S&P Capital IQ

CONTENTS

Principal Financial Group, Inc. NYSE:PFG

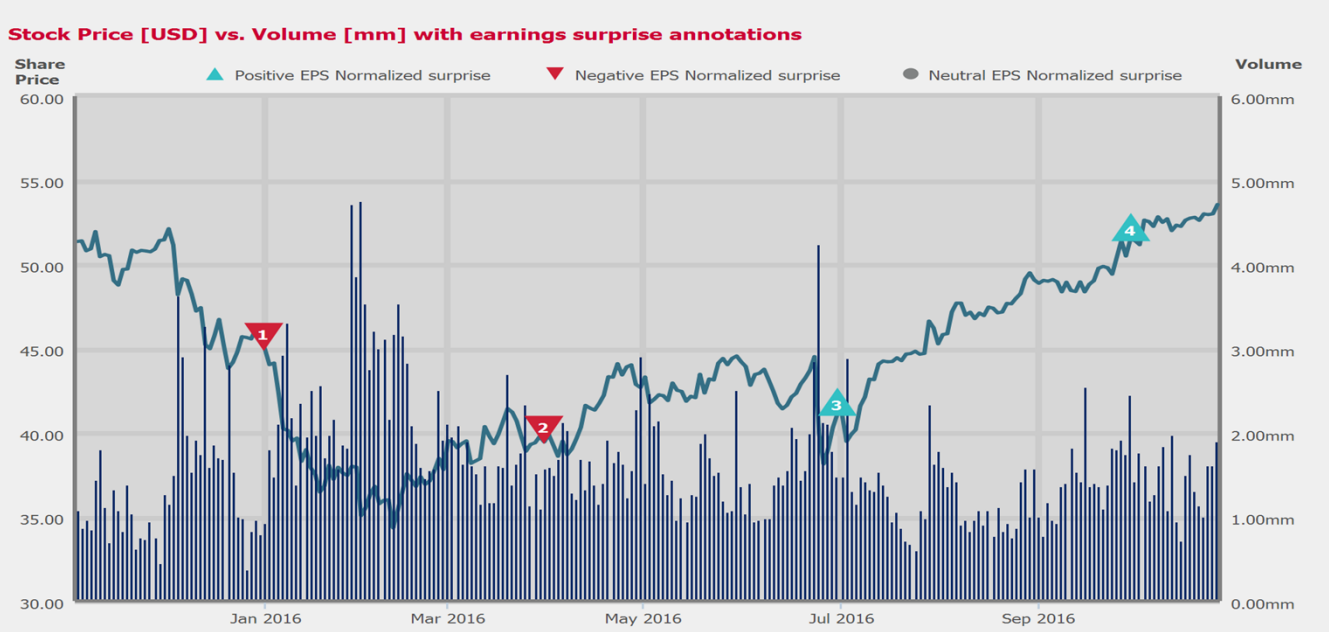
FQ4 2016 Earnings Call Transcripts

Tuesday, January 31, 2017 3:00 PM GMT

S&P Capital IQ Estimates

	-FQ4 2016-			-FQ1 2017-	-FY 2016-	
	CONSENSUS	ACTUAL	SURPRISE	CONSENSUS	CONSENSUS	ACTUAL
EPS Normalized	1.15	1.27	▲10.43	1.16	4.42	4.55
Revenue (mm)	3038.56	3593.40	▲18.26	3245.40	11732.36	12380.80

Currency: USD
Consensus as of Jan-31-2017 11:27 AM GMT



- EPS NORMALIZED -

	CONSENSUS	ACTUAL	SURPRISE
FQ4 2015	1.05	1.02	▼(2.86 %)
FQ1 2016	0.99	0.97	▼(2.02 %)
FQ2 2016	1.05	1.15	▲9.52 %
FQ3 2016	1.12	1.15	▲2.68 %

Call Participants

EXECUTIVES

Daniel J. Houston
Chairman, Chief Executive Officer and President

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

John Egan

Luis E. Valdés
President of Principal International Inc

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Terrance J. Lillis
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Presentation

Operator

Good morning, and welcome to the Principal Financial Group Fourth Quarter 2017 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 fourth 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.

Following the reading of the safe harbor provision, CEO, Dan Houston; and CFO, Terry Lillis, will deliver some prepared remarks. Then we will open up the call for questions. Others available for the Q&A session 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. Risks and uncertainties that could cause actual results to differ materially from those that are 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.

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

Now I'd like to turn the call over to Dan.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Thanks, John, and welcome to everyone on the call. This morning, I'll share some highlights for the year and key accomplishments that position us for continued growth. Then Terry will provide more details on our financial results and cover capital deployment.

2016 was a very good year for Principal. We delivered very strong results. We balanced investments in growth with the needs for expense discipline, and we continue to be good stewards of shareholder capital. At over $1.3 billion, we delivered record after-tax operating earnings in 2016 and double-digit growth compared to 2015, excluding the impacts from the actuarial assumption reviews in both years. I see this as particularly compelling given a challenging start to the year with strong headwinds from equity markets and foreign currency, low interest rates and volatility and uncertainty associated with Brexit, regulatory changes and the U.S. presidential election. We grew assets under management, or AUM, by $64 billion from year-end 2015 or 12% to $592 billion at year-end 2016. Although down sequentially due to impact of rising interest rates on our fixed income investments and the impact of weakness in the yen and euro on client currency hedging, this base gives us a strong foundation for revenue earnings growth in 2017, and we continue to earn important recognition for our asset management franchise.

In the fourth quarter, Willis Towers Watson released research on the world's largest asset managers. We again improved our rankings, moving up to #38. And we were the 10th fastest-growing firm in the top 50 based on AUM growth from 2010 through 2015. Other 2016 recognition includes Pensions & Investments' Best Places to Work in Money Management, our fifth consecutive year on the list; Barron's sixth best mutual fund company in the U.S.; and AsianInvestor's Best Fund House in Malaysia. We also received

multiple best fund awards including best moderate balanced funds in Chile, best Asia Pacific equity fund and best fixed income fund in Indonesia and best balanced fund in Mexico.

As shown on Slide 5, our longer-term Morningstar investment performance remains among the best in the industry. At year-end 2016, 76% of Principal mutual funds, separate accounts and collective investment trusts were above median for 3-year performance and 86% were above median for 5-year performance. Our 1-year performance with 51% above median is down from a year ago. We continue to watch this closely but see this as no more than the normal ebbs and flow in performance. Over the past 20 quarters, on average, 76% of our investments have been above median for 1-year performance, 86% have been above median for 3-year performance and 80% have been above median for 5-year performance.

The strength and consistency of this result is notable, and boils down to conviction: conviction in our investment teams, global research platform and investment process; and conviction in diversification and noncorrelation benefits of our multi-asset, multi-manager, multi-boutique model. I remain confident in our ongoing ability to stand out among active managers in terms of both investment performance and net cash flow generation.

2016 was, in fact, our seventh consecutive year of positive total company net cash flows, reflecting competitive performance and multiple sources of demand for our investment solutions. Over this 7-year period, we generated net cash flows totaling $115 billion. In 2016, Principal delivered more than $19 billion of positive total company net cash flow, a very strong result in an industry in outflows. Our track record underscores the benefit of 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.

I was particularly pleased with the net cash flow for the year in 3 areas. In Brazil, we generated nearly $9 billion of net cash flows, an increase of 26% from 2015. This helped Brasilprev, our pension and long-term savings joint venture with Banco do Brasil, achieve an important milestone in December and an industry first: BRL 200 billion in assets under management. RIS generated $7 billion of net cash flows in 2016, nearly 4x our 2015 result. RIS-Fee increased total deposits by 13%, reflecting strong underlying growth in the businesses, and 95% contract level retention for retirement business. For RIS spread, record Full Service Payout sales as well as strong fixed annuity sales and opportunities in the investment-only business drove a 53% increase in deposits over the prior year. PGI institutional net cash flows were $3 billion in 2016. More than 80% of the boutiques delivered positive flows for the year.

Our multi-manager target date suite, including mutual funds, collective investment trusts and separate accounts, saw positive net cash flows in the fourth quarter as well as the full year 2016, highlighting the strength and diversification of our offering.

Before moving on, I'll comment on 2 pockets of negative net cash flow in the fourth quarter. As expected and signaled at our last call, we experienced outflows of short-term funds in China. Despite the outflows, we had a $65 billion of positive net flows in China for the year including solid flows in our longer-term retail funds. As a reminder, China is not included in reported AUM.

In Chile, we experienced outflows given turmoil in the Chilean pension system. Importantly, our fundamentals remain strong. In October, we received multiple awards from El Mercurio in their rankings of the best mutual funds in Chile. In November, we were recognized by Praxis as the #1 Chilean pension service provider, our fifth consecutive #1 ranking. And in December, the Superintendent of Pensions reaffirmed the merger of our legal entities in Chile.

I'll now share a few execution highlights, starting with our efforts to expand and enhance our solution set. In 2016, we launched 10 new investment strategies in the U.S. and 2 on our offshore platform as we continue to build out 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 to capitalize on tremendous opportunities in Latin America, Asia and Europe; and our ETF and CIT platforms to provide cost-effective alternatives to pure passive management. We also remain highly focused on digital solutions that are simpler and faster, address how future generations will buy financial services and reduce barriers to action and eliminate pain points for customers and advisors.

Throughout 2016, I shared some early successes. Here's an update on 2 of them: In its first full year, we saw strong results from our interactive retirement education enrollment resource. People enrolling through My Virtual Coach saved at a rate that is 3 percentage points higher than those using traditional enrollment and were nearly 5x as likely to elect automatic annual savings rate increases.

We're having similar success with Easy Elect, our new group voluntary enrollment experience for Specialty Benefits. Participation is up more than 10% over traditional enrollment, in particular employees are purchasing higher amounts of life insurance coverage.

Moving to distribution. We continue to advance our multichannel, multiproduct approach. In 2016, we increased the number of firms producing at least $1 billion in sales from 7 to 9, including 5 firms producing at least $2 billion in sales for the year. And we continue to make strong progress towards getting our funds added to recommended list and model portfolios. In 2016, we earned nearly 60 total placements, getting more than 30 different funds on 22 different third-party platforms with success across asset classes.

I'd also like to highlight promising early results for the online insurance purchasing portal. We converted more than 25% of our digital life insurance leads into sales in 2016, including nearly $140 million in face amount sold.

I'll close with some thoughts on the future. We go forward from a position of strength with excellent fundamentals and the benefit of broad diversification. Regarding the impact of the new administration on the DOL fiduciary rule, while there's speculation around potential delays, we're still prepared for an April 2017 applicability date. Importantly, we'll go forward with strong relationships because of our efforts to help distributors work through the implementation process. While competitive and environmental challenges clearly remain, we're seeing certain headwinds beginning to abate and certain opportunities further materialize. While rising interest rates will continue to negatively impact fixed income AUM, we expect to benefit from additional pension closeout and fixed annuity sales opportunities and from higher new money yields.

We continued to see signs of recovery in Brazil in 2016 with the BOVESPA index improving 39% throughout the year and the Brazilian real strengthening 22% relative to the U.S. dollar. We also continue to make strides in China with our partner, China Construction Bank. Our existing mutual fund joint venture moved up 2 spots in 2016, becoming the sixth largest fund company in China based on year-end AUM. And we're making meaningful progress in our efforts to develop a new pension and asset management partnership.

I'd be remiss if I didn't comment on our upcoming CFO succession. As announced in February of last year, Terry Lillis is retiring in the coming months after 35 years of service. On behalf of The Principal, I want to thank Terry for the strong contributions he made throughout his career and in particular for the instrumental role he played in guiding us through difficult times and positioning Principal for a long and successful future.

I also want to welcome Deanna Strable to the CFO role. Since joining the company in 1990, Deanna has held positions of increasing responsibility, including most recently President of U.S. Insurance Solutions. Deanna brings not only strong financial expertise, but importantly, experience running one of the company's most successful businesses. Clearly, we remain in good hands.

2016 was again a year of strong progress. I look for us to continue to build momentum in 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 focus my comments on operating earnings for the quarter and full year; net income, including performance of the investment portfolio; and I'll close with an update on capital deployment.

The fourth quarter was a very strong finish to a record-setting year. Total company reported a record $372 million of after-tax operating earnings in fourth quarter 2016, up 23% over the year ago quarter. Our diversified business model again demonstrates that it will grow profitably through an ever volatile macroeconomic environment. Reported fourth quarter 2016 earnings per share was $1.27 compared to the fourth quarter 2015 earnings per share of $1.02, up 24%. However, in fourth quarter 2016, we had 2 substantially offsetting variances: higher variable investment income and lower-than-expected encaje returns.

For the full year 2016, we delivered a record $1.3 billion in both total company after-tax operating earnings and net income. Compared to 2015, on a reported basis, operating earnings were up 5% and net income increased 8%. Excluding the negative impact of the 2016 actuarial review and the positive impact of the 2015 actuarial review, operating earnings were up over 11% and net income was up nearly 15% and ROE improved more than 80 basis points. These strong results reflect the good growth in the business, disciplined expense management, favorable variable investment income and balanced capital deployment. While variable investment income was more favorable than our expectations for the year, it was predominately due to real estate sales and prepayment fees that were back-end loaded in the last half of the year.

Throughout 2016, the volatility in the domestic and international equity markets as well as the fixed income market impacted our AUM. The daily average S&P 500 Index was up 1.6% for the full year, depressed due to the drop in the equity market in the first quarter of 2016. The rise in interest rates in the fourth quarter of the year offset the drop in interest rates through the first 3 quarters but negatively impacted our fourth quarter fixed income AUM. As Dan mentioned, AUM was up over 12% in 2016 and will contribute to future earnings growth. As always, aligning growth in expenses with growth in revenue was top of mind throughout 2016, as we focused on balancing growth and profitability while still investing in our businesses. Disciplined expense management will continue to be a focus in 2017.

Now I'll discuss the business unit results starting on Slide 6 with the fee-based earnings of Retirement and Income Solutions, or RIS-Fee. Fourth quarter reported pretax operating earnings of $124 million were flat when compared to the year ago quarter. Higher variable investment income was offset by higher amortization expense. Quarterly net revenues increased 3% from the prior year quarter driven by growth in the business and higher variable investment income. Full year 2016 pretax operating earnings were flat relative to 2015 levels driven by an increase in net revenue and strong expense discipline. Additionally, excluding the actuarial assumption review, the trailing 12-month pretax return on net revenue of 33% ended the year above our 2016 guided range of 28% to 32%.

RIS-Fee's full year net cash flows was $4.2 billion or 2.4% of beginning of year account values, reflecting strong sales and retention as well as solid growth in recurring deposits. Net cash flow was slightly negative in fourth quarter 2016 due to a few large contract lapses despite strong sales of $2.9 billion during the quarter. In 2016, recurring deposits increased 6%, and we added nearly 1,000 net new defined contribution plans over the prior year as differentiators like PlanWorks and Total Retirement Suite continue to resonate with clients. As we look forward to 2017, we remain optimistic as the fundamentals of the business remains strong.

Turning to Slide 7. RIS-Spread reported pretax operating earnings of $88 million for fourth quarter 2016. Excluding $12 million of higher variable investment income during the quarter, pretax operating earnings were $76 million. This was a 21% increase over the year ago quarter driven by growth in the business. We delivered a record $2 billion of pension risk transfer sales and capitalized on attractive opportunities in Investment Only in 2016. Coupled with strong fixed annuity sales, account values increased 13% over the prior year.

In the pension risk transfer business, our niche focus on plans under $500 million in assets and our ability to handle complex cases differentiates us in the industry. In 2016, the spread business capitalized on the growing demand for guaranteed income in retirement. The rising interest rate environment is fueling a strong pipeline and additional opportunities for sales growth in 2017. On a trailing 12-month basis and excluding the impact of the actuarial assumption review, pretax return on net revenue was 62%. This is

above our guided range due in large part to the high level of variable investment income and continued expense discipline in 2016.

Slide 8 shows Principal Global Investor's fourth quarter record pretax operating earnings of $134 million, a 31% increase over the prior year quarter. This growth in earnings was driven by higher revenue across the board: management fees driven by growth in AUM, large performance fees primarily from real estate and transaction and borrower fees as well as continued discipline in expense management. 2016 pretax return on operating revenue less pass-through commissions increased to 37% on a trailing 12-month basis. This reflects continued demand for our outcomes-orientated solutions, our success in high added value niche strategies and our strong expense discipline.

As Jim mentioned in our 2017 outlook call, Principal Global Investors anticipates overall growth in management fees as well as transaction and borrower fees. However, we do anticipate lower levels of performance fees in 2017, strictly due to fewer incidents of multiyear performance fees. Additionally, we want to remind you of the seasonality in PGI's earnings. The fourth quarter is typically the highest due to timing of year-end performance fees and first quarter is usually the lowest due to elevated payroll taxes. As we look forward to 2017, the institutional pipeline remains very strong.

As shown on Slide 9, excluding $11 million of unfavorable encaje performance in fourth quarter 2016, pretax operating earnings for Principal International were $77 million, a 15% increase over the year ago quarter. In addition, relative to the prior year quarter, Principal International fourth quarter pretax earnings benefited from foreign currency tailwinds but was more than offset by the impact of lower inflation. Excluding the impacts of encaje and the actuarial assumption review, Principal International's 2016 combined pretax return on net revenue was 38% and within our guided range.

Other highlights for the quarter included record quarterly pretax earnings of $18 million from our Asian operation. Brasilprev maintained its leadership position in terms of market share and captured over 50% of industry net deposits in 2016. Principal International plays an advocacy role in many of these emerging retirement markets and there will be periods of disruption as shown in Chile. That said, we have a diverse group of businesses and we will remain on track to meet our guidance as we outlined in our 2017 outlook call.

On Slide 10, Specialty Benefits fourth quarter reported pretax operating earnings were $72 million. Excluding $5 million of higher variable investment income during the quarter, pretax operating earnings were $67 million, up 18% over the year ago quarter. The growth in earnings was driven by benefits of scale and underlying growth in the business. As a reminder, there is seasonality in Specialty Benefits earnings. Dental and vision claims are highest in the first quarter and lowest in the fourth quarter. As a rule of thumb, typically 20% of full year pretax operating earnings occur in the first quarter, 25% in the second and third quarters and 30% in the fourth quarter.

On a trailing 12-month basis, the Specialty Benefits loss ratio of 64% is at the lower end of our guided range driven by our disciplined underwriting and our focus on the smaller end of the market. Strong sales and persistency have driven in-force coverages up 9% to nearly 150,000 in 2016. Pretax return on premium and fees in Specialty Benefits was 13% on a trailing 12-month basis, excluding the impact of the actuarial assumption review. This is a 90 basis point increase from our prior year period, reflecting the benefits of scale and favorable loss ratios.

As shown on Slide 11, Individual Life pretax operating earnings were $35 million for the quarter, up 17% from the prior year quarter, reflecting effective expense management on a growing block of business. The trailing 12-month pretax return on premium and fees increased to 15% or 40 basis points from the prior year period. Both Specialty Benefits and Individual Life insurance are growing faster than their respective industries due to our focus on the small- to medium-sized business market and service differentiators. Specialty Benefits continues to drive significant top line growth while expanding margins. Individual Life continues to have in-line mortality as well as success with its differentiating capabilities in the business market.

Corporate's 2016 pretax operating losses of $219 million were more favorable than our guided range driven by expense management. Additionally, 2017 will benefit from our 2016 debt refinancing with lower interest expense of $19 million.

For the quarter, total company net income was $318 million, including net realized capital losses of $2 million, which included $19 million of credit-related losses. Total credit losses continued to be below our pricing expectations in 2016. We expect this trend to continue in 2017.

Included in other after-tax adjustments for the quarter was a $52 million loss due to the prepayment penalty associated with a very successful refinancing of our debt and capital restructure.

In conjunction with the rise in interest rates during the quarter, net unrealized gains in the U.S. investment operations fixed maturity portfolio fell to $1.3 billion at the end of 2016. This represents a large drop from third quarter 2016 but is higher than the $1.1 billion net unrealized gain at year-end 2015. As a reminder, we have a disciplined approach to asset/liability management regardless of the interest rate environment. Our investment portfolio reflects characteristics of our liabilities. It is high quality and diversified by industry, geography, property type and individual credit exposures. As a result of our disciplined approach to asset/liability management, we are not forced sellers in times of distress.

As outlined on Slide 12, we used a balanced approach when weighing our capital deployment options to enhance long-term value for shareholders. Our goal is to deploy between 65% to 70% of net income in any 1 year with variability in any given period. In 2016, we deployed $856 million of capital or 65% of net income. Deployments include $465 million in common stock dividends; $257 million in share repurchases, $94 million in debt reduction with our fourth quarter 2016 debt refinancing and $40 million in increased ownership in our investment boutiques. In both 2014 and 2015, we were above our capital deployment guidance. In 2016, we were within our guided range.

While we didn't find the right M&A opportunity in 2016, the pipeline looks strong going into 2017. We proactively issued debt in the fourth quarter to refinance near-term maturities, and as a result, we extended our maturity profile while lowering ongoing interest expense. Additionally, we completed a tender offer during the quarter that reduced balance sheet debt and lowered our leverage ratio. This adds to our financial flexibility and better positions us for future opportunities.

As shared in our 2017 outlook call, we plan to deploy $800 million to $1.1 billion of capital in a strategic and balanced manner to enhance long-term value for shareholders. The full year common stock dividend was $1.61 per share. This is a 7% increase over full year 2015 as we continue to increase our payout ratio towards our 40% target. Additionally, last night, we announced a $0.45 per share common stock dividend payable in first quarter 2017. This represents a $0.02 increase above the previous quarter's dividend and is an 11% increase on a trailing 12-month basis. Despite the volatility that we experienced in 2016, our diversified and integrated business model continues to perform well under many different economic scenarios.

This is my last earnings call and has a significantly better feel than my first few calls in 2008 and 2009. This management team executes. And with Deanna transitioning into the CFO role in the coming weeks, I'm very excited about the possibility this company has heading into 2017, and I believe Principal is well positioned for continued profitable growth well beyond 2017. I have appreciated my time meeting with everyone and being given the opportunity to tell the Principal story to anyone who will listen. I will miss our interactions, most of them anyway. Thanks for making my time as Principal's CFO very enjoyable and memorable.
This concludes our prepared remarks. Operator, please open the call for questions.

Question and Answer

Operator

[Operator Instructions] Our first question is from the line of John Barnidge with Sandler O'Neill.

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

Firstly, congrats to Terry, on your retirement, and I hope you enjoy watching the Lady Bulldogs basketball team. A couple of questions. Firstly, and then I'll have a follow-up, net revenue grew nicely in RIS-Spread in the fourth quarter in 2016. How much of that is sustainable? And did you see like a tick-up post-election from companies feeling more comfortable, having more clarity?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Is there a second question, John?

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

Yes, yes, yes. And then your benefit from the dividend-received deduction in full year 2016, what was that? And can you talk about the corporate tax reform kind of in that context?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Sure, be happy to. And just a couple of quick comments on Full Service Accumulation. I'll ask that Nora ask -- answer your question specifically on the net revenue sustainability in the fourth quarter. This franchise is incredibly strong franchise for Full Service Accumulation. Net new growth and the number of plans there this year was 1,000, we saw 120,000 new participants. We had net cash flow fall well within the range that we had outlined for you this past fall. So I would just tell you on a trailing 12-month basis, and I'd look at that business for the last 5 years, this just continues to perform to our satisfaction on a number of different metrics, and certainly fourth quarter revenue is something that we can chat about briefly.

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

So John, you asked about spread, and let's talk a little bit about the net revenue growth there because there is a significant amount that's being driven by the business. So if you look at quarter-over-quarter on RIS-Spread, net revenue is up about 23%, $25 million; OE up about 40%, $25 million. If you look at the breakdown on that delta, the net revenue growth driven by the higher variable investment income is about $12 million of that, and then the growth in the business is really driving the balance. So when you look at mean account value and you look at the increase quarter-over-quarter, that's about a 13% increase. And its strong growth that's being driven across the product lines. We mentioned the pension risk transfer business, but we also have the Investment Only business in there as well as our retail annuities. And so we're seeing growth in each of those underlying line items, significant growth that's driving this double-digit increase in account value, net revenue and then operating earnings.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Thanks, Nora. Terry, do you want to tackle the tax question?

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

Yes, John. Let's focus on tax. And when we talk about tax, in particular for Principal, you want to look at it over a longer period of time. You don't want to look at any volatility that could happen in any one particular quarter. As we talked about the different effective tax rates for Principal, we gave guidance at the beginning of the year that would be within the 20% to 22% range. Now when you look at it, we reported an effective tax rate of just over 20% this quarter. However, because of the annual actuarial review in the third quarter, if you looked at that and adjusted for that, it would be right in that 21% range. And so the number's in line with what we said. Now as you've commented, there are some permanent differences that we get a benefit from, and the DRD is one of those. That has an impact of about anywhere from 8%, 9%, 10% of that reduction in that federal 35% tax rate. So -- and it's about in line with what we've seen in 2015, up slightly. But one of the things that we're seeing, the reasons for that -- the increase in that DRD benefit is because of the domestic equity performance that we've seen. That's been very, very strong, and that's where we get our benefit: the target date funds with the positive flows that we've had there and the strong performance that we've had as well as investments that individuals as well as advisors are directing their funds to our Principal branded investments and higher dividends. People are simply paying higher -- companies are paying higher dividends. And so that is expected to continue into the future. However, as we've given the guidance for 2017, we think the effective tax rate will go up into that 21%, 23% range because pretax earnings are going to grow faster than those permanent differences. And in particular, we think that it'll grow faster than the DRD. I hope that helps.

Operator

Our next question is from the line of John Nadel with Credit Suisse.

John Matthew Nadel
Crédit Suisse AG, Research Division

And Terry, I wish you all the best. I guess, a couple of questions. In PGI, can you quantify for us how much the performance fees and real estate gains contributed to the quarter because it seems to me that, that was a pretty significant contributor? I know 1Q was relatively weak for maybe some different reasons. But if you can just comment on that, that would be helpful. And then in RIS-Fee, I hate to sort of get down and dirty into the details, but can we talk about what the right or normalized level of net DAC amortization you expect going forward because that's been swinging a lot?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Yes. Good question, and I -- as you answered -- or asked that question, John, I was reflecting back to when we really saw a lot of volatility in that number. And as you know we took some steps, it's been probably, Terry, within the last couple of years to narrow that down, but there remains some volatility. John, on the PGI, quantifying that, I'll just ask Jim to respond accordingly. Jim?

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

Yes. Thank you. Thank you, John. If it had been a totally normal quarter, if there is such a thing, we might have had pretax $4 million or $5 million less. I think that's about the extent of it. We didn't call it out because if you look in the supplement on Page 3, other revenue is the line that includes performance fees and transaction fees. For the 12 months, as a whole, that was 24% of management fee revenue. The previous 2 trailing 12-months we're -- the previous 2 calendar years, it was 23% and 26%. In other words, performance fees plus transaction fees was at a normal level in 2016 compared with the previous 2 years and relative to our business structure. So I don't think it was an unusual year for performance fees and the quarter was maybe $4 million or $5 million better than it would have been had it been totally normal on that particular basis. But looking forward, we have called out that the incidence of real estate performance fees, which are mostly multiyear, in 2017 will be a bit lower than it was in the last 3 years, picking up in 2018 and 2019, by the way. Since these are multiyear, we already have quite a lot of visibility into the 3-year outlook. So 2017 looks like the outlier when you take the 2 or 3 years either side of it. That's why in the guidance call, as Terry mentioned, we talked about 4% to 8% growth in revenues

for PGI 2017 over 2016. That is a lower number than long term, we expect, and that is because of the fact that we've had a decent and normal couple of years for incentive fees, and 2017 may be a little bit below trend.

John Matthew Nadel
Crédit Suisse AG, Research Division

That's very helpful.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Ironically enough, Jim, I was thinking about that in the context of the first quarter, we were light, and you had a lot of confidence about Q2, 3 and 4. And it's really developed as we really had planned and expected. So there's some level of predictability in these.

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

Yes, there is. And actually, the first quarter last year was down because the transaction fees were small because of activity, and we're not seeing that at the moment.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Nora, you want to talk a little about the DAC moving around here?

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Sure. So John, yes, certainly, this 4Q and 3Q we saw it bounce around quite a bit. And we're always going to see it bounce around a bit. Remember, in RIS-Fee, we have both that full service retirement business and our VA business. But we still expect the range, if there's a normal range, we would still expect that range to be somewhere between $15 million and $20 million per quarter. What you saw in 4Q at $23.7 million and the reason we called it out as high is it was outside that range, $6 million to $7 million or so higher amort, resulting from a couple of things, primarily what we see in that point-to-point actuarial exercise is, because of the interest rate jump and because of our fixed income portfolio getting that unfavorable reaction there and the interest rate increase and also our international equity performance. So that unfavorable performance drove some of that excess DAC amort as well as just some timing issues as part of that normal quarterly roll forward. So yes, it will bounce around but both 4Q and 3Q tended to be outside the range, which is why we called it out. We're still looking at an expected range of between $15 million and $20 million.

John Matthew Nadel
Crédit Suisse AG, Research Division

And just as a quick follow-up. I think you guys mentioned that in RIS-Fee, that higher variable investment income was offset by this -- or offset this higher DAC amortization. Is that -- do I have that right, so variable investment income was maybe about that same level?

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Right. So higher variable investment income, so in that $6 million to $7 million range, correct.

Operator

Our next question is from the line of Jimmy Bhullar with JPMorgan.

Jamminder S. Bhullar
JP Morgan Chase & Co, Research Division

Terry, I'd like to wish you a happy retirement as well. I had a few questions. First, on PGI, obviously, this is just one quarter and -- but for the year, your flows were pretty strong. But to what extent have you seen -- or have you seen an impact on your flows and client activity just from the weaker short-term performance that you've seen recently in terms of investment performance? And then second, if you could talk about trends in the Chilean business, what are you seeing in the market and what your outlook is for the business given everything that's going on there.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Just one quick comment, Jimmy, that PGI has just had an extraordinary run. As I look at the last decade, strong growth, strong performance, great mix in our products. Jim has done a great job assimilating a nice group of boutiques. And when I think about 4 out of 5 of those boutiques having positive net cash flow, it leaves with you with 1 in 5 of those boutiques that, for one reason or another, are not performing at the same level. But with that sort of backdrop, I'll have Jim address your specific question.

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

Thank you, Jimmy. The reason that the fourth quarter was an unusually negative one in flows is almost entirely to do with foreign clients who hedge their international, primarily dollar, balances back into their home currency. The biggest piece of that is Japanese clients, where we have $20 billion of Japanese clients who hedge back into the yen. The yen was weak by 15% in the quarter against the U.S. dollar. That's a straight impact on assets under management of about $3 billion just from the Japanese clients. There was more from Europe. The euro was not as weak as the Japanese yen during the quarter, but it still led to some losses from hedging, which, as you'll realize, is actually client driven. They want something that's hedged back into their home currency. So in round numbers, there was about a $4 billion diminution of AUM from the foreign currency hedging directed by clients. About half of that comes through the line flows. And so you'll see that without that, we would have been positive. Maybe there's hope on this one, Jimmy, because the dollar has weakened again in January which is actually, through the hedge mechanism, bringing in some assets from those Japanese and European clients. So I think that's the main point to make. Clearly, in terms of investment performance, we are not the standout winner in 2016 that we were for many years, we're in the middle of the pack. If you look at the supplement on Page 14, it shows boutique by boutique the AUM numbers. Only 2 of our boutiques are down in the year. That's Columbus Circle, which is a growth equity manager, it's been a tough year for them; and Macro Currency Group, where we had the large passive mandate that went out in the first quarter. That, by the way, had pretty well no revenues. It was very low revenues being passive. So those are the only 2 boutiques, and the only one where there's any impact of revenue is Columbus Circle. I'd point out that our other equity boutiques are generally still growing. Aligned and Edge both have strategies that beat the benchmark as well as the peer group last year. Principal Global Equities and Origin were middle of the pack, which in their description is struggling. But it's not that it's an outlier, and they were certainly gaining assets as they kept client confidence and as they did constructive things in a difficult market. So I would put a pretty brave and pretty positive outlook on this. Our equity boutiques, in general, are in very, very good shape. The sub-advised was down a bit in assets, if you see the assets under management by boutique. Some of our non-affiliate sub-advisors had performance issues, but I think that the PGI set and array of boutiques, the diversification shows up well and we're in very good shape looking forward. The pipeline is as strong as it's ever been right now with interest in our niche strategies.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Jimmy, one of my big takeaways clearly around doing business internationally, whether it's China or India or Chile or Brazil, in these emerging markets, there is some degree of volatility. The good news about Chile to me is that Luis has a very strong team, whether you're talking about the annuity business, the accumulation business on both the AFP as well as the voluntary. But I'll have Luis speak specifically at the heart of some of his take on Chile and the future and what that means for Principal going forward.

Luis E. Valdés

President of Principal International Inc

Okay. Jimmy, this is Luis. As a reminder, and this is very important to keep in mind, Jimmy, one thing that is going on in Chile the pension discussion, pension reform -- by the way, in the 10 country that we're in, this is a common theme everywhere. So we are very active not just in Chile. If you're paying attention about other countries like Brazil, Mexico, even Hong Kong and Southeast Asia, the pension thing and the pension issue is something that is going to remain as a high and hot topics going forward. And we're very, very involved in that kind of discussion, not just with the countries but with lawmakers, think tanks, World Bank, IMF and OECD. So this is going to be a trending topic for the next 3 years, if not more. Having said that 2 things and as a follow-up about what I have said in the last earnings call, we have faced some negative outflows in our portfolio. But it's important to qualify this, Jimmy. We have had in one line, which is our transfer out, that line has been negative. But in the mandatory business, our net customer cash flows in total, including recurring contributions, transfer and others, remain positive. Our voluntary net customer cash flows remain barely positive, but positive. And the main line which is also affecting our total net customer cash flows is about what we call pension, is all about income solutions. Something that we have to keep in mind, we paid in 2016 more than $1.4 billion in what we call income solution. It might be a program with withdrawals or money, which has been transferred to life insurance companies, like the one that we do have in Chile. So the point that I'm trying to make here is 2 main things were affecting our transfers. The main factor was the whole discussion about the pension system and the second subject was about the merger. That second factor we're putting behind as the merger discussion. In mid-December, the superintendency for the third time and for the final time, they put a resolution in which they confirmed the legality of our merger. More than that, last week, the Comptroller General in Chile, they rubber-stamped and they closed the case saying that they confirmed that our merger was fully in compliance and completely legal. More than that, we're going to -- this was an issue that was affecting us for 2 years in a row. And it's important to say that we're working on that, and certainly, the competitors are not going to be able use that argument against us anymore. Three things -- 3 aspects in order to close my comments about our business in Chile, 3 aspects that remain as important fundamentals for our business. Number one, our investment performance. We're #2 in 3- and 5-years in a row. We're #1 since inception. That speaks to our long-term investment capabilities in Chile. Second, customer service. For the fifth consecutive period, we ranked #1 in terms of customer service, and this is an award given by third party in Chile. The third thing is our strong and highly respected branding. Cuprum is a very and highly resilient corporation and brand. We made the ranking of the top 100 most reputable companies at the end of 2016. Just one other AFP made the ranking as well. So we remain very confident, and we're paying a lot of attention about those volatile customers that for any given reason they might decide to leave Cuprum. We're working on that. We're paying a lot of attention about that. We have been able in order to identify those segments, and we're working on that in order to increase and to work on that -- in that particular segment. So short term speaking, some volatility is coming. 2017 is election year for Chile, so presidential election is in November, so the pension discussion is going to be on the table. But on the other hand, we remain very confident about our long term in that business.

Operator

Our next question is from the line of Seth Weiss with Bank of America.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Had a question just on the timing of the incentive fees out to 2017 and I just want to make sure I'm interpreting this right. You commented that the lower guidance for '17, that 48%, incorporates that viewpoint there. The '17 guidance, it's just that low point that's -- the midpoint is like 0.5% lower. So are we talking in the range of like $5 million, that's the impact to top line and bottom line in terms of those yearly incentive fees?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Go ahead, Jim.

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

Thanks very much, Seth. No, it's not -- I can't really give you it that precisely because there are so many moving parts to incentive fees. The basic reason that we see 2017 as low is many of these incentive fees are multiyear. For example, the biggest one -- or one of the biggest ones in the second and third -- sorry, the third and fourth quarters of 2016 was on our green fund, our green real estate fund that we launched in, I think it was 2008 -- 2008, '09. And that fund got to the end of its life. The developments had been done, the real estate sold at a very considerable profit. And that's where the incentive fees came from. If I look forward, 2017 is a bit light on these long-term incentive fees. There are some, but there's not very -- not as much as usual. 2018, 2019, we see a lot of resurgence in the seeds we've planted in the last few years that should give us good incentive fees in those years. So that's really the point. It's not that I can pin on $4 million or $5 million here or there on incentive fees. Even on, say, Finisterre, where it's emerging debt and there's a lot of incentive fee possibility, it's not possible to be precise. There's simply -- we put ourselves in the way of that opportunity. But in aggregate you can predict, even if for any one it's highly uncertain what the incentive fee will be. And I think the stability of our other revenue line shows that we have a good portfolio of these opportunities. So I hope that helps put it in perspective, Seth.

Seth M. Weiss
BofA Merrill Lynch, Research Division

It's helpful. I mean, it sounds from your commentary that you have maybe not a level of precision but at least a general sense of how much lower they may be in '17. So I'm just trying to set the baseline of what that is as we try to triangulate our models. So if there's any number you could give, that would be helpful in terms of not having any surprises.

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

Yes. It's in that 4% to 8% overall revenue gain guidance. That's where it's encapsulated. Gosh, what would have it been if 2017 was going to be 2016 all over again? It's hard to speculate, but it might have been high single to low double digits. So I mean, I think that quantifies it.

Seth M. Weiss
BofA Merrill Lynch, Research Division

Okay. And then I'm sorry, if I could just follow up one on RIS-Spread. You commented earlier on the strong net revenue gains. There's been a nice tick-up in margins also in the back half of the year. Just curious if that's sustainable and what's driving that, if it's been stronger interest rates or if there's anything seasonal there that's driving that, that should repeat next year.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Nora?

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Yes. Those margins are likely unsustainable and over and above the guidance that we gave on the 2017 outlook call. And it's primarily driven by that higher-than-expected variable investment income. So you can connect those 2 dots. It's certainly a very attractive business. We expect to continue to drive these industry-leading margins, but this particular quarter is unsustainable.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Yes. Correct.

Operator

Our next question is from the line of Erik Bass with Autonomous Research.

Erik Bass

I guess, there have been a number of recent lawsuits against 401(k) plan sponsors related to fees and bias in fund selection. So what impact do you see this having on plan sponsors and their decisions regarding things like active versus passive or manager selection?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Those issues have gone on for a long time, class action lawsuits going after these sorts of issues. And it's frankly one of the reasons why we adopted an open architecture approach over 10 years ago to make sure that advisors working as advisors to their plan sponsors that they would have a full suite of investment options to choose from whether that was PGI, whether it was where we subcontracted because so many of our large, small- to medium-sized employers may not have that level of expertise. But that window for all the other outside retail mutual fund offerings had been wide open for a very long time. And as you know, even on our target date structure, we have an open architecture approach. So if you're asking a question about Principal and what our exposure is, we feel like we've done an exceptional job providing lots of choice by manager, by asset class and, in particular, all the way down to the small-sized clients. And even the DOL rules that are currently proposed does not in any way infringe upon that continued model to make those investment options broadly available in a variety of different structures. And I probably hit that one a bit hard, but I'll look at Nora and see if she has anything else she like to add onto that response.

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

No, well said. The only thing I would add is that when you think about a plan sponsor who's a fiduciary, they need -- that fiduciary needs to be looking at many, many things, price being one of them. And one of the things that's as important as price is the investment strategy, in particular, for the qualified default. And Dan spoke to it, but I think it's really important to highlight how we've addressed that issue. And one of the reasons our target date continues to be such -- in such strong demand is with this hybrid approach, in particular, allowing in that bundled solution to have both passive and active: passive in those very efficient asset classes; active, where active is absolutely part of that fiduciary equation. You can think about different asset classes where you would want active management. So that bundled solution has been very powerful and really resonates both with plan sponsors, fiduciaries and also with their advisors. But that's an example, to Dan's point, where we were out ahead both with regard to the multi-manager structure but also with regard to the hybrid investment structure.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Jim, did you have a comment...

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

Yes. And if I could just add, Erik, I do think looking forward, our broad range of target date solutions, which Nora touched on and Dan did, which includes different legal vehicles, 40 Act funds, insurance separate accounts and collective investment trusts, it includes use of active, enhanced passive and passive, we have a very strong range of capabilities. That's why, as was mentioned during the quarter and during the year, we've seen significant inflows to our target date suite. Furthermore, I think the environment you described will over the next few years give us opportunities in the defined contribution investment-only market for target date funds. So we're feeling pretty optimistic about all the work we've done over the years to position ourselves for growth.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Erik, did you have a follow-up?

Erik Bass

Yes. No, that's helpful color. And then on the target date funds, maybe if you could just quantify what the flows have been because, obviously, it's been in the news with T. Rowe last week. And I think also we, on the public data, for mutual funds only see sort of a portion of the activity, and you obviously have them in other vehicles as well. So if you could just talk about the overall flow trend and target date that will be helpful.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Yes. This seems to be getting a lot of airtime in the last couple of weeks. And so we've done our homework, and you're right, it's a partial story just to talk about the 40 Act funds. But Nora, because she leads that retirement franchise, is probably in the best position to answer your question.

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Yes. And to Dan's earlier comments, we were positive overall with our target date suite, both in 4Q and full year, full year at about $4.5 billion and in 4Q about $600 million. So that took that total AUM, with regard to our target date suite, increased from $53.6 billion at the end of 3Q to $54.2 billion at the end of 4Q. And again, if you look at that AUM, it includes both retirement plans and retail investors, but the vast majority of that AUM is in our retirement business.

Daniel J. Houston
Chairman, Chief Executive Officer and President

Of course, the one thing that's changed over the years is there's the 40 Act funds, we have managed accounts, we have separate accounts, we have collective investment trusts. And as you say, the public screens don't catch all those assets. And at $4.5 billion on a full year basis for target date, that's a very, very strong number for Principal.

Operator

Our next question is from the line of Sean Dargan with Wells Fargo.

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

I'd also like to extend my best wishes to Terry. Just following up on RIS-Fee, just have a question about flows. So if you had net inflows of $600 million in target date funds, where were the outflows? And how much of that was caused by M&A taking funds away from you?

Nora Mary Everett
Chairman of Principal Funds and President of Retirement & Income Solutions

Sure. So the net cash flow with regard to RIS-Fee in the fourth quarter, and I think Terry mentioned this in his comment, was really impacted by, and we've talked about this before, a couple of larger cases in our block of business can impact that net cash flow in a particular quarter. Very strong net cash flow full year at $4.2 billion, in fact, $4 billion increase year-over-year in the full year net cash flow. So we're really pleased with the net cash flow. A couple of those cases were absolutely related to M&A. We're going to win some. We're going to lose some. We had a couple that our particular client was the acquired or part of a merger, so we're going to see that. We saw a little bit of that a year ago, 4Q as well. But we're really pleased with our overall net cash flow results. And we would expect -- just looking at the momentum we see in the sales pipeline, we're optimistic about 2017 as well.

Daniel J. Houston
Chairman, Chief Executive Officer and President

That help Sean?

Sean Robert Dargan
Wells Fargo Securities, LLC, Research Division

Yes, it does. And if I could just ask a follow-up about China. You had very strong net cash flows in the first 3 quarters, and there's been a fairly sharp reversal in the fourth quarter. Is there some seasonality in there? Or can you give us some color on what happened there?

Daniel J. Houston
Chairman, Chief Executive Officer and President

Well, I think the reality is the long-term funds are actually quite stable. It's the short term, what I'll describe as money market structure that is most problematic. But -- and very quickly, I'll have Luis answer that last question.

Luis E. Valdés
President of Principal International Inc

Sean, the real reason about this massive inflows coming from CCB is what's due to necessarily the decision that the central government in China made, which is they called a lending cap. They tried to deleverage that economy, so they put a lending cap to those banks. So the excess money that they had on time deposit there flows into asset managers. That's one of the reasons of this massive flow into our company. Having said that, we expect that, that particular lending company is going to remain. We don't know in which level. So that's telling us that part of that money flew back into CCB, but the most important thing is that they reroute part of that short term mandates. $11 billion, I'm talking about $11 billion, they reroute $11 billion into our retail mutual funds. So even though that we faced $23 billion in outflows, our revenues didn't suffer that much. In fact, we are facing an increase, about 2% or 3%, in our revenues in spite of this $23 billion outflow.

Operator

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

Daniel J. Houston
Chairman, Chief Executive Officer and President

Just a couple of quick comments. The first of which, I would say, is we feel like we had a very solid 2016. But as Terry iterated, we remain very optimistic about '17. The demand for products that we provide to small- to medium-sized employers, individual and institutions has not gone away. We still see the small- to medium-sized business as the growth engine for the U.S., and seems like tax policy and other policies are going to be supportive of that. These baby boomers are going to need income and retirement. We're enthusiastic about that. A lot of our digital investments are driving towards a millennial solution, and you heard about some of those today. Long-term financial security is not going to go away in the U.S. nor in Chile or in China. We feel good about that. And frankly, we feel good about Nora's businesses when you talk about that spread business. People want guaranteed income in retirement. We don't think being a stand-alone investment manager is the right answer nor just an accumulation firm. We think the fact that we can provide a comprehensive approach to retirement long-term protection is very important, in addition to providing, of course, life insurance or your benefits. But I'd be remiss if I didn't look at Terry Lillis and first, say, to thank you and let Terry Lillis give the very last word of this call today to all the analysts and investors out there. Terry?

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

Thanks, Dan. It's been a good run, and I look back and I reflect on it, we're in a much stronger position now in terms of our strategy on a go-forward basis, a much stronger position in terms of our capital. And I think we have the best years still ahead of Principal. We take a balanced approach and make sure that we reflect the needs of our customers, our staff and our shareholders. And thank you all very much for the support that you've given me over the last several years.

Daniel J. Houston

Chairman, Chief Executive Officer and President

So thank you. We'll see you on the road with Deanna over the next 90 days, and look forward to seeing you very soon. Have a great day. Bye.

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 day, February 7, 2017. 42828234 is the access code for the replay. The number to dial for the replay is (855) 859-2056, U.S. and Canadian callers, or (404) 537-3406 for international callers.