S&P Capital IQ

CONTENTS

Principal Financial Group Inc. NYSE:PFG

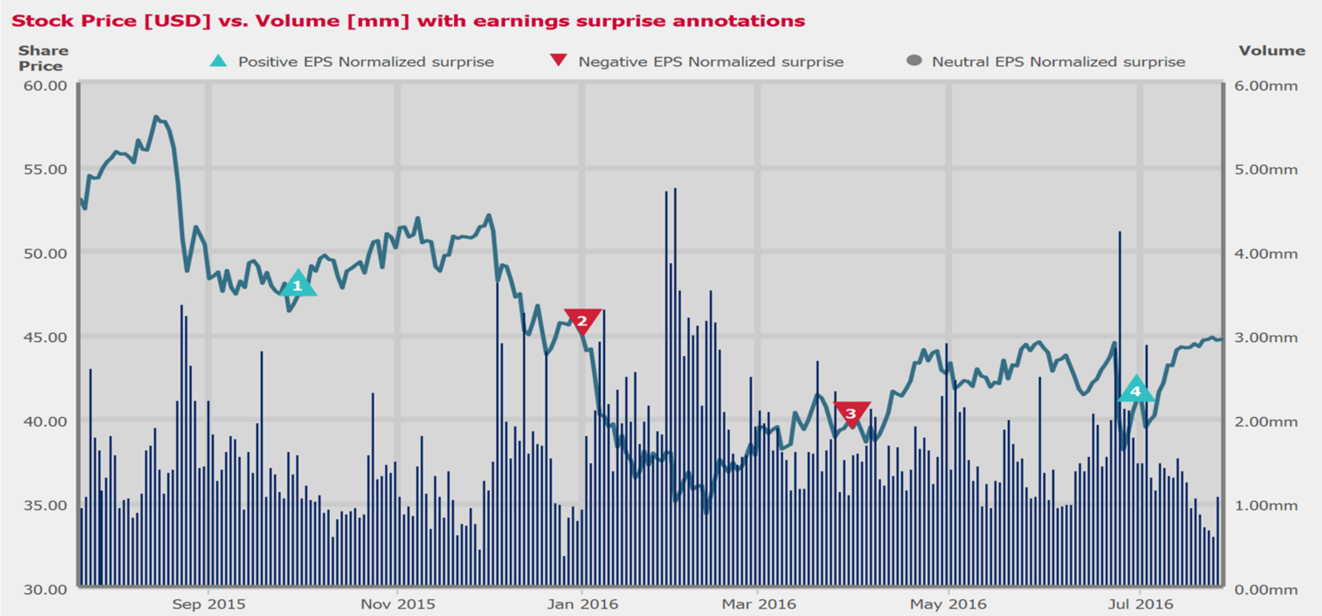
FQ3 2016 Earnings Call Transcripts

Friday, October 28, 2016 2:00 PM GMT

S&P Capital IQ Estimates

	-FQ3 2016-			-FQ4 2016-	-FY 2016-	-FY 2017-
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	CONSENSUS
EPS Normalized	1.12	1.15	2.68	1.15	4.40	4.76
Revenue (mm)	3008.62	2814.40	(6.46 %)	3021.75	11465.60	12349.03

Currency: USD
Consensus as of Oct-28-2016 12:27 PM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ3 2015	1.05	1.06	0.95 %
FQ4 2015	1.05	1.02	(2.86 %)
FQ1 2016	0.99	0.97	(2.02 %)
FQ2 2016	1.05	1.15	9.52 %

Call Participants

EXECUTIVES

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Deanna D. Strable-Soethout
President of U.S. Insurance Solutions

James Patrick McCaughan
Chief Executive Officer of Principal Global Investors, President of Principal Global Investors and President of Global Asset Management

John Egan

Luis E. Valdés
Chairman of Principal International Inc., Chief Executive Officer of Principal International Inc, President of Principal International Inc and President of International Asset Management & Accumulation

Nora Mary Everett
Chief Executive Officer, President, Director and Member of Executive Committee

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

ANALYSTS

Humphrey Lee
Dowling & Partners Securities, LLC

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

John Matthew Nadel
Crédit Suisse AG, Research Division

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

Ryan Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

Seth M. Weiss
BofA Merrill Lynch, Research Division

Yaron Kinar
Deutsche Bank AG, Research Division

Presentation

Operator

Good morning, and welcome to The Principal Financial Group Third Quarter 2016 Financial Results Conference Call. [Operator Instructions] I would now like to turn the conference call over to John Egan, Vice President of Investor Relations.

John Egan

Thank you, and good morning. Welcome to Principal Financial Group's third quarter conference call.

As always, our earnings release, financial supplement and slide presentation related to today's call are available on our website at principal.com/investor. Due to the annual actuarial assumption review and other significant variances at this quarter, we posted some additional materials on the website, including comparison of quarterly operating earnings, excluding significant variances from the third quarter 2016 compared to the year ago quarter. Keep in mind, our reporting structure changed in the fourth quarter 2015.

Following a reading of the safe harbor provision, CEO, Dan Houston; and CFO, Terry Lillis will deliver some prepared remarks. Then we'll open up the call for questions. Others available for the Q&A include Nora Everett, Retirement and Income Solutions; Jim McCaughan, Principal Global Investors; Luis Valdés, Principal International; Deanna Strable, U.S. Insurance Solutions; and Tim Dunbar, our Chief Investment Officer.

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. Risk 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 and quarterly report on Form 10-Q filed by the company with the U.S. Securities and Exchange Commission.

Before I turn the call over to Dan, I'd like to remind everyone of our upcoming Investor Day event in New York City on November 16. Our executive team will provide strategic updates on each of our businesses, with a particular focus on some of the key topics impacting our businesses. Please let me know if you haven't received an email invitation. We look forward to seeing you in a couple of weeks. Dan?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Thanks, John, and welcome to everyone on the call. This morning, I'll focus my comments on 3 areas. I'll characterize results for third quarter and through the first 9 months of 2016. I'll share some thoughts on execution highlights as we continue to extend our distribution reach and expand our product and service solution set. I'll close with some thoughts on certain external factors and how they're impacting our outlook for the future.

I'm very pleased with the third quarter results. With reported operating earnings of $336 million, excluding significant variances, we had double-digit growth in operating earnings when compared to a year ago quarter. Terry will provide more details on the significant variances for the quarter, including the annual actuarial assumption review, later in the call.

Compared to a year ago, we increased assets under management, or AUM, by some $80 billion or 15%, bringing AUM to record $596 billion as of the end of the third quarter. As shown on Slide 5, our longer-term Morningstar investment performance remains among the best in the industry. As of September 30, 90% of Principal mutual funds, separate accounts and collective investment trusts were above the median for the 3-year performance and 86% were above the median for the 5-year performance. For 10 consecutive quarters, at least 85% of our investment options have been above median for 3- and 5-year performance. Though our 3- and 5-year investment performance remains among the best in the industry, the 1-year number, with 59% of funds above median, is off its highs.

Because of investment needs of our customers, we focus on managing assets for retirement and other long-term strategies. We've created a leading array of multi-asset, multi-manager, outcomes-oriented solutions, and we purposely designed our investment platform to provide diversification and noncorrelation for different teams within key asset classes. Between the strength of our investment teams, our global research platform and our process, we remain confident in our ability to continue to stand out among active managers in both performance and net cash flows.

With multiple sources of demand for our investment solutions, we're on track for a seventh consecutive year of positive net cash flows. By comparison, approximately half of the funds complexes were in outflows between 2010 and 2015, according to data from the Investment Company Institute.

Our track record of positive net cash flows during the same time frame underscores the benefit of our diversified integrated business model, with strong diversification by investor type, asset class and geography, and strong integration of our businesses, enabling us to meet investor needs as they transition from accumulation into retirement.

While Terry will cover these topics in more detail, I'll provide a couple of comments on expense management and capital deployment.

As stated on previous calls, we continue to focus on aligning revenue and expense growth. Over the trailing 12 months, despite flat equity markets, a strong U.S. dollar and competitive pressures, we have managed expenses and improved margins, driving growth in operating earnings compared to a year ago.

I'm particularly proud of this result in light of 8% higher average AUM on a year-to-date basis; the additional cost to implement the Department of Labor's fiduciary rule as we've quantified in last quarter's call; and increased investment in key areas, including technology, product development and our global brand.

Through the first 9 months of 2016, our capital deployment strategy has enabled us to deploy more than $600 million between common stock dividends, share repurchases and increased ownership in boutiques. As announced last night, we've increased our quarterly common stock dividend for a third time this year.

Moving to execution, I'll start with enhancements to our solution set. In the third quarter, we've launched 5 new funds, bringing year-to-date launches to 9. Our global product strategy contemplates both opportunities and challenges, including aging global populations and growth in emerging-market middle class, potential regulatory disruption and the trend towards lower-cost product structures.

We remain purposeful on our approach building out 4 key areas: our suite of outcomes-based funds with a particular focus on income solutions; our alternative investment platform to enhance diversification and manage downside risk; our international retail platform in light of tremendous opportunities in Latin America, Asia and Europe; and our ETF platform as part of a larger effort to address increased demand for lower-cost options and provide cost-effective alternatives to passive management.

Beyond our investment platform, we're also highly focused on digital solutions that are simpler and faster, address how future generations will buy financial services and reduce barriers to action, allow easier decision-making and eliminate pain points for our customers and advisors.

Throughout 2016, I've shared some initial success with recently launched digital enrollment solutions like Easy Elect [ph] and My Virtual Couch. As another example, we launched an online application for our individual disability income products earlier this year. Since the launch, we received 2,400 applications electronically, nearly 20% of the total volume. This is helping fuel strong sales within Specialty Benefits.

Moving to distribution. We continue to make meaningful progress towards getting our funds on third-party platforms' recommended list and model portfolios. Through 9 months, we've had more than 40 placements in total, putting 30 different funds on 18 different investment platforms, with success across asset classes.

I also want to comment on the joint venture with China Construction Bank. While not included in our reported AUM, China reported a record $127 billion of AUM in the third quarter 2016. A majority of the recent net cash flows in China have been short-term investments, meaning lower fees and shorter duration in nature. The result illustrates 2 important points: one, the magnitude of the opportunity in China; and two, the power of our partnership with China Construction Bank, even more so as we expand our relationship and execute on our strategic cooperation agreement focused on asset management and pensions. China is now the third-largest contributor to the pretax operating earnings within Principal International, with a trailing 12-months pretax operating earnings more than doubling from a year ago quarter.

I'll close by sharing some thoughts on the future. First and foremost, we go forward from a position of strength. Importantly, we're also seeing certain opportunities further materialize and certain headwinds beginning to abate.

First, I'll express my optimism around Latin America. In 2016, the tide seems to be turning in the region's largest economy, with the Brazilian real and the Brazilian's benchmark equity index, the BOVESPA, strengthening. Our third quarter net cash flows in Brazil increased 50% compared to a year ago quarter.

On the continued strength of Brasilprev, our joint venture with Banco do Brasil, we generated at least $1 billion of positive flows in Brazil for 12 consecutive quarters. Importantly, we're taking market share from the next 2 largest competitors.

Claritas, our mutual fund company in Brazil, is gaining traction as well, delivering its best quarter of net cash flows on record.

Despite recent press, we remain optimistic about Chile. Our value proposition in the AFP market is intact as we continue to be a market leader in long-term investment performance and customer satisfaction. To be clear, our 2013 Cuprum acquisition is not under review by the Chilean regulatory authorities. They are, once again, reviewing the merger of 2 legal entities in Chile that gave rise to the deferred tax benefit we recognized in 2015. The merger has already been reviewed and approved twice, and we have no reason to believe it will be overturned.

Over recent weeks, Luis and I have had multiple opportunities to meet with senior-level officials in Chile. There's increasing awareness of the pressure on pay-as-you-go systems and the ability of workers to support a growing number of retirees who are living longer. In turn, they're increasing awareness of importance of voluntary contributions to achieve adequate income in retirement.

We'll continue to be an advocate for retirement readiness and an active participant in the pension dialogue, not only in Chile but around the world. Additionally, lower-for-longer interest rates present an opportunity, and we continue to expand our suite of income solutions, including guarantees, to meet the increasing demand for yield and security. Additionally, our business mix makes us less rate-sensitive than many of our peers.

Lastly, while the DOL fiduciary rule clearly presents challenges, it also presents opportunities. During the third quarter, one of our top third-party distributors communicate a decision to reduce their approved record keeper list by more than 80%. Principal was selected as one of their approved providers. We expect this consolidation trend to continue. In the meantime, we'll continue to strengthen relationships by helping our distributors work through implementation.

In closing, our business fundamentals remain strong. While I'm pleased with our financial results through 9 months, I'm even more satisfied with our execution. We've again made meaningful progress towards enhancing distribution, expanding our solution set and strengthening the relationship with customers and advisors. I look for us to continue to build momentum as we wrap up 2016 and move into 2017 and for that momentum to translate into long-term value for our shareholders. Terry?

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

Thanks, Dan. This morning, I'll provide commentary on operating earnings for the quarter; net income, including performance of the investment portfolio; and I'll close with an update on capital deployment.

Principal reported $336 million of operating earnings for third quarter 2016, up 6% over the year ago quarter, driven by over 10% growth in quarterly average AUM. Total company net cash flows were $7 billion for third quarter and $20 billion on a trailing 12-month basis. Strong net cash flows and positive market performance drove total company AUM to a record $596 billion in third quarter. Keep in mind that total company AUM excludes $127 billion of AUM in China that also contributed to quarterly earnings.

As shown on Slide 6, there were 3 significant variances from expectations reflected in third quarter 2016 operating earnings. This slide provides the line item impact by business unit of our annual actuarial assumption review and model enhancements, a single large real estate sale and higher-than-expected encaje returns in Principal International.

Consistent with prior years, we completed our annual review of actuarial assumption and model enhancements in the third quarter. The review reflected a lower interest rate environment in 2016 compared to what we expected a year ago and other refinements to our actuarial models.

As part of the review, no changes were made to the long-term interest rates or the time it takes to get to the ultimate rates. The actuarial assumption review decreased third quarter reported pretax operating earnings by $74 million. However, third quarter operating earnings benefited from a real estate sale that generated higher-than-expected variable investment income. As a reminder, real estate sales are part of our overall investment strategy but can add volatility to any given quarter. This significant variance increased third quarter reported pretax operating earnings by $35 million. Third quarter operating earnings also benefited from higher-than-expected encaje performance in Chile and increased reported pretax operating earnings by $8 million.

Slide 7 provides a comparison of the significant variances in operating earnings in third quarter 2016 versus the year ago quarter. Both quarters were impacted by actuarial assumption review and other significant variances.

Third quarter 2016 reported earnings per share of $1.15 was up 8% over the year ago quarter. Excluding significant variances in both periods, earnings per share of $1.22 was up 17% from the prior year period.

At the end of the third quarter, trailing 12-month return on equity, excluding AOCI other than foreign currency translation adjustments, was 13.5%. However, excluding the impact of both 2015 and 2016 actuarial assumption reviews, this measure was approximately 14% in both third quarter 2016 and third quarter 2015.

Now I'll discuss the business unit results, starting on Slide 8, with Retirement and Income Solutions, or RIS-Fee. Third quarter reported operating earnings of $131 million increased 57% from the year ago quarter. Excluding the significant variances shown on Slide 7, third quarter pretax operating earnings were $145 million, a 6% increase from the year ago quarter. This was driven by a combination of growth in business and disciplined expense management.

The fundamentals of the business remain strong as RIS-Fee net cash flows were a positive $1.4 billion in the third quarter. The positive net cash flows were driven by quarterly sales of $2.7 billion, a 7% increase in recurring deposits from the prior year quarter and continued strong plan retention levels. Excluding the impact of the actuarial assumption review, RIS-Fee's trailing 12-month pretax return on net revenue was 34% in third quarter 2016. We expect to end the year at the high end of our guided range.

Turning to Slide 9. RIS-Spread reported third quarter operating earnings of $76 million, up 52% over the year ago quarter. Excluding the significant variances shown on Slide 7, RIS-Spread third quarter pretax operating earnings were $66 million, a $14 million increase over the prior year quarter.

Average account values grew 13% over the same time frame, driving growth in net revenue.

Continued low interest rates negatively impacted retail annuity sales, while pension buyout in investment-only businesses continue to be opportunistic. We continue to maintain our pricing discipline when deploying capital in this space. On a trailing 12-month basis and excluding the impact of the actuarial assumption review, third quarter pretax return on net revenue was 60%, above our guided range.

Turning to Slide 10. Principal Global Investors reported pretax operating earnings of $113 million in the third quarter, an 18% increase over the year ago quarter on 12% growth in AUM. This demonstrates the continued benefit of scale in Principal Global Investors.

Both the retail and the institutional platforms contributed to a record AUM of $397 billion, with more than $4 billion of positive net cash flows in the third quarter. Our unique boutique strategy is proving successful in allowing us to provide value-added solutions that continue to resonate with clients.

On a trailing 12-month basis, PGI's pretax return on adjusted revenue was 35% and at the higher end of our guided range.

As shown on Slide 11, reported third quarter pretax operating earnings for Principal International were $84 million, up 65% from the year ago quarter, including record operating earnings in Brasilprev.

Encaje performance was higher-than-expected during third quarter 2016 but was more than offset by the impact of the actuarial assumption review.

Excluding the significant variances shown on Slide 7, third quarter 2016 pretax operating earnings increased 25% over the year ago quarter.

Foreign currency translation was a $1 million benefit to pretax operating earnings for the third quarter compared to the prior year quarter, excluding significant variances. This is the first time in the past 5 years we've experienced tailwinds from currency translations in earnings when compared to the prior year quarter.

As Slide 11 shows, there can be volatility from quarter-to-quarter in Principal International's growth rates. Excluding significant variances and on a constant-currency basis, Principal International continues to produce mid-teens growth in pretax operating earnings on a trailing 12-month basis.

Principal International's net cash flows for the third quarter were $2.5 billion, primarily driven by $1.8 billion from Brazil and a very strong $1.1 billion from Southeast Asia.

While not included in Principal International's reported net cash flows, China reported third quarter net cash flows of nearly $27 billion, another very strong quarter that contributed to China's 51% growth in pretax operating earnings from a year ago.

Excluding the significant variances shown on Slide 7, Principal International's trailing 12-month combined pretax return on net revenue was 38% and within our guided range.

On Slide 12, Specialty Benefits reported third quarter pretax operating earnings were $74 million, up 13% over the year ago quarter. Excluding the significant variances shown on Slide 7, pretax operating earnings were $56 million, an increase of 5% from the prior year quarter, driven by underlying growth in the business. Additionally, Specialty Benefits hit a milestone during the third quarter and crossed $2 billion of in force premium.

On a trailing 12-month basis, excluding the impact of the actuarial assumption review, our loss ratio of 64% reflects continued strong underwriting and pricing discipline. Pretax return on premium and fees in Specialty Benefits was 12% on a trailing 12-month basis, excluding the impact of the actuarial assumption review. This was at the top end of our guided range.

As shown on Slide 13, Individual Life reported third quarter pretax operating earnings were a negative $4 million. However, excluding the significant variances shown on Slide 7, Individual Life pretax operating earnings were $40 million, 8% lower than the prior year period. While mortality for both quarters was within the expected range, third quarter 2015 experienced favorable mortality, while third quarter 2016 mortality was in line with expectations. Excluding the impact of the actuarial assumption review, the trailing 12-month pretax return on premium and fees was 15% and was within the guided range.

Corporate's third quarter pretax operating losses were $58 million, in line with our guided range. For the quarter, total company net income was $308 million. Credit-related losses remained well below our pricing assumptions at $7 million.

Turning to Slide 14. We've deployed and committed nearly $730 million of capital so far in 2016. In third quarter 2016, we paid a $0.41 per share common stock dividend. Last night, we announced another $0.02 increase in our common stock dividend, bringing the fourth quarter dividend to $0.43 per share.

We take a long-term view of our balanced capital deployment strategy, looking for ways to increase long-term shareholder value and improving our financial flexibility.

While capital deployment may fluctuate quarter-to-quarter, we expect to be within our $800 million to $1 billion guided range for full year 2016.

As we near the end of our prepared remarks, I'd like to leave you with a couple of thoughts. We continue to manage to the competitive pressures and volatile macroeconomic environments to forecast growth in revenue. We have aligned growth and expenses accordingly as we focus on balancing growth and profitability while still investing in our businesses. As a result, our efforts to manage expense growth have contributed to operating earnings growth and margin expansions over the trailing 12 months.

In conclusion, I'll echo Dan's earlier comments. Third quarter was another strong quarter, adding to a very strong 2016 thus far. I'm very excited as I look ahead and see great momentum going into the end of the year and 2017.
This concludes our prepared remarks. Operator, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Your first question comes from the line of Sean Dargan with Wells Fargo Securities.

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

I have a question about Chile, and, Dan, you addressed the issue at length. But realizing that the merger itself is not under review, what is the status of the tax benefit that you have on your books? And if that was unwound, what would that do to earnings in the quarter, in which it was unwound? And secondarily, I'm wondering if you see -- if Luis is there, if you see any impacts to Cuprum's flows next year as fall out from this protest.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes. So thanks, Sean, for the question, and I'll have Terry hit the tax piece and Luis make some additional comments. But let me just, first, come at this from the perspective of we have every reason to believe that this tax credit is very much intact. There are actually 48 other companies that took the exact same tax credit back in 2015. So again, we feel very, very confident we'll prevail. We've been in Chile now since 1995. There's a 21-year history of providing Chileans with retirement solutions on the voluntary, certainly on the payout and now the mandatory program. We have great performance. We have strong customer service. We're well positioned in Chile to continue to do that. We employed 1,500 individuals down there that can go work every day, trying to strengthen that program. And again, as you noted in my prepared comments, we've had this codified now twice. So with that as a bit of a backdrop, on a very, very stretch, if you will, I'll have Terry comment on the tax implications, if it were to be overturned.

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

Yes, Sean, this is Terry. Just to put it in context here, in 2015, we recognized the benefit of the merger with the AFP with one of our subsidiaries in Chile. As a result of that merger, we were allowed to amortize or reflect the amortization of the intangible in our tax calculation. That amount was $105 million at that point in time. And we ran it through an other after-tax adjustment. Now that would be reflected over a 7- to 10-year period on a quarterly basis, so it wasn't going to have a significant impact in any one particular period. But if we were to have that overturned, we would have to unwind that $105 million. And again, we'd probably run it through another after-tax adjustment as we did in the -- when we recognized the benefit.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Thanks, Terry.

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

Hopefully that helps.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Luis, you want to make a couple of comments relative to the flows in Cuprum and your thoughts there?

Luis E. Valdés
Chairman of Principal International Inc., Chief Executive Officer of Principal International Inc, President of Principal International Inc and President of International Asset Management & Accumulation

Yes, thanks for your question. In talking about our flows in Chile that you may see now, were Pages 16 in the supplement, it's important to say that if you're paying attention now, our ability to put inflows remains intact in the $1.4 billion level. So the problem that we have had is certainly about outflows during this particular quarter. Two main factors that are affecting our outflows. One is affecting the whole industry. There's a new discussion about a potential pension reform in Chile. It's making the -- more customers have and are anticipating their retirement decisions. So they're taking their money out from the AFPs and mostly they're buying in a compulsory annuity in a asset payout vehicle in life insurance companies. That is one factor that -- which is affecting the industry and is affecting Cuprum as well. The second thing is a further market aggressiveness and the transfer market in the AFPs. Certainly, they're using and abusing about this window opportunity that the headlines and press is providing to them about our merger. We are working and paying a lot of attention about asset retention and client retentions because all our fundamentals remain very solid. Investment performance and client service remains among the best in the industry. So we're taking care of all that, and I'm saying that our people is paying a lot of attention about that. And as I'm saying, we continue to present good inflows and we're paying a lot of attention about these 2 factors. Having said that, it's important to remember, Sean, that in Cuprum, we don't charge fees over AUMs. We charge -- instead, we charge fees over flows on contributions, in monthly contributions. So this effect particularly -- specifically like what happened the last quarter, has a very marginal impact in our financials.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Sean, hopefully that helps.

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

Yes.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

All right.

Operator

Your next question comes from the line of Ryan Krueger with KBW.

Ryan Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

On RIS-Fee, your margins are currently running ahead of plan. I know you talked about kind of the high end for the year of the 28% to 32% range. Is that still the right general range to think about going forward? Or has there anything changed given some of the expense management that you've been able to complete?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

As you know, we don't update on the ranges that we provide, but what I would say generally is we still feel as optimistic about the long-term potential for our Full Service Accumulation business for a variety of different reasons. But with that, let me have Nora frame for you our expectations.

Nora Mary Everett
Chief Executive Officer, President, Director and Member of Executive Committee

Sure. Yes, we -- and Terry mentioned this as well, we still expect to be at the high end of our outlook guidance, the guidance that we gave last year, and we've mentioned that over the last couple earnings calls. What you saw this quarter were a couple of things. Obviously, even when you adjust for the annual assumption review and adjust for the real estate sales that were called out, we're still going to be, this quarter, lower with regard to our DAC amortization expense, and we've got some expense timing issues as well. So we're very -- great quarter. We're very confident with regard to our ability to manage expenses going forward, but you're always going to get some lumpiness with regard to timing of expenses, and we got the benefit of some of that this quarter. So high end of the range for sure, great quarter, and we look forward to continuing to extend the success of the business.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

And just a reminder on that point, Ryan, that if you look at the trailing 12-month S&P performance, on the average contribution, it's actually only up 0.4%. So there really is a lot of heavy lifting going on in terms of managing the expenses and driving reoccurring deposits and improving overall quality of these plans.

Ryan Krueger
Keefe, Bruyette, & Woods, Inc., Research Division

And then, Terry, could you provide some more detail on the interest rate assumption changes you made and, I guess, what your long-term assumption is at this point?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Terry?

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

Sure. Thanks, Ryan. As we talk about the assumptions, there's more to it than just simply the interest rates assumptions. We look at all the experience adjustments in our annual actuarial review that we do. And if you recall, in 2012 and 2015, we took a look at our long-term interest rate assumption and we brought those long-term ultimate rates down, but probably more importantly, we changed their trajectory in order to get to that longer-term rate. We went from a relatively short period of time to over 10 years in order to get to it. Now you're very well aware that the long-term interest rate assumption really varies by product that we have and will be across the yield curve, and it will also reflect not only what the risk-free rate is, but it'll also have an impact on the -- for the spread that we have, the default rate that goes into the assumption, which we don't disclose any of that information. That's for pricing and for proprietary purposes. But to try to give you a little bit of -- maybe a little bit more insight in terms of using as a proxy, a proxy of the yield curve, we talked about the 10-year treasury and that seems to be a pretty good proxy to use. A year ago, when the 10-year treasury was about 2%, we talked about basically a 25 basis point increase to that rate over a 10-year period. Now the expectation then was that we would be up by 25 basis points this year. But as you're very well aware, the -- instead of going up by 25 basis points, it went down by 50 basis points or so, the 10-year treasury. However, as we look in terms of our forecast into the future, which everybody will have a forecast as to what they think, we take into consideration what we're hearing in the industry, what we're hearing from rating agencies, what we're hearing from auditors, what we're hearing from different groups, economists, central banks, investments. We take all these things into consideration, and we feel very comfortable where we are at this point in time. We have actually moved out in keeping that time period, that 10-year time period, in order to get to our long-term rate consistent, but we're from a different starting point, so you'll look at going out into the future. What we're hearing anecdotally is that others are starting to increase their trajectory or their time period as well. But still, we feel that our ultimate rate as well as our time period in order to get to the rate, we're very comfortable with that at this point in time. Hopefully that helps.

Operator

And your next question comes from the line of Seth Weiss with Bank of America.

Seth M. Weiss
BofA Merrill Lynch, Research Division

A lot of commentary on the call in terms of expense management driving the margins. I think more broadly speaking, there's concerns of secular pressure on fees in both retirement and asset management. Can you talk about what you're seeing, both in the retirement space as well as asset management, in the different asset categories that you manage in terms of the fee side of the equation?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes. So first, let me kind of hit the macro sort of expense initiative that we have, and we've always had a lot of expense discipline around Principal. What we try to do is to make sure, Seth, that we're aligning our expenses with the revenue that we're able to generate. And as part of that process, as you might expect, we rigorously go through the organization to determine if there's services that were provided that are valued by our clients or they're unwilling to pay for. So I would say it's basic blocking and tackling, making sure that we have a disciplined approach to expense management. Now having said that, we're also continuing to make some very significant investments around digital and technology. Certainly, we've talked about the expenses related to the DOL implementation. And we're wanting to make sure we're still planting seeds within all of our businesses so we've got future growth. So I don't want anybody to walk away from the call or the quarter to think that somehow it's taking out all expenses at all cost because that's just not -- it's not the approach that we would take here at Principal. So with that as a backdrop as it relates specifically to fee, growth and revenue growth along the lines of business, I'll have Jim go first and then have Nora make some additional comments. Jim?

James Patrick McCaughan
Chief Executive Officer of Principal Global Investors, President of Principal Global Investors and President of Global Asset Management

Thank you, Dan, and thank you for the questions. If I look at the industry in institutional, the fee pressures depend a lot on which product and which asset category you're in. If you want a sort of rule of thumb, over the last 3 to 4 years, passive fees for institutions have roughly halved. When you look at large-scale, large-cap core assets in fixed income and equities, where there is a passive alternative, there has been intense fee pressure, and in the industry, those maybe halved over the last decade or 15 years. There is a whole area, however, of relatively newer, relatively less liquid, relatively less efficient markets, and those are areas where there is still quite a lot of pricing power and the fees have not moved for at least a decade, and that includes areas such as real estate, both public and private, high-yield, other investment grade fixed income and preferreds; all of which are areas we're strong in. And that's why our revenues have been quite buoyant relative to assets compared with most of the industry. So we have some carefully chosen, less liquid categories where active management still pays and where clients benefit from it and are prepared to pay. In the retail and mutual fund area, you can add some of those areas as helping the general performance. But the other piece to this, in terms of where fees are going, is our strength in multi-asset, multi-manager strategies, which are designed to produce an outcome that's desired by clients. Here, I think, target date, target risk, diversified income, diversified real asset. Those are areas where the outcome is beneficial to the client so the pricing is more resilient than it would be for the more commoditized passive and core areas. So we feel pretty good right now about where we are relative to the fee pressures in the industry. We need to become more efficient because pricing is going down. But I would say that relative to the industry, we feel very well-placed.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Also, do you have, Nora, a few comments?

Nora Mary Everett
Chief Executive Officer, President, Director and Member of Executive Committee

Sure, and I'll be brief. To Jim's point, we got a couple of things going in our favor here. One is in the retirement area. Tremendous scale with regard to services and record keeping in that platform, just tremendous scale. And with the consolidation in the industry, we're going to be a net gainer on that front. Two, and this is really critical, part of our retirement franchise -- well, 2 pieces of it. One is what we call

Total Retirement Suite. We are one of very few competitors in the U.S. where you can have one-stop shopping with regard to your DB, your DC, your nonqual and you ESOP plan, and that is hugely valuable to our plan sponsors and our advisors with regard to that one-stop shopping. Three, and this is another critical piece, is we have one of the most extensive lineups of target-date funds in the U.S. and they're multi-managed, which is a real benefit in this environment. Multi-managed and hybrid, in other words, the choice not only around sub-advisors but also around passive versus active. We don't pick a position in that space. We have the choice, and what we've seen is plan sponsors really, really taking that particular investment product and putting a premium on that and the ability to have the one-stop shopping in addition to that qualified default option.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Seth, thanks for the question.

Operator

Your next question comes from the line of Humphrey Lee within Dowling Partners.

Humphrey Lee
Dowling & Partners Securities, LLC

Just a follow-up question to Luis in terms of what you see in terms of the Chilean pension reform, like what you're hearing or what can you see in terms of the potential impact to the industry.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes, very good. Thanks for the question. Luis?

Luis E. Valdés
Chairman of Principal International Inc., Chief Executive Officer of Principal International Inc, President of Principal International Inc and President of International Asset Management & Accumulation

Yes. Humphrey, thanks for your question. And let me say, first, that we're very pleased about the fact that, finally, the Chilean government is taking serious actions in order to review and propose a more comprehensive pension reform in Chile. That -- it might sounds to you a little bit counterintuitive, but I have to say also that Principal, since the early 2000, we're been a strong advocator in order to review the pension reform in Chile in a much more comprehensive way, as I said. The pension system, as you know, is the golden standard in sustainability, but it has some issues that has to be addressed about adequacy. And the most important problem is the one that's created the -- this kind of social unrest that you have seen. It's Pillar 0 that has nothing to do with the AFPs. It's the pillar that's being called the Solidarity Pillar and in which the government is in charge of. That pillar is very much more the one that's provided a safety net for low-income segment in Chile. And most of this low-income segment, they haven't been part of the labor force. If they were, they had a few contributions to the AFP system. For you to know this government, many governments even in the past, they hadn't take -- or they took a kind of free ride with the pension system. The total government retirement expenditure in the Pillar O is 0.7% of the GDP. Average for OECD countries is about 18% up to 20%. So here, we have the most important issue about adequacy in this pension system. The Chilean government, they sent very quickly a bill in order to raise their minimum pensions in Pillar 0 up to 10% last week. So they're reacting very quickly. Having said that, the government has to pay a lot of attention about Pillar O and Pillar 0, and that's where the most important initiatives about these whole discussions are going with. The second thing that we have to address in Chile, in this discussion is about the self-employed segment. They're not well covered. They don't have any compulsory contribution. They don't belong to any system and they have to. The third element is to put some adjustment for the AFP system, which are Pillar 1. Still, they start to do 10% contribution rate over salary. I mean, it's absolutely insufficient. Longer for -- I mean, lower for longer is an issue for every place, and Chileans are living longer as well. Also, they do have a salary cap, and their salary cap remains almost the same one in the last 30 years. At the beginning of the system, just 2% of the labor force was capped. Today, more than 20% of the labor force is capped. 35% of our customers in Cuprum are capped. So the 10% over year salary is even lower than 10%. So we have to address the 10%. We're advocating for a 15% minimum and to remove the salary cap. The third issue is to reinforce the Pillar 2, which is the workplace solutions and group solutions in that country. And we have, I would say, good and fairly trained in order to put and -- to put those, I will say, improvements. But I will say that the whole discussion is going to take a kind of long time in order to really have a solid and good, I will say, a pension reform. And I think that it's very unlikely that this current administration is going to be over to go through. I'm absolutely sure that probably this whole discussion is going to go over the next administration in 2018.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Humphrey hopefully, that was helpful.

Humphrey Lee
Dowling & Partners Securities, LLC

Yes, I think just a quick follow-up. I think there was some discussion about the fees. I think some opposition of the current system are complaining about the fee being charged to the pensioners. Can you just talk about, in general, how do you see the fee structure right now and what could potentially be at risk?

Luis E. Valdés
Chairman of Principal International Inc., Chief Executive Officer of Principal International Inc, President of Principal International Inc and President of International Asset Management & Accumulation

Humphrey, thanks for your questions, and we're going into details. I mean, we have been vocal. And our proposal, not just now, is to charge over AUMs instead of flows. That's much more transparent. It's much more clear. That is going to align the interest of our customers and our -- all the stakeholders in the AFP system. So we really do think that the system has to charge fees over AUMs. On average today, that discussion is going to help us in order to make much more clear that the pension system in Chile is one of the most efficient and cheapest. Around their 27 pensions plan that has been reviewed by Mercer in their annual review, on average, the pension system charge 60 basis point over AUMs. And in the case of Cuprum, we charge a number which is lower than that.

Operator

Your next question comes from the line of John Nadel with Credit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

So it sounds like if pension reform really gets through ultimately in Chile, there's actually some potential for your business to thrive a bit more if some of these things go through. But I'm interested in what the sort of near to intermediate term might end up looking like as you sort of transition through this process. And the deposits, if I'm looking at Page 16 of your supplement, have been very stable, but the withdrawal side has started to really expand these last couple of quarters, and I'm wondering if there's really cause and effect there, cause being the protesting. And where you expect that might end up going? And what your flows could look like at least during a transitory period here?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Thanks, John. I guess the way I'd go at this is to, again, remind everyone on the call that our strategy in Chile does not limit itself just to the compulsory. That's the newest piece of business that we have. Second is the voluntary workplace environment that Luis very appropriately articulated. And the last piece is our ability to provide lifetime income to retirees. Again, all 3 of those are key components in the strategy. I don't think Chile is any different than the U.S., in the DOL debates that we're having today or some of the same challenges around the rest of the world, whether it was a conversation in Hong Kong. There is an outcry, I would suggest, about making sure that the fees are appropriate. And just like in the case of Chile and Hong Kong and U.S., there's conversation with the DOL and the various regulators around the world to make sure that they understand the products and services that are being provided for by the services companies. And we all know and we can speak to the issue of asset management, but the handholding, the call centers, the ability to provide information, education and advice, in some instances, is really the lifeblood of this business model around the world. And so as Luis was articulating, we've spent a lot of the time around the world educating regulators that there needs to be a reasonable fee associated with all of these products. So to answer your specific question, we're getting some outflows today in Chile, in large part, I believe, because some of the protests that were large 6 weeks ago that continue to get smaller and smaller and smaller in terms of the number of people participating. I don't think this is going to have any sort of meaningful impact on our flows or our ability to generate an earnings off the investments that we've made in Chile. Hopefully that helps.

John Matthew Nadel
Crédit Suisse AG, Research Division

No, that does help, and I had a separate question for Terry. If we look at, on a consolidated basis, your investment income in the quarter and we adjust for the fact that encaje was a little bit stronger and you had the real estate gain, would you characterize investment income ex those items as still a bit elevated, maybe driven by some prepayments or bond calls? Or would you characterize it as more normal?

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

John, this is Terry. As we look at all of these items here, there's going to be volatility from quarter-to-quarter as to higher or lower, a little bit from expected variances. What we try to do is we try to call out the significant items. In this particular quarter, we talked about 3 significant items, the one being the annual actuarial review. That had, obviously, a volatile number this quarter. But the large real estate sale that we had as well as the encaje performance, we felt that, that was a little bit more transparency, visibility into the volatility that we've seen. In terms of volatility, we -- I've talked in the past about real estate sales as well as prepayment activity generating anywhere from $0.03 to $0.07 EPS. This quarter, we were significantly higher than that, well north of $0.12, $0.13. And so actually, this volatility that we called out brings us right back into that more normal range for that particular piece. But as I said, you'll have periods where the alternative investments might be a little bit higher or a little bit lower. The general account is actually growing, so you'd see some increase in the net income because of that. But we try to give you the best information possible in terms of the variance or volatility from what we would have expected. So the $1.22 that we had is the run rate that we believe is an appropriate number for this quarter.

Operator

Your next question comes from Yaron Kinar with Deutsche Bank.

Yaron Kinar
Deutsche Bank AG, Research Division

I want to go back to the RIS margins, which seem to be quite strong relative to your guidance and in the previous periods. Is -- I guess, what's driving this outperformance? You've highlighted expenses or expense management. Is there a timing issue there or other -- also other drivers that are really driving this outperformance here?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes, good question, and I think it's a fair -- a clear explanation. But, Nora, please go ahead and make some additional comments.

Nora Mary Everett
Chief Executive Officer, President, Director and Member of Executive Committee

Yes, and I had mentioned earlier, one of the -- even when you exclude some of the variances that Terry's talked about, we're still on the lower end of our DAC amort expense this quarter, and we still have some meaningful timing issues with expenses. So that's why we're not creating -- we're not saying, this is the run rate. What I would say, though, what is creating the very strong quarter, and we can't lose sight of it, is the fundamentals, the really strong fundamentals in this business. You're seeing growth across basically every metric, whether that's plan count, whether that's total recurring deposits. We're just seeing very strong, very broad growth in this business. So the underlying growth is exceptionally strong. What we're just -- what we're speaking to is that run rate and just want to make sure people understand that we've got 2 issues here. One is a timing issue with regard to expenses this quarter, and the other is this DAC amort that tends to be light this quarter, in addition to the annual assumption review issue with DAC amort. So that combination of things is why we're still guiding towards the higher end of our original outlook guidance.

Yaron Kinar
Deutsche Bank AG, Research Division

Okay, that's helpful. And then we haven't spent a ton of time on this, this quarter for a change. But as we're nearing the implementation deadline of DOL, just wondered if you had any updated thoughts on where you stand there?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes, just a couple of quick comments. I'm very pleased to say that the way things are turning out are fairly consistent with what we have been articulating, and that is that our large distribution partners, who we have been out to see and worked very closely with, most of them have come in on what their strategy is, in allowing their financial advisors to work under 2 different environments: one on a fee basis, one on the basis of the best interest contract standard. And we're seeing a full range and a lot of discussion around that. And again, we were anticipating that, and we would expect it. Secondly, we don't see any sort of change as reflects our ability to continue to have a robust investment platform with proprietary investment options being made available to small- to medium-sized employers, certainly requires all the appropriate disclosure. And third, at benefit event for job changers and retirees, again, requires disclosure, but again, a workable model for the sake of being able to continue to provide our customers with choices at retirement, whether they decide to keep the money in the plan, choose a rollover IRA with Principal or to take their funds to a different services provider. And then lastly, as we've worked through our own broker-dealer and looking closely at our financial advisors, our 1,500-or-so financial advisors, we're retaining our talent. They have found what we have shared with them as a workable solution to allow them to continue to have a successful practice here at Principal. So again, we don't think there's really a lot of new news as it relates to DOL here.

Operator

Your next question is from the line of John Barnidge with Sandler O'Neill.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

You mentioned that foreign currency favorably impacted your year-over-year for the first time in 5 years, I believe. How much of a tailwind do you think this could prove? And then I have one follow-up.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes. Terry, you want to take a shot at that? And then I'm going to have Luis make some additional comments.

Terrance J. Lillis
Chief Financial Officer, Chief Accounting Officer and Executive Vice President

Sure. As we look at the exchange rate, the -- actually, we saw more stability in the exchange rate on a year-over-year basis. However, on a trailing 12-month basis, there's still a pretty significant headwind that we're fighting because of the strengthening of the dollar has really -- excuse me, the weakening of the dollar has really occurred since the beginning of the year. So this was the first quarter-over-quarter comparison where we actually saw some benefit from it. I think long term, we have always talked about stability in the dollar. Now we're not actually looking for tailwinds or looking for headwinds, but when you actually reflect it on a constant-currency basis, which I think is the way we want to look at the business, on a constant-currency basis, we're still seeing that mid to upper teens growth rate of our international businesses. It's very strong, and we've been trying to reflect that at a year-over-year basis -- or excuse me, for several quarters. But now we actually have some numbers, when the dollar is relatively stable, that you're actually seeing the growth of that underlying business.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes, what's so unfortunate, as you think about the last 5 years, there's been really solid work and performance from those local businesses driving local net cash flows, driving revenues, driving customer satisfaction, accumulating a lot of really significant number of investors, and unfortunately, because of the FX, it undermined its credibility. And now we hopefully can see that start to turn around the other way. Thank you, John, for the question.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

And then my follow-up, if I my may.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Sure.

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Yesterday, the DOL released FAQs on the fiduciary rule that significantly disrupts how brokers recruit and require a major overhaul to recruitment bonuses away from making them contingent on asset sales or sales targets. How do you see this change impacting your distribution partners?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

I'll ask Deanna Strable to weigh in on that one.

Deanna D. Strable-Soethout
President of U.S. Insurance Solutions

Yes, you're right, those FAQs came out yesterday and we expect a couple more rounds of those. I would say what was clarified in that FAQ was actually very consistent with how we had set up our plan forward with our advisors. So again, I think we had anticipated this. The clarification would have been there, and we feel good relative to how we were planning to comply and compete going forward. I think as Dan mentioned, we've actually made announcements relative to our internal sales force and where we move from decision-making into implementation. But I think those FAQs that came out really align with how we were targeting our implementation path going forward.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

John, did that help?

John Bakewell Barnidge
Sandler O'Neill + Partners, L.P., Research Division

Yes, indeed.

Operator

Your next question comes from the line of Michael Kovac with Goldman Sachs.

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

I have one for Dan here. As you think about uses of capital, in the past, acquisitions have been a key strategy in use of capital at Principal, and we've seen increased deal activity in some of your core markets, and you did mention, I believe in your prepared remarks, some expected consolidation continuing. So I'm wondering if you're expecting this to increase, this use of capital, heading into either year-end or into 2017, specifically as you think about kind of asset management multiples at these compressed levels today. And then as you build just sort of upon that, where would you be looking, whether it's asset management, retirement operations, internationally? And then sort of give us a sense of what you see as the deployable capital against those type of acquisitions.

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Very good. Thanks for the question, Michael. That's probably a 30-minute response, but I'll give a relatively brief response, and what I would say is we have tried to really have a disciplined approach to capital deployment, whether it's to increase our dividends, stock buyback, making investments in our organic growth strategies here at Principal, being very cautious about, even within the organic lines, allocating that capital, where we can -- where we feel the shareholder is benefiting the most. And as you point out, we have had a nice track record of making relatively small tuck-in acquisitions. I wouldn't call Cuprum a tuck-in, but certainly, across asset management and asset accumulation, we've had some really, really nice acquisitions over the years. And I would say that we're going to continue to look for those opportunities and we're going to continue to take a larger ownership share in some of the boutiques that we've acquired in the past. You saw some of that traffic in the most recent quarter. We just believe fundamentally that's a great way to deploy capital for our shareholders. The other area that we want to emphasize is getting tangential strategies, where we've got an existing boutique where we can infuse some additional capital and maybe acquire some talent and build out that capability. Jim's also added some sales offices over the course of 2016 to try to drive sales. So that's still very, very much a part of our strategy. We feel like we've had really good organic growth in the core funds business. I don't think we'd have to necessarily acquire another fund's operation. And in terms of asset classes, we've talked about European real estate. We've talked about strategies that really align with what our investors' needs are, which is generating long-term income in retirement and long-dated solutions. Infrastructure is another area where we've looked at. So we're going to continue to be inquisitive where, again, we can deploy capital in the best interest of our long-term shareholders' needs. Is that helpful?

Michael Edward Kovac
Goldman Sachs Group Inc., Research Division

That is. So just as we think about the mix this year versus maybe future years, it appears sort of pretty light, I guess, on the acquisition front. Would you -- so it sounds like you're expecting maybe that shifts in the future?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Well, pricing has a lot to do with these decisions. And again, we try to be very organic and very disciplined in making acquisitions. It hasn't been from a lack of taking a hard look, but we're going to continue to hold ourselves to very high standard in terms of how we deploy our capital. And whether it's managing our debt, managing our acquisitions, managing our share count or dividends, we're going to just take a very, very disciplined approach. Appreciate the question.

Operator

We have reached the end of our Q&A. Mr. Houston, your closing remarks, please?

Daniel J. Houston
Chairman, Chief Executive Officer, President and Member of Executive Committee

Yes. Again, thanks, everyone, for joining the call today. I know it was a busy day with a number of other companies reporting.

From our perspective, we're going to continue to invest in our business. We're going to continue to grow our businesses globally. We want to make sure that we have a disciplined approach to aligning our expenses with our revenues, and we're going to continue to take a very disciplined approach to our capital deployment to the benefit of our long-term shareholders. Again, we look forward to seeing many of you on Investor Day, as John mentioned in the opening comments, on November 16.

So with that, have a great day, and thank you, again, for taking time to listen to the call today.

Operator
Thank you for participating in today's conference call. This call will be available for replay beginning at approximately 1 p.m. Eastern time until the end of the day, November 4, 2016. 82188007 is the access code for the replay. The number to dial for the replay is (855) 859-2056 for U.S. and Canadian callers or (404) 537-3406 for international callers. Thank you. This ends the call.