number one on your telephone keypad. Again, ladies and gentlemen that is star one for any questions. We'll pause for just a moment to compile the Q&A roster.

And the first question will come from Humphrey Lee with Dowling & Partners. Please go ahead.

Humphrey Lee: Good morning and thank you for taking my first question.

My first question is about your capital deployment. You reiterated the plan to return $3 billion to shareholders in 2021 and 2022, but given the excess capital and RBC you intend to draw down and the expected free cash flow generation between now and the end of next year, there seems to be substantial flexibility at your disposal. Like how should we think about the capital deployment as you right size the excess capital?

Daniel J. Houston: Yes. Good morning, Humphrey and appreciate your question. I think the best way to look at it is, we went through a very rigorous process with the finance committee of the Board of Directors when we were leading up to the strategic review. And what you see today is this $3 billion of targeted capital deployment through dividend and share buyback, we also want to be mindful of potential ways to grow the business organically as well through acquisition, which is why you see that debt-to-equity ratio where it's at today.

But the bottom line is we have a lot of financial flexibility as we move and push our way through '22 and into '23 and my guess is here when we're updating you in January on our outlook for next year, we'll be refreshing that. But with that, let me throw it to Deanna if she wants to add additional comments.

Deanna D. Strable: Yes, a couple of things there. I think you got to the right bottom line is that we have a lot of flexibility. In addition to buybacks, we remain committed to a 40% payout on our dividend ratio and have continued to prioritize that as we think about capital deployment. And we have announced that we will use $300 million of that excess capital to pay

down our debt that matures in the third quarter of '22. And so again, as we move through the next few quarters and into outlook, we'll continue to refine those numbers, but again we are very much committed and on the path of getting down to our targeted levels of capital at both the Lifeco and the Holdco by the end of '22.

Daniel J. Houston: Do you have a follow-up, Humphrey?

Humphrey Lee: Yes. My second question is about the pension business in Chile. There have been many headlines on the proposed fourth withdrawal and the potential overhaul the system proposed by one of the presidential candidates. Can you just talk about the kind of overall dynamic? And in a worst-case scenario, what would be the impacts on Principal?

Daniel J. Houston: Yes. So, it's a great question. And if you'll allow me, I'm going to probably be a little elongated in terms of trying to provide a comprehensive response because I think it's a really important question. It's one that we've touched on here before.

Just as a reminder, in Chile, this is a 40-year-old pension scheme that has actually worked quite well. It's a compulsory model. The Chileans led the world around building this out after the PayGo system was shut down. Its biggest gap was not recognizing and having too low of a cap on wages, the actual percentage of payroll in the compulsory plan was working well up to roughly $40,000 or so in annual income.

So the AFP model, which was a public private sector scheme, it works. It has potential. It was complemented with a voluntary scheme that was added in addition to that to help people achieve that goal. As I said, it was voluntary, not compulsory, and so there's relatively low

participation. Well, then comes along a pandemic and the government in addition to other ways of trying to provide solutions for COVID relief allow for AFP withdrawals of roughly 10%. And as you know, those were treated on a very favorable tax basis.

There have been now three approved AFP withdrawals and one annuity withdrawal, and they're now contemplating a fourth AFP withdrawal and a second annuity withdrawal. Although it's being heavily debated, literally as we speak. They're contemplating alternatives to these two structured, and we don't know what the outcome is going to be, but we also know that we're looking down the road here at a presidential election, which will certainly have some impact on the timing and the magnitude of this change.

So now the question might be directly over to your question to answer, is we have been working extremely collaboratively with the government officials to try to educate key decision-makers on ways to improve and stabilize the existing AFP model. You did or you may have read that Principal did invoke our rights as an investor requesting consultation with the Chilean government and again, we look forward to those continued conversations. We have a good working relationship. We obviously, along with the rest of the industry, want an amicable solution and protecting the retirement interest of all the Chileans. That is a huge priority for us.

There is a proposed pension modification that would enhance the basic pension or the solidarity model, we support that. We're squarely behind it. If you think about pairing that along with an enhanced employer-based system and removing that cap, you can see how that could be quite additive to financial security.

And then lastly, there is a working session with the congressional folks that will be occurring in the first quarter of 2022, and we'll be working hard to try to promote the idea of a sustainable multi-pillar retirement system.

So Chile, by very definition, is an emerging market. They've had a good track record of good pension policy. Principal has a good working relationship with key decision makers. Roberto Walker and his team have just done a magnificent job down there. So, we remain quite hopeful that there is a solution that allows us to still benefit from being a market participant.

We have not tried to quantify at this point in time what the financial ramifications are. To date, you'll notice they have not been necessarily significant, and that has, in large part, with the way in which fees are collected. So probably more than you want to know, but I know that this has been top of mind for a lot of our institutional investors as we've been visiting with them. So hopefully, that helps, Humphrey.

Humphrey Lee: Done. Thank you for the color.

Operator: The next question is from Ryan Krueger with KBW. Please go ahead.

Ryan Krueger: Hey, thanks. Good morning. If I could just ask one quick follow-up on Chile, how big is -- I know that you don't -- your earnings are not affected by excess AFP withdrawals, but how big is the annuity business in Chile for you at this point?

Daniel J. Houston: Deanna, do you want to quantify for that, quantify that? And then also it's -- yes, I know we'll find it here in the supplementary, the size of the

annuity. The other point worth mentioning on the pension scheme, we do have a higher average balance for annuitants. And as you know, we have actually gained the number of participants in the AFP in large part because of the system that we put in place that allowed us to have payouts that occurred literally in a more expedited manner in a digital way, which again has allowed us and endeared us. That gives us more opportunity to expand on those relationships with those participants. Deanna, do you have a number there on the annuity piece?

Deanna D. Strable: Yes. A couple of comments here. I don't have the exact answer. We can get back to you, Ryan. But if you look on Page 20 of the supplement, you'll see that our total AUM in Chile is around $41 billion, and the Chile Cuprum AFP fund balances is a $34 billion. The remainder of that would be our voluntary mutual fund as well as our annuity. So, it would be some portion of that difference there.

The other thing, to expand upon Dan's comments on the fact that our customer base has been less impacted. Obviously, having the Chilean people have money in their AFP is critical for the long-term viability of a strong pension system, our customer base has been less impacted partially due to the composition and partially due to some of the digital outreach that we've done to our customers. So just to put that into perspective, as of the end of second quarter, industrywide, 20% of AFP participants had a 0 balance in their fund. And for Cuprum, it was only 4%. And the next closest competitor was at 13%. And so again, we are focused on, obviously, the long-term financial security of the customer and I think that's a testament and a proof point relative to that.

Daniel J. Houston: Thanks, Deanna. Ryan, do you have a follow-up?

Ryan Krueger: Yes. On RIS-Fee, I guess, can you give us any sense of how much cost saves have been achieved to date relative to the $90 million target? And then once the trust and custody migration occurs, would you expect the remaining cost saves to be achieved fairly quickly?

Daniel J. Houston: Yes. I'll throw that to Renee pretty quickly. I just -- I'd be remiss if I didn't go on the record just there. Whenever you're going to acquire 10 years of organic growth, you're going to have some challenges. And it was a big milestone this past quarter to have successfully migrated over this block business all hats off to Renee and her team for doing that and we frankly feel very good about the revenue and expense synergies, but I'll have Renee add the appropriate detail. Renee?

Renee Schaaf: Ryan, thank you for that question. We are on track to achieve the $90 million net expense synergies by the end of 2023. And so far, we have recognized about 25% of that, but you have to understand that is on an annual run rate basis. So, in any one quarter, you'll see about -- we've achieved about $5 million of the savings so far. In terms of the pattern for how we think this might emerge, certainly, once the trust and custody business has been fully integrated and it is on board, that will allow us to begin to sunset the duplicate recordkeeping system on the Wells Fargo side. It allows us to reduce some of the duplicate headcount. But then longer term, the synergy gains will continue to emerge as we automate processes, and we continue to streamline the customer experience. So, you can expect to see that the expense synergies will emerge relatively smoothly from now to the end of 2023.

Daniel J. Houston: Thanks for that. Hopefully that helps, Ryan.

Ryan Krueger: Thank you. That's very helpful.

Operator: The next question will come from Josh Shanker with Bank of America. Please go ahead.

Josh Shanker: Yes. Sorry to go to South America again, but I'm wondering if we can talk a little about Brazilian inflation. John, helped me out a little bit earlier, but still need some help on the two indicators of inflation, whether they're converging or not? Whether they're -- I think that they're not diverging further. Can you go into some details on how it impacts your outlook?

Daniel J. Houston: Absolutely. There's two things in addition to the inflation that have been helpful here. And that is, in the current quarter, they stayed on top of one another. We didn't see divergent, which was quite helpful. The other thing that occurred is we actually saw the interest rates move up roughly 2% from the year ago quarters from roughly 4.25% to 6.25%. So, these are modest improvements going back to higher interest rates and, of course, inflation coming in line without that separation. Deanna, any additional detail on the two indices for inflation?

Deanna D. Strable: Yes. I'll just make a few comments. And if we need to go offline after the call, we can go further Josh. But yes, in the third quarter, as we had anticipated, they did converge and come back on top of each other. So again, much more of what we have seen kind of pre the current cycle when we did see those two indices separate. So, our outlook would continue to expect that convergence but you could have some periods

where there is a little bit of a difference, but we do expect that to be more modest than what we've experienced over the last 12 months. So again, we can follow up in more detail, but that would tell you what we saw here in the third quarter and what we anticipate going forward.

Daniel J. Houston: And ironically enough, in spite of the interest rate movement, which is favorable in inflation, we're still the market share leader when it comes to deposits for PGBL as well as GBBL for the industry, roughly 30% of the flow. So strong operating results here masked by some macro events. Did you have a follow-up, Josh?

Josh Shanker: Yes. So, if I just extend that chart you included in the 2Q '21 presentation out one quarter, has the gap narrowed? Or has it just held the guess held persistent but not gotten worse?

Deanna D. Strable: No. Again, we will extend that out, but they were right on top of each other for the third quarter.

Daniel J. Houston: Didn't get worse or better.

Josh Shanker: Okay. Okay. And then on -- look, your long term, the rating of your fund performance is excellent, but it did deteriorate a little bit in 3Q, I'm just wondering that if we could talk about which strategies and whether or not its a bias on how Principal invests or whether or not, it will revert and what you think about the other third quarter performance?

Daniel J. Houston: My guess is that there is a bias on everything we do in terms of how we invest in short-term and long-term performance. Pat?

Pat Halter: Yeah Josh, thanks for that question, just in terms of the performance on the one year, I think it's really a specific question, we have a few strategies predominantly in our international suite that have kept us a little bit below the second quarter to third quarter.

One is our diversified international continues to be this benchmark but from a performance perspective relative to peers, a little bit behind in that performance long-term very, very strong performance, don't see any concerns with the process or with the approach that we continue taking with respect to that.

The other two internationals with investment capabilities are little bit sort of a in the third quartile category or international small cap and Origin. Again, a little bit of a preference in terms of what investors are looking for and with international small cap, we have a very strong quality bias, strong fundamental bias, and really I think there has been a little bit of risk on in a way from strong fundamentals and quality bias right now in that category and then relative to Origin again harder to keep up again quality bias rated sort of lower quality name seem to be winning the day there.

So, a process or approach or philosophy continues to stay intact, long-term numbers are very good for those two investment capabilities also and then just a run down on US equities, our US equities continue to do very well third quarter in terms of first and second quartile. 67% of those funds were still in the first or second quartile, so still feel pretty good about our equity suite, feel good about our international suite, Josh.

And frankly as you highlighted, long-term performances driving really our flows and that's what investors are really looking at when they are

making decisions to retain their activity with us or to grow their activity with us and the 4- and 5-star Morningstar ratings that we are receiving in really the areas that will continue to prove significant net cash flow growth whether it's our go-to's like Aligned or small cap US or capabilities in earning from suites like preferreds, munis, emerging market debt, high-yield REITs, all continue to be in 4- and 5-star Morningstar categories and all continue to see positive net cash flow in the third quarter.

So, feel good about the depth, breadth of our investment capabilities relative to what we're seeing in terms of investor interest and we're actually, I think, very aligned with investor interests. They are still looking for yield. They're still looking for noncorrelated asset experience and exposure. I think our suite of investment capabilities offer a solution set for that. I also think they're looking for inflation protection. So real estate today is offering a nice sort of a fit to that capability and desire and they're looking for a global exposure.

And I think we have, I think, some long-term investment capabilities that are well suited for that need. So, feel good about our capabilities, our suite, the 1-year numbers aren't really concerning me at this point in time. And I think we're starting to see, I think, strong interest in the continuation of our builds also in new things like listed infrastructure. So, all good on that front.

Josh Shanker: Appreciated.

Dan Houston: Yep, very good.

Operator: The next question is from Andrew Kligerman with Credit Suisse. Please go ahead.

Andrew Kligerman: Hey, good morning. A few follow-up questions on some of the earlier questions. With regard to capital management, my understanding from the June Investor Day is that free cash flow from the subsidiaries to the parent would be about $1.8 billion to $2 billion over the '21 through 2022 timeframe. That figure represents roughly 50% to 55% of earnings, but the company principal target 70% to 80% capital return to the parent company. So, as I think about that figure in particular and I know Dan and Deanna, you both talked a little bit about flexibility earlier, I just want to zero in on that number because it's probably north of $0.5 billion shy of that 70% to 80% range. And hence, is it possible then given that flexibility that there's room for at least another $0.5 billion on the buyback?

Daniel J. Houston: Deanna, do you want to go head take that?

Deanna D. Strable: Yes. Thanks, Andrew, for the question. So obviously, there's a lot of components that go into free cash flow, and they can be volatile by any one period. But over the long term, we do feel post transaction, we can be in that 70% to 80% range and we're continuing to work across our businesses to make sure that we stay and remain in that range. So again, relative to the particular time frame, we're not saying every time frame will be in that range. There could be some volatility around that. But I think as you've done the math, there could be some upside for that numbers we think through the next couple of years.

Andrew Kligerman: Excellent. And then just following up on the Chilean question. Could you -- I think it's -- I think AFP is around 4% of earnings. Could you

clarify if I'm right on that? And then with respect to the capital in that business, if you ever did decide to exit, how much capital is sitting there? And could that be extracted, if you made that decision, not that you would?

Daniel J. Houston: Well, yes, I mean there's a lot of speculation in there. I think the earnings are approximately -- yes, 6%, in that range. And we'll get back to you on the capital that's currently deployed and sorted out the difference between Cuprum and the balance of that business. As you know, we also have an annuity business there in Chile, but that's a good item for follow-up, Andrew.

Andrew Kligerman: Okay. And the 6% is all in, meaning it includes annuity and mutual fund as they -- retention?

Daniel J. Houston: It is everything. it's our entire Chilean -- yes it is. Yes.

Operator: The next question is from Tracy Benguigui with Barclays. Please go ahead.

Tracy Benguigui: Thank you. I'm curious if you have any updated views on COVID fatality. As we saw another life insurer forecasting COVID deaths of 75,000 to 125,000 in 4Q and 150,000 next year with the bulk of the first half of the year. Just trying to think about what your updated forecast maybe just given elevated activity in the third quarter?

Daniel J. Houston: Yes. And that's certainly the Delta variant gives us all something to think about as we look at our modeling and our original projections. Deanna, further thoughts?

Deanna D. Strable: Yes. I mean, obviously, we can only go by what other governments and other agencies are forecasting. And so, we would be pretty close to what you see there. Our current forecast would have 90,000 in the fourth quarter and around 150,000 in '22. But obviously, that's going to be very impacted by the different variants as well as vaccination rates. And so, I think I wouldn't lock those in and we'll continue to update those as we go into outlook.

We did see a heightened number of deaths in the third quarter in our block more heavily weighted toward the younger ages. We still think our rule of thumb is appropriate, but we could skew a little bit higher over the next few quarters if it continues to be more heavily dominated in the younger ages just because of our composition of business. But since the start of the pandemic, our rule of thumb is right on. There's volatility by quarter. We'll still continue to see that. But that outlines what our current thought process is on fourth quarter in 2022.

Daniel J. Houston: Any follow-up, Tracy.

Tracy Benguigui: Yes. Thank you and turning to block deal plans, it's good to hear that you'll be able to brief us in the coming months. But I'm wondering if you could discuss the process, where are you spending most of your time in these conversations that get into the bid-ask spread?

Daniel J. Houston: I'm sorry, Tracy, you broke up at the beginning part of your question. Could you ask that again?

Tracy Benguigui: Sure. I mean you kind of alluded that in the next coming months, you're going to be able to brief us on your block deal plans with your

retail FA and ULSG blocks and I'm just wondering in the meantime, in those -- in that process, if you could just shed some light where you're spending most of your time in these conversations that ultimately get into the bid-ask spread?

Daniel J. Houston: Yeah, happy to try to respond to that in the best way that I can. But first, recognize that, as you point out, we made the decision to divest the retail annuity business as well as ULSG. There's better owners for those businesses.

The first thing I'd say is there's been very strong interest in the assets, absolutely strong interest and so I think our window was actually quite good for the first round of bids. The starting of the second round of bids has now begun and undoubtedly there's more refinements that will take place. And as you asked the question, our conversations, our conversation through ourselves and the advisors very healthy. These are pretty straightforward blocks of business. So, I don't think there's a lot of confusion. We're very confident in our ability to execute on the transactions. And as we've said, we'll look for opportunities to be increasingly capital-efficient in creating long-term shareholder value as we contemplate the proceeds.

But it's right on track with where we thought it would be. There's strong interest in the assets. We're expediting it. We're certainly moving it through the process at an appropriate pace while at the same time, creating long-term shareholder value. And so, as anything changes, and I'm sure the next update with investors, we'll be able to give you more clarity on the outcome of that. Hopefully, that helps, Tracy.

Tracy Benguigui: Ok. Thank you.

Operator: The next question will come from Erik Bass with Autonomous Research. Please go ahead.

Erik Bass: Hi. Thank you. On an adjusted basis, RIS-Fee earnings were roughly flat 3Q '21 versus 3Q '20, which I guess I found somewhat surprising given the tailwind from positive markets, positive flows and then some of the emerging synergies. I was just hoping you could give a little bit more color on the drivers there and then talk about kind of the expected earnings power of the business heading into 2022.

Daniel J. Houston: Yes, sure, good morning and it's a great question. And the backdrop of all this which I find really interesting is we've got record retention, lowest lapses that we can think of. There's higher deferrals, there's higher retention, there's employer matches returning. We've expanded into the larger case market and in spite of all of those strong fundamentals of the business, including TRS really being the mainstay of our value proposition to customers, it doesn't necessarily get reflected in operating earnings growth and the revenue growth. And so really, Renee is in the best position to provide you some additional insights on that, Renee?

Renee Schaaf: Yes. Thank you for that question, Erik. And you're absolutely right. The -- when you look at third quarter '21 earnings compared to one quarter a year ago, the earnings were flat. And let me walk through the components of that and then share some additional insight with you about how to view this business going forward.

First off, as you noted, we did see nice tailwinds from the equity markets over the past year. But those tailwinds were offset first by and notably by the IRT shock lapse, which was right in line with where we had expected. So, shock lapses on a revenue basis came in right where we had anticipated with our acquisition model. We also saw very normal fee compression during the same time period. And as Deanna noted in her comments, we did see increase in comp and other expenses as we return to a more normal work environment.

The other comment that I'll make is that we did have a onetime revenue true-up in third quarter '21. And so when you compare revenues from second quarter '21 to third quarter '21, it created about a $7 million reduction. And again, this is a onetime revenue adjustment.

So now, let me turn my comments towards how we think about the fee business. So one of the comments that Deanna made was that if you look at our revenue as a basis point applied against account values, we see about a 25 basis point drop one year -- from a quarter one year ago. So in third quarter 2020, if you look at that fee expressed as account values, it was about 63 basis points. Third quarter of this year, that fell to about 38 to 39 basis points.

The primary driver behind that decrease is that we are combining an IRT block of business that is characterized by large plant sizes with our legacy block of business that is more characterized in that small and medium size. And so large plans typically have a lower price point when you look at it on a basis point method. So logically, when we blend those two together, the fee rate declined. And this was completely in line with our expectations when we acquired the business and as we see the business begin to unfold.

We also saw normal fee compression in that time period, again, in line with our expectations. So moving forward, we think that, that 38, 39 basis point revenue -- fee revenue run rate is a good place to start with your modeling.

Then, as Deanna also noted, we would expect to see about a 2 to 3 basis point headwind applied against that or normal fee compression. So that's how to think about the revenue. Let's turn our attention to the margin. So as noted, we are deferring the trust and custody integration and we're doing that in keeping with our core value of keeping the customer at the center of everything that we do. And by deferring the integration, we're able to provide a much more smooth experience for our customers as they migrate onto our platform.

So, what this means then is that the TSA and the integration expenses will continue through first quarter 2022. When we look at full year 2020 margin, we do believe that we will be in that 23% to 27% range that we communicated to you at the 2021 guidance, but at the low end of the range for the entire year.

I think in closing, the thing that it's so important to see I think from our perspective is that the IRT acquisition did exactly what we wanted it to do. It increased our scale, it increased our capabilities, particularly in the large plan market, and it created momentum for us across all plan sizes as we strengthened our position as a top-tier retirement provider. And I think the underlying strong fundamentals of this business reinforce that, strong sales, strong client retention, strong recurring deposits all speak to the strength of the underlying model. And we're very, very pleased with what we see in terms of the strength of the business itself. So, I'm hoping that helps, Erik.

Erik Bass: Yes. Thank you very much. It's helpful. I appreciate all the detail. And then for my follow-up, just sorry to go back to Chile one more time, but I guess just with the election looming at the end of November, just wondering how much power does a new President have to make changes in the AFP system? And if there were changes put in, how does that mechanically happen?

Daniel J. Houston: It still requires a congressional approval. So, there isn't -- I don't believe -- and maybe the nomenclature is wrong here, an executive order that would give them the power to just simply modify it. So, it does require -- it goes through the Senate and the House for the approval process. So I think there's a lot of debate.

Now, all of -- in every country, people have their proclivities with regards to how things like this are vocalized by a President in terms of their advocacy. But I think there is a realization at least that's what we're hearing locally that this system isn't completely broken and that it's been undermined by these withdrawals and that at this point in time, they need to be mindful of what steps can be taken to reinforce and enhance and improve on the existing AFP system. And I think that the voters out there are realizing that as well. So hopefully, that helps.

One additional comment, Erik, to your the back and forth, with Renee there, I want to weigh in on. So, what on that to me would be it's why we have increased scale to drive down our cost per participant, which we've done that. We're leveraging our technology. We're pulling all those other levers around asset retention and proprietary asset management in those roll-ins and rollovers. And as you very well know, a lot of those economics are not necessarily captured within

that RIS-Fee line. They're captured within PGI and other parts of RIS. So just again -- and we probably need to continue to work on refining how we demonstrate the value of that platform. But there's no question in my mind, the long-term value creation of the RIS-Fee platform is really significant. Hopefully, those answers help.

Erik Bass: Yes. Thank you. Appreciate it.

Operator: The next question is from Tom Gallagher with Evercore ISI. Please go ahead.

Tom Gallagher: Hi. Just a follow-up, Renee, to the point you made on the $7 million revenue adjustment in RIS-Fee. Should we be adding that back to normalize the run rate? I think, Deanna, you showed a normalized run rate for that segment of $123 million. When we think about the go forward, should we add back $7 million for that onetime revenue adjustment? Or is that already factored into the $123 million?

Renee Schaaf: Tom, that's already been factored in, in terms of -- may go a little bit deeper. So the actual revenue true-up was $3.5 million, which created a $7 million swing from second quarter to third quarter. So when we think about that run rate revenue, that $3.5 million adjustment is already reflected in -- would be reflected in what we see going forward. Does that makes sense?

Deanna D. Strable: But we did not adjust the significant variances for that. So the ex significant variance earnings would be pressured by that $3.5 million.

Daniel J. Houston: That makes sense, Tom?

Tom Gallagher: So I guess, is the punch on the $123 million is a good baseline to assume going forward to build off of?

Renee Schaaf: Tom, I think I would go back to using the revenue run rate that we described, the basis points that we described, and then thinking about the margins for full year '21 being at the low end of the range and using that as a guide for determining how 2021 will unfold. And then longer term, we communicated guidance in the Investor Day that looked at where we anticipate earnings and revenue growth at the end of '23. Those guidances remain intact. And then what we'll do in 2022 is give you further guidance on how to do 2022.

Tom Gallagher: Okay. That's fair enough. And just my follow-up is, Dan, just can you give any more color, I think the last comments you made on what you were thinking about for risk transfer is you were going to package-fixed annuities and life insurance together. Is that still the case? Or has that evolved at all where you might consider separating them? And are you -- on the life insurance side, is it still ULSG only? Or are you open to doing something broader?

Daniel J. Houston: Yes. What we've said and what we've -- what is currently out there being contemplated by potential buyers is our retail-fixed annuity and our ULSG block. Again, the balance of the life business, as we think about it's important strategically to the company, still very much remains intact, which is something we talked about in the strategic review. There's other potential things we could do within the closed block of the life insurance business, which would be separate and apart from the current transactions in which we're obtaining bids on for today.

As it relates to structure, we said our ideal outcome would be if they were combined; however, having said that, we know that the second round bidders, there are combinations of stand-alone and combined. And again, the objective here is to maximize shareholder value for, obviously, our investors. So let me throw it over to Deanna and see if she wants to add to that.

Deanna D. Strable: Yes. Just a clarification. We're marketing them together. The actual structure that we transact will depend on what we think is the best for our customers and our shareholders. And so we're entertaining different combinations of those, but we're marketing them at the same time because we do know that some of these interested parties may think of them differently as they contemplate them together versus separately. So we're laser-focused on executing on those blocks that we have told you about. But obviously, we'll constantly evaluate if there's other options that would make us provide shareholder value and positively impact our capital and returns.

Daniel J. Houston: Did that help, Tom?

Tom Gallagher: That does. Thank you.

Daniel J. Houston: Thanks for the question.

Operator: The final question is from John Barnidge with Piper Sandler. Please go ahead.

John Barnidge: Thank you. Can you talk about the strong growth in group sales? It's now above pre-pandemic 3Q '19 distribution demand driven or kind of where is that coming from?

Daniel J. Houston: Yes. I'll pass that off to Amy and her team. Amy, you want to take that one?

Amy C. Friedrich: Sure. Yes. Thanks for the question. Glad you noticed the strong growth because it's really pretty remarkable. We're seeing good traction all across the nation in terms of there's just general attractiveness in terms of group benefits products. I think the pandemic has helped the entire industry see how these products really help provide a support mechanism. And so the demand is high across the industry. I would say it's particularly high in the areas where Principal does really well, which is working with smaller or midsize or growing employers and putting together packages across the ancillary lines of business they can make really good sense for them, whether they're voluntary or employer pay packages.

The other piece I would say is that, that really strong sales growth is also being complemented in terms of the total revenue growth by strong persistency. Our lapse numbers look good, and our in-group growth, the places where we're saying we particularly do business with the types of customers who are either increasing wages or adding jobs, we're seeing that as particularly notable. All of those things mean it's a really good sign for revenue growth as we head into fourth quarter in 2022.

Daniel J. Houston: John, do you have a follow-up?

John Barnidge: No, we're at the hour. Thanks for the answer.

Daniel J. Houston: Yes. Really appreciate it -- thank you.

Operator: We have reached the end of our Q&A session. Mr. Houston, any closing comments?

Daniel J. Houston: Yes. The first thing I'd just say as we talked about some of these challenges, the demand for the products and services we have remain in high demand, both in the US as well as Asia and Latin America and as I said earlier, those emerging markets can be challenging. We know that. We're going to continue to be disciplined in our capital deployment, and we're going to continue to emphasize and grow these capital-light businesses, that's a priority for the organization. When we can deploy capital -- more capital intensive -- in some of these more capital-intensive businesses, we want to make sure we're getting adequately paid and compensated for that. So we certainly appreciate your continued support and look forward to visiting with many of you on the weeks to ahead. So with that, have a great day. Thank you.

Operator: Thank you for participating in today's conference call. This call will be available for replay beginning at approximately 1 PM eastern time until end of day November 2, 2021, 7184017 is the access code for the replay. The number to dial for the replay is 855-859-2056 US and Canadian callers or 404-537-3406 international callers.

Ladies and gentlemen, thank you for participating. You may all disconnect.

About Principal®[1]

Principal helps people and companies around the world build, protect and advance their financial well-being through retirement, insurance and asset management solutions that fit their lives. Our employees are passionate about helping clients of all income and portfolio sizes achieve their goals – offering innovative ideas, investment expertise and real-life solutions to make financial progress possible. To find out more, visit us at 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.