Participants:  James Nelson, Dean Rowland, Randy Freund, Cheryl McCullough
(Federal Reserve Bank of Chicago)

Larry Zimpleman, Greg Elming, Barrie Christman, Tim Dunbar, Mike Streck,
Terry Lillis, Karen Shaff, Julia Lawler and Elizabeth Swanson
(Principal Financial Group)

Summary:  Representatives of the Federal Reserve Bank of Chicago met with representatives of Principal Financial Group. The representatives from Principal commented on the Board’s recent NPR for regulatory capital rules (Regulatory Capital Rules: Regulatory Capital, Implementation of Basel III, Minimum Regulatory Capital Ratios, Capital Adequacy, Transition Provisions, and Prompt Corrective Action, and Standardized Approach for Risk-weighted Assets; Market Discipline and Disclosure Requirements, FRS Docket No. R-1442) issued June 7, 2012. Principal representatives expressed concern about including unrealized gains/losses in capital ratio calculations for insurance companies, including non-guaranteed separate accounts in the denominator of the leverage ratio, the deduction of 200 percent of the Authorized Control Level NAIC Risk Based Capital for insurance companies, and timing of the end of the comment period and the implementation date. A copy of the written presentation provided by Principal is attached.
Federal Reserve Board
Notices of Proposed Rules
Re: Capital Requirements

Principal Financial Group Meeting
With Federal Reserve Bank of Chicago
August 6, 2012
Savings & Loan Holding Company
Key Areas of Concern

• Important differences between SLHCs & BHCs
• Key Areas of Concern to SLHCs
  – Treatment of unrealized G & L from an insurers view
  – Treatment of Separate Accounts in Leverage Ratio
  – Treatment of NAIC RBC Requirements
  – Effective Date
• Proposals
Unrealized G & L Treatment for Insurers
Value of Asset Liability Management

• Insurance companies are in the business of managing risk
• Asset & Liability Management is a key risk management tool
  – Industry Data: Duration of 7 years for fixed income investments
  – An unrealized loss does not necessarily mean increased risk
  – If liability durations are also 7 years, the asset cash flows are financially aligned with liability cash flows
  – Insurance products often discourage or may not allow early withdrawals (e.g. payout annuity, surrender charges, etc.)
  – We price for expected losses
• Illustrated by examples on next three pages
Results are for Principal Life Insurance Company
Asset Liability Management:

ACTUAL ASSET CASH FLOW

Results are for Principal Life Insurance Company
Asset Liability Management:

ACTUAL NET CASH FLOW

Results are for Principal Life Insurance Company and do not reflect any cash positions that may exist at the holding company level.

In summary

- Liability and asset portfolios are performing as expected
- Strong ALM means we are not forced sellers
- Managed to a stress/panic environment

Actual NCF
Cash balance

$ in millions

Jan-09, Mar-09, May-09, Jul-09, Sep-09, Nov-09, Jan-10, Mar-10, May-10, Jul-10, Sep-10, Nov-10, Jan-11, Mar-11, May-11, Jul-11, Sep-11, Nov-11
Unrealized G & L Treatment for Insurers
Concern & Proposals

• Current proposal creates capital volatility
  – Using a rule of thumb, a 1% rise in interest rates would decrease asset market values by 7% (Using a duration of 7 years)
  – This volatility is largely unreal and does not reflect real or expected capital impacts

• Proposals
  – Remove unrealized G&L treatment from capital ratios
  – Stress testing is a far better tool for understanding the risks that may occur from unrealized losses
  – NAIC capital requirements use asset & liability duration measures which is another option
Treatment of Separate Accounts in Leverage Ratio

• Non-guaranteed separate accounts have no risk to insurer

• Impact of inclusion in the Leverage Ratio
  – Total Assets increased by non-guaranteed separate accounts
  – Drives the ratio lower; without increased risk
  – Effectively a 4% capital charge on non-guaranteed Separate Accounts

• Proposal: Remove non-guaranteed separate accounts from Leverage Ratios
Treatment of NAIC RBC Requirements

• Federal capital framework covers credit and interest rate risks
• State RBC reqs. also cover credit and interest rate risks
• NPR’s remove state RBC requirements from capital
  – Double counting credit and interest rate risks
  – This is an unnecessary adjustment for insurers

• Proposal
  – Capital should only be reduced by the insurance risk / non-bank portion of state RBC requirements
  – Also known as the C-2 Component
SLHC Effective Date

- The NPRs contain a January 1, 2013 effective date with numerous phase-in provisions
- Dodd Frank requires SLHC to have consolidated minimum capital requirements by July 21, 2015
- The federal capital framework is new for SLHCs
- Preparation time is needed to implement framework
- Proposal - Defer impact on SLHCs until July 21, 2015
Key Take Aways

• Unrealized Gains & Losses
  – Not an issue for insurers with effective ALM
  – Stress testing is best means for assessing this risk

• Non-Guaranteed Separate Accounts
  – Removed from Leverage Ratio

• NAIC RBC Capital Adjustment
  – Reduce adjustment to only cover Insurance Risks (C-2)

• SLHC Effective Date Changed to July 21, 2015

• Extend the comment period by 90-days