GRIFFON CORP
Form S-3
September 26, 2003

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As filed with the Securities and Exchange Commission on September 26, 2003

Registration No. 333-

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM S-3

**REGISTRATION STATEMENT
UNDER
THE SECURITIES ACT OF 1933**

GRIFFON CORPORATION

(Exact name of Registrant as Specified in Its Charter)

Delaware	**11-1893410**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

**100 Jericho Quadrangle
Jericho, New York 11753
(516) 938-5544**

(Address, Including Zip Code, and Telephone Number, Including Area Code, of Registrant's Principal Executive Offices)

**Robert Balemian
100 Jericho Quadrangle
Jericho, New York 11753**

(Name, Address, Including Zip Code, and Telephone Number, Including Area Code, of Agent for Service)

Copies to:

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Approximate date of commencement of proposed sale to the public: From time to time following the effectiveness of this registration statement.

If the only securities being registered on this form are being offered pursuant to dividend or interest reinvestment plans, please check the following box o.

If any of the securities being registered on this form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, other than securities offered only in connection with dividend or interest reinvestment plans, check the following box ý.

If this form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering o.

If this form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. o

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box o.

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to be Registered	Amount to be Registered	Proposed Maximum Offering Price Per unit	Proposed Maximum Aggregate Offering Price	Amount of Registration Fee
4.0% Contingent Convertible Subordinated Notes due 2023	$130,000,000	100%(1)(2)	$130,000,000(1)(2)	$10,517
Common Stock, par value $.25 per share(3)	5,387,484(4)	(5)	(5)	(5)

(1) Estimated solely for the purpose of calculating the registration fee pursuant to Rule 457(i) of the Securities Act of 1933, as amended.

(2) Exclusive of accrued interest, if any.

(3) Includes associated preferred stock purchase rights ("Rights") to purchase 11/10,000 of a share of Series A Junior Participating Preferred Stock, par value $0.25 per share, subject to adjustment. Rights initially are attached to and trade with the common stock of the Registrant and will not be exercisable until the occurrence of specified events.

(4) Represents the number of shares of common stock that are initially issuable upon conversion of the 4.0% Contingent Convertible Subordinated Notes due 2023 registered hereby. For purposes of estimating the number of shares of common stock issuable upon conversion of the notes, the Registrant used a conversion price of $24.13 per share of common stock. In addition to the shares set forth in the table, pursuant to Rule 416 under the Securities Act of 1933, as amended, the amount of common stock registered hereby also includes such indeterminate number of shares of common stock, including the associated Rights, as may be issuable from time to time upon conversion of the notes as a result of stock splits, stock dividends and antidilution adjustments.

(5) No additional consideration will be received for the common stock and, therefore, no registration fee is required pursuant to Rule 457(i).

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Subject to Completion, Dated September 26, 2003

The information contained in this prospectus is not complete and may be changed. These securities may not be sold until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

$130,000,000

GRIFFON CORPORATION

4.0% Contingent Convertible Subordinated Notes Due 2023

and
the Common Stock Issuable upon Conversion of the Notes

This prospectus relates to the resale by various selling securityholders of $130,000,000 aggregate principal amount of our 4.0% contingent convertible subordinated notes due 2023 and shares of our common stock into which the notes are convertible. The notes and shares may be offered and sold from time to time by the securityholders specified in this prospectus or their successors in interest. See "Selling Securityholders." The notes and shares are being registered pursuant to an agreement with the initial purchasers of the notes. The selling securityholders will receive all of the proceeds from the sale of the securities under this prospectus. We will not receive any proceeds from the sale of securities under this prospectus by the selling securityholders.

We will bear the expenses in connection with the offering, including filing fees and our legal and accounting fees, estimated at $90,000.

Our common stock is quoted on the New York Stock Exchange under the symbol "GFF." On September 23, 2003, the last reported sales price of the common stock on the New York Stock Exchange was $18.30.

The notes are not listed on any securities exchange or approved for quotation through any automated system.

Investing in our notes and common stock involves risks. See "Risk Factors" beginning on page 6.

Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of these securities or determined if this prospectus is truthful or complete. Any representation to the contrary is a criminal offense.

The date of this prospectus is September 26, 2003.

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You should rely only on the information contained or incorporated or deemed to be incorporated by reference in this prospectus. We have not authorized anyone to provide you with different information. Neither the notes nor any shares of common stock issuable upon conversion of the notes are being offered in any jurisdiction where the offer or sale is not permitted. The information contained in this prospectus speaks only as of the date of this prospectus and the information in the documents incorporated or deemed to be incorporated by reference in this prospectus speaks only as of the respective dates those documents were filed with the Securities and Exchange Commission.

This prospectus contains summaries of certain provisions contained in some of the documents described herein, but reference is made to the actual documents for complete information. All of the summaries are qualified in their entirety by the actual documents. Copies of some of the documents referred to herein have been filed or incorporated by reference as exhibits to the registration statement of which this prospectus is a part and you may obtain copies of those documents as described below under "Where You Can Find More Information."

SUMMARY

This summary contains basic information about us and this offering. Because it is a summary, it does not contain all of the information that you should consider before investing. You should read this entire prospectus and all the information that it incorporates by reference carefully, including the section entitled "Risk Factors" and our financial statements, the related notes and the management's discussion and analysis of our financial condition and results of operations for the periods covered by those financial statements, all of which are incorporated by reference into this prospectus, before making an investment decision. Unless the context indicates otherwise, all references in this offering memorandum to "Griffon," the "company," "our," "us" and "we" refer to Griffon Corporation and its subsidiaries.

Griffon Corporation

We are a diversified manufacturing company with operations in four business segments: garage doors; installation services; specialty plastic films; and electronic information and communication systems. Our garage doors segment designs, manufactures and sells garage doors for use in the residential housing and commercial building markets. The installation services segment sells, installs and services garage doors, garage door openers, manufactured fireplaces, floor coverings, cabinetry and a range of related building products primarily for the new residential housing market. Our specialty plastic films segment develops, produces and sells plastic films and film laminates for use in infant diapers, adult incontinence products, feminine hygiene products and disposable surgical and patient care products. Our electronic information and communication systems segment designs, manufactures, sells and provides logistical support for communications, radar, information, command and control systems and large-scale integrated circuits for defense and commercial markets.

As of June 30, 2003, we had approximately 5,400 employees. Our principal executive offices are located at 100 Jericho Quadrangle, Jericho, New York 11753. Our telephone number is (516) 938-5544. Our web site is *www.griffoncorp.com*. The information contained on our web site is not incorporated by reference in this prospectus.

We were incorporated on May 18, 1959 under the laws of the State of New York, and reincorporated in Delaware in 1970. Our name was changed to Griffon Corporation in 1995.

You can get more information regarding our business by reading our Annual Report on Form 10-K for the fiscal year ended September 30, 2002, our Quarterly Reports on Form 10-Q for the quarters ended December 31, 2002, March 31, 2003 and June 30, 2003, and the other reports we file with the SEC. See "Where You Can Find More Information" on page 46.

The Offering

Issuer	Griffon Corporation
Securities Offered	$130 million aggregate principal amount of 4.0% Contingent Convertible Subordinated Notes due 2023 and shares of our common stock issuable upon conversion of the notes.
Maturity	July 18, 2023.
Ranking	The notes are our unsecured subordinated obligations. The notes rank junior in right of payment to all of our existing and future senior indebtedness. We and our subsidiaries are not restricted by the notes or the indenture under which the notes were issued from incurring additional indebtedness or liens.

Interest Payment Dates	January 18 and July 18 of each year, beginning January 18, 2004.
Contingent Interest	In addition to regular interest on the notes, beginning with the six-month interest period beginning July 18, 2010, contingent interest will also accrue during any six-month interest period where the average trading price of a note for the five trading day period ending on the third trading day immediately preceding the first day

of such six-month interest period equals $1,200 or more. During any period in which contingent interest accrues, the contingent interest payable on the notes will be 0.50% per annum based on such average trading price.

Conversion Rights	Holders may surrender notes for conversion into shares of our common stock prior to the maturity date in the following circumstances:

- during any calendar quarter if our common stock price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter preceding the quarter in which the conversion occurs is more than 120% of the conversion price per share of our common stock on that 30th trading day;
- if we have called the particular notes for redemption and the redemption has not yet occurred;
- during the five trading day period after any five consecutive trading day period in which the trading price of $1,000 principal amount of the notes for each day of such five-day period was less than 95% of the product of our common stock price on that day multiplied by the number of shares issuable upon conversion of $1,000 principal amount of the notes; or
- upon the occurrence of specified corporate transactions described under "Description of the Notes Conversion Rights."

Holders may convert any outstanding notes into shares of our common stock at an initial conversion price per share of $24.13. This represents a conversion rate of approximately 41.4422 shares of common stock per $1,000 principal amount of notes. The conversion price is subject to adjustment, but will not be adjusted for accrued interest, contingent interest or for liquidated damages referred to under "Description of the Notes Registration Rights." Upon conversion, the holder will not receive any cash payment representing accrued but unpaid interest, including contingent interest and liquidated damages, if any. Instead, such accrued interest will be deemed paid by the shares of common stock received upon conversion.

In respect of any note presented for conversion, in lieu of delivering shares of common stock upon conversion of that note, we may elect to pay the holder cash in an amount equal to the product of the number of shares of common stock issuable upon conversion of that note and the average of the common stock price for the five consecutive trading days following either:

- our notice of our election to deliver cash, which we must give within two business days after receiving a conversion notice unless we have earlier given notice of redemption as described herein; or
- the conversion date, if we have given notice of redemption of that note specifying that we intend to deliver cash upon conversion after the redemption notice.

Optional Redemption	We may redeem some or all of the notes at any time on or after July 26, 2010, at a price equal to 100% of the principal amount of the notes, plus accrued but unpaid interest, including contingent interest and liquidated damages, if any, up to but not including the date of redemption, payable in cash. See "Description of the Notes Optional Redemption of the Notes."
Sinking Fund	None.
Repurchase of Notes at the Option	You may require us to purchase all or a portion of your notes on July 18, 2010, of the Holder 2013 and 2018 for a purchase price equal to 100% of the principal amount plus accrued but unpaid interest, including contingent interest and liquidated damages, if any, up to, but not including, the date of repurchase, payable in cash. See "Description of the Notes Repurchase of Notes at the Option of the Holder."
Change in Control	If a change in control, as that term is defined in "Description of the Notes Right to Require Purchase of Notes upon a Change in Control," occurs, you will have the right to require us to repurchase all or a portion of your notes for a period of time after the change in control. The repurchase price will be equal to 100% of the principal amount of the notes, plus accrued but unpaid interest, including contingent interest and liquidated damages, if any, to the date of repurchase, payable in cash.
Form of the Notes	The notes are represented by one or more global notes in fully registered form, without coupons, deposited with a custodian for, and registered in the name of a nominee of, The Depository Trust Company, or DTC. Beneficial interests in the global notes are shown on, and transfers of those beneficial interests are effected only through, records maintained by DTC and its participants. See "Description of Notes Book-Entry System."

Ratio of Earnings to Fixed Charges	The following table presents the ratio of earnings to fixed charges for Griffon Corporation and its consolidated subsidiaries for each of the periods indicated.

Years ended September 30,					
1998	**1999**	**2000**	**2001**	**2002**	**Nine months ended June 30, 2003**
4.3	2.6	2.8	3.6	5.2	5.6

For the purpose of calculating the ratio of earnings to fixed charges, "earnings" consist of income before income taxes plus "fixed charges" and certain other adjustments. "Fixed charges" consist of interest incurred on all indebtedness, amortization of debt issuance costs, and the portion of rent expense deemed representative of the interest factor.

Use of Proceeds	The selling securityholders will receive all of the net proceeds from the sale of the notes or shares of common stock issued upon conversion of the notes. We will not receive any of the proceeds from the sale of any of these securities.
Registration Rights	Pursuant to a registration rights agreement that we entered into in connection with the private offering of the notes in July 2003, we have filed a shelf registration statement under the Securities Act of 1933 relating to the resale of the notes and the common stock issuable upon conversion of the notes. This prospectus constitutes a part of that registration statement. We filed the shelf registration statement solely to permit the resale of notes issued in the July 2003 private offering and shares of common stock issued upon conversion of those notes, and investors who purchase notes or shares of common stock from selling securityholders in this offering will not be entitled to any registration rights under the registration rights agreement. In addition, under the registration rights agreement, selling securityholders may be required to discontinue the sale or other disposition of notes and shares of common stock issued upon conversion of notes pursuant to the shelf registration statement and to discontinue the use of this prospectus under certain circumstances specified in the registration rights agreement.
Risk Factors	See "Risk Factors" and the other information in, and incorporated by reference into, this prospectus for a discussion of factors you should carefully consider before deciding to invest in the notes or the shares of common stock issuable upon conversion of the notes.
Trading	There is no public market for the notes and we do not intend to apply for listing of the notes on any securities exchange or for quotation of the notes through any automated quotation system. The notes currently trade in the PORTAL Market. However, once the notes are sold under this prospectus, those notes will no longer trade in the PORTAL Market. No assurance can be given that a trading market for the notes will exist or as to the liquidity of any trading market for the notes that may exist. Our common stock is listed on the New York Stock Exchange under the symbol "GFF."

Tax Summary

Pursuant to the indenture under which the notes are issued, each holder agrees to treat the notes, for United States federal income tax purposes, as "contingent payment debt instruments" as provided in Treasury Regulation section 1.1275-4 and to be bound by our application of the Treasury regulations that govern contingent payment debt instruments, including our determination that the rate at which interest will be deemed to accrue for United States federal income tax purposes is 8.5%, compounded semi-annually. Accordingly, each holder will recognize taxable income significantly in excess of cash received while the notes are outstanding. In addition, a U.S. Holder will recognize ordinary income upon a sale, exchange, conversion, redemption or repurchase of the notes at a gain. See "Certain United States Federal Income Tax Consequences."

RISK FACTORS

Investing in the notes and underlying shares of common stock involves a high degree of risk. You should carefully consider the following factors, in addition to the other information contained in, or incorporated by reference into, this prospectus, in determining whether or not to purchase notes or underlying shares of our common stock.

Risks Relating to our Business

We operate in highly competitive industries and may be unable to compete effectively with other companies.

We face intensive competition in each of our markets. We have a number of competitors, some of which are larger than us and have greater resources than we do. We compete primarily on the basis of competitive prices, technical expertise, product differentiation, and quality of products and services. In addition, there can be no assurance that we will not encounter increased competition in the future, which could have a material adverse effect on our business.

If we were to lose any of our largest customers, our results of operations could be significantly harmed.

A small number of customers have accounted for a substantial portion of our historical net sales, and we expect that a limited number of customers will continue to represent a substantial portion of our net sales for the foreseeable future. Approximately 18% of our total sales and 70% of our specialty plastic films sales for the fiscal year ended September 30, 2002 were made to Procter & Gamble, which is our largest customer in the specialty plastic films segment. Our significant customers in our garage doors and electronic information and communication systems segments are The Home Depot, Inc. and Boeing Co. and Lockheed Martin Corp., respectively. Our future operating results will continue to substantially depend on the success of our largest customers and our relationships with them. Orders from these customers are subject to fluctuation, and may be reduced materially. Any reduction or delay in sales of our products to one or more of these customers could significantly harm our business. Our operating results will also depend on our ability to successfully develop relationships with additional key customers. We cannot assure you that we will retain our largest customers or that we will be able to recruit additional key customers.

Increases in raw material costs could adversely impact our financial condition and operating results.

We purchase raw materials from various suppliers. While all our raw materials are available from numerous sources, commodity raw materials are subject to fluctuations in price. Because raw materials in the aggregate constitute significant components of our cost of goods sold, such fluctuations could have a material adverse effect on our results of operations. Our ability to pass on to our customers increases in raw material prices is limited, and there is generally a time lag between our increased costs and our ability to increase our prices. We have not always been able to increase our prices to fully recoup our increased expense levels. In addition, sharp increases in raw material prices are more difficult to pass through to the customers in a short period of time and may negatively affect our short-term financial performance. For example, recent price increases in plastic resins, which are the basic raw materials used in the manufacture of substantially all of our specialty plastic films products, have reduced our profit margin for the nine months ended on June 30, 2003. The supply agreements that we enter into relating to plastic resin purchases do not specify fixed pricing terms. Therefore, we are more sensitive to price changes in plastic resins.

Trends in the housing sector and in general economic conditions will directly impact our business.

Our garage doors and installation services segments are influenced by construction of new homes and renovation of existing homes. For the year ended September 30, 2002, approximately 53% of our total net sales were related to new home construction and renovation of existing homes. Trends in the

housing sector directly affect our financial performance. Accordingly, the strength of the U.S. economy, the age of existing home stock, job growth, interest rates, consumer confidence and the availability of consumer credit, as well as demographic factors such as the migration into the United States and migration of the population within the United States have a direct effect on our business. The declining interest rates in the recent period have generated strong growth in the housing sector. If interest rates increase or there are adverse changes in any of the other factors affecting trends in the housing sector, activities in new housing construction and renovation of existing homes may decrease. Such a decrease may have a material adverse effect on our business, operating results or financial condition.

Our electronic information and communication systems segment depends heavily upon government contracts.

Our electronic information and communication systems segment sells products to the U.S. government primarily as a subcontractor. We are generally a first tier supplier to prime contractors in the defense industry such as Boeing Co., Lockheed Martin Corp., Northrop Grumman Systems Corp. and BAE Systems Aerospace Inc. In the fiscal year ended September 30, 2002, U.S. government contracts and subcontracts

accounted for approximately 9% of our sales. Our contracts involving the U.S. government may include various risks, including:

- Termination by the government;
- Reduction or modification in the event of changes in the government's requirements or budgetary constraints;
- Increased or unexpected costs causing losses or reduced profits under contracts where our prices are fixed, or unallowable costs under contracts where the government reimburses us for costs and pays an additional premium;
- The failure or inability of the prime contractor to perform its contract in circumstances where we are a subcontractor;
- The failure of the government to exercise options for additional work provided for in the contracts; and
- The government's right in certain circumstances to freely use technology developed under these contracts.

The programs in which we participate may extend for several years, but are normally funded on an annual basis. The U.S. government may not continue to fund programs to which our contracts relate. Even if funding is continued, we may fail to compete successfully to obtain funding pursuant to such programs.

There can be no assurance that the capital expansion program that we are implementing in our specialty plastic films segment will be completed on schedule or that it will generate the revenue and profits anticipated.

Our specialty plastic films segment has implemented a capital expansion program in fiscal year 2003 to support new opportunities with its major customers and to increase capacity throughout its operations. Equipment and plant additions over the next two years are anticipated to total between $60 and $70 million. Our new plants and equipment are not yet fully operational and are not yet making significant contributions to revenue. There can be no assurance that this capital expansion program will be completed on schedule or that it will generate the revenue or profits anticipated.

We must continually improve existing products, design and sell new products and manage the costs of research and development in order to compete effectively.

The markets for our specialty plastic films and electronic information and communication systems segments are characterized by rapid technological change, evolving industry standards and continuous

improvements in products. Due to constant changes in these markets, our future success depends on our ability to develop new technologies, products, processes and product applications.

We develop our technologies and products through internally funded research and development and strategic partnerships with our customers. Because it is generally not possible to predict the amount of time required and the costs involved in achieving certain research and development objectives, actual development costs may exceed budgeted amounts and estimated product development schedules may be extended.

Our business, financial condition and results of operations may be materially and adversely affected if:

- we are unable to improve our existing products on a timely basis;

our new products are not introduced on a timely basis or do not achieve sufficient market penetration;

we incur budget overruns or delays in our research and development efforts; or

our new products experience reliability or quality problems.

The loss of certain key officers or employees could adversely affect us.

The success of our business is materially dependent upon the continued services of certain key officers and employees. The loss of such key personnel could have a material adverse effect on our business, operating results or financial condition.

Our segments are subject to seasonal variations.

Historically, our revenues and earnings are lowest in the second fiscal quarter ending on March 31 and highest in the fourth fiscal quarter ending September 30. The quarterly operating results fluctuation is mainly due to the seasonality in our garage doors and installation services segments, whose primary revenues are driven by residential construction and renovation. Cold weather in the winter months usually reduces the level of building and remodeling activity in both the home improvement and new construction markets and, accordingly, has an adverse effect on the demand for our garage door products and installation services. Seasonal fluctuation in the demand for our garage door products and installation services could have a material adverse effect on our results of operations. Because a high percentage of our manufacturing overhead and operating expenses is relatively fixed throughout the year, operating margins have historically been lower in quarters with lower sales. As a result, our operating results and stock price could be volatile, particularly on a quarterly basis.

We are exposed to a variety of risks relating to our international sales and operations, including local economic and political conditions and fluctuations in exchange rates.

We own properties and conduct operations in Europe and South America through our foreign subsidiaries. Sales of our products from our foreign subsidiaries accounted for approximately 13% of our net sales for the fiscal year ended September 30, 2002. These foreign sales could be adversely affected by changes in various foreign countries' political and economic conditions, trade protection measures, differing intellectual property rights and changes in regulatory requirements that restrict the sales of our products or increase our costs. Currency fluctuations between the U.S. dollar and the currencies in the foreign countries or regions in which we do business may have an impact on our future operating results.

We may not be able to protect our proprietary rights.

We rely on a combination of patent, copyright and trademark laws, trade secrets, confidentiality and non-disclosure agreements and other contractual provisions to protect our proprietary rights. Such measures provide only limited protection. We cannot assure you that our means of protecting our proprietary rights will be adequate or that competitors will not independently develop similar technologies.

We are exposed to product liability claims.

We may be exposed to product liability claims in the future relating to the performance of our products or the performance of a product in which any of our products was a component part. There can be no assurance that product liability claims will not be brought against us in the future, either by an injured customer of an end product manufacturer who used one of our products as a component or by a direct purchaser from us. In addition, no assurance can be given that indemnification from our customers or coverage under insurance policies will be adequate to cover future product liability claims against us. Moreover, liability insurance is expensive, difficult to maintain and may be unobtainable in the future on acceptable terms. The amount and scope of any insurance coverage may be inadequate if a product liability claim is successfully asserted against us. Furthermore, if any significant claims are made against us, our business may be adversely affected by any resulting negative publicity.

We have been, and may in the future be, subject to claims and liabilities under environmental laws and regulations.

Our operations and assets are subject to federal, state, local and foreign environmental laws and regulations pertaining to the discharge of materials into the environment, the handling and disposal of wastes, including solid and hazardous wastes, or otherwise relating to health, safety and protection of the environment. We do not expect to make any expenditures with respect to ongoing compliance with or remediation under

these environmental laws and regulations that would have a material adverse effect on our business, operating results or financial condition. However, the applicable requirements under the law may change at any time.

We can also incur environmental liabilities in respect of sites that we no longer own or operate, as well as third party sites to which we sent hazardous materials in the past. We cannot assure you that material costs or liabilities will not be incurred in connection with such claims. A site in Peekskill in the town of Cortland, New York was previously owned and used by two of our subsidiaries. The Peekskill site was sold in December 1982. In 1984, we were advised by the New York State Department of Environmental Conservation ("DEC") that random sampling of the Peekskill site indicated concentrations of solvents and other chemicals common to the operations of our subsidiary that used the site. In May 1996, our subsidiary that formerly owned the site entered into a consent order with the DEC to investigate and remediate the environmental condition at this site, including the performance of a remedial investigation and feasibility study. After completing the initial remedial investigation, such subsidiary now is required to perform a supplemental remedial investigation under the consent order. We believe, based on facts presently known to us, that the outcome of this matter will not have a material adverse effect on our operating results and financial condition. We cannot assure you, however, that the discovery of presently unknown environmental conditions, changes in environmental laws and regulations or other unanticipated events will not give rise to claims that may involve material expenditures or liabilities.

Our compliance with restrictions and covenants in our debt agreements may limit our ability to take corporate actions and harm our business.

Our debt agreements contain a number of covenants that significantly restrict our ability to issue additional debt and our ability to pay dividends. Under our revolving credit agreement we are also required to comply with specific financial ratios and tests. We may not be able to comply in the future with these covenants or restrictions as a result of events beyond our control, such as prevailing economic, financial and industry conditions. If we default in our compliance with the covenants and restrictions in our debt agreements, our lenders could declare all of the principal and interest amounts outstanding due and payable and terminate their commitments to extend credit to us in the future. If we are unable to secure credit in the future, our business could be harmed.

Risks Relating to an Investment in the Notes and Our Common Stock

Our obligations under the notes are unsecured and are subordinated to all of our existing and future senior debt.

Our obligations under the notes are unsecured and rank junior in priority of payment to all of our present and future senior debt. As a result, upon any distribution to our creditors in a bankruptcy, liquidation or reorganization or similar proceeding relating to us or our property, the holders of our senior debt will be entitled to be paid in full and before any payment may be made with respect to the notes. In the event of a bankruptcy, liquidation or reorganization or similar proceeding relating to us, holders of the notes will participate with trade creditors and any holders of our subordinated indebtedness in the assets remaining after we have paid all of our senior debt. In addition, upon a payment default with respect to designated senior debt, a covenant default entitling designated senior debt to accelerate or upon acceleration of the notes, the holders of our senior debt will be entitled to be paid before any payment will be made on the notes. As of June 30, 2003, we had approximately $49 million of outstanding debt under our revolving credit agreement, which was repaid with some of the proceeds received from the sale of the notes to the initial purchasers. However, we may borrow amounts under our revolving credit agreement and any other senior credit facilities in the future. We also have or may incur new or additional obligations under letters of credit, guarantees, foreign exchange contracts or interest swap contracts that will be senior to our obligations under the notes. The notes and the related indenture do not limit our ability to incur additional indebtedness, liabilities and obligations.

Creditors of our subsidiaries will get paid before you will get paid.

We operate our business through our subsidiaries. Accordingly, we are dependent upon the cash flows of, and receipt of dividends and advances from, or repayments of advances by, our subsidiaries in order to meet our debt obligations, including our obligations under the notes. The notes are not guaranteed by our subsidiaries and, consequently, our subsidiaries are not obligated or required to pay any amounts pursuant to the notes or to make funds available in the form of dividends or advances. In the future, we may change some portion of our business that we operate through our subsidiaries. Any payment of dividends, distributions, loans or advances by our subsidiaries will also be contingent upon our subsidiaries' earnings and are subject to contractual or statutory restrictions.

In addition, our right to participate in any distribution of assets of any of our subsidiaries, upon any subsidiary's bankruptcy, liquidation, reorganization or similar proceeding, and thus your ability as a holder of the notes to benefit indirectly from such distribution, will be subject to the prior claims of creditors of that subsidiary, except to the extent that any of our claims as a creditor of such subsidiary may be recognized. As a result, the notes are structurally subordinated to all existing and future liabilities and obligations of our subsidiaries, if any. Therefore, holders

of the notes should look only to our assets for payments on the notes. The notes and the related indenture do not limit the ability of

any of our subsidiaries to incur additional indebtedness, liabilities or obligations. As of June 30, 2003, our subsidiaries had approximately $191 million in liabilities.

If we experience a change in control, we may be unable to purchase your notes as required under the indenture.

Upon a change in control, as defined in the indenture, you will have the right to require us to repurchase your notes. If we experience a change in control and do not have sufficient funds to pay the repurchase price for all of the notes you tendered, an event of default under the indenture governing the notes would occur as a result of such failure. In addition, a change in control might breach a covenant under our revolving credit agreement and may be otherwise restricted by that facility, and may be prohibited or limited by, or create an event of default under, other agreements relating to borrowings that we may enter into from time to time. Borrowings under our revolving credit agreement are, and other borrowings are likely to be, senior indebtedness. Therefore, a change in control at a time when we cannot pay for your notes that are tendered as a result of such change in control could result in your receiving substantially less than the principal amount of the notes. See "Description of the Notes Right to Require Purchase of Notes upon a Change in Control" and " Subordination."

Our reported earnings per share may be more volatile because of the conversion contingency provision of the notes.

Holders of the notes are entitled to convert the notes into shares of our common stock, among other circumstances, if the common stock price for the periods described in this prospectus is more than 120% of the conversion price. Unless and until this contingency or another conversion contingency is met, the shares of our common stock underlying the notes are not included in the calculation of our basic or fully diluted earnings per share. Should this contingency be met, fully diluted earnings per share would, depending on the relationship between the interest on the notes and the earnings per share of our common stock, be expected to decrease as a result of the inclusion of the underlying shares in the fully diluted earnings per share calculation. Volatility in our stock price could cause this condition to be met in one quarter and not in a subsequent quarter, increasing the volatility of fully diluted earnings per share.

You will recognize income for federal income tax purposes significantly in excess of current cash payments.

We intend to treat the notes as contingent payment debt instruments for U.S. federal income tax purposes. As a result of this treatment, if you acquire notes, you will be required to include amounts in income significantly in excess of the stated interest on the notes. Any gain you recognize will generally be ordinary interest income; any loss will be ordinary loss to the extent of interest on the notes previously included in income and, thereafter, capital loss. There is some uncertainty as to the proper application of the Treasury regulations governing contingent payment debt instruments, and if our treatment were successfully challenged by the Internal Revenue Service, it might be determined that, among other things, you should have accrued interest income at a lower or higher rate, should not have recognized ordinary income upon the conversion, and should have recognized capital gain or loss, rather than ordinary income or loss upon a taxable disposition of the notes. See "Certain United States Federal Income Tax Consequences."

We expect that the trading value of the notes will be significantly affected by the price of our common stock and other factors.

The market price of the notes is expected to be significantly affected by the market price of our common stock. This may result in greater volatility in the trading value of the notes than would be expected for nonconvertible debt securities. In addition, the notes have a number of features, including conditions to conversion, which, if not met, could result in a holder receiving less than the value of our

common stock into which a note would otherwise be convertible. These features could adversely affect the value and the trading prices of the notes.

There is no public market for the notes.

We issued the notes in July 2003 in a private offering made to "qualified institutional buyers," as defined in Rule 144A under the Securities Act. The offering was made through a group of investment banks, which we refer to as the "initial purchasers." Prior to that offering there was

no trading market for the notes. Although the initial purchasers advised us at the time of that offering that they intended to make a market in the notes, they are not obligated to do so and may discontinue such market making at any time without notice. Accordingly, there can be no assurance that any market for the notes will develop or, if one does develop, that it will be maintained. If an active market for the notes fails to develop or be sustained, the value of the notes could be materially adversely affected.

There is no public market for the notes and we do not intend to apply for listing of the notes on any securities exchange or for quotation of the notes through any automated quotation system. The notes issued to qualified institutional buyers in the July 2003 offering currently trade on the PORTAL Market. However, once notes are sold under this prospectus, those notes will no longer trade on the PORTAL market.

We may be unable to raise additional financing necessary to conduct our business, make payments when due or refinance our debt.

We may need to raise additional funds in the future in order to implement our business plan, to refinance our debt or to acquire complementary businesses or products. Any required additional financing may be unavailable on terms favorable to us, or at all. If we raise additional funds by issuing equity securities, holders of common stock may experience significant dilution of their ownership interest and these securities may have rights senior to those of the holders of our common stock.

Our indebtedness and interest expense will limit our cash flow and could adversely affect our operations and our ability to make full payment on your notes.

Upon consummation of the offering contemplated hereby, we will have an increased level of debt and interest expense. Our indebtedness poses risks to our business, including the risks that:

- we could use a substantial portion of our consolidated cash flow from operations to pay principal and interest on our debt, thereby reducing the funds available for working capital, capital expenditures, acquisitions, product development and other general corporate purposes;

- insufficient cash flow from operations may force us to sell assets, or seek additional capital, which we may be unable to do at all or on terms favorable to us; and

- our level of indebtedness may make us more vulnerable to economic or industry downturns.

We have the ability to issue additional equity securities, which would lead to dilution of our issued and outstanding common stock.

The issuance of additional equity securities or securities convertible into equity securities would result in dilution of existing stockholders' equity interests in us. We are authorized to issue, without stockholder approval, 3,000,000 shares of preferred stock in one or more series, which may give other stockholders dividend, conversion, voting, and liquidation rights, among other rights, which may be superior to the rights of holders of our common stock. Our board of directors has the authority to issue, without vote or action of stockholders, shares of preferred stock in one or more series, and has the ability to fix the rights, preferences, privileges and restrictions of any such series. Any such series of preferred stock could contain dividend rights, conversion rights, voting rights, terms of redemption,

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redemption prices, liquidation preferences or other rights superior to the rights of holders of our common stock. Our board of directors has no present intention of issuing any such preferred stock, but reserves the right to do so in the future. In addition, we are authorized to issue, without stockholder approval, up to 85,000,000 shares of common stock, of which approximately 32,609,432 shares were outstanding as of June 30, 2003. We are also authorized to issue, without stockholder approval, securities convertible into either shares of common stock or preferred stock.

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

All statements other than statements of historical fact included or incorporated by reference in this prospectus, including without limitation statements regarding our financial position, business strategy, and the plans and objectives of our management for future operations, are forward-looking statements within the meaning of the securities laws. When used in this prospectus, words such as "anticipate," "believe," "estimate," "expect," "intend" and similar expressions, as they relate to the company or our management, identify forward-looking statements. Such forward-looking statements are based on the beliefs of our management, as well as assumptions made by and information currently available to our management. Actual results could differ materially from those contemplated by the forward-looking statements as a result of certain factors, including but not limited to, business and economic conditions, competitive factors and pricing pressures, capacity and supply constraints. Such statements reflect our views with respect to future events and are subject to these and other risks, uncertainties and assumptions relating to our operations, results of operations, growth strategy and liquidity. Readers are cautioned not to place undue reliance on these forward-looking statements. We do not undertake any obligation to release publicly any revisions to these forward-looking statements to reflect future events or circumstances or to reflect the occurrence of unanticipated events.

You should carefully read the "Risk Factors" section of this prospectus for a description of certain risks that could, among other things, cause our actual results to differ from those predicted or anticipated in the forward-looking statements.

USE OF PROCEEDS

The selling securityholders will receive all of the net proceeds from the sale of the notes or shares of our common stock issued upon conversion of the notes. We will not receive any of the proceeds from the sale of any of these securities.

DESCRIPTION OF THE NOTES

We issued the notes under an indenture between us and American Stock Transfer & Trust Company, as trustee. The following description is only a summary of the material provisions of the notes, the related indenture and the registration rights agreement. We urge you to read the indenture, the notes and the registration rights agreement in their entirety because they, and not this description, define your rights as holders of the notes. Copies of the indenture, including the form of note, and the registration rights agreement have been filed as exhibits to the registration statement of which this prospectus is a part and you may request copies of the indenture or registration rights agreement at our address shown under the caption "Where You Can Find More Information" on page of this prospectus. The terms of the notes include those stated in the indenture and those made part of the indenture by reference to the Trust Indenture Act of 1939, as amended. For purposes of this section, references to "the company," "we," "us," "our" and "Griffon" include only Griffon Corporation and not its subsidiaries.

General

We issued the notes in an aggregate principal amount of $130,000,000. The notes are our unsecured obligations, subordinated in right of payment to senior indebtedness to the extent provided in the indenture and will mature on July 18, 2023, unless earlier redeemed at our option as described under " Optional Redemption of the Notes," repurchased by us at a holder's option on certain dates as described under " Repurchase of Notes at the Option of the Holder," repurchased by us upon a change in control of Griffon as described under " Right to Require Purchase of Notes Upon a Change in Control" or converted at a holder's option as described under " Conversion Rights."

Interest on the notes accrues at 4.0% per annum and is payable semiannually on January 18 and July 18 of each year, commencing on January 18, 2004. Interest on the notes accrues from the initial date of issuance or, if interest has already been paid, from the date on which it was most recently paid. We will make each interest payment to persons who are holders of record of the notes on the immediately preceding January 1 and July 1, whether or not this day is a business day. Interest (including contingent interest and liquidated damages, if any) payable upon redemption or repurchase is paid to the person to whom principal is payable unless the redemption or repurchase date is between the close of business on any record date for the payment of interest and the opening of business on the related interest payment date. Interest on the notes is computed on the basis of a 360-day year comprised of twelve 30-day months. We will pay the principal of, and interest (including contingent interest and liquidated damages, if any) on, the notes at the office or agency maintained by us in the Borough of Manhattan in New York City. Holders may register the transfer of their notes at the same location. We reserve the right to pay interest to holders of the notes by check mailed to the holders at their registered addresses. However, a holder of notes with an aggregate principal amount in excess of $1,000,000 may request payment by wire transfer in immediately available funds to an account in North America. The notes were issued only in fully registered book-entry form, without coupons, and are represented by one or more global notes. There is no service charge for any registration of transfer or exchange of notes. We may, however, require holders to pay a sum sufficient to cover any tax or other governmental charge payable in connection with any transfer or exchange.

The indenture does not contain any restriction on the payment of dividends, the incurrence of indebtedness or liens or the repurchase of our securities, and does not contain any financial covenants. Other than as described under " Right to Require Purchase of Notes upon a Change in Control," the indenture contains no covenants or other provisions that afford protection to holders of notes in the event of a highly leveraged transaction.

Contingent Interest

Subject to the accrual, record date and payment provisions described above, beginning with the six-month interest period commencing July 18, 2010, contingent interest will also accrue during any six-month interest period where the average trading price (as determined below) for the five trading days ending on the third trading day immediately preceding the first day of such six-month period equals $1,200 or more. During any period in which contingent interest accrues, it will be payable at a rate per annum equal to 0.50% of such average trading price.

Upon determination that contingent interest on the notes will accrue during a relevant six-month period, on or prior to the start of such six-month period, we will issue a press release and notify the trustee. Although the indenture does not obligate us to do so, we also expect to publish such information on our web site at http://www.griffoncorp.com.

The "trading price" of the notes on any date of determination means the average of the secondary market bid quotations per $1,000 principal amount of notes obtained by the trustee for $5,000,000 principal amount of the notes at approximately 3:30 p.m., New York City time, on such determination date from three independent nationally recognized securities dealers we select, provided that if at least

three such bids cannot reasonably be obtained by the trustee, but two such bids are obtained, then the average of the two bids shall be used, and if only one such bid can reasonably be obtained by the trustee, this one bid shall be used. If the trustee cannot reasonably obtain at least one bid for $5,000,000 principal amount of the notes from a nationally recognized securities dealer or, in our reasonable judgment, the bid quotations are not indicative of the secondary market value of the notes, then the trading price of the notes will be determined in good faith by the trustee acting as calculation agent taking into account in such determination such factors as it, in its sole discretion after consultation with us, deems appropriate.

Conversion Rights

Subject to the restrictions described in this "Description of the Notes," a holder may convert any outstanding notes into shares of our common stock at an initial conversion price per share of $24.13. This represents an initial conversion rate of approximately 41.4422 shares per $1,000 principal amount of the notes. The conversion price (and resulting conversion rate) is, however, subject to adjustment as described below. A holder may convert notes only in denominations of $1,000 and integral multiples of $1,000.

General

Holders may surrender notes for conversion into shares of our common stock prior to the maturity date in the following circumstances:

- during any fiscal quarter if our common stock price for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter preceding the quarter in which the conversion occurs is more than 120% of the conversion price per share of our common stock on that 30th trading day;
- if we have called the particular notes for redemption and the redemption has not yet occurred;
- during the five trading day period after any five consecutive trading day period in which the average trading price for each day of such five-day period was less than 95% of the product of the common stock price on that day multiplied by the number of shares issuable upon conversion of $1,000 principal amount of the notes; or
- upon the occurrence of specified corporate transactions.

In addition, in respect of any note presented for conversion, we may, at our option, in lieu of delivering shares of common stock, elect to pay the holder surrendering such note an amount of cash equal to the average of the common stock price for the five consecutive trading days immediately following (a) the date of our notice of our election to deliver cash as described below if we have not given notice of redemption, or (b) the conversion date, in the case of a conversion following our notice of redemption with respect to such note, specifying that we intend to deliver cash upon conversion, in either case multiplied by the number of shares of common stock issuable upon conversion of such note on that date. We will inform holders through the trustee no later than two business days following the conversion date of our election to deliver shares of common stock or to pay cash in lieu of the delivery of shares, unless we have already informed holders of our election in connection with our optional redemption of the notes as described under " Optional Redemption of the Notes." If we deliver only shares of common stock upon conversion, the shares will be delivered through the trustee no later than the fifth business day following the conversion date. If we elect to satisfy all or a portion of our obligation to deliver shares upon conversion in cash, the payment, including any delivery of common stock, will be made to holders surrendering notes no later than the tenth business day following the applicable conversion date. If an event of default, as described under " Events of Default" (other

than a default in a cash payment upon conversion of the notes), has occurred and is continuing, we may not pay cash upon conversion of any notes (other than cash in lieu of fractional shares).

The "common stock price" on any date means the closing sale price per share (or if no closing sale price is reported, the average of the bid and ask prices or, if more than one in either case, the average of the average bid and the average ask prices) on such date for our common stock as reported in composite transactions reported on the principal United States securities exchange on which the common stock is traded or, if the common stock is not listed on a United States national or regional securities exchange, as reported by the Nasdaq System.

If a holder of a note has delivered notice of its election to have such note repurchased at the option of such holder or as a result of a change in control, such note may be converted only if the notice of election is withdrawn as described, respectively, under " Repurchase of Notes at the Option of the Holder" or " Right to Require Purchase of Notes upon a Change in Control."

Conversion Upon Notice of Redemption

A holder may surrender for conversion any note called for redemption at any time prior to the close of business on the day that is two business days prior to the redemption date, even if the notes are not otherwise convertible at such time.

Conversion Upon Satisfaction of Trading Price Condition

A holder may surrender any of its notes for conversion into shares of common stock during the five trading day period immediately after any five consecutive trading day period in which the trading price (as determined following a request by a holder of the notes in accordance with the procedures described below) for each day of such five-day period was less than 95% of the product of the common stock price on that day multiplied by the number of shares issuable upon conversion of $1,000 principal amount of the notes (the "trading price condition"); provided, that if on the date of any conversion pursuant to the trading price condition, the common stock price of our common stock is greater than the effective conversion price but less than 120% of the effective conversion price, then you will receive, in lieu of shares of our common stock based on the conversion rate, shares of our common stock with a value equal to the principal amount of your notes plus accrued but unpaid interest (including contingent interest), if any, as of the conversion date ("principal value conversion"). Shares of our common stock delivered upon a principal value conversion will be valued at the greater of the effective conversion price on the conversion date and the applicable stock price as of the conversion date. We will deliver such common shares no later than the third business day following the determination of the applicable stock price. The "effective conversion price" is, as of any date of determination, a dollar amount (initially $24.13) derived by dividing $1,000 by the conversion rate then in effect (assuming a conversion date eight trading days prior to the date of determination).

The trustee shall have no obligation to determine the trading price of the notes unless we have requested such determination, and we shall have no obligation to make such request unless you provide us with reasonable evidence that the trading price would be less than 95% of the product of the closing sale price of our common stock and the conversion rate. At such time, we shall instruct the trustee to determine the trading price beginning on the next trading day and on each successive trading day until the trading price is greater than or equal to 95% of the product of the closing sale price of our common stock and the conversion rate.

Conversion Upon Specified Corporate Transactions

If we elect to:

- distribute to all holders of our common stock rights, warrants or options entitling them to subscribe for or purchase, for a period expiring within 60 days of the date of distribution, shares of our common stock at less than the then current market price; or

- distribute to all holders of shares of our common stock any assets, debt securities or certain rights to purchase our securities, which distribution has a per share value exceeding 10% of the closing price of our common stock on the day preceding the declaration date for such distribution,

we must notify the holders of notes at least 20 days prior to the ex-dividend date for such distribution. Once we have given such notice, holders may surrender their notes for conversion until the earlier of the close of business on the business day prior to the ex-dividend date or our announcement that such distribution will not take place. This provision shall not apply if the holder of a note otherwise participates in the distribution without conversion.

In addition, if we are a party to a consolidation, merger, share exchange, sale of all or substantially all of our assets or other similar transaction, in each case pursuant to which the shares of our common stock would be converted into cash, securities or other property, a holder may surrender its notes for conversion at any time from and after the date that is 15 days prior to the anticipated date of such transaction until and including the date that is 15 days after the actual date of such transaction. If we are a party to a consolidation, merger, share exchange, sale of all or substantially all of our assets or other similar transaction, in each case pursuant to which the shares of our common stock are converted into cash, securities, or other property, then at the effective time of the transaction, a holder's right to convert its notes into shares of our common stock will be changed into a right to convert such notes into the kind and amount of cash, securities and other property that such holder would have received if such holder had converted such notes immediately prior to the transaction. If the transaction also constitutes a change in control, such holder can require us to repurchase all or a portion of its notes as described under " Right to Require Purchase of Notes upon a Change in Control."

Conversion Rate Adjustments

We will adjust the conversion price if (without duplication):

(1) we issue shares of common stock to all holders of shares of our common stock as a dividend or distribution on our common stock;

(2) we subdivide, combine or reclassify our common stock;

(3) we issue to all holders of our common stock rights, warrants or options entitling them to subscribe for or purchase shares of our common stock at less than the then current market price;

(4) we distribute to all holders of shares of our common stock evidences of our indebtedness, shares of capital stock (other than shares of our common stock), securities, property, rights, warrants or options, excluding: (a) those rights, warrants or options referred to in clause (3) above; (b) any dividend or distribution paid in cash referred to in clause (5) below; and (c) any dividend or distribution referred to in clause (1) above;

(5) we declare a cash dividend or distribution to all or substantially all of the holders of our common stock. If we declare such a cash dividend or distribution, the conversion price shall be

decreased to equal the number determined by multiplying the conversion price in effect immediately prior to the record date for such dividend or distribution by the following fraction:

$$\frac{\text{(Pre-Dividend Sale Price - Dividend Adjustment Amount)}}{\text{(Pre-Dividend Sale Price)}}$$

provided that no adjustment to the conversion price or the ability of a holder of a note to convert will be made if we provide that holders of notes will participate in the cash dividend or distribution without conversion, *provided further* that if the numerator of the foregoing fraction is less than $1.00 (including a negative amount) then in lieu of any adjustment under this clause (5), we shall make adequate provision so that each holder of notes shall have the right to receive upon conversion, in addition to the shares of common stock issuable upon such conversion, the amount of cash such holder would have received had such holder converted such notes on the record date for such cash dividend or distribution;

"Pre-Dividend Sale Price" means the average common stock price for the three consecutive trading days ending on the trading day immediately preceding the ex-dividend date for such dividend or distribution. "Dividend Adjustment Amount" means the full amount of the dividend or distribution to the extent payable in cash applicable to one share of common stock.

(6) we or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer for our common stock to the extent that the cash and value of any other consideration included in the payment per share of common stock exceeds the current market price per share of common stock on the trading day next succeeding the last date on which tenders or exchanges may be made pursuant to such tender or exchange offer; or

(7) someone other than Griffon or one of our subsidiaries makes a payment in respect of a tender offer or exchange offer in which, as of the closing date of the offer, our board of directors is not recommending rejection of the offer. The adjustment referred to in this clause will only be made if: (a) the tender offer or exchange offer is for an amount that increases the offeror's ownership of common stock to more than 25% of the total shares of our common stock outstanding, and (b) the cash and value of any other consideration included in the payment per share of common stock exceeds the current market price per share of common stock on the business day next succeeding the last date on which tenders or exchanges may be made pursuant to the tender or exchange offer. However, the adjustment referred to in this clause will not be made if as of the closing of the offer, the offering documents disclose a plan or an intention to cause us to engage in a consolidation or merger or a sale of all or substantially all of our assets.

If the rights provided for in our shareholder rights agreement, dated as of May 9, 1996, and any subsequent similar rights plan, have separated from our common stock in accordance with the provisions of the rights agreement so that the holders of the notes would not be entitled to receive any rights in respect of shares of our common stock issuable upon conversion of the notes, the conversion price will be adjusted as provided in clause (4) above, subject to readjustment in the event of expiration, termination or redemption of the rights. In lieu of any such adjustment, we may amend our rights agreement to provide that upon conversion of the notes, the holder will receive, in addition to shares of our common stock issuable upon such conversion, the rights that would have attached to such shares of our common stock if the rights had not become separated from our common stock under our rights agreement. To the extent that we adopt any future rights plan, upon conversion of notes into our common stock, you will receive, in addition to our common stock, the rights under the future rights plan whether or not the rights have separated from our common stock at the time of conversion and no adjustment to the conversion price will be made.

Our existing shareholders rights plan expires on May 9, 2006. If we adopt another similar plan in the future, no adjustment will be made in connection with a distribution of rights thereunder.

No adjustment in the conversion price will be required unless the adjustment would require an increase or decrease of at least 1% in the conversion price as last adjusted; provided, however, that any adjustments which by reason of the foregoing are not required to be made will be carried forward and taken into account in any subsequent adjustment.

We will not issue fractional shares of common stock to a holder who converts a note. In lieu of issuing fractional shares, we will pay cash based upon our common stock price on the date of conversion.

Except as described in this paragraph, no holder of notes will be entitled, upon conversion of the notes, to any actual payment or adjustment on account of accrued but unpaid interest, including contingent interest and liquidated damages, if any, or on account of dividends on shares issued in connection with the conversion. If any holder surrenders a note for conversion between the close of business on any record date for the payment of an installment of interest and the opening of business on the related interest payment date, when the holder surrenders the note for conversion, the holder must deliver payment to us of an amount equal to the interest payable on the interest payment date (including contingent interest and liquidated damages, if any) on the principal amount to be converted. The foregoing sentence shall not apply to notes called for redemption on a redemption date within the period between and including the record date and the interest payment date.

If we make a distribution of property to our stockholders that would be taxable to them as a dividend for United States federal income tax purposes and the conversion price of the notes is decreased, this decrease will generally be deemed to be the receipt of taxable income by

holders of the notes and would generally result in withholding taxes for Non-U.S. Holders (as defined in "Certain United States Federal Income Tax Consequences"). See "Certain United States Federal Income Tax Consequences."

We may from time to time reduce the conversion price if our board of directors determines that this reduction would be in the best interests of Griffon. Any such determination by our board of directors will be conclusive. Any such reduction in the conversion price must remain in effect for at least 20 trading days. In addition, we may from time to time reduce the conversion price if our board of directors deems it advisable to avoid or diminish any income tax to holders of our common stock resulting from any stock or rights distribution on our common stock.

Subordination

The payment of the principal of, premium, if any, and interest (including contingent interest and liquidated damages, if any) on the notes is subordinated in right of payment to the prior payment in full, in cash or other payment satisfactory to the holders of senior indebtedness, of all existing and future senior indebtedness. If we dissolve, wind up, liquidate or reorganize, or if we are the subject of any bankruptcy, insolvency, receivership or similar proceedings, we will pay the holders of senior indebtedness in full in cash or other payment satisfactory to the holders of senior indebtedness before we pay the holders of the notes. If the notes are accelerated because of an event of default, we must pay the holders of senior indebtedness in full all amounts due and owing thereunder before we pay the holders of the notes. The indenture requires us to promptly notify holders of senior indebtedness if payment of the notes is accelerated because of an event of default under the indenture.

We may not make any payment on the notes or purchase or otherwise acquire the notes if:

- a default in the payment of any designated senior indebtedness occurs and is continuing beyond any applicable period of grace, or

- any other default in respect of designated senior indebtedness occurs and is continuing that permits holders of the designated senior indebtedness to accelerate its maturity and the trustee

receives a payment blockage notice from a person permitted to give such notice under the indenture.

We are required to resume payments on the notes:

- in case of a payment default, upon the date on which such default is cured or waived or ceases to exist, and

- in case of a nonpayment default, upon the earlier of the date on which such nonpayment default is cured or waived or ceases to exist or 179 days after the date on which the payment blockage notice is received.

No new period of payment blockage based on a nonpayment default may be commenced for a default unless:

- 365 consecutive days have elapsed since the effectiveness of the immediately prior payment blockage notice, and

- all scheduled payments on the notes that have come due have been paid in full in cash.

No nonpayment default that existed or was continuing on the date of delivery of any payment blockage notice shall be the basis for a subsequent payment blockage notice, unless such nonpayment default shall have ceased to exist for a period of at least 60 consecutive days prior to the date of such subsequent payment blockage notice.

As a result of these subordination provisions, in the event of our bankruptcy, dissolution or reorganization, holders of senior indebtedness may receive more, ratably, and holders of the notes may receive less, ratably, than our other creditors. These subordination provisions will not prevent the occurrence of any event of default under the indenture. If either the trustee or any holder of notes receives any payment or distribution of our assets in contravention of these subordination provisions before all senior indebtedness is paid in full, then such payment or distribution will be held by the recipient in trust for the benefit of holders of senior indebtedness to the extent necessary to make payment in full

of all senior indebtedness remaining unpaid.

We operate our business through our subsidiaries. Accordingly, we are dependent upon the cash flows of, and receipt of dividends and advances from, or repayments of advances by, our subsidiaries in order to meet our debt obligations, including our obligations under the notes. The notes are not guaranteed by our subsidiaries and, consequently, our subsidiaries are not obligated or required to pay any amounts pursuant to the notes or to make funds available in the form of dividends or advances. In the future, we may change some portion of our business that we operate through our subsidiaries. See "Risk Factors Risks Relating to an Investment in the Notes and our Common Stock."

Our subsidiaries are separate and distinct legal entities. Our subsidiaries have no obligation to pay any amounts due on the notes or to provide us with funds for our payment obligations, whether by dividends, distributions, loans or other payments. In addition, any payment of dividends, distributions, loans or advances by our subsidiaries will also be contingent upon our subsidiaries' earnings and are subject to contractual or statutory restrictions.

Our right to receive any assets of any of our subsidiaries upon their liquidation or reorganization, and therefore the right of the holders of the notes to participate in those assets, will be structurally subordinated to the claims of that subsidiary's creditors, including trade creditors. In addition, even if we were a creditor of any of our subsidiaries, our rights as a creditor would be subject to the rights of the holders of any security interest in the assets of our subsidiaries and subordinate to any indebtedness of our subsidiaries senior to that held by us.

As of June 30, 2003, we had approximately $100 million of senior indebtedness outstanding and our subsidiaries had approximately $191 million of liabilities, to which the notes are structurally subordinated.

Neither we nor our subsidiaries are limited from incurring senior indebtedness or additional debt under the indenture. If we or our subsidiaries incur additional debt, our ability to pay our obligations on the notes could be affected. We expect from time to time that we and/or our subsidiaries may incur additional indebtedness and other liabilities.

We are obligated to pay reasonable compensation to the trustee. We have agreed to indemnify the trustee against any losses, liabilities or expenses incurred by it in connection with its duties. The trustee's claims for such payments will be senior to the claims of the note holders.

"Credit Agreement" means the Loan Agreement, dated as of October 25, 2001, among Griffon, Telephonics Corporation, the Lenders Party Thereto and Fleet National Bank, as Administrative Agent and The Chase Manhattan Bank, as Documentation Agent, as such agreement may be amended, supplemented or otherwise modified from time to time. The Credit Agreement includes any agreement extending the maturity of, refinancing, replacing or otherwise restructuring, whether immediately after the termination of the existing Credit Agreement or later (including increasing the amount of available borrowings or adding our subsidiaries as additional borrowers or guarantors thereunder) all or any portion of the indebtedness under any such agreement or any successor or replacement agreement whether by the same or any other agent, lender or group of lenders.

"designated senior indebtedness" means (i) any indebtedness under or in respect of the Credit Agreement and (ii) any senior indebtedness in which the instrument creating or evidencing the indebtedness, or any related agreements or documents to which we are a party, expressly provides that such indebtedness is "designated senior indebtedness" for purposes of the indenture (provided that the instrument, agreement or other document may place limitations and conditions on the right of the senior indebtedness to exercise the rights of designated senior indebtedness).

"indebtedness" means:

(1) all of our indebtedness, obligations and other liabilities, contingent or otherwise, (a) for borrowed money, including overdrafts and any loans or advances from banks, whether or not evidenced by notes or similar instruments, or (b) evidenced by credit or loan, agreements, bonds, debentures, notes or similar instruments, whether or not the recourse of the lender is to the whole of our assets or to only a portion thereof, other than any account payable or other accrued current liability or obligation incurred in the ordinary course of business in connection with the obtaining of materials or services;

(2) all of our reimbursement obligations and other liabilities, contingent or otherwise, with respect to letters of credit, bank guarantees or bankers' acceptances;

(3) all of our obligations and liabilities, contingent or otherwise, in respect of leases required, in conformity with generally accepted accounting principles, to be accounted for as capitalized lease obligations on our balance sheet;

(4) all of our obligations and other liabilities, contingent or otherwise, under any lease or related document, including a purchase agreement, conditional sale or other title retention agreement, in connection with the lease of real property or improvements thereon (or any personal property included as part of any such lease) which provides that we are contractually obligated to purchase or cause a third party to purchase the leased property or pay an agreed upon residual value of the leased property, including our obligations under such lease or related document to purchase or cause a third party to purchase such leased property or pay an agreed upon residual

value of the leased property to the lessor (whether or not such lease transaction is characterized as an operating lease or a capitalized lease in accordance with generally accepted accounting principles);

(5) all of our obligations, contingent or otherwise, with respect to an interest rate or other swap, cap, floor or collar agreement or hedge agreement, forward contract or other similar instrument or agreement or foreign currency hedge, exchange, purchase or similar instrument or agreement;

(6) all of our direct or indirect guaranties or similar agreement by us in respect of, and all of our obligations or liabilities to purchase or otherwise acquire or otherwise assure a creditor against loss in respect of, indebtedness, obligations or liabilities of another person of the kinds described in clauses (1) through (5); and

(7) any and all deferrals, renewals, extensions, refinancings and refundings of, or amendments, modifications or supplements to, any indebtedness, obligation or liability of the kinds described in clauses (1) through (6).

Indebtedness shall not include obligations of any person (i) arising from the honoring by a bank or other financial institution of a check, draft or similar instrument inadvertently drawn against insufficient funds in the ordinary course of business, provided that such obligations are extinguished within two business days of their incurrence, (ii) resulting from the endorsement of negotiable instruments for collection in the ordinary course of business and consistent with past business practices or (iii) stand-by letters of credit to the extent collateralized by cash or cash equivalents.

"senior indebtedness" means the principal of, premium, if any, interest, including any interest accruing after the commencement of any bankruptcy or similar proceeding, whether or not a claim for post-petition interest is allowed as a claim in the proceeding, and rent payable on or in connection with, and all fees, costs, expenses and other amounts accrued or due on or in connection with, our indebtedness whether secured or unsecured, absolute or contingent, due or to become due, outstanding on the date of the indenture or thereafter created, incurred, assumed, guaranteed or in effect guaranteed by us, including all deferrals, renewals, extensions or refundings of, or amendments, modifications or supplements to, the foregoing. Senior indebtedness does not include (i) any indebtedness or obligation whose terms expressly provide that such indebtedness or obligation shall not be senior in right of payment to the notes or expressly provides that such indebtedness is equal or *pari passu* in right of payment with or junior in right of payment to the notes; (ii) any indebtedness we owe to any of our subsidiaries and (iii) the notes.

Optional Redemption of the Notes

Beginning on July 26, 2010, we may redeem the notes, in whole at any time, or in part from time to time, for cash at a price equal to 100% of the principal amount of the notes plus accrued but unpaid interest (including contingent interest and liquidated damages, if any) up to but not including the date of redemption. We will give not less than 30 days' nor more than 60 days' notice of redemption by mail to holders of the notes. If we opt to redeem less than all of the notes at any time, the trustee will select or cause to be selected the notes to be redeemed by any method that it deems fair and appropriate. In the event of a partial redemption, the trustee may provide for selection for redemption of portions of the principal amount of any note of a denomination larger than $1,000.

Repurchase of Notes at the Option of the Holder

A holder has the right to require us to repurchase all or a portion of the notes on July 18, 2010, 2013 and 2018. We will repurchase the notes for an amount of cash equal to 100% of the principal

amount of the notes on the date of purchase, plus accrued but unpaid interest (including contingent interest and liquidated damages, if any) up to but not including the date of repurchase.

We are required to give notice on a date not less than 30 business days prior to each purchase date to all holders at their addresses shown in the register of the registrar, and to beneficial owners as required by applicable law, stating among other things, the procedures that holders must follow to require us to purchase their notes.

The purchase notice given by each holder electing to require us to purchase notes shall state:

- the certificate numbers of the holder's notes to be delivered for purchase; and
- the portion of the principal amount notes to be purchased, which must be $1,000 or an integral multiple of $1,000.

For a discussion of the tax treatment of a holder exercising the right to require us to purchase notes, see "Certain United States Federal Income Tax Consequences U.S. Holders Sale, Exchange, Conversion, Repurchase or Redemption."

Any purchase notice may be withdrawn by the holder by a written notice of withdrawal delivered to the paying agent prior to the close of business on the purchase date. The notice of withdrawal shall state:

- the principal amount being withdrawn;
- the certificate numbers of the notes being withdrawn; and
- the principal amount of the notes that remain subject to the purchase notice, if any.

Payment of the purchase price for a note for which a purchase notice has been delivered and not validly withdrawn is conditioned upon delivery of the note, together with necessary endorsements, to the paying agent at any time after delivery of the purchase notice. Payment of the purchase price for the notes will be made promptly following the later of the purchase date or the time of delivery of the notes.

If the paying agent holds money sufficient to pay the purchase price of the note on the business day following the purchase date in accordance with the terms of the indenture, then, immediately after the purchase date, the note will cease to be outstanding, whether or not the note is delivered to the paying agent. Thereafter, all other rights of the holder shall terminate, other than the right to receive the purchase price upon delivery of the note.

Our ability to purchase notes may be limited by the terms of our then existing indebtedness or financing agreements and by the subordination provisions of the notes.

No notes may be purchased at the option of holders if there has occurred and is continuing an event of default with respect to the notes, other than a default in the payment of the purchase price with respect to such notes.

Mandatory Redemption

Except as described in this prospectus under " Right to Require Purchase of Notes upon a Change in Control" and " Repurchase of Notes at the Option of the Holder," we are not required to make mandatory redemption of, or sinking fund payments with respect to, the notes.

Right to Require Purchase of Notes upon a Change in Control

If a change in control (as defined below) occurs, each holder of notes may require that we repurchase the holder's notes on the date fixed by us that is not less than 30 days nor more than 45 days after we give notice of the change in control. We will repurchase the notes for an amount

of cash equal to 100% of the principal amount of the notes, plus accrued but unpaid interest (including contingent interest and liquidated damages, if any) to the date of repurchase.

"Change in control" means the occurrence of one or more of the following events:

- any sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of our assets, to any person or group of related persons, as defined in Section 13(d) of the Exchange Act (a "Group");
- the approval by the holders of our capital stock of any plan or proposal for our liquidation or dissolution, whether or not otherwise in compliance with the provisions of the indenture;
- any person or group becomes the owner, directly or indirectly, beneficially or of record, of shares of our voting stock representing more than 30% of the aggregate ordinary voting power of all shares represented by our issued and outstanding voting stock; or
- the first day on which a majority of the members of our board of directors are not continuing directors.

The definition of "change in control" includes a phrase relating to the sale, lease, transfer, conveyance or other disposition of "all or substantially all" of our assets. Although there is a developing body of case law interpreting the phrase "substantially all," there is no precise established definition of the phrase under applicable law. Accordingly, the ability of a holder of notes to require us to repurchase such notes as a result of a sale, lease, transfer, conveyance or other disposition of less than all of our assets to another person or Group may be uncertain.

"Continuing directors" means, as of any date of determination, any member of our board of directors who:

- was a member of such board of directors on the date of the original issuance of the notes, or
- was nominated for election or elected to such board of directors with the approval of a majority of the continuing directors who were members of such board at the time of such nomination or election.

On or prior to the date of repurchase, we will deposit with a paying agent an amount of money sufficient to pay the aggregate repurchase price of the notes that is to be paid on the date of repurchase.

On or before the 30th day after the change in control, we must mail to the trustee and all holders of the notes a notice of the occurrence of the change in control offer, stating the procedures that a holder of notes must follow in order to exercise the repurchase right.

To exercise the repurchase right, holders of notes must deliver, on or before the repurchase date specified in our notice of a change in control, the notes to be repurchased, duly endorsed for transfer, together with a written repurchase notice and the form entitled "Option to Elect Repurchase Upon a Change in Control" on the reverse side of the note duly completed, to the paying agent. The repurchase notice given by each holder electing to require us to repurchase notes shall state:

- the certificate numbers of the holder's notes to be delivered for repurchase;

- the portion of the principal amount of notes to be repurchased, which must be $1,000 or an integral multiple of $1,000;

For a discussion of the tax treatment of a holder exercising the right to require us to purchase notes, see "Certain United States Federal Income Tax Consequences U.S. Holders Sale, Exchange, Conversion, Repurchase or Redemption."

Any repurchase notice may be withdrawn by the holder by a written notice of withdrawal delivered to the paying agent prior to the close of business on the repurchase date. The notice of withdrawal shall state:

- the principal amount being withdrawn; and

- the certificate numbers of the notes being withdrawn.

In connection with any change in control purchase offer, we expect to comply with any tender offer rules under the Exchange Act that may then be applicable.

We will within 30 days following any change in control:

- obtain the consents under all senior indebtedness required to permit the repurchase of the notes pursuant to a change in control offer; or

- repay in full all indebtedness and terminate all commitments under all senior indebtedness, the terms of which would prohibit the purchase of the notes under a change in control offer.

If we are obligated to make a change in control offer, there can be no assurance that we will be able to obtain all required consents under senior indebtedness or have available funds sufficient to repay senior indebtedness and to pay the change in control purchase price for all the notes tendered under a change in control offer. We would need to seek third party financing to the extent we do not have available funds to meet our purchase obligations. However, there can be no assurance that we would be able to obtain any such financing.

The effect of these provisions granting the holders the right to require us to repurchase the notes upon the occurrence of a change in control may make it more difficult for any person or group to acquire control of us or to effect a business combination with us. Our ability to pay cash to holders of notes following the occurrence of a change in control may be limited by our then existing financial resources. We cannot assure you that sufficient funds will be available when necessary to make any required repurchases. See "Risk Factors Risks Relating to an Investment in the Notes and our Common Stock."

Our obligation to make a change in control offer will be satisfied if a third party makes the change in control offer in the manner and at the times and otherwise in compliance in all material respects with the requirements applicable to a change in control offer made by us and purchases all notes properly tendered and not withdrawn under the change in control offer.

The term "beneficial owner" will be determined in accordance with Rules 13d-3 and 13d-5 promulgated by the SEC under the Exchange Act or any successor provision, except that a person shall be deemed to have "beneficial ownership" of all shares of our common stock that the person has the right to acquire, whether exercisable immediately or only after the passage of time.

No notes may be purchased at the option of holders if there has occurred and is continuing an event of default with respect to the notes, other than a default in the payment of the purchase price with respect to such notes.

Consolidation, Merger and Sale of Assets

We may, without the consent of the holders of any of the notes, consolidate with, or merge into any other person or convey, transfer or lease our properties and assets substantially as an entirety to, any other person, if:

- we are the resulting or surviving corporation or the successor, transferee or lessee, if other than us, is a corporation or limited liability company organized under the laws of any U.S. jurisdiction and expressly assumes our obligations under the indenture and the notes by means of a supplemental indenture entered into with the trustee; and

after giving effect to the transaction, no event of default and no event that, with notice or lapse of time, or both, would constitute an event of default, shall have occurred and be continuing.

Under any consolidation, merger or any conveyance, transfer or lease of our properties and assets as described in the preceding paragraph, the successor company will be our successor and shall succeed to, and be substituted for, and may exercise every right and power of, Griffon under the indenture. If the predecessor is still in existence after the transaction, it will be released from its obligations and covenants under the indenture and the notes, except in the case of a lease of all or substantially all of our properties and assets.

Modification and Waiver

We and the trustee may enter into one or more supplemental indentures that add, change or eliminate provisions of the indenture or modify the rights of the holders of the notes with the consent of the holders of at least a majority in principal amount of the notes then outstanding. However, without the consent of each holder of an outstanding note, no supplemental indenture may, among other things:

change the stated maturity of the principal of, or payment date of any installment of interest (including contingent interest, if any) on, any note;

reduce the principal amount or redemption price of, or the rate of interest (including contingent interest, if any) on, any note;

change the currency in which the principal of any note or interest is payable or adversely affect the price or ratio at which common stock may be substituted for currency in connection with any payments made;

impair the right to institute suit for the enforcement of any payment on or with respect to any note when due;

adversely affect the right provided in the indenture to convert any note;

modify the provisions of the indenture relating to our requirement to repurchase notes:

upon a change in control after the occurrence thereof; or

on July 18, 2010, 2013 and 2018;

reduce the percentage in principal amount of the outstanding notes necessary to modify or amend the indenture or to consent to any waiver provided for in the indenture; or

waive a default in the payment of any amount or shares of common stock due in connection with any note.

The holders of a majority in principal amount of the outstanding notes may, on behalf of the holders of all notes:

waive compliance by us with restrictive provisions of the indenture other than as provided in the preceding paragraph; and

waive any past default under the indenture and its consequences, except a default in the payment of the principal of, or redemption or purchase price of, or any interest (including contingent interest, if any) on, any note or in respect of a provision that under the indenture cannot be modified or amended without the consent of the holder of each outstanding note affected.

Without the consent of any holders of notes, we and the trustee may enter into one or more supplemental indentures for any of the following purposes:

- to cure any ambiguity, omission, defect or inconsistency in the indenture;
- to evidence a successor to us and the assumption by the successor of our obligations under the indenture and the notes;
- to make any change that does not adversely affect the rights of any holder of the notes;
- to comply with any requirement in connection with the qualification of the indenture under the Trust Indenture Act; or
- to complete or make provision for certain other matters contemplated by the indenture.

Events of Default

Each of the following is an event of default under the indenture:

(1) if we fail to pay interest (including contingent interest and liquidated damages, if any) on any note when it becomes due and payable and the default continues for a period of 30 days, whether or not such failure shall be due to the subordination provisions of the indenture or agreements with respect to any other indebtedness or any other reason;

(2) if we fail to pay the principal on any note, when it becomes due and payable, at maturity, upon acceleration, upon redemption or otherwise (including the failure to make a change in control offer or make a payment to purchase notes tendered pursuant to a change in control offer or the failure to repurchase notes at your option on July 18, 2010, 2013 or 2018), whether or not such failure shall be due to the subordination provisions of the indenture or agreements with respect to any other Indebtedness or any other reason;

(3) if we fail to provide notice of the occurrence of a change in control event on a timely basis;

(4) if we fail to observe or perform any other covenant or agreement contained in the indenture that continues for a period of 30 days after we received written notice specifying the default (and demanding that such default be remedied) from the trustee or the holders of at least 25% of the outstanding principal amount of the notes (except in the case of our default with respect to the "Merger, Consolidation and Sale of Assets" covenant, which will constitute an event of default with such notice requirement but without such passage of time requirement);

(5) if we fail to pay at final maturity (giving effect to any applicable grace periods and any extensions thereof) the principal amount of any of our or our subsidiaries' recourse indebtedness, or the acceleration of the final stated maturity of any such recourse indebtedness if the aggregate principal amount of such indebtedness, together with the principal amount of any other such

recourse indebtedness in default for failure to pay principal at final maturity or that has been accelerated, aggregates $25.0 million or more at any time;

(6) one or more judgments in an aggregate amount in excess of $25.0 million shall have been rendered against us or any of our subsidiaries and remain undischarged, unpaid or unstayed for a period of 60 days after such judgment or judgments become final and nonappealable; and

(7) certain events of bankruptcy affecting us or any of our significant subsidiaries.

The events of default described in clauses (5), (6) and (7) above with respect to a subsidiary shall not apply if that person was not a subsidiary at the time such event or condition occurred unless, in the case of clause (5) or (6) above, we or another of our subsidiaries assumes or otherwise becomes liable for the liability referred to therein or the liabilities generally of such person.

If an event of default (other than an event of default specified in clause (7) above) shall occur and be continuing, the trustee may, and at the request of the holders of at least 25% in principal amount of outstanding notes shall, declare the principal of and accrued interest on all the notes to be due and payable by written notice to us and, if it is given at the request of the holders, the trustee must specify the respective event of default and that it is a "notice of acceleration". Upon delivery of a notice of acceleration, the principal of and accrued interest (including contingent interest and liquidated damages, if any) on all the notes:

- shall become immediately due and payable; or

- if there are any amounts outstanding under the Credit Agreement, shall become immediately due and payable upon the first to occur of an acceleration under the Credit Agreement or five business days after receipt by us and the representative under the Credit Agreement of such notice of acceleration but only if such event of default is then continuing.

If an event of default specified in clause (7) above occurs and is continuing with respect to us, then all unpaid principal of, and premium, if any, and accrued but unpaid interest on all of the outstanding notes shall become and be immediately due and payable without any declaration or other act on the part of the trustee or any holder.

At any time after a declaration of acceleration with respect to the notes, the holders of a majority in aggregate principal amount of the notes may rescind and cancel such declaration and its consequences:

- if the rescission would not conflict with any judgment or decree;

- if all existing events of default have been cured or waived except nonpayment of principal or interest that has become due solely because of such acceleration;

- if interest on overdue installments of interest (to the extent the payment of such interest is lawful) and on overdue principal, which has become due otherwise than by such declaration of acceleration, has been paid;

- if we have paid the trustee its reasonable compensation and reimbursed the trustee for its expenses, disbursements and advances; and

- in the event of the cure or waiver of an event of default of the type described in clause (4) of the description above of events of default, the trustee has received an officers' certificate and an opinion of counsel that such event of default has been cured or waived.

No such rescission shall affect any subsequent default or impair any rights arising from a subsequent default.

The holders of a majority in aggregate principal amount of the notes may waive any existing default or event of default under the indenture, and its consequences, except a default in the payment of the principal of or interest on any notes. The holders of the notes may not enforce the indenture or the notes except as provided in the indenture and under the Trust Indenture Act. Subject to the provisions of the indenture relating to the duties of the trustee, the trustee is under no obligation to exercise any of its rights or powers under the indenture at the request, order or direction of any of the holders, unless such holders have offered to the trustee reasonable indemnity. Subject to all provisions of the indenture and applicable law, the holders of a majority in aggregate principal amount of the then outstanding notes have the right to direct the time,

method and place of conducting any proceeding for any remedy available to the trustee or exercising any trust or power conferred on the trustee.

We are required to provide an officers' certificate to the trustee promptly upon our obtaining knowledge of any default or event of default that has occurred and, if applicable, describe such default or event of default and the status thereof. In addition, we must provide an annual certification as to the existence of defaults and events of default.

Book-Entry System

The notes are issued in the form of global securities held in book-entry form. DTC or its nominee is the sole registered holder of the notes for all purposes under the indenture. Owners of beneficial interests in the notes represented by the global securities hold their interests pursuant to the procedures and practices of DTC. As a result, beneficial interests in any such securities are shown on, and transfers are effected only through, records maintained by DTC and its direct and indirect participants. Any such interests may not be exchanged for certificated securities, except in limited circumstances. Owners of beneficial interests must exercise any rights in respect of their interests, including any right to convert or require repurchase of their interests in the notes, in accordance with the procedures and practices of DTC. Beneficial owners are not holders and are not entitled to any rights under the global securities or the indenture. We and the trustee, and any of our respective agents, may treat DTC as the sole holder and registered owner of the global securities.

Exchange of Global Securities

The notes, represented by one or more global securities, will be exchangeable for certificated securities in fully registered form with the same terms only if:

- DTC is unwilling or unable to continue as depositary or if DTC ceases to be a clearing agency registered under the Exchange Act and we do not appoint a successor depositary within 90 days;
- we decide to discontinue use of the system of book-entry transfer through DTC or any successor depositary, or
- a default under the indenture occurs and is continuing.

DTC has advised us as follows: DTC is a limited-purpose trust company organized under the New York Banking Law, a "banking organization" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" for registered participants, and it facilitates the settlement of transactions among its participants in those securities through electronic computerized book-entry changes in participants' accounts, eliminating the need for physical movement of securities certificates. DTC's participants include securities brokers and dealers, including the agent, banks, trust companies, clearing corporation and other organizations, some of whom and/or their representatives own DTC. Access to DTC's book-entry system is also available to others, such as banks, brokers, dealers and trust companies that clear through or maintain a custodial relationship with a participant, either directly or indirectly.

Registration Rights

On July 18, 2003, we entered into a registration rights agreement with the initial purchasers of the notes for the benefit of the holders of the notes and the shares of our common stock issuable on conversion of the notes. Under this agreement, we agreed that we will at our cost:

- on or prior to the 90th day after July 18, 2003, the first date of original issuance of the notes, file a shelf registration statement, of which this prospectus is a part, with the Commission covering resales of the notes and the shares of our common stock issuable on conversion of the notes;
- use all reasonable efforts to cause the shelf registration statement to be declared effective under the Securities Act no later than 180 days after July 18, 2003, the first date of original issuance of the notes; and

use all reasonable efforts to keep the shelf registration statement effective after its effective date until the earlier of: (1) the sale pursuant to the shelf registration statement of all of the notes and any shares of our common stock issued upon conversion of the notes; and (2) the expiration of the holding period applicable to the notes and the shares of our common stock issuable upon conversion of the notes held by non-affiliates of Griffon under Rule 144(k) under the Securities Act, or any successor provision; and (3) the date on which all of the notes and any shares of our common stock issued upon conversion of the notes (i) cease to be outstanding or (ii) have been resold pursuant to Rule 144 under the Securities Act.

This prospectus is part of the shelf registration statement we agreed to file. We have the right to suspend use of the shelf registration statement during specified periods of time for any bona fide reason, including pending corporate developments and public filings with the SEC and similar events. The registration rights agreement provides that if we fail to file the shelf registration on or prior to the 90th day after July 18, 2003, the date of original issuance of the notes, the shelf registration statement is not declared effective on or prior to the 180th day after July 18, 2003, the date of original issuance of the notes or, after the shelf registration statement has been declared effective, we fail to keep the shelf registration statement effective or usable in accordance with and during the periods specified in the registration rights agreement, other than the periods during which we are permitted to suspend registration, then, in each case, we will pay liquidated damages to all holders of notes and all holders of our common stock issued on conversion of notes equal to (i) in respect of each $1,000 principal amount of notes, at a rate per annum equal to 0.50% of such principal amount and (ii) in respect of any shares of common stock issued upon conversion of notes, at a rate per annum equal to 0.50% of the principal amount of notes that would then be convertible into such number of shares. So long as the failure to file or become effective or such unavailability continues, we will pay liquidated damages in cash on January 18 and July 18 of each year to the person who is the holder of record of the notes or common stock issued in respect of the notes on the immediately preceding January 1 or July 1. When such registration default is cured, accrued but unpaid liquidated damages will be paid in cash on the subsequent interest payment date to the record holder as of the date of such cure. The right to receive liquidated damages is the sole and exclusive remedy to the noteholders for breach by the company of its registration obligations.

We filed the shelf registration statement of which this prospectus is a part prior to the date specified in the registration rights agreement and, accordingly, no liquidated damages were or will be payable as a result of any failure to make that filing on a timely basis. However, if the applicable registration default results from the failure of the shelf registration statement to be timely declared effective, then such registration default shall be deemed to have occurred on the 181st day after the original date of issuance of the notes and liquidated damages will accrue from and including such 181st day to, but excluding, the date on which the shelf registration statement is declared effective by the SEC. If the applicable registration default results from the failure to keep the shelf registration

statement effective or usable in accordance with and during the periods specified in the registration rights agreement, other than the periods during which we are permitted to suspend registration, then such registration default will be deemed to have occurred on the first day on which the shelf registration statement fails to remain effective or usable, and liquidated damages will accrue from and including the first day on which the shelf registration statement fails to remain effective or usable to, but excluding, the date on which the shelf registration statement becomes effective or usable again.

Only holders of registrable securities who have been named in this prospectus and have satisfied certain other conditions will be entitled to receive any liquidated damages which may be payable because the shelf registration statement is not effective or usable in accordance with and during the periods specified in the registration rights agreement, other than the periods during which we are permitted to suspend registration. Upon any sale or other transfer of any notes or shares of common stock issued upon conversion of notes pursuant to the registration statement of which this prospectus is a part, such notes or shares of common stock, as the case may be, will cease to be registrable securities, and our obligation to pay liquidated damages, if any, in respect of those notes or shares of common stock will terminate.

Concerning the Trustee

American Stock Transfer & Trust Company, the trustee under the indenture pursuant to which the notes were issued, also acts as the transfer agent for our common stock and as the rights agent in connection with our shareholders rights plan. See "Description of Capital Stock."

Governing Law

The indenture and the notes are governed by and construed in accordance with the laws of the State of New York without regard to principles of conflict of laws.

DESCRIPTION OF CAPITAL STOCK

Our authorized capital stock consists of 85,000,000 shares of common stock, par value $0.25 per share, and 3,000,000 shares of preferred stock, par value $0.25 per share. The transfer agent and registrar for our common stock is American Stock Transfer & Trust Company. At June 30, 2003, approximately 32,609,432 shares of common stock and no shares of preferred stock were outstanding. In addition to the summary of our capital stock that follows, we encourage you to review our certificate of incorporation and bylaws, which we have filed with the Securities and Exchange Commission.

Common Stock

Holders of shares of our common stock are entitled to one vote for each share held of record on all matters on which shareholders are generally entitled to vote. The vote of the holders of a majority of the stock represented at a meeting at which a quorum is present is generally required to take shareholder action, unless a greater vote is required by law. Directors are elected by a plurality of the votes cast at any election and there is no cumulative voting of shares.

Holders of shares of our common stock have no preemptive rights. Subject to the applicable laws and the rights of the holders of preferred stock, holders of shares of common stock are entitled to such dividends as may be declared by our board of directors. The common stock is not entitled to any sinking fund, redemption or conversion provisions. Upon our dissolution, liquidation or winding up, the holders of shares of our common stock are entitled to share ratably in our net assets remaining after the payment of all creditors and liquidation preferences of preferred stock. The outstanding shares of common stock are duly authorized, validly issued, fully paid and nonassessable.

Preferred Stock

We are authorized to issue 3,000,000 shares of preferred stock, of which 37,000 shares consist of Series A preferred stock, and 1,950,000 shares consist of Second Preferred Stock. The 1,950,000 shares of such Second Preferred Stock have been designated Second Preferred Stock Series I. Of the authorized preferred stock, 575,000 shares have been designated as the $12.50 Cumulative Redeemable Exchangeable Preferred Stock, and 60,000 shares have been designated as the Series A Junior Participating Preferred Stock. Presently, we have no shares of preferred stock outstanding.

Subject to the provisions of our charter, our board of directors, without further stockholder authorization, is authorized to establish, from time to time, one or more series of preferred stock and to fix the designations, powers, preferences and rights of the shares of each of these series and any qualifications, limitations or restrictions thereof, including dividend rights and preferences over dividends on our common stock, conversion rights, voting rights, redemption rights, the terms of any sinking fund therefor and rights upon liquidation. The ability of the board of directors to issue preferred stock, while providing flexibility in connection with financing, acquisitions and other corporate purposes, could have the effect of discouraging, deferring or preventing a change in control or an unsolicited acquisition proposal, since the issuance of preferred stock could be used to dilute the share ownership of a person or entity seeking to obtain control of us. In addition, because the board of directors has the power to establish the preferences, powers and rights of the shares of any of these series of preferred stock, it may afford the holders of any preferred stock preferences, powers and rights (including voting rights) senior to the rights of the holders of common stock, which could adversely affect the rights of holders of common stock.

Shareholders Rights Plan

On May 9, 1996, our board of directors declared a dividend of one preferred share purchase right for each outstanding share of our common stock. The dividend was paid on June 3, 1996, the record date, to the stockholders of record on that date. Each right entitles the registered holder to purchase from us eleven ten-thousandths of a share of our Series A Junior Participating Preferred Stock, par value $0.25 per share, at a purchase price of $34.00 per eleven-ten-thousandth of a preferred share, subject to adjustment. The description and terms of the rights are set forth in a rights agreement between us and American Stock Transfer & Trust Company, as rights agent.

Until the earlier to occur of (i) 10 days following a public announcement that a person or group of affiliated or associated persons, referred to as an acquiring person, have acquired beneficial ownership of 10% or more of the outstanding shares of common stock or (ii) 10 business days (or such later date as may be determined by action of the board of directors prior to such time as any person or group of affiliated persons becomes an acquiring person) following the commencement of, or announcement of an intention to make, a tender offer or exchange offer the consummation of which would result in the beneficial ownership by a person or group of 10% or more of the outstanding shares of common stock (the earlier of such dates being called the distribution date), the rights will be evidenced, with respect to any of the common stock certificates outstanding as of the record date, by such common stock certificate with a copy of the summary of rights attached thereto.

Until the distribution date (or earlier redemption or expiration of the rights), the rights will be transferred with and only with the shares of common stock. The rights are not exercisable until the distribution date. The rights will expire on May 9, 2006, unless otherwise extended or the rights are earlier redeemed or exchanged by us, in each case, as described below.

The purchase price payable, and the number of preferred shares or other securities or property issuable, upon exercise of the rights are subject to adjustment from time to time to prevent dilution (i) in the event of a stock dividend on, or a subdivision, combination or reclassification of, the preferred shares, (ii) upon the grant to holders of the preferred shares of certain rights or warrants to

subscribe for or purchase preferred shares at a price, or securities convertible into preferred shares with a conversion price, less than the then current market price of the preferred shares or (iii) upon the distribution to holders of the preferred shares of evidences of indebtedness or assets (excluding regular periodic cash dividends paid out of earnings or retained earnings or dividends payable in preferred shares) or of subscription rights or warrants (other than those referred to above).

The number of outstanding rights and the number of one one-thousandths of a preferred share issuable upon exercise of each right are also subject to adjustment in the event of a stock split of the common stock or a stock dividend on the common stock payable in shares of common stock or subdivisions, consolidations or combinations of the common stock occurring, in any such case, prior to the distribution date.

Preferred shares purchasable upon exercise of the rights will not be redeemable. Each preferred share will be entitled to a minimum preferential quarterly dividend payment of the greater of $1 per share or 11,000 times the aggregate per share amount of all dividends, other than a stock dividend, payable to holders of shares of common stock. In the event of liquidation, the holders of the preferred shares will be entitled to a minimum preferential liquidation payment of $11,000 per share, plus accrued and unpaid dividends, but will be entitled to an aggregate payment of 11,000 times the payment made per share of common stock. Each preferred share will have 11,000 votes, voting together with the common stock. Finally, in the event of any merger, consolidation or other transaction in which the common stock are exchanged, each preferred share will be entitled to receive 11,000 times the amount received per share of common stock. These rights are protected by customary antidilution provisions.

Because of the nature of the preferred shares' dividend, liquidation and voting rights, the value of the eleven ten-thousandth interest in a preferred share purchasable upon exercise of each right should approximate the value of one share of common stock.

In the event that we are acquired in a merger or other business combination transaction or 50% or more of its consolidated assets or earning power are sold after a person or group has become an acquiring person, proper provision will be made so that each holder of a right will thereafter have the right to receive, upon the exercise thereof at the then current exercise price of the right, that number of shares of common stock of the acquiring company which at the time of such transaction will have a market value of two times the exercise price of the right. In the event that any person or group of affiliated or associated persons becomes an acquiring person, proper provision shall be made so that each holder of a right, other than rights beneficially owned by the acquiring person (which will thereafter be void), will thereafter have the right to receive upon exercise that number of shares of common stock having a market value of two times the exercise price of the right.

At any time after any person or group becomes an acquiring person and prior to the acquisition by such person or group of 50% or more of the outstanding shares of our common stock, our board of directors may exchange the rights (other than rights owned by such person or group which will have become void), in whole or in part, at an exchange ratio of one share of common stock, or one one-thousandth of a preferred share (or of a share of a class or series of our preferred stock having equivalent rights, preferences and privileges), per right (subject to adjustment).

With certain exceptions, no adjustment in the purchase price will be required until cumulative adjustments require an adjustment of at least 1% in such purchase price. No fractional preferred shares will be issued (other than fractions which are integral multiples of one one-thousandth of a preferred share, which may, at our election, be evidenced by depositary receipts) and in lieu thereof, an adjustment in cash will be made based on the market price of the preferred shares on the last trading day prior to the date of exercise.

At any time prior to the acquisition by a person or group of affiliated or associated persons of beneficial ownership of 10% or more of the outstanding shares of our common stock, our board of

directors may redeem the rights in whole, but not in part, at a redemption price of $.01 per right. The redemption of the rights may be made effective at such time on such basis with such conditions as the board of directors in its sole discretion may establish. Immediately upon any redemption of the rights, the right to exercise the rights will terminate and the only right of the holders of rights will be to receive the Redemption Price.

The terms of the rights may be amended by our board of directors without the consent of the holders of the rights, except that from and after such time as any person or group of affiliated or associated persons becomes an acquiring person no such amendment may adversely affect the interests of the holders of the rights.

Until a right is exercised, the holder thereof, as such, will have no rights as a stockholder of ours, including, without limitation, the right to vote or to receive dividends.

The rights have certain anti-takeover effects. The rights will cause substantial dilution to a person or group that attempts to acquire us on terms not approved by our board of directors, except pursuant to an offer conditioned on a substantial number of rights being acquired. The rights should not interfere with any merger or other business combination approved by the board of directors since the rights may be redeemed by us at the Redemption Price prior to the time that a person or group has acquired beneficial ownership of 10% or more of the shares of common stock.

Anti-Takeover Considerations

Our certificate of incorporation and by-laws contain a number of provisions that may have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from acquiring us.

Classified Board of Directors

Our certificate of incorporation and by-laws divide our board of directors into three classes, as nearly equal in size as possible, with staggered three year terms, and provide that:

- directors may be removed only for cause by the affirmative vote of the holders of a majority of the outstanding shares of capital stock entitled to vote; and

- any vacancy on our board of directors may only be filled by vote of a majority of the directors then in office.

Stockholder Action, Special Meeting of Stockholders

Our certificate of incorporation and by-laws eliminate the ability of our stockholders to act by written consent. Our certificate of incorporation and by-laws further provide that special meetings of our stockholders may be called only at the written request of stockholders owning at least 66?% of the entire voting power of our capital stock.

Advance Notice Requirements for Stockholder Proposals and Directors Nominations

Our by-laws provide that stockholders seeking to bring business before an annual meeting of stockholders, or to nominate candidates for election as directors at an annual meeting of stockholders, must provide timely notice in writing. To be timely, a stockholder's notice must be delivered to or mailed and received at our principal executive offices not less than 90 days nor more than 120 days prior to the anniversary date of the immediately preceding annual meeting. However, in the event that the annual meeting is called for a date that is not within 25 days before or after such anniversary date, notice by the stockholder in order to be timely must be received not later than the close of business on the tenth day following the date on which notice of the date of the annual meeting was mailed to stockholders or made public, whichever first occurs. Our by-laws also specify requirements as to the form and content of a stockholder's notice. These provisions may preclude stockholders from bringing

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matters before an annual meeting of stockholders or from making nominations for directors at an annual meeting of stockholders.

Business Combinations and Limitations in our Certificate of Incorporation

Our certificate of incorporation provides that in the event that it is proposed that we enter into a merger or consolidation with any other corporation and such other corporation or its affiliates singly or in the aggregate own or control, directly or indirectly, 5% or more of the outstanding voting power of our capital stock, or that we sell substantially all of our assets or business to such other corporation, the affirmative vote of the holders of not less than $66^2/_3$% of the total voting power of all outstanding shares of our capital stock shall be required for the approval of any such proposal. However, such requirements shall not apply to any such merger, consolidation or sale of assets or business that was approved by resolutions of our board of directors prior to the acquisition of the ownership or control of 5% of our outstanding shares of capital stock by such other corporation or its affiliates, nor shall it apply to any such merger, consolidation or sale of assets or business between us and another corporation, 50% or more of the total voting power of which is owned by us. An "affiliate" is any person (including a corporation, partnership, trust, estate or individual) who directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified; "control" means the possession, directly or indirectly, of the power to direct or cause the direction of management and policies of a person, whether through the ownership of voting securities, by contract or otherwise.

Amendments; Supermajority Vote Requirements

Our certificate of incorporation requires the affirmative vote of $66^2/_3$% of our voting stock to amend certain provisions of our certificate of incorporation, including those provisions relating to the business combinations limitations, classified board of directors, action by written consent and the ability of stockholders to call special meetings.

Delaware Anti-Takeover Law

Section 203 of the Delaware General Corporation Law prohibits certain "business combination" transactions between a Delaware corporation and any "interested stockholder" owning 15% or more of the corporation's outstanding voting stock for a period of three years after the date on which the stockholder became an interested stockholder, unless:

- the board of directors approves, prior to the date, either the proposed business combination or the proposed acquisition of stock which resulted in the stockholder becoming an interested stockholder;

- upon consummation of the transaction in which the stockholder becomes an interested stockholder, the interested stockholder owned at least 85% of those shares of the voting stock of the corporation which are not held by the directors, officers or certain employee stock plans; or

- on or subsequent to the date on which the stockholder became an interested stockholder, the business combination with the interested stockholder is approved by the board of directors and also approved at a stockholder's meeting by the affirmative vote of the holders of at least two-thirds of the outstanding shares of the corporation's voting stock other than shares held by the interested stockholder.

Under Delaware law, a "business combination" includes a merger, asset sale or other transaction resulting in a financial benefit to the interested stockholder.

Although a corporation may elect not to be governed by Section 203, we have made no such election.

CERTAIN UNITED STATES FEDERAL INCOME TAX CONSEQUENCES

The following is a general summary of certain United States federal income tax consequences of the purchase, ownership, conversion, and other disposition of the notes and of the common stock received upon a conversion of the notes. This summary is based upon existing United States federal income tax law, which is subject to change or differing interpretations, possibly with retroactive effect. This summary does not discuss all aspects of United States federal income taxation which may be important to particular investors in light of their individual circumstances, some of which may be subject to special tax rules that differ significantly from those summarized below such as:

- financial institutions,

- insurance companies,
- broker-dealers,
- tax-exempt organizations,
- persons that will hold the notes as part of a straddle, hedge, conversion, constructive sale, or other integrated transaction for United States federal income tax purposes, or
- U.S. Holders (as defined below) that have a functional currency other than the United States dollar.

In addition, this summary does not discuss any foreign, state, or local tax considerations. This summary assumes that investors will hold their notes as "capital assets" under the Internal Revenue Code of 1986, as amended.

Each prospective investor is urged to consult its tax advisor regarding the United States federal, state, local, and foreign income and other tax consequences of the purchase, ownership, conversion, and other disposition of the notes and common stock received upon a conversion of the notes.

For purposes of this summary, a "U.S. Holder" is a beneficial owner of a note that is, for United States federal income tax purposes:

- an individual who is a citizen or resident of the United States,
- a corporation, partnership, or other entity created in, or organized under the law of, the United States or any state or political subdivision thereof,
- an estate the income of which is includible in gross income for United States federal income tax purposes regardless of its source, or
- a trust (A) the administration of which is subject to the primary supervision of a United States court and which has one or more United States persons who have the authority to control all substantial decisions of the trust, or (B) that was in existence on August 20, 1996, was treated as a United States person on the previous day, and elected to continue to be so treated.

A beneficial owner of a note that is not a U.S. Holder is referred to herein as a "Non-U.S. Holder." If a partnership (including any entity or arrangement treated as a partnership for United States federal income tax purposes) is a beneficial owner of notes or shares of common stock, the treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. A holder of notes or shares of common stock that is a partnership and partners in such partnership should consult their tax advisors about the United States federal income tax consequences of holding and disposing of notes or shares of common stock, as the case may be.

Classification of the Notes

Pursuant to the terms of the indenture, each holder of notes agrees to treat the notes, for United States federal income tax purposes, as debt instruments that are subject to the CPDI regulations, which are the Treasury regulations that govern contingent payment debt instruments and to

be bound by our application of the CPDI regulations to the notes, including our determination of the rate at which interest will be deemed to accrue on the notes and the related "projected payment schedule." The remainder of this discussion assumes that the notes will be treated in accordance with that agreement and our determinations.

No authority directly addresses the treatment of all aspects of the notes for United States federal income tax purposes. The Internal Revenue Service has issued Revenue Ruling 2002-31 and Notice 2002-36, in which the IRS addressed the United States federal income tax classification and treatment of a debt instrument similar, although not identical, to the notes, and the IRS concluded that the debt instrument addressed in that published guidance was subject to the CPDI regulations. In addition, the IRS clarified various aspects of the applicability of certain other provisions of the Internal Revenue Code to the debt instrument addressed in that published guidance. The applicability of Revenue Ruling 2002-31 and Notice 2002-36 to any particular debt instrument, however, such as the notes, is uncertain. In addition, no rulings are expected to be sought from the IRS with respect to any of the United States federal income tax consequences discussed below, and no assurance can be given that the IRS will not take contrary positions. As a result, no assurance can be given that the IRS will agree with the tax characterizations and the tax consequences described below. A different treatment of the notes for United States federal income tax purposes could significantly alter the amount, timing, character, and treatment of income, gain or loss recognized in respect of the notes from that which is described below and could require a U.S. Holder to accrue interest income at rate different from the "comparable yield" rate described below.

U.S. Holders

Interest Income

Under the CPDI regulations, a U.S. Holder will generally be required to accrue interest income on the notes on a constant yield to maturity basis based on the adjusted issue price (as defined below) of the notes and the comparable yield (as defined below), regardless of whether the U.S. Holder uses the cash or accrual method of tax accounting. Accordingly, a U.S. Holder will be required to include interest in taxable income in each year significantly in excess of the amount of interest payments, including contingent interest payments, actually received by it in that year.

The "issue price" of a note is the first price at which a substantial amount of the notes is sold to investors, excluding bond houses, brokers or similar persons or organizations acting in the capacity of underwriters, placement agents or wholesalers. The "adjusted issue price" of a note is its issue price increased by any interest income previously accrued, determined without regard to any adjustments to interest accruals described below and decreased by the amount of any projected payments scheduled to be made with respect to the notes.

Under the CPDI regulations, we are required to establish the "comparable yield" for the notes. The comparable yield for the notes is the annual yield we would incur, as of the initial issue date, on a fixed rate nonconvertible debt instrument with no contingent payments, but with terms and conditions otherwise comparable to those of the notes. Accordingly, we have determined the comparable yield to be 8.5% compounded semi-annually.

We are required to provide to U.S. Holders, solely for United States federal income tax purposes, a schedule of the projected amounts of payments on the notes. This schedule must produce the comparable yield. Our determination of the projected payment schedule for the notes includes

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estimates for payments of contingent interest and an estimate for a payment at maturity that takes into account the conversion feature. U.S. Holders may obtain the projected payment schedule by submitting a written request for it to us at the address set forth under "Where You Can Find More Information."

The comparable yield and the projected payment schedule are not determined for any purpose other than for the determination of a U.S. Holder's interest accruals and adjustments thereof in respect of the notes for United States federal income tax purposes and do not constitute a projection or representation regarding the actual amounts payable to U.S. holders of the notes.

Adjustments to Interest Accruals on the Notes

If a U.S. Holder receives actual payments with respect to the notes in a tax year that in the aggregate exceed the total amount of projected payments for that tax year, the U.S. Holder will have a "net positive adjustment" equal to the amount of such excess. The U.S. Holder will be required to treat the "net positive adjustment" as additional interest income for the tax year. For this purpose, the payments in a tax year include the fair market value of any property received in that year.

If a U.S. Holder receives actual payments with respect to the notes in a tax year that in the aggregate are less than the amount of the projected payments for that tax year, the U.S. Holder will have a "net negative adjustment" equal to the amount of such deficit. This adjustment will (a) reduce the U.S. Holder's interest income on the notes for that tax year, and (b) to the extent of any excess after the application of (a), give rise to an ordinary loss to the extent of the U.S. Holder's interest income on the notes during prior tax years, reduced to the extent such interest income was offset by prior net negative adjustments. Any negative adjustment in excess of the amounts described in (a) and (b) will be carried forward to offset future interest income in respect of the notes or to reduce the amount realized upon a sale, exchange, repurchase or redemption of the notes.

If subsequent purchasers of the notes have a basis in the notes which differs from the adjusted issue price of the notes, such a holder must reasonably allocate such difference to the interest on the notes or the projected payments. If the holder's basis is less than the adjusted issue price (e.g., discount), the amounts allocated are treated as a positive adjustment. If the holder's basis exceeds the adjusted issue price (e.g., premium), the adjustment is a negative adjustment. Holders should consult their tax advisors regarding such potential adjustments.

Sale, Exchange, Conversion, Repurchase or Redemption

Generally, the sale, exchange, repurchase, or redemption of a note will result in gain or loss to a U.S. Holder, which will be subject to tax. As described above, our calculation of the comparable yield and the schedule of projected payments for the notes includes the receipt of shares of our common stock upon conversion as a contingent payment with respect to the notes. Accordingly, we intend to treat the payment of shares of our common stock to a U.S. Holder upon the conversion of a note as a contingent payment under the CPDI regulations. As described above, U.S. Holders are generally bound by our determination of the comparable yield and the schedule of projected payments. Under this treatment, a conversion will also result in taxable gain or loss to a U.S. Holder. The amount of gain or loss on a taxable sale, exchange, conversion, repurchase or redemption will be equal to the difference between (a) the amount of cash plus the fair market value of any other property received by the U.S. Holder, including the fair market value of any shares of our common stock received, reduced by any negative adjustment carryforward as described above, and (b) the U.S. Holder's adjusted tax basis in the note. A U.S. Holder's adjusted tax basis in a note on any date will generally be equal to the U.S. Holder's original purchase price for the note, increased by any interest income previously accrued by the U.S. Holder under the CPDI regulations as described above (determined without regard to any adjustments to interest accruals described above), and decreased by the amount of any projected

payments, as described above, scheduled to be made on the notes to the U.S. Holder through such date (without regard to the actual amount paid).

Gain recognized upon a sale, exchange, conversion, repurchase or redemption of a note will generally be treated as ordinary interest income. Any loss recognized upon a sale, exchange, conversion, repurchase or redemption of a note will be treated as an ordinary loss to the extent of the excess of previous interest inclusions over the total negative adjustment previously taken into account as ordinary loss, and thereafter, as capital loss (which will be long-term if the note is held for more than one year). The deductibility of capital losses is subject to limitations. Under recently finalized Treasury regulations intended to address so-called tax shelters and other tax-motivated transactions, a U.S. Holder that recognizes a loss that meets certain thresholds upon the sale, exchange, conversion, repurchase or redemption of a note may have to comply with certain disclosure requirements and should consult its tax advisor.

A U.S. Holder's tax basis in shares of our common stock received upon a conversion of a note will equal the fair market value of such common stock at the time of conversion. The U.S. Holder's holding period for the shares of our common stock received will commence on the day immediately following the date of conversion.

Constructive Dividends

If at any time we make a distribution of property to our stockholders that would be taxable to the stockholders as a dividend for United States federal income tax purposes and, in accordance with the anti-dilution provisions of the notes, the conversion rate of the notes is increased, such increase may be deemed to be the payment of a taxable dividend to U.S. Holders of the notes. For example, a Pre-Dividend Adjustment, or an increase in the conversion rate in the event of our distribution of our debt instruments or our assets will generally result in deemed dividend treatment to U.S. Holders of the notes, but an increase in the event of stock dividends or the distribution of rights to subscribe for our common stock will generally not.

Dividends on Common Stock

If we make cash distributions on our common stock, the distributions will generally be treated as dividends to a U.S. Holder of our common stock to the extent of our current or accumulated earnings and profits as determined under United States federal income tax principles at the end

of the tax year of the distribution, then as a tax-free return of capital to the extent of the U.S. Holder's adjusted tax basis in the common stock, and thereafter as gain from the sale or exchange of that stock. Under recently enacted tax legislation, eligible dividends received in tax years ending on or before December 31, 2008, will be subject to tax to a non-corporate U.S. Holder at the special reduced rate generally applicable to long-term capital gains. A U.S. Holder will be eligible for this reduced rate only if the U.S. Holder has held our common stock for more than 60 days during the 120-day period beginning 60 days before the ex-dividend date.

Disposition of Common Stock

Upon the sale or other disposition of our common stock received on conversion of a note, a U.S. Holder will generally recognize capital gain or loss equal to the difference between (i) the amount of cash and the fair market value of any property received upon the sale or exchange and (ii) the U.S. Holder's adjusted tax basis in our common stock. That capital gain or loss will be long-term if the U.S. Holder's holding period in respect of such note is more than one year. The deductibility of capital losses is subject to limitations. Under recently finalized Treasury regulations intended to address so-called tax shelters and other tax-motivated transactions, a U.S. Holder that recognizes a loss that

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meets certain thresholds upon the sale or exchange of our common stock may have to comply with certain disclosure requirements and should consult its tax advisor.

Non-U.S. Holders

Notes

All payments on the notes made to a Non-U.S. Holder, including a payment in our common stock pursuant to a conversion, and any gain realized on a sale or exchange of the notes, will be exempt from United States income and withholding tax, provided that: (i) such Non-U.S. Holder does not own, actually or constructively, 10% or more of the total combined voting power of all classes of our stock entitled to vote, (ii) such Non-U.S. Holder is not a controlled foreign corporation related, directly or indirectly, to us through stock ownership, (iii) such Non-U.S. Holder is not a bank receiving certain types of interest, (iv) the beneficial owner of the notes certifies, under penalties of perjury, to us or our paying agent on IRS Form W-8BEN that it is a United States person and provides its name, address and certain other required information or certain other certification requirements are satisfied, (v) such payments and gain are not effectively connected with the conduct by such Non-U.S. Holder of a trade or business in the United States, and (v) with respect only to gain realized on a sale, exchange or conversion of the notes, our common stock continues to be actively traded within the meaning of section 871(h)(4)(C)(v)(I) of the Code and we have not been a U.S. real property holding corporation, as defined in the Code, at any time within the five-year period preceding the disposition or the Non-U.S. Holder's holding period, whichever is shorter. We believe that we have not been during the past five years, are not, and do not anticipate becoming, a U.S. real property holding corporation.

If a Non-U.S. Holder of a note were deemed to have received a constructive dividend (see " U.S. Holders Constructive Dividends" above), however, the Non-U.S. Holder would generally be subject to United States withholding tax at a 30% rate on the amount of such dividend, thereby potentially reducing the amount of interest payable to it, subject to reduction (i) by an applicable treaty if the Non-U.S. Holder provides an IRS Form W-8BEN certifying that it is entitled to such treaty benefits or (ii) upon the receipt of an IRS Form W-8ECI from a Non-U.S. Holder claiming that the constructive dividend on the notes is effectively connected with the conduct of a United States trade or business.

Common Stock

Dividends paid to a Non-U.S. Holder of common stock will generally be subject to withholding tax at a 30% rate subject to reduction (a) by an applicable treaty if the Non-U.S. Holder provides an IRS Form W-8BEN certifying that it is entitled to such treaty benefits or (b) upon the receipt of an IRS Form W-8ECI from a Non-U.S. Holder claiming that the payments are effectively connected with the conduct of a United States trade or business.

A Non-U.S. Holder will generally not be subject to United States federal income tax on gain realized on the sale or exchange of the common stock received upon a conversion of notes unless (a) the gain is effectively connected with the conduct of a United States trade or business of the Non-U.S. Holder or (b) in the case of a Non-U.S. Holder who is a nonresident alien individual, the individual is present in the United States for 183 or more days in the taxable year of the disposition and certain other conditions are met, or (c) we will have been a U.S. real property holding corporation at any time within the shorter of the five-year period preceding such sale or exchange and the Non-U.S. Holder's holding period in the common stock. We believe that we have not been during the past five years, are not and do not anticipate becoming, a U.S. real property holding corporation.

Income Effectively Connected with a United States Trade or Business

If a Non-U.S. Holder of notes or our common stock is engaged in a trade or business in the United States, and if interest on the notes, dividends on our common stock, or gain realized on the

sale, exchange, conversion or other disposition of the notes and gain realized on the sale or exchange of our common stock is effectively connected with the conduct of such trade or business, the Non-U.S. Holder, although exempt from the withholding tax discussed in the preceding paragraphs, will generally be subject to regular United States federal income tax on such interest, dividends or gain in the same manner as if it were a U.S. Holder. In addition, if such a Non-U.S. Holder is a foreign corporation, such holder may be subject to a branch profits tax equal to 30% (or such lower rate provided by an applicable treaty) of its effectively connected earnings and profits for the taxable year, subject to certain adjustments.

Information Reporting and Backup Withholding

Payments of interest or dividends made by us on, or the proceeds of the sale or other disposition of, the notes or shares of common stock may be subject to information reporting and United States federal backup withholding tax at the rate then in effect if the recipient of such payment fails to supply an accurate taxpayer identification number or otherwise fails to comply with applicable United States information reporting or certification requirements. Any amount withheld under the backup withholding rules is allowable as a credit against the holder's United States federal income tax, provided that the required information is furnished to the IRS.

SELLING SECURITYHOLDERS

The notes offered hereby were originally issued by us in a private offering in July 2003. Pursuant to a purchase agreement that we and the initial purchasers entered into in connection with that offering, the initial purchasers agreed to offer and sell the notes only to persons they reasonably believed to be "qualified institutional buyers" within the meaning of Rule 144A under the Securities Act. The selling securityholders, which term includes their transferees, pledgees, donees and successors, may from time to time offer and sell pursuant to this prospectus any or all of the notes and common stock issued upon conversion of the notes.

The following table sets forth information regarding the respective principal amounts of notes and numbers of shares of common stock beneficially owned by the selling securityholders prior to this offering and the respective principal amounts of notes and numbers of shares of common stock offered by the selling securityholders pursuant to this prospectus. This information has been obtained from the selling securityholders and we have not independently verified this information. Unless otherwise indicated, none of the selling securityholders has, or within the past three years has had, any position, office or other material relationship with us or, insofar as we are aware, any of our predecessors or affiliates. Because the selling securityholders may offer all or some portion of the notes or the common stock issuable upon conversion of the notes pursuant to this prospectus, no estimate can be given as to the amount of the notes or common stock that will be held by the selling securityholders upon termination of this offering. In addition, the selling securityholders identified below may have sold,

transferred or otherwise disposed of all or a portion of their notes or common stock since the date on which they provided the information to us for inclusion in the following table.

Name of Selling Securityholder(1)	Principal Amount of Notes Beneficially Owned Prior to this Offering	Principal Amount of Notes Offered by This Prospectus	Number of Shares of Common Stock Beneficially Owned Prior to this Offering(2)	Number of Shares of Common Stock Offered by This Prospectus(2)
Alpine Associates	$ 3,100,000	$ 3,100,000	128,470	128,470
Alpine Partners, L.P.	$ 400,000	$ 400,000	16,576	16,576
Black Diamond Convertible Offshore LC	$ 1,089,000	$ 1,089,000	45,130	45,130
Black Diamond Offshore Ltd.	$ 607,000	$ 607,000	25,155	25,155
Double Black Diamond Offshore LDC	$ 3,188,000	$ 3,188,000	132,117	132,117

Name of Selling Securityholder(1)	Principal Amount of Notes Beneficially Owned Prior to this Offering	Principal Amount of Notes Offered by This Prospectus	Number of Shares of Common Stock Beneficially Owned Prior to this Offering(2)	Number of Shares of Common Stock Offered by This Prospectus(2)
Durango Investments L.P.	$ 5,000,000	$ 5,000,000	207,210	207,210
Grace Convertible Arbitrage Fund, Ltd.	$ 3,000,000	$ 3,000,000	124,326	124,326
Polaris Vega Fund L.P.	$ 1,000,000	$ 1,000,000	41,442	41,442
All other holders of notes or shares of common stock issued on conversion of notes and future transferees, pledgees, donees and successors thereof(3)	$ 112,616,000	$ 112,616,000	4,667,058	4,667,058
Total	$ 130,000,000	$ 130,000,000	5,387,484(4)	5,387,484

(1) Information concerning the selling securityholders may change from time to time. Any such changed information will be set forth in amendments or supplements to this prospectus, if and when required.

(2) Unless otherwise indicated, includes all shares of common stock issuable upon conversion of the notes and assumes a conversion price of $24.13 per share and a cash payment in lieu of any fractional share. However, this conversion price will be subject to adjustment as described under "Description of the Notes Conversion Rights Conversion Rate Adjustments." As a result, the number of shares of common stock beneficially owned prior to this offering and the number of shares of common stock offered hereby may increase or decrease in the future. Also assumes that the notes are convertible immediately. As described above under "Description of the Notes Conversion Rights," the notes are convertible only in specified circumstances.

(3) Information concerning other selling securityholders will be set forth in amendments or supplements to this prospectus, if required.

(4) Assumes that any other holders of notes or shares of common stock issuable on conversion of notes and their respective transferees, pledgees, donees and successors do not beneficially own any common stock other than the common stock issued or issuable upon conversion of the notes.

PLAN OF DISTRIBUTION

The selling securityholders (including their transferees, pledgees, donees and successors) may sell the notes and the common stock issuable upon conversion of the notes from time to time directly to purchasers or through broker-dealers or agents who may receive compensation in the form of discounts, concessions or commissions from the selling securityholders or the purchasers. If the notes or the shares of common stock issuable upon conversion of notes are sold through broker-dealers or agents, the selling securityholders will be responsible for any discounts, concessions or commissions payable to those broker-dealers or agents.

The notes and the common stock issuable upon conversion of the notes may be sold in one or more transactions at:

- fixed prices;

prevailing market prices at the time of sale;

varying prices determined at the time of sale; or

negotiated prices.

These sales may be effected in transactions, which may involve crosses or block transactions:

on any national securities exchange or quotation service on which the notes or the common stock may be listed or quoted at the time of sale;

in the over-the-counter market;

otherwise than on such exchanges or services or in the over-the-counter market; or

through the writing of options.

Crosses are transactions in which the same broker acts as an agent on both sides of the trade.

In connection with the sale of the notes and the common stock issuable upon conversion of the notes or otherwise, the selling securityholders may enter into hedging transactions with broker-dealers or other financial institutions, which may in turn engage in short sales of the notes or common stock in the course of hedging their positions. The selling securityholders also may deliver the notes and shares of common stock issuable upon conversion of notes to close out short positions, or loan or pledge the notes or the common stock issuable upon conversion of such notes to broker-dealers or other financial institutions that in turn may sell those securities. The selling securityholders also may transfer, donate and pledge notes and shares of common stock issuable upon conversion of notes, in which case the transferees, donees, pledgees or other successors in interest will be deemed selling securityholders for purposes of this prospectus.

The aggregate proceeds to the selling securityholders from the sale of the notes or the common stock issuable upon the conversion of the notes offered by them will be the purchase price of such notes or common stock less discounts and commissions, if any, payable by them. Each of the selling securityholders reserves the right to accept and, together with their broker-dealers or agents from time to time, to reject, in whole or in part, any proposed purchase of the notes or the common stock issuable upon conversion of the notes to be made directly or through broker-dealers or agents. We will not receive any of the proceeds from the offering of the notes and the common stock issuable upon conversion of the notes.

There is no public market for the notes and we do not intend to apply for listing of the notes on any securities exchange or for quotation of the notes through any automated quotation system. The notes are currently designated for trading on the PORTAL Market. However, once notes are sold by

means of this prospectus, those notes will no longer trade on the PORTAL Market. Our common stock is listed on the New York Stock Exchange under the symbol "GFF".

In order to comply with the securities laws of some states, if applicable, the notes and the common stock issuable upon conversion of the notes may be sold in those jurisdictions only through registered or licensed brokers or dealers. In addition, in some states the notes and the common stock issuable upon conversion of the notes may not be sold unless they have been registered or qualified for sale or an exemption from registration or qualification requirements is available and is complied with.

The selling securityholders may not sell any, or may sell less than all, of the notes and shares of common stock issuable upon conversion of the notes offered by them pursuant to this prospectus. In addition, any selling securityholder may, to the extent permitted by applicable law, sell, transfer, devise or gift the notes or shares of common stock issuable upon conversion of notes by means not described in this prospectus. In that

regard, any notes or shares of common stock issuable upon conversion of notes that qualify for sale pursuant to Rule 144A or Rule 144 under the Securities Act may be sold under that rule, if applicable, rather than pursuant to this prospectus.

The selling securityholders and any broker-dealers or agents that participate in the distribution of the notes and the common stock issuable upon conversion of the notes may be "underwriters" within the meaning of Section 2(11) of the Securities Act. As a result, any profits on the sale of the notes or the shares of common stock issued on conversion of notes received by selling securityholders and any discounts, commissions or concessions received by any such broker-dealers or agents might be deemed to be underwriting discounts and commissions under the Securities Act. If the selling securityholders were deemed to be underwriters, the selling securityholders could be subject to certain statutory liabilities under the federal securities laws, including under Sections 11, 12 and 17 of the Securities Act and Rule 10b-5 under the Securities Exchange Act of 1934.

The selling securityholders and any other persons participating in the distribution of the notes and the shares of common stock issuable upon conversion of the notes will be subject to the Securities Exchange Act. The Securities Exchange Act rules include, without limitation, Regulation M, which may limit the timing of or prohibit the purchase and sale of notes and shares of common stock by the selling securityholders and any such other person. In addition, under Regulation M, any selling securityholder or other person engaged in the "distribution," within the meaning of Regulation M, of the notes or the shares of common stock issuable upon conversion of the notes may not engage in market-making activities with respect to the notes or the common stock for certain periods prior to the commencement of that distribution, unless, in the case of persons other than selling securityholders, an applicable exemption is available under Regulation M. The foregoing may affect the marketability of the notes and the common stock issuable upon conversion of the notes and the ability of any person or entity to engage in market-making activities with respect to those securities.

In that regard, the selling securityholders are required to acknowledge that they understand their obligations to comply with the provisions of the Securities Exchange Act and the rules thereunder relating to stock manipulation, particularly Regulation M thereunder (or any successor rules or regulations), in connection with the offering made by this prospectus. Each selling securityholder is required to agree that neither it nor any person acting on its behalf will engage in any transaction in violation of such provisions.

To the extent required, the specific notes or common stock to be sold, the names of the selling securityholders, the respective purchase prices and public offering prices, the names of any agent or broker-dealer, and any applicable commissions or discounts with respect to a particular sale or other disposition of notes or shares of common stock issued on conversion of notes pursuant to this prospectus will be set forth in a supplement to this prospectus or, if appropriate, a post-effective amendment to the shelf registration statement of which this prospectus is a part.

Pursuant to the registration rights agreement described above under "Description of the Notes Registration Rights," we and the selling securityholders have agreed, subject to exceptions, to indemnify each other against specified liabilities, including liabilities under the Securities Act, and may be entitled to contribution from each other in respect of those liabilities.

We will pay substantially all of the expenses incident to the offering and sale of the notes and the common stock issuable upon conversion of the notes pursuant to this prospectus, other than commissions, fees and discounts payable to brokers-dealers or agents, fees and disbursements of any counsel or other advisors or experts retained by the selling securityholders and any documentary, stamp or similar issue or transfer tax.

Under the registration rights agreement, we may be required from time to time to require holders of notes and shares of common stock issued on conversion of notes to discontinue the sale or other disposition of those notes and shares of common stock under specified circumstances. See "Description of the Notes Registration Rights" above.

LEGAL MATTERS

Kramer, Coleman, Wactlar & Lieberman, P.C., Jericho, New York and Skadden, Arps, Slate, Meagher & Flom LLP, New York, New York have acted as counsel to Griffon Corporation in connection with this registration statement.

EXPERTS

The consolidated financial statements as of and for the year ended September 30, 2002 incorporated in this prospectus by reference to the Annual Report on Form 10-K for the year ended September 30, 2002 have been so incorporated in reliance on the report of PricewaterhouseCoopers LLP, independent accountants, given on the authority of said firm as experts in auditing and accounting.

Our financial statements as of and for the fiscal years ended September 30, 2001 and 2000, included in our Annual Report on Form 10-K for the fiscal year ended September 30, 2002, incorporated by reference into this prospectus, were audited by Arthur Andersen LLP ("Andersen"), as stated in their report dated November 6, 2001, which is also incorporated by reference herein. The report of Andersen was not reissued by Andersen and they did not give permission to use such report in this prospectus. The ability of Andersen to satisfy any claims (including claims arising from Andersen's provision of auditing and other services to us) may be limited as a practical matter due to events regarding Andersen.

WHERE YOU CAN FIND MORE INFORMATION

We file reports, proxy statements, and other information with the SEC. Such reports, proxy statements, and other information concerning us can be read and copied at the SEC's Public Reference Room at 450 Fifth Street, N.W., Washington, D.C. 20549. Please call the SEC at 1-800-SEC-0330 for further information on the Public Reference Room. The SEC maintains an internet site at *http://www.sec.gov* that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC, including us. Our common stock is listed on the New York Stock Exchange under the trading symbol "GFF." These reports, proxy statements, and other information are also available for inspection at the offices of the New York Stock Exchange, 20 Broad Street, New York, New York 10005. For further information on obtaining copies of our public filings at the New York Stock Exchange, you should call 212-656-5060.

Any information in documents incorporated by reference in this prospectus is considered part of this prospectus, and any information filed with the SEC subsequent to this prospectus and prior to the sale of all the notes and common stock to which this prospectus relates will automatically update and supersede this information. We incorporate by reference the documents listed below which have been filed with the SEC:

- Annual Report on Form 10-K for the fiscal year ended September 30, 2002;
- Quarterly Reports on Form 10-Q for the quarters ended December 31, 2002, March 31, 2003 and June 30, 2003;
- Report on Form 8-K dated July 18, 2003;
- Proxy Statement, dated December 30, 2002, relating to our Annual Meeting of Stockholders held on February 5, 2003;
- Registration Statement on Form 8-A dated January 19, 1993, as amended by a Form 8-A/A filed with the SEC on November 29, 1994; and
- Registration Statement on Form 8-A filed with the SEC on May 16, 1996.

Any statement contained in a document incorporated or considered to be incorporated by reference in this prospectus shall be considered to be modified or superseded for purposes of this prospectus to the extent that a statement contained in this prospectus or in any subsequently filed document that is or is considered to be incorporated by reference modifies or supersedes such statement. Any statement that is modified or superseded shall not, except as so modified or superseded, constitute a part of this prospectus.

We will provide without charge, upon written or oral request, a copy of any or all of the documents which are incorporated by reference in this prospectus, other than exhibits to such documents, unless the exhibits are incorporated by reference into such documents. Requests should be directed to our Secretary, Griffon Corporation, 100 Jericho Quadrangle, Jericho, New York 11753.

You should rely only on the information included or incorporated by reference in this prospectus or the prospectus supplement, if any. We have not authorized anyone else to provide you with different information. These securities are being offered only in states where the offer is permitted. You should not assume that the information in this prospectus is accurate as of any date other than the date on the front cover hereof. Information on our web site is not a part of this prospectus.

PART II

INFORMATION NOT REQUIRED IN PROSPECTUS

Item 14. Other Expenses of Issuance and Distribution

The following table sets forth the fees and expenses, other than discounts, commissions and concessions payable to broker-dealers and agents, in connection with the offering and distribution of the securities being offered hereunder. All amounts other than the filing fee for the registration statement are estimates. All of these fees and expenses will be borne by the Registrant.

Securities and Exchange Commission Filing Fee	$	10,517
Printing Fees and Expenses		15,000
Trustees' Fees and Expenses		3,500
Legal Fees		25,000
Accounting and Auditor Fees		30,000
Miscellaneous		5,983
Total	$	90,000

Item 15. Indemnification of Directors and Officers

Under provisions of the By-Laws of Griffon, each person who is or was a director or officer of Griffon may be indemnified by Griffon to the full extent permitted or authorized by the General Corporation Law of Delaware.

Under such law, to the extent that such person is successful on the merits of defense of a suit or proceeding brought against him by reason of the fact that he is a director or officer of Griffon, such person shall be indemnified against expenses (including attorneys' fees) reasonably incurred in connection with such action.

If unsuccessful in defense of a third-party civil suit or if a criminal suit is settled, such a person may be indemnified under such law against both (1) expenses (including attorneys' fees) and (2) judgments, fines and amounts paid in settlement if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of Griffon, and with respect to any criminal action, had no reasonable cause to believe his conduct was unlawful.

If unsuccessful in defense of a suit brought by or in the right of Griffon, or if such suit is settled, such a person may be indemnified under such law only against expenses (including attorneys' fees) incurred in the defense or settlement of such suit if he acted in good faith and in a manner he reasonably believed to be in, or not opposed to, the best interests of Griffon except that if such a person is adjudged to be liable in such suit for negligence or misconduct in the performance of his duty to Griffon, he cannot be made whole even for expenses unless the court determines that he is fairly and reasonably entitled to indemnity for such expenses.

Determinations made as to whether such person has met the applicable standard of conduct in order to be indemnified shall be made (1) by a majority vote of the directors who are not parties to such action, suit or proceeding, even though less than a quorum, or (2) by a committee of such directors designated by majority vote of such directors, even though less than a quorum, or (3) if there are no such directors, or if such directors so direct, by independent legal counsel in a written opinion, or (4) by the stockholders.

The indemnification and advancement of expenses shall, unless otherwise provided when authorized or ratified, continue as to a person who has ceased to be a director, officer, employee or agent and shall inure to the benefit of the heirs, executors and administrators of such a person.

The officers and directors of Griffon are covered by officers and directors liability insurance. Griffon has entered into indemnification agreements with all of its officers and directors. The agreements provide for reimbursement for all direct and indirect costs of any type or nature whatsoever (including attorneys' fees and related disbursements) actually and reasonably incurred in connection with either the investigation, defense or appeal of a proceeding (as defined in such agreements) including amounts paid in settlement by or on behalf of an indemnitee.

Item 16. Exhibits

3.1 Restated Certificate of Incorporation (incorporated by reference to Exhibit 3.1 of our Annual Report on Form 10-K for the year ended September 30, 1995)

3.2 Amended and restated By-laws (incorporated by reference to Exhibit 3 of our Current Report on Form 8-K dated May 2, 2001)

4.1 Indenture, dated as of July 18, 2003, between Griffon Corporation and American Stock Transfer & Trust Company, as Trustee, including the form of 4.0% Contingent Convertible Subordinated Note due 2023

4.2 Registration Rights Agreement, dated July 18, 2003, by and between Griffon Corporation and Deutsche Bank Securities Inc., as representative of the initial purchasers.

4.3 Form of Certificate Evidencing the Common Stock

4.4		0.9	0.9					
Adjustments to redemption amount of redeemable noncontrolling interest			(0.5)					(0.5)
Net income (1)				348.9			1.9	350.8
Other comprehensive income (1)					220.1		0.4	220.5
Balances as of March 31, 2017	**$**	**4.7**	**$ 9,780.5**	**$ 7,937.4**	**$ (455.1)**	**$ (6,651.4)**	**$ 68.8**	**$ 10,684.9**

(1) Excludes amounts attributable to redeemable noncontrolling interest. See Note 9, Stockholders Equity, for further details.

See accompanying notes.

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Principal Financial Group, Inc.

Consolidated Statements of Cash Flows

(Unaudited)

	For the three months ended March 31,	
	2017	**2016**
	(in millions)	
Operating activities		
Net income	**$ 353.6**	$ 369.2
Adjustments to reconcile net income to net cash provided by operating activities:		
Amortization of deferred acquisition costs	**52.3**	99.6
Additions to deferred acquisition costs	**(104.4)**	(103.2)
Accrued investment income	**(44.6)**	(34.7)
Net cash flows for trading securities	**109.0**	(11.9)
Premiums due and other receivables	**(44.1)**	124.2
Contractholder and policyholder liabilities and dividends	**429.8**	617.1
Current and deferred income taxes	**50.3**	57.1
Net realized capital (gains) losses	**16.6**	(136.6)
Depreciation and amortization expense	**48.1**	45.8
Real estate acquired through operating activities	**(10.7)**	(12.8)
Real estate sold through operating activities	**0.4**	0.1
Stock-based compensation	**22.1**	22.3
Other	**(355.5)**	(140.7)
Net adjustments	**169.3**	526.3
Net cash provided by operating activities	**522.9**	895.5
Investing activities		
Available-for-sale securities:		
Purchases	**(4,307.0)**	(3,558.6)
Sales	**333.7**	205.5
Maturities	**2,460.8**	1,616.0
Mortgage loans acquired or originated	**(473.8)**	(475.9)
Mortgage loans sold or repaid	**329.3**	479.3
Real estate acquired	**(90.8)**	(44.5)
Real estate sold	**47.1**	15.0
Net purchases of property and equipment	**(43.8)**	(44.2)
Net change in other investments	**(86.5)**	(45.9)
Net cash used in investing activities	**(1,831.0)**	(1,853.3)
Financing activities		
Issuance of common stock	**70.8**	10.0
Acquisition of treasury stock	**(142.8)**	(105.6)
Proceeds from financing element derivatives	**0.1**	
Payments for financing element derivatives	**(20.9)**	(21.3)
Excess tax benefits from share-based payment arrangements		5.0
Purchase of subsidiary shares from noncontrolling interest		(2.3)
Dividends to common stockholders	**(130.0)**	(110.4)
Issuance of long-term debt		3.2
Net proceeds from (repayments of) short-term borrowings	**7.6**	(59.9)
Investment contract deposits	**2,629.1**	3,976.3
Investment contract withdrawals	**(2,303.9)**	(3,166.3)
Net increase in banking operation deposits	**6.8**	4.0

Other		**6.4**		3.2
Net cash provided by financing activities		**123.2**		535.9
Net decrease in cash and cash equivalents		**(1,184.9)**		(421.9)
Cash and cash equivalents at beginning of period		**2,719.6**		2,564.8
Cash and cash equivalents at end of period	**$**	**1,534.7**	$	2,142.9

See accompanying notes.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements

March 31, 2017
(Unaudited)

1. Nature of Operations and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Principal Financial Group, Inc. (PFG) have been prepared in conformity with accounting principles generally accepted in the U.S. (U.S. GAAP) for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2017, are not necessarily indicative of the results that may be expected for the year ended December 31, 2017. These interim unaudited consolidated financial statements should be read in conjunction with our annual audited financial statements as of December 31, 2016, included in our Form 10-K for the year ended December 31, 2016, filed with the United States Securities and Exchange Commission (SEC). The accompanying consolidated statement of financial position as of December 31, 2016, has been derived from the audited consolidated statement of financial position but does not include all of the information and footnotes required by U.S. GAAP for complete financial statements.

Consolidation

We have relationships with various special purpose entities and other legal entities that must be evaluated to determine if the entities meet the criteria of a variable interest entity (VIE) or a voting interest entity (VOE). This assessment is performed by reviewing contractual, ownership and other rights, including involvement of related parties, and requires use of judgment. First, we determine if we hold a variable interest in an entity by assessing if we have the right to receive expected losses and expected residual returns of the entity. If we hold a variable interest, then the entity is assessed to determine if it is a VIE. An entity is a VIE if the equity at risk is not sufficient to support its activities, if the equity holders lack a controlling financial interest or if the entity is structured with non-substantive voting rights. In addition to the previous criteria, if the entity is a limited partnership or similar entity, it is a VIE if the limited partners do not have the power to direct the entity s most significant activities through substantive kick-out rights or participating rights. A VIE is evaluated to determine the primary beneficiary. The primary beneficiary of a VIE is the enterprise with (1) the power to direct the activities of a VIE that most significantly impact the entity s economic performance and (2) the obligation to absorb losses of the entity or the right to receive benefits from the entity that could potentially be significant to the VIE. When we are the primary beneficiary, we are required to consolidate the entity in our financial statements. We reassess our involvement with VIEs on a quarterly basis. For further information about VIEs, refer to Note 2, Variable Interest Entities.

If an entity is not a VIE, it is considered a VOE. VOEs are generally consolidated if we own a greater than 50% voting interest. If we determine our involvement in an entity no longer meets the requirements for consolidation under either the VIE or VOE models, the entity is deconsolidated. Entities in which we have significant management influence over the operating and financing decisions but are not required to consolidate, other than investments accounted for at fair value under the fair value option, are reported using the equity method.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Recent Accounting Pronouncements

Description	Date of adoption	Effect on our consolidated financial statements or other significant matters
Standards not yet adopted:		
Goodwill impairment testing This authoritative guidance simplifies how an entity is required to test goodwill for impairment by eliminating Step 2 (which measures a goodwill impairment loss by comparing the implied fair value of a reporting unit s goodwill to the carrying amount of that goodwill) from the goodwill impairment test. A goodwill impairment loss will be the amount by which a reporting unit s carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. Entities will continue to have the option to perform a qualitative assessment to determine if a quantitative impairment test is necessary. Early adoption is permitted.	January 1, 2020	We are currently evaluating the impact this guidance will have on our consolidated financial statements.
Credit losses This authoritative guidance requires entities to use a current expected credit loss (CECL) model to measure impairment for most financial assets that are not recorded at fair value through net income. Under the CECL model, an entity will estimate lifetime expected credit losses considering available relevant information about historical events, current conditions and reasonable and supportable forecasts. The CECL model does not apply to available-for-sale debt securities. This guidance also expands the required credit loss disclosures and will be applied using a modified retrospective approach by recording a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. Early adoption is permitted.	January 1, 2020	We are currently evaluating the impact this guidance will have on our consolidated financial statements. We believe estimated credit losses under the CECL model will generally result in earlier loss recognition for loans and other receivables.
Premium amortization on purchased callable debt securities This authoritative guidance applies to entities that hold certain non-contingently callable debt securities, where the amortized cost basis is at a premium to the price repayable by the issuer at the earliest call date. Under the guidance the premium will be amortized to the first call date. This guidance requires adoption through a cumulative-effect adjustment to retained earnings as of	January 1, 2019	We are currently evaluating the impact this guidance will have on our consolidated financial statements.

the beginning of the period of adoption. Early adoption is permitted.		
Leases This authoritative guidance requires lessee recognition of lease assets and lease liabilities on the balance sheet. The concept of an operating lease, where the lease assets and liabilities are off balance sheet, is eliminated under the new guidance. For lessors, the guidance modifies lease classification criteria and accounting for certain types of leases. Other key aspects of the guidance relate to the removal of the current real estate-specific guidance and new presentation and disclosure requirements. Lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach, which includes certain optional practical expedients that may be elected. Early adoption is permitted.	January 1, 2019	We have primarily focused our implementation efforts on identifying our leases that are within the scope of the guidance and will be added to our balance sheet. We are currently evaluating other impacts this guidance will have on our consolidated financial statements.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Description	Date of adoption	Effect on our consolidated financial statements or other significant matters
Nonfinancial asset derecognition and partial sales of nonfinancial assets This authoritative guidance clarifies the scope of the recently established guidance on nonfinancial asset derecognition and the accounting for partial sales of nonfinancial assets. The guidance conforms the derecognition guidance on nonfinancial assets with the model for transactions in the new revenue recognition standard.	January 1, 2018	We are currently evaluating the impact this guidance will have on our consolidated financial statements.
Presentation of net periodic pension cost and net periodic postretirement benefit cost This authoritative guidance requires that an employer disaggregate the service cost component from the other components of net benefit cost. The guidance also provides explicit guidance on the presentation of the service cost component and the other components of net benefit cost in the income statement and allows only the service cost component of net benefit cost to be eligible for capitalization.	January 1, 2018	We are currently evaluating the impact this guidance will have on our consolidated financial statements.
Definition of a business This authoritative guidance clarifies the definition of a business to assist with evaluating when transactions involving an integrated set of assets and activities (a set) should be accounted for as acquisitions or disposals of assets or businesses. The guidance requires that when substantially all of the fair value of the gross assets acquired or disposed of is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. The guidance also requires a set to include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output to be considered a business. Lastly, the guidance removes the evaluation of whether a market participant could replace missing elements and narrows the definition of outputs by more closely aligning it with how outputs are described in the revenue recognition guidance. The guidance will be applied prospectively. Early application is permitted in certain circumstances.	January 1, 2018	We are currently evaluating the impact this guidance will have on our consolidated financial statements.
Financial instruments - recognition and measurement This authoritative guidance addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The primary focus of this guidance is to supersede the guidance to classify equity securities with readily determinable fair values into different categories (trading or available-for-sale) and requires equity securities to be measured at fair value with changes in the fair value recognized through net income. This	January 1, 2018	As of March 31, 2017, we did not hold material equity securities accounted for at fair value through other comprehensive income that will be accounted for at fair value through net income under the updated guidance. We continue to evaluate the impact of this standard; however, this change is not expected to have a material impact

guidance requires adoption through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption.		on our consolidated financial statements.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Description	Date of adoption	Effect on our consolidated financial statements or other significant matters
Revenue recognition This authoritative guidance replaces all general and most industry specific revenue recognition guidance (excluding insurance) currently prescribed by U.S. GAAP. The core principle is that an entity recognizes revenue to reflect the transfer of a promised good or service to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for that good or service. This guidance also provides clarification on when an entity is a principal or an agent in a transaction. In addition, the guidance updates the accounting for certain costs associated with obtaining and fulfilling a customer contract. The guidance may be applied using one of the following two methods: (1) retrospectively to each prior reporting period presented, or (2) retrospectively with the cumulative effect of initially applying the standard recognized at the date of initial application.	January 1, 2018	Only a portion of our total revenues, less than 20%, are subject to this guidance as it does not apply to revenue on contracts accounted for under the financial instruments or insurance contracts standards. Our evaluation process is ongoing and includes, but is not limited to, identifying contracts within the scope of the guidance, reviewing and documenting our accounting for these contracts, identifying and determining the accounting for any related contract costs, and preparing the required financial statement disclosures. To date, the impacts we have identified primarily relate to deferring and amortizing certain sales compensation related to obtaining customer contracts. We have not identified material changes in the timing of our revenue recognition. We plan to adopt the guidance on January 1, 2018, using the modified retrospective application; however, we continue to evaluate the impact of the standard and our adoption method is subject to change.
Income tax - intra-entity transfers of assets This authoritative guidance requires entities to recognize current and deferred income tax resulting from an intra-entity asset transfer when the transfer occurs. Prior to issuance of this guidance, U.S. GAAP did not allow recognition of income tax consequences until the asset had been sold to a third party. This guidance requires adoption through a cumulative-effect adjustment to the balance sheet as of the beginning of the fiscal year of adoption with early adoption permitted.	January 1, 2018	We are currently evaluating the impact this guidance will have on our consolidated financial statements.

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Description	Date of adoption	Effect on our consolidated financial statements or other significant matters
Standards adopted:		
Employee share-based payment accounting This authoritative guidance changes certain aspects of accounting for and reporting share-based payments to employees including changes related to the income tax effects of share-based payments, tax withholding requirements and accounting for forfeitures. Various transition methods will apply depending on the situation being addressed.	January 1, 2017	The guidance was adopted prospectively as indicated by the guidance for each area of change and did not have a material impact on our consolidated financial statements.
Short-duration insurance contracts This authoritative guidance requires additional disclosures related to short-duration insurance contracts.	December 31, 2016	The disclosure requirements of this guidance were adopted retrospectively.
Net asset value per share as a practical expedient for fair value This authoritative guidance removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient.	January 1, 2016	The guidance was adopted retrospectively and did not have a material impact on our consolidated financial statements. See Note 10, Fair Value Measurements, for further details.
Simplifying the presentation of debt issuance costs This authoritative guidance requires debt issuance costs related to a recognized debt liability to be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts.	January 1, 2016	The guidance was adopted retrospectively and did not have a material impact on our consolidated financial statements.
Consolidations This authoritative guidance makes changes to both the variable interest and voting interest consolidation models and eliminates the investment company deferral for portions of the variable interest model. The amendments in the standard impact the consolidation analysis for interests in investment companies and limited partnerships and similar entities.	January 1, 2016	The guidance was adopted using the modified retrospective approach. See Note 2, Variable Interest Entities, for further details.

When we adopt new accounting standards, we have a process in place to perform a thorough review of the pronouncement, identify the financial statement and system impacts and create an implementation plan among our impacted business units to ensure we are compliant with the pronouncement on the date of adoption. This includes having effective processes and controls in place to support the reported amounts. Each of the standards listed above is in varying stages in our implementation process based on its issuance and adoption dates. We are on track to implement guidance by the respective effective dates.

Derivatives

Over-The-Counter Derivatives Cleared on Chicago Mercantile Exchange

We use certain over-the-counter (OTC) interest rate contracts that are subject to derivative clearing agreements. These agreements require the daily cash settlement of variation margin based on changes in the fair value of the derivative instrument. Prior to 2017, variation margin for all such interest rate contracts was treated as collateral, which was accounted for separately as an interest-bearing asset or liability. For reporting purposes, we did not offset fair value amounts recognized for the right to reclaim variation margin collateral or the obligation to return variation margin collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements.

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Effective January 2017, the Chicago Mercantile Exchange (CME) rulebook was amended to legally characterize variation margin payments for cleared OTC derivatives as settlements of the derivative exposure rather than collateral against the derivative exposure. The economic cash flows exchanged do not change and therefore hedge accounting is unchanged; however, the variation margin and derivative instrument are considered a single unit of account for accounting and presentation purposes. As settlements, variation margin receipts and payments are considered cash flows of the derivative and reduce the recognized asset or liability arising from the derivative s mark-to-market for balance sheet presentation, effectively resulting in the derivative having a fair value that approximates zero. As of December 31, 2016, our consolidated statements of financial position included $528.0 million in other investments and $527.7 million in other liabilities related to OTC interest rate contracts cleared with the CME. The balance of those line items was reduced by those amounts in January 2017 as a result of the CME rulebook amendment. The rulebook amendment did not have an impact on net income. Additionally, the change by the CME did not impact the accounting for our OTC derivatives not cleared with the CME.

Separate Accounts

The separate accounts are legally segregated and are not subject to the claims that arise out of any of our other business. The client, rather than us, directs the investments and bears the investment risk of these funds. The separate account assets represent the fair value of funds that are separately administered by us for contracts with equity, real estate and fixed income investments and are presented as a summary total within the consolidated statements of financial position. An equivalent amount is reported as separate account liabilities, which represent the obligation to return the monies to the client. We receive fees for mortality, withdrawal and expense risks, as well as administrative, maintenance and investment advisory services that are included in the consolidated statements of operations. Net deposits, net investment income and realized and unrealized capital gains and losses of the separate accounts are not reflected in the consolidated statements of operations.

Separate account assets and separate account liabilities include certain international retirement accumulation products where the segregated funds and associated obligation to the client are consolidated within our financial statements. We have determined that summary totals are the most meaningful presentation for these funds.

As of March 31, 2017 and December 31, 2016, the separate accounts included a separate account valued at $166.9 million and $158.4 million, respectively, which primarily included shares of our stock that were allocated and issued to eligible participants of qualified employee benefit plans administered by us as part of the policy credits issued under our 2001 demutualization. These shares are included in both basic and diluted earnings per share calculations. In the consolidated statements of financial position, the separate account shares are recorded at fair value and are reported as separate account assets with a corresponding separate account liability to eligible participants of the qualified plan. Changes in fair value of the separate account shares are reflected in both the separate account assets and separate account liabilities and do not impact our results of operations.

2. Variable Interest Entities

We have relationships with various types of entities which may be VIEs. Certain VIEs are consolidated in our financial results. See Note 1, Nature of Operations and Significant Accounting Policies, under the caption Consolidation for further details of our consolidation accounting policies. We did not provide financial or other support to investees designated as VIEs for the periods ended March 31, 2017 and December 31, 2016.

Consolidated Variable Interest Entities

Grantor Trusts

We contributed undated subordinated floating rate notes to three grantor trusts. The trusts separated their cash flows by issuing an interest-only certificate and a residual certificate related to each note contributed. Each interest-only certificate entitles the holder to interest on the stated note for a specified term, while the residual certificate entitles the holder to interest payments subsequent to the term of the interest-only certificate and to all principal payments. We retained the interest-only certificates and the residual certificates were subsequently sold to third parties. We determined these grantor trusts are VIEs due to insufficient equity to sustain them. We determined we are the primary beneficiary as a result of our contribution of securities into the trusts and our significant continuing interest in the trusts.

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Collateralized Private Investment Vehicles

We invest in cash and synthetic collateralized debt obligations, collateralized bond obligations, collateralized loan obligations and other collateralized structures, which are VIEs due to insufficient equity to sustain the entities (collectively known as collateralized private investment vehicles). The performance of the notes of these synthetic structures is primarily linked to a synthetic portfolio by derivatives; each note has a specific loss attachment and detachment point. The notes and related derivatives are collateralized by a pool of permitted investments. The investments are held by a trustee and can only be liquidated to settle obligations of the trusts. These obligations primarily include derivatives and the notes due at maturity or termination of the trusts. We determined we were the primary beneficiary for one of these synthetic entities because we acted as the investment manager of the underlying portfolio and we had the power to make decisions and to receive benefits and the obligation to absorb losses that could be potentially significant to the VIE. This synthetic entity matured in the first quarter of 2017.

Commercial Mortgage-Backed Securities

We sold commercial mortgage loans to a real estate mortgage investment conduit trust. The trust issued various commercial mortgage-backed securities (CMBS) certificates using the cash flows of the underlying commercial mortgages it purchased. This is considered a VIE due to insufficient equity to sustain itself. We determined we are the primary beneficiary as we retained the special servicing role for the assets within the trust as well as the ownership of the bond class that controls the unilateral kick-out rights of the special servicer.

Mandatory Retirement Savings Funds

We hold an equity interest in Chilean mandatory privatized social security funds in which we provide asset management services. We determined the mandatory privatized social security funds, which also include contributions for voluntary pension savings, voluntary non-pension savings and compensation savings accounts, are VIEs. This is because the equity holders as a group lack the power, due to voting rights or similar rights, to direct the activities of the entity that most significantly impact the entity s economic performance and also because equity investors are protected from below-average market investment returns relative to the industry s return, due to a regulatory guarantee that we provide. Further we concluded we are the primary beneficiary through our power to make decisions and our significant variable interest in the funds. The purpose of the funds, which reside in legally segregated entities, is to provide long-term retirement savings. The obligation to the customer is directly related to the assets held in the funds and, as such, we present the assets as separate account assets and the obligation as separate account liabilities within our consolidated statements of financial position.

Principal International Hong Kong offers retirement pension schemes in which we provide trustee, administration and asset management services to employers and employees under the Hong Kong Mandatory Provident Fund (MPF) and Occupational Retirement Schemes Ordinance (ORSO) pension schemes. Each pension scheme has various guaranteed and non-guaranteed constituent funds, or investment options, in which customers can invest their money. The guaranteed funds provide either a guaranteed rate of return to the customer or a minimum guarantee on

withdrawals under certain qualifying events. We determined the guaranteed funds are VIEs due to the fact the equity holders, as a group, lack the obligation to absorb expected losses due to the guarantee we provide. We concluded we are the primary beneficiary because we have the power to make decisions and to receive benefits and the obligation to absorb losses that could be potentially significant to the VIE. Therefore, we consolidate the underlying assets and liabilities of the funds and present as separate accounts or within the general account, depending on the terms of the guarantee.

Real Estate

We invest in several real estate limited partnerships and limited liability companies. The entities invest in real estate properties. Certain of these entities are VIEs based on the combination of our significant economic interest and related voting rights. We determined we are the primary beneficiary as a result of our power to control the entities through our significant ownership. Due to the nature of these real estate investments, the investment balance will fluctuate as we purchase and sell interests in the entities and as capital expenditures are made to improve the underlying real estate.

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Sponsored Investment Funds

We sponsor and invest in certain investment funds for which we provide asset management services. Although our asset management fee is commensurate with the services provided and consistent with fees for similar services negotiated at arms-length, we have a variable interest for funds where our other interests are more than insignificant. The funds are VIEs as the equity holders lack power through voting rights to direct the activities of the entity that most significantly impact its economic performance. We determined we are the primary beneficiary of the VIEs where our interest in the entity is more than insignificant and we are the asset manager.

Assets and Liabilities of Consolidated Variable Interest Entities

The carrying amounts of our consolidated VIE assets, which can only be used to settle obligations of consolidated VIEs, and liabilities of consolidated VIEs for which creditors do not have recourse were as follows:

	March 31, 2017		December 31, 2016	
	Total assets	Total liabilities	Total assets	Total liabilities
		(in millions)		
Grantor trusts (1)	**$ 243.1**	**$ 223.6**	$ 233.3	$ 212.3
Collateralized private investment vehicle (2)			82.4	61.5
CMBS	**11.6**		12.5	
Mandatory retirement savings funds (3)	**38,670.2**	**38,320.8**	36,526.7	36,202.8
Real estate (4)	**342.0**	**12.1**	329.2	26.8
Sponsored investment funds (5)	**199.3**	**23.0**	114.3	0.9
Total	**$ 39,466.2**	**$ 38,579.5**	$ 37,298.4	$ 36,504.3

(1) The assets of grantor trusts are primarily fixed maturities, available-for-sale. The liabilities are primarily other liabilities that reflect an embedded derivative of the forecasted transaction to deliver the underlying securities.

(2) The assets of the collateralized private investment vehicle were primarily fixed maturities, trading. The liabilities included derivative liabilities and an obligation to redeem notes at maturity or termination of the trusts, which were reported in other liabilities.

(3) The assets of the mandatory retirement savings funds include separate account assets and equity securities, trading. The liabilities include separate account liabilities and contractholder funds.

(4) The assets of the real estate VIEs primarily include real estate, other investments and cash. Liabilities primarily include other liabilities.

(5) The assets of sponsored investment funds are primarily fixed maturities and equity securities, which are reported in other investments, and cash. The consolidated statements of financial position included a $57.6 million and $58.8 million redeemable noncontrolling interest for sponsored investment funds as of March 31, 2017 and December 31, 2016, respectively.

Unconsolidated Variable Interest Entities

Invested Securities

We hold a variable interest in a number of VIEs where we are not the primary beneficiary. Our investments in these VIEs are reported in fixed maturities, available-for-sale; fixed maturities, trading; equity securities, trading and other investments in the consolidated statements of financial position and are described below.

Unconsolidated VIEs include certain CMBS, residential mortgage-backed pass-through securities (RMBS) and other asset-backed securities (ABS). All of these entities were deemed VIEs because the equity within these entities is insufficient to sustain them. We determined we are not the primary beneficiary in the entities within these categories of investments. This determination was based primarily on the fact we do not own the class of security that controls the unilateral right to replace the special servicer or equivalent function.

As previously discussed, we invest in several types of collateralized private investment vehicles that are VIEs. These include cash and synthetic structures that we do not manage. We have determined we are not the primary beneficiary of these

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collateralized private investment vehicles primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

We have invested in various VIE trusts as a debt holder. All of these entities are classified as VIEs due to insufficient equity to sustain them. We have determined we are not the primary beneficiary primarily because we do not control the economic performance of the entities and were not involved with the design of the entities.

We have invested in partnerships and other funds, which are classified as VIEs. The entities are VIEs as equity holders lack the power to control the most significant activities of the entities because the equity holders do not have either the ability by a simple majority to exercise substantive kick-out rights or substantive participating rights. We have determined we are not the primary beneficiary because we do not have the power to direct the most significant activities of the entities.

As previously discussed, we sponsor and invest in certain investment funds that are VIEs. We determined we are not the primary beneficiary of the VIEs for which we are the asset manager but do not have a potentially significant variable interest in the funds.

We hold an equity interest in Mexican mandatory privatized social security funds in which we provide asset management services. Our equity interest in the funds is considered a variable interest. We concluded the funds are VIEs because the equity holders as a group lack decision-making ability through their voting rights. We are not the primary beneficiary of the VIEs because although we, as the asset manager, have the power to direct the activities of the VIEs, we do not have a potentially significant variable interest in the funds.

The carrying value and maximum loss exposure for our unconsolidated VIEs were as follows:

	Asset carrying value	Maximum exposure to loss (1)
	(in millions)	
March 31, 2017		
Fixed maturities, available-for-sale:		
Corporate	**$ 370.2**	**$ 303.1**
Residential mortgage-backed pass-through securities	**2,839.9**	**2,807.4**
Commercial mortgage-backed securities	**3,862.9**	**3,903.8**
Collateralized debt obligations	**987.9**	**1,006.9**
Other debt obligations	**5,246.9**	**5,252.1**
Fixed maturities, trading:		

Residential mortgage-backed pass-through securities		**18.8**		**18.8**
Equity securities, trading		**76.5**		**76.5**
Other investments:				
Other limited partnership and fund interests		**719.2**		**1,220.0**
December 31, 2016				
Fixed maturities, available-for-sale:				
Corporate	$	368.4	$	298.6
Residential mortgage-backed pass-through securities		2,834.7		2,798.0
Commercial mortgage-backed securities		4,096.5		4,153.2
Collateralized debt obligations		758.6		780.1
Other debt obligations		5,036.1		5,048.9
Fixed maturities, trading:				
Residential mortgage-backed pass-through securities		19.9		19.9
Commercial mortgage-backed securities		1.9		1.9
Collateralized debt obligations		10.6		10.6
Equity securities, trading		68.3		68.3
Other investments:				
Other limited partnership and fund interests		654.6		1,127.8

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(1) Our risk of loss is limited to our initial investment measured at amortized cost for fixed maturities, available-for-sale. Our risk of loss is limited to our investment measured at fair value for our fixed maturities, trading and equity securities, trading. Our risk of loss is limited to our carrying value plus any unfunded commitments and/or guarantees for our other investments. Unfunded commitments are not liabilities on our consolidated statements of financial position because we are only required to fund additional equity when called upon to do so by the general partner or investment manager.

Money Market Funds

We are the investment manager for certain money market mutual funds. These funds are exempt from assessment under any consolidation model due to a scope exception for money market funds registered under Rule 2a-7 of the Investment Company Act of 1940 or similar funds. As of March 31, 2017 and December 31, 2016, these funds held $0.7 billion and $0.8 billion in total assets, respectively. We have no contractual obligation to contribute to the funds; however, we provided support to these money market mutual funds through the waiver of fees and expense reimbursements. The amount of fees waived and expenses reimbursed was insignificant.

3. Investments

Fixed Maturities and Equity Securities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain non-redeemable preferred securities. Equity securities include mutual funds, common stock, non-redeemable preferred stock and required regulatory investments. We classify fixed maturities and equity securities as either available-for-sale or trading at the time of the purchase and, accordingly, carry them at fair value. See Note 10, Fair Value Measurements, for methodologies related to the determination of fair value. Unrealized gains and losses related to available-for-sale securities, excluding those in fair value hedging relationships, are reflected in stockholders equity, net of adjustments associated with deferred acquisition costs (DAC) and related actuarial balances, derivatives in cash flow hedge relationships and applicable income taxes. Unrealized gains and losses related to hedged portions of available-for-sale securities in fair value hedging relationships and mark-to-market adjustments on certain trading securities are reflected in net realized capital gains (losses). Mark-to-market adjustments related to certain securities carried at fair value with an investment objective to realize economic value through mark-to-market changes are reflected in net investment income.

The cost of fixed maturities is adjusted for amortization of premiums and accrual of discounts, both computed using the interest method. The cost of fixed maturities and equity securities classified as available-for-sale is adjusted for declines in value that are other than temporary. Impairments in value deemed to be other than temporary are primarily reported in net income as a component of net realized capital gains (losses), with noncredit impairment losses for certain fixed maturities, available-for-sale reported in other comprehensive income (OCI). For loan-backed and structured securities, we recognize income using a constant effective yield based on currently anticipated cash flows.

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The amortized cost, gross unrealized gains and losses, other-than-temporary impairments in accumulated other comprehensive income (AOCI) and fair value of fixed maturities and equity securities available-for-sale were as follows:

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value	Other-than-temporary impairments in AOCI (1)
			(in millions)		
March 31, 2017					
Fixed maturities, available-for-sale:					
U.S. government and agencies	**$ 1,430.3**	**$ 19.1**	**$ 11.2**	**$ 1,438.2**	**$**
Non-U.S. governments	**881.9**	**126.3**	**3.4**	**1,004.8**	
States and political subdivisions	**5,854.1**	**215.4**	**70.0**	**5,999.5**	**1.1**
Corporate	**33,806.8**	**1,988.2**	**229.5**	**35,565.5**	**20.0**
Residential mortgage-backed pass-through securities	**2,807.4**	**63.2**	**30.7**	**2,839.9**	
Commercial mortgage-backed securities	**3,903.8**	**29.3**	**70.2**	**3,862.9**	**74.8**
Collateralized debt obligations	**1,006.9**	**2.5**	**21.5**	**987.9**	**0.3**
Other debt obligations	**5,295.4**	**38.4**	**43.4**	**5,290.4**	**48.7**
Total fixed maturities, available-for-sale	**$ 54,986.6**	**$ 2,482.4**	**$ 479.9**	**$ 56,989.1**	**$ 144.9**
Total equity securities, available-for-sale	**$ 116.4**	**$ 6.3**	**$ 8.7**	**$ 114.0**	
December 31, 2016					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 1,426.7	$ 17.2	$ 10.9	$ 1,433.0	$
Non-U.S. governments	781.7	119.3	7.4	893.6	
States and political subdivisions	5,463.9	192.4	87.1	5,569.2	1.1
Corporate	32,699.7	1,843.5	350.8	34,192.4	17.2
Residential mortgage-backed pass-through securities	2,798.0	67.3	30.6	2,834.7	
Commercial mortgage-backed securities	4,153.2	31.2	87.9	4,096.5	77.5
Collateralized debt obligations	780.1	2.8	24.3	758.6	0.3
Other debt obligations	5,080.9	37.0	49.8	5,068.1	50.3
Total fixed maturities, available-for-sale	$ 53,184.2	$ 2,310.7	$ 648.8	$ 54,846.1	$ 146.4
Total equity securities, available-for-sale	$ 104.9	$ 4.9	$ 10.9	$ 98.9	

(1) Excludes $126.3 million and $120.9 million as of March 31, 2017 and December 31, 2016, respectively, of net unrealized gains on impaired fixed maturities, available-for-sale related to changes in fair value subsequent to the impairment date, which are included in gross unrealized gains and gross unrealized losses.

The amortized cost and fair value of fixed maturities available-for-sale as of March 31, 2017, by expected maturity, were as follows:

	Amortized cost	Fair value
	(in millions)	
Due in one year or less	**$ 3,071.0**	**$ 3,097.7**
Due after one year through five years	**12,366.7**	**12,772.7**
Due after five years through ten years	**9,178.9**	**9,444.8**
Due after ten years	**17,356.5**	**18,692.8**
Subtotal	**41,973.1**	**44,008.0**
Mortgage-backed and other asset-backed securities	**13,013.5**	**12,981.1**
Total	**$ 54,986.6**	**$ 56,989.1**

Actual maturities may differ because borrowers may have the right to call or prepay obligations. Our portfolio is diversified by industry, issuer and asset class. Credit concentrations are managed to established limits.

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Net Realized Capital Gains and Losses

Net realized capital gains and losses on sales of investments are determined on the basis of specific identification. In general, in addition to realized capital gains and losses on investment sales and periodic settlements on derivatives not designated as hedges, we report gains and losses related to the following in net realized capital gains (losses): other-than-temporary impairments of securities and subsequent realized recoveries, mark-to-market adjustments on certain trading securities, mark-to-market adjustments on sponsored investment funds, fair value hedge and cash flow hedge ineffectiveness, mark-to-market adjustments on derivatives not designated as hedges, changes in the mortgage loan valuation allowance provision, impairments of real estate held for investment and impairments on equity method investments. Investment gains and losses on sales of certain real estate held for sale due to investment strategy and mark-to-market adjustments on certain securities carried at fair value with an investment objective to realize economic value through mark-to-market changes are reported as net investment income and are excluded from net realized capital gains (losses). The major components of net realized capital gains (losses) on investments were as follows:

	For the three months ended March 31, 2017	2016
	(in millions)	
Fixed maturities, available-for-sale:		
Gross gains	**$ 4.0**	$ 3.2
Gross losses	**(8.2)**	(2.5)
Net impairment losses	**(28.8)**	(48.1)
Hedging, net	**(13.3)**	7.4
Fixed maturities, trading	**0.3**	8.9
Equity securities, trading	**21.7**	(22.9)
Mortgage loans	**(0.4)**	2.5
Derivatives	**(6.7)**	185.6
Other	**14.8**	2.5
Net realized capital gains (losses)	**$ (16.6)**	$ 136.6

Proceeds from sales of investments (excluding call and maturity proceeds) in fixed maturities, available-for-sale were $361.3 million and $205.8 million for the three months ended March 31, 2017 and 2016, respectively.

Other-Than-Temporary Impairments

We have a process in place to identify fixed maturity and equity securities that could potentially have an impairment that is other than temporary. This process involves monitoring market events that could impact issuers credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by

rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

Each reporting period, all securities are reviewed to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. We consider relevant facts and circumstances in evaluating whether a credit or interest rate-related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; (4) for structured securities, the adequacy of the expected cash flows; (5) for fixed maturities, our intent to sell a security or whether it is more likely than not we will be required to sell the security before the recovery of its amortized cost which, in some cases, may extend to maturity and (6) for equity securities, our ability and intent to hold the security for a period of time that allows for the recovery in value. To the extent we determine a security is deemed to be other than temporarily impaired, an impairment loss is recognized.

Impairment losses on equity securities are recognized in net income and are measured as the difference between amortized cost and fair value. The way in which impairment losses on fixed maturities are recognized in the financial statements is dependent on the facts and circumstances related to the specific security. If we intend to sell a security or it is more likely than not that we would be required to sell a security before the recovery of its amortized cost, we recognize an other-than-temporary impairment in net income for the difference between amortized cost and fair value. If we do not expect to recover the amortized cost basis, we do not plan to sell the security and if it is not more likely than not that we would be required to sell a security

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before the recovery of its amortized cost, the recognition of the other-than-temporary impairment is bifurcated. We recognize the credit loss portion in net income and the noncredit loss portion in OCI (bifurcated OTTI).

Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities, were as follows:

	For the three months ended March 31,	
	2017	**2016**
	(in millions)	
Fixed maturities, available-for-sale	**$ (27.3)**	$ (55.6)
Equity securities, available-for-sale		
Total other-than-temporary impairment losses, net of recoveries from the sale of previously impaired securities	**(27.3)**	(55.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) OCI (1)	**(1.5)**	7.5
Net impairment losses on available-for-sale securities	**$ (28.8)**	$ (48.1)

(1) Represents the net impact of (a) gains resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI and (b) losses resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold.

We estimate the amount of the credit loss component of a fixed maturity security impairment as the difference between amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate cash flows discounted at the effective interest rate implicit to the security at the date of purchase or the current yield to accrete an asset-backed or floating rate security. The methodology and assumptions for establishing the best estimate cash flows vary depending on the type of security. The ABS cash flow estimates are based on security specific facts and circumstances that may include collateral characteristics, expectations of delinquency and default rates, loss severity and prepayment speeds and structural support, including subordination and guarantees. The corporate security cash flow estimates are derived from scenario-based outcomes of expected corporate restructurings or liquidations using bond specific facts and circumstances including timing, security interests and loss severity.

The following table provides a rollforward of accumulated credit losses for fixed maturities with bifurcated credit losses. The purpose of the table is to provide detail of (1) additions to the bifurcated credit loss amounts recognized in net realized capital gains (losses) during the period and (2) decrements for previously recognized bifurcated credit losses where the loss is no longer bifurcated and/or there has been a positive change in expected cash flows or accretion of the bifurcated credit loss amount.

	For the three months ended March 31,	
	2017	**2016**
	(in millions)	
Beginning balance	**$ (139.9)**	$ (131.5)
Credit losses for which an other-than-temporary impairment was not previously recognized	**(13.3)**	(26.5)
Credit losses for which an other-than-temporary impairment was previously recognized	**(9.5)**	(6.3)
Reduction for credit losses previously recognized on fixed maturities now sold, paid down or intended to be sold	**7.5**	5.1
Net reduction (increase) for positive changes in cash flows expected to be collected and amortization (1)	**2.9**	(1.0)
Foreign currency translation adjustment	**(0.1)**	(0.2)
Ending balance	**$ (152.4)**	$ (160.4)

(1) Amounts are recognized in net investment income.

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Gross Unrealized Losses for Fixed Maturities and Equity Securities

For fixed maturities and equity securities available-for-sale with unrealized losses, including other-than-temporary impairment losses reported in OCI, the gross unrealized losses and fair value, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows:

	March 31, 2017					
	Less than twelve months		Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
U.S. government and agencies	$ **420.6**	$ **11.1**	$ **10.7**	$ **0.1**	$ **431.3**	$ **11.2**
Non-U.S. governments	**146.7**	**1.6**	**10.2**	**1.8**	**156.9**	**3.4**
States and political subdivisions	**1,931.2**	**69.5**	**5.9**	**0.5**	**1,937.1**	**70.0**
Corporate	**5,780.4**	**150.1**	**1,016.7**	**79.4**	**6,797.1**	**229.5**
Residential mortgage-backed pass- through securities	**1,277.0**	**29.8**	**15.6**	**0.9**	**1,292.6**	**30.7**
Commercial mortgage-backed securities	**1,433.1**	**33.6**	**593.5**	**36.6**	**2,026.6**	**70.2**
Collateralized debt obligations	**239.4**	**0.5**	**161.2**	**21.0**	**400.6**	**21.5**
Other debt obligations	**2,354.2**	**26.1**	**414.6**	**17.3**	**2,768.8**	**43.4**
Total fixed maturities, available-for-sale	$ **13,582.6**	$ **322.3**	$ **2,228.4**	$ **157.6**	$ **15,811.0**	$ **479.9**
Total equity securities, available-for-sale	$	$ **0.1**	$ **37.2**	$ **8.6**	$ **37.2**	$ **8.7**

Of the total amounts, Principal Life Insurance Company s (Principal Life s) consolidated portfolio represented $15,385.4 million in available-for-sale fixed maturities with gross unrealized losses of $461.1 million. Of those fixed maturity securities in Principal Life s consolidated portfolio with a gross unrealized loss position, 94% were investment grade (rated AAA through BBB-) with an average price of 97 (carrying value/amortized cost) as of March 31, 2017. Gross unrealized losses in our fixed maturities portfolio decreased during the three months ended March 31, 2017, primarily due to tightening of credit spreads and a decrease in interest rates.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 1,686 securities with a carrying value of $13,316.1 million and unrealized losses of $316.5 million reflecting an average price of 98 as of March 31, 2017. Of this portfolio, 97% was investment grade (rated AAA through BBB-) as

of March 31, 2017, with associated unrealized losses of $308.8 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 408 securities with a carrying value of $2,069.3 million and unrealized losses of $144.6 million. The average credit rating of this portfolio was A- with an average price of 93 as of March 31, 2017. Of the $144.6 million in unrealized losses, the corporate sector accounts for $68.0 million in unrealized losses with an average price of 93 and an average credit rating of BB+. The remaining unrealized losses consist primarily of $36.6 million within the commercial mortgage-backed securities sector with an average price of 94 and an average credit rating of AA. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired as of March 31, 2017.

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	December 31, 2016					
	Less than twelve months		Greater than or equal to twelve months		Total	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
	(in millions)					
Fixed maturities, available-for-sale:						
U.S. government and agencies	$ 570.3	$ 10.9	$ 8.2	$	$ 578.5	$ 10.9
Non-U.S. governments	198.0	5.4	12.2	2.0	210.2	7.4
States and political subdivisions	2,229.4	86.6	4.8	0.5	2,234.2	87.1
Corporate	6,559.7	189.2	1,285.6	161.6	7,845.3	350.8
Residential mortgage-backed pass- through securities	1,265.6	29.8	16.0	0.8	1,281.6	30.6
Commercial mortgage-backed securities	1,637.2	41.0	612.5	46.9	2,249.7	87.9
Collateralized debt obligations	265.7	0.9	195.6	23.4	461.3	24.3
Other debt obligations	2,229.4	32.8	376.2	17.0	2,605.6	49.8
Total fixed maturities, available-for-sale	$ 14,955.3	$ 396.6	$ 2,511.1	$ 252.2	$ 17,466.4	$ 648.8
Total equity securities, available-for-sale	$ 18.2	$ 0.4	$ 35.4	$ 10.5	$ 53.6	$ 10.9

Of the total amounts, Principal Life s consolidated portfolio represented $16,918.9 million in available-for-sale fixed maturities with gross unrealized losses of $615.1 million. Of those fixed maturity securities in Principal Life s consolidated portfolio with a gross unrealized loss position, 94% were investment grade (rated AAA through BBB-) with an average price of 96 (carrying value/amortized cost) as of December 31, 2016. Gross unrealized losses in our fixed maturities portfolio decreased during the year ended December 31, 2016, primarily due to tightening of credit spreads, partially offset by an increase in interest rates.

For those securities that had been in a continuous unrealized loss position for less than twelve months, Principal Life s consolidated portfolio held 1,911 securities with a carrying value of $14,549.4 million and unrealized losses of $384.6 million reflecting an average price of 97 as of December 31, 2016. Of this portfolio, 98% was investment grade (rated AAA through BBB-) as of December 31, 2016, with associated unrealized losses of $374.1 million. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

For those securities that had been in a continuous unrealized loss position greater than or equal to twelve months, Principal Life s consolidated portfolio held 453 securities with a carrying value of $2,369.5 million and unrealized losses of $230.5 million. The average credit rating of this portfolio was A- with an average price of 91 as of December 31, 2016. Of the $230.5

million in unrealized losses, the corporate sector accounts for $141.9 million in unrealized losses with an average price of 89 and an average credit rating of BBB-. The remaining unrealized losses consist primarily of $46.9 million within the commercial mortgage-backed securities sector with an average price of 93 and an average credit rating of AA-. The unrealized losses on these securities can primarily be attributed to changes in market interest rates and changes in credit spreads since the securities were acquired.

Because we expected to recover our amortized cost, it was not our intent to sell the fixed maturity available-for-sale securities with unrealized losses and it was not more likely than not that we would be required to sell these securities before recovery of the amortized cost, which may be maturity, we did not consider these investments to be other-than-temporarily impaired as of December 31, 2016.

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Net Unrealized Gains and Losses on Available-for-Sale Securities and Derivative Instruments

The net unrealized gains and losses on investments in available-for-sale securities, the noncredit component of impairment losses on fixed maturities available-for-sale and the net unrealized gains and losses on derivative instruments in cash flow hedge relationships are reported as separate components of stockholders equity. The cumulative amount of net unrealized gains and losses on available-for-sale securities and derivative instruments in cash flow hedge relationships net of adjustments related to DAC and related actuarial balances and applicable income taxes was as follows:

		March 31, 2017		December 31, 2016
		(in millions)		
Net unrealized gains on fixed maturities, available-for-sale (1)	**$**	**2,084.9**	$	1,727.8
Noncredit component of impairment losses on fixed maturities, available-for-sale		**(144.9)**		(146.4)
Net unrealized losses on equity securities, available-for-sale		**(2.4)**		(6.0)
Adjustments for assumed changes in amortization patterns		**(136.2)**		(121.9)
Adjustments for assumed changes in policyholder liabilities		**(545.2)**		(469.2)
Net unrealized gains on derivative instruments		**163.6**		186.5
Net unrealized gains on equity method subsidiaries and noncontrolling interest adjustments		**53.7**		68.0
Provision for deferred income taxes		**(494.1)**		(411.8)
Net unrealized gains on available-for-sale securities and derivative instruments	**$**	**979.4**	$	827.0

(1) Excludes net unrealized gains (losses) on fixed maturities, available-for-sale included in fair value hedging relationships.

Mortgage Loans

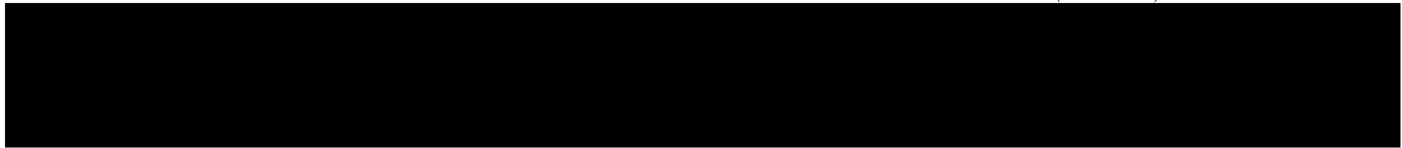
Mortgage loans consist of commercial and residential mortgage loans. We evaluate risks inherent in our commercial mortgage loans in two classes: (1) brick and mortar property loans, including mezzanine loans, where we analyze the property s rent payments as support for the loan, and (2) credit tenant loans (CTL), where we rely on the credit analysis of the tenant for the repayment of the loan. We evaluate risks inherent in our residential mortgage loan portfolio in two classes: (1) home equity mortgages and (2) first lien mortgages. The carrying amount of our mortgage loan portfolio was as follows:

	March 31, 2017	December 31, 2016

		(in millions)		
Commercial mortgage loans	**$**	**12,165.7**	$	12,055.2
Residential mortgage loans		**1,267.6**		1,219.9
Total amortized cost		**13,433.3**		13,275.1
Valuation allowance		**(45.2)**		(44.9)
Total carrying value	**$**	**13,388.1**	$	13,230.2

We periodically purchase mortgage loans as well as sell mortgage loans we have originated. Mortgage loans purchased and sold were as follows:

	For the three months ended March 31,	
	2017	**2016**
	(in millions)	



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Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on stabilized properties. Our commercial mortgage loan portfolio is diversified by geographic region and specific collateral property type as follows:

	March 31, 2017		December 31, 2016	
	Amortized cost	Percent of total	Amortized cost	Percent of total
		($ in millions)		
Geographic distribution				
New England	**$ 569.4**	**4.7%**	$ 532.1	4.4%
Middle Atlantic	**3,463.6**	**28.5**	3,317.3	27.5
East North Central	**638.4**	**5.2**	652.6	5.4
West North Central	**183.2**	**1.5**	185.6	1.5
South Atlantic	**2,177.3**	**17.9**	2,189.5	18.2
East South Central	**323.2**	**2.7**	239.3	2.0
West South Central	**1,153.6**	**9.5**	1,211.7	10.1
Mountain	**893.8**	**7.3**	932.6	7.7
Pacific	**2,674.8**	**22.0**	2,707.2	22.5
International	**88.4**	**0.7**	87.3	0.7
Total	**$ 12,165.7**	**100.0%**	$ 12,055.2	100.0%
Property type distribution				
Office	**$ 4,467.9**	**36.7%**	$ 4,417.6	36.6%
Retail	**2,631.2**	**21.6**	2,671.1	22.2
Industrial	**1,796.0**	**14.8**	1,802.4	15.0
Apartments	**2,844.0**	**23.4**	2,741.4	22.7
Hotel	**236.9**	**1.9**	260.7	2.2
Mixed use/other	**189.7**	**1.6**	162.0	1.3
Total	**$ 12,165.7**	**100.0%**	$ 12,055.2	100.0%

Our residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of $152.3 million and $165.6 million and first lien mortgages with an amortized cost of $1,115.3 million and $1,054.3 million as of March 31, 2017 and December 31, 2016, respectively. Our residential home equity mortgages are concentrated in the United States and are generally second lien mortgages comprised of closed-end loans and lines of credit. Our first lien loans are concentrated in Chile and the United States.

Mortgage Loan Credit Monitoring

Commercial Credit Risk Profile Based on Internal Rating

We actively monitor and manage our commercial mortgage loan portfolio. All commercial mortgage loans are analyzed regularly and substantially all are internally rated, based on a proprietary risk rating cash flow model, in order to monitor the financial quality of these assets. The model stresses expected cash flows at various levels and at different points in time depending on the durability of the income stream, which includes our assessment of factors such as location (macro and micro markets), tenant quality and lease expirations. Our internal rating analysis presents expected losses in terms of an S&P Global (S&P) bond equivalent rating. As the credit risk for commercial mortgage loans increases, we adjust our internal ratings downward with loans in the category B+ and below having the highest risk for credit loss. Internal ratings on commercial mortgage loans are updated at least annually and potentially more often for certain loans with material changes in collateral value or occupancy and for loans on an internal watch list .

Commercial mortgage loans that require more frequent and detailed attention than other loans in our portfolio are identified and placed on an internal watch list . Among the criteria that would indicate a potential problem are significant negative changes in ratios of loan to value or contract rents to debt service, major tenant vacancies or bankruptcies, borrower sponsorship problems, late payments, delinquent taxes and loan relief/restructuring requests.

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The amortized cost of our commercial mortgage loan portfolio by credit risk, as determined by our internal rating system expressed in terms of an S&P bond equivalent rating, was as follows:

	March 31, 2017		
	Brick and mortar	CTL	Total
		(in millions)	
A- and above	**$ 10,624.0**	**$ 155.2**	**$ 10,779.2**
BBB+ thru BBB-	**1,112.5**	**97.0**	**1,209.5**
BB+ thru BB-	**163.3**		**163.3**
B+ and below	**13.0**	**0.7**	**13.7**
Total	**$ 11,912.8**	**$ 252.9**	**$ 12,165.7**

	December 31, 2016		
	Brick and mortar	CTL	Total
		(in millions)	
A- and above	$ 10,612.8	$ 158.5	$ 10,771.3
BBB+ thru BBB-	1,009.8	100.6	1,110.4
BB+ thru BB-	160.5		160.5
B+ and below	12.1	0.9	13.0
Total	$ 11,795.2	$ 260.0	$ 12,055.2

Residential Credit Risk Profile Based on Performance Status

Our residential mortgage loan portfolio is monitored based on performance of the loans. Monitoring on a residential mortgage loan increases when the loan is delinquent or earlier if there is an indication of potential impairment. We define non-performing residential mortgage loans as loans 90 days or greater delinquent or on non-accrual status.

The amortized cost of our performing and non-performing residential mortgage loans was as follows:

	March 31, 2017		
	Home equity	First liens	Total
		(in millions)	
Performing	**$ 143.6**	**$ 1,104.7**	**$ 1,248.3**
Non-performing	**8.7**	**10.6**	**19.3**
Total	**$ 152.3**	**$ 1,115.3**	**$ 1,267.6**

	December 31, 2016		
	Home equity	First liens	Total

			(in millions)			
Performing	$	156.8	$	1,043.1	$	1,199.9
Non-performing		8.8		11.2		20.0
Total	$	165.6	$	1,054.3	$	1,219.9

Non-Accrual Mortgage Loans

Commercial and residential mortgage loans are placed on non-accrual status if we have concern regarding the collectability of future payments or if a loan has matured without being paid off or extended. Factors considered may include conversations with the borrower, loss of major tenant, bankruptcy of borrower or major tenant, decreased property cash flow for commercial mortgage loans or number of days past due and other circumstances for residential mortgage loans. Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. When a loan is placed on non-accrual status, the accrued unpaid interest receivable is reversed against interest income. Accrual of interest resumes after factors resulting in doubts about collectability have improved. Residential first lien mortgages in the Chilean market are carried on accrual for a longer period of delinquency than domestic loans, as assessment of collectability is based on the nature of the loans and collection practices in that market.

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The amortized cost of mortgage loans on non-accrual status was as follows:

	March 31, 2017	December 31, 2016
	(in millions)	
Residential:		
Home equity	$ 8.7	$ 8.8
First liens	4.1	5.6
Total	$ 12.8	$ 14.4

The aging of our mortgage loans, based on amortized cost, was as follows:

	March 31, 2017						
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due	Current	Total loans	Recorded investment 90 days or more and accruing
				(in millions)			
Commercial-brick and mortar	$	$	$	$	$ 11,912.8	$ 11,912.8	$
Commercial-CTL					252.9	252.9	
Residential-home equity	1.8	0.9	1.5	4.2	148.1	152.3	
Residential-first liens	39.3	11.1	9.9	60.3	1,055.0	1,115.3	6.5
Total	$ 41.1	$ 12.0	$ 11.4	$ 64.5	$ 13,368.8	$ 13,433.3	$ 6.5

	December 31, 2016						
	30-59 days past due	60-89 days past due	90 days or more past due	Total past due	Current	Total loans	Recorded investment 90 days or more and accruing
				(in millions)			
Commercial-brick and mortar	$	$	$	$	$ 11,795.2	$ 11,795.2	$
Commercial-CTL					260.0	260.0	
Residential-home equity	1.9	1.1	1.4	4.4	161.2	165.6	
Residential-first liens	40.1	11.3	10.0	61.4	992.9	1,054.3	5.6
Total	$ 42.0	$ 12.4	$ 11.4	$ 65.8	$ 13,209.3	$ 13,275.1	$ 5.6

Mortgage Loan Valuation Allowance

We establish a valuation allowance to provide for the risk of credit losses inherent in our portfolio. The valuation allowance includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. Mortgage loans on real estate are considered impaired when, based on current information and events, it is probable we will be unable to collect all amounts due according to contractual terms of the loan agreement. When we determine a loan is impaired, a valuation allowance is established equal to the difference between the carrying amount of the mortgage loan and the estimated value reduced by the cost to sell. Estimated value is based on either the present value of the expected future cash flows discounted at the loan s effective interest rate, the loan s observable market price or fair value of the collateral. Subsequent changes in the estimated value are reflected in the valuation allowance. Amounts on loans deemed to be uncollectible are charged off and removed from the valuation allowance. The change in the valuation allowance provision is included in net realized capital gains (losses) on our consolidated statements of operations.

The valuation allowance is maintained at a level believed adequate by management to absorb estimated probable credit losses. Management s periodic evaluation and assessment of the valuation allowance adequacy is based on known and inherent risks in the portfolio, adverse situations that may affect a borrower s ability to repay, the estimated value of the underlying collateral, composition of the loan portfolio, portfolio delinquency information, underwriting standards, peer group information, current economic conditions, loss experience and other relevant factors. The evaluation of our impaired loan component is subjective, as it requires the estimation of timing and amount of future cash flows expected to be received on impaired loans.

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We review our commercial mortgage loan portfolio and analyze the need for a valuation allowance for any loan that is delinquent for 60 days or more, in process of foreclosure, restructured, on the internal watch list or that currently has a valuation allowance. In addition to establishing allowance levels for specifically identified impaired commercial mortgage loans, management determines an allowance for all other loans in the portfolio for which historical experience and current economic conditions indicate certain losses exist. These loans are segregated by risk rating level with an estimated loss ratio applied against each risk rating level. The loss ratio is generally based upon historical loss experience for each risk rating level as adjusted for certain current environmental factors management believes to be relevant.

For our residential mortgage loan portfolio, we separate the loans into several homogeneous pools, each of which consist of loans of a similar nature including but not limited to loans similar in collateral, term and structure and loan purpose or type. We evaluate loan pools based on aggregated risk ratings, estimated specific loss potential in the different classes of credits, and historical loss experience by pool type. We adjust these quantitative factors for qualitative factors of present conditions. Qualitative factors include items such as economic and business conditions, changes in the portfolio, value of underlying collateral and concentrations. Residential mortgage loan pools exclude loans that have been restructured or impaired, as those loans are evaluated individually.

A rollforward of our valuation allowance and ending balances of the allowance and loan balance by basis of impairment method was as follows:

	Commercial	Residential	Total
		(in millions)	
For the three months ended March 31, 2017			
Beginning balance	**$ 27.4**	**$ 17.5**	**$ 44.9**
Provision	**0.6**		**0.6**
Charge-offs		**(1.6)**	**(1.6)**
Recoveries		**1.3**	**1.3**
Ending balance	**$ 28.0**	**$ 17.2**	**$ 45.2**
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	**$**	**$ 5.8**	**$ 5.8**
Collectively evaluated for impairment	**28.0**	**11.4**	**39.4**
Allowance ending balance	**$ 28.0**	**$ 17.2**	**$ 45.2**
Loan balance by basis of impairment method:			
Individually evaluated for impairment	**$**	**$ 18.0**	**$ 18.0**
Collectively evaluated for impairment	**12,165.7**	**1,249.6**	**13,415.3**
Loan ending balance	**$ 12,165.7**	**$ 1,267.6**	**$ 13,433.3**
For the three months ended March 31, 2016			
Beginning balance	$ 27.5	$ 24.1	$ 51.6
Provision	(0.4)	(1.9)	(2.3)
Charge-offs		(0.8)	(0.8)
Recoveries		0.8	0.8
Ending balance	$ 27.1	$ 22.2	$ 49.3
Allowance ending balance by basis of impairment method:			
Individually evaluated for impairment	$	$ 7.2	$ 7.2

Collectively evaluated for impairment		27.1		15.0		42.1
Allowance ending balance	$	27.1	$	22.2	$	49.3
Loan balance by basis of impairment method:						
Individually evaluated for impairment	$		$	21.6	$	21.6
Collectively evaluated for impairment		11,267.7		1,138.7		12,406.4
Loan ending balance	$	11,267.7	$	1,160.3	$	12,428.0

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Impaired Mortgage Loans

Impaired mortgage loans are loans with a related specific valuation allowance, loans whose carrying amount has been reduced to the expected collectible amount because the impairment has been considered other than temporary or a loan modification has been classified as a troubled debt restructuring (TDR). Based on an assessment as to the collectability of the principal, a determination is made to apply any payments received either against the principal or according to the contractual terms of the loan. Our recorded investment in and unpaid principal balance of impaired loans along with the related loan specific allowance for losses, if any, and the average recorded investment and interest income recognized during the time the loans were impaired were as follows:

	March 31, 2017		
	Recorded investment	**Unpaid principal balance**	**Related allowance**
	(in millions)		
With no related allowance recorded:			
Residential-first liens	**$ 0.4**	**$ 0.4**	**$**
With an allowance recorded:			
Residential-home equity	**13.0**	**14.1**	**5.4**
Residential-first liens	**4.6**	**4.5**	**0.4**
Total:			
Residential	**$ 18.0**	**$ 19.0**	**$ 5.8**

	December 31, 2016		
	Recorded investment	**Unpaid principal balance**	**Related allowance**
	(in millions)		
With no related allowance recorded:			
Residential-first liens	$ 1.5	$ 1.5	$
With an allowance recorded:			
Residential-home equity	13.0	14.1	5.5
Residential-first liens	4.7	4.6	0.4
Total:			
Residential	$ 19.2	$ 20.2	$ 5.9

	Average recorded investment	**Interest income recognized**
	(in millions)	
For the three months ended March 31, 2017		
With no related allowance recorded:		
Residential-first liens	**$ 1.0**	**$**
With an allowance recorded:		

Residential-home equity		**13.0**		**0.1**
Residential-first liens		**4.7**		
Total:				
Residential	**$**	**18.7**	**$**	**0.1**
For the three months ended March 31, 2016				
With no related allowance recorded:				
Residential-first liens	$	3.4	$	
With an allowance recorded:				
Residential-home equity		13.4		0.1
Residential-first liens		5.7		
Total:				
Residential	$	22.5	$	0.1

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Mortgage Loan Modifications

Our commercial and residential mortgage loan portfolios include loans that have been modified. We assess loan modifications on a case-by-case basis to evaluate whether a TDR has occurred. The commercial mortgage loan TDRs were modified to delay or reduce principal payments and to reduce or delay interest payments. For these TDR assessments, we have determined the loan rates are now considered below market based on current circumstances. The commercial mortgage loan modifications resulted in delayed cash receipts and a decrease in interest income. The residential mortgage loan TDRs include modifications of interest-only payment periods, delays in principal balloon payments, and interest rate reductions. Residential mortgage loan modifications resulted in delayed or decreased cash receipts and a decrease in interest income.

The following table includes information about outstanding loans that were modified and met the criteria of a TDR during the periods indicated. In addition, the table includes information for loans that were modified and met the criteria of a TDR within the past twelve months that were in payment default during the periods indicated:

	For the three months ended March 31, 2017			
	TDRs		**TDRs in payment default**	
	Number of contracts	**Recorded investment**	**Number of contracts**	**Recorded investment**
		(in millions)		*(in millions)*
Residential-home equity	**5**	**$ 0.3**		**$**
Residential-first liens			**1**	**0.1**
Total	**5**	**$ 0.3**	**1**	**$ 0.1**

	For the three months ended March 31, 2016			
	TDRs		**TDRs in payment default**	
	Number of contracts	**Recorded investment**	**Number of contracts**	**Recorded investment**
		(in millions)		*(in millions)*
Residential-home equity	2	$ 0.2		$
Total	2	$ 0.2		$

Commercial mortgage loans that have been designated as a TDR have been previously reserved for in the mortgage loan valuation allowance at the estimated fair value of the underlying collateral reduced by the cost to sell.

Residential mortgage loans that have been designated as a TDR are specifically reserved for in the mortgage loan valuation allowance if losses result from the modification. Residential mortgage loans that have defaulted or have been discharged through bankruptcy are reduced to the expected collectible amount.

Securities Posted as Collateral

As of March 31, 2017 and December 31, 2016, we posted $2,987.1 million and $2,562.8 million, respectively, in commercial mortgage loans and home equity mortgages to satisfy collateral requirements associated with our obligation under funding agreements with Federal Home Loan Bank of Des Moines (FHLB Des Moines). In addition, as of March 31, 2017 and December 31, 2016, we posted $2,042.2 million and $2,233.2 million, respectively, in fixed maturities, available-for-sale securities to satisfy collateral requirements primarily associated with a reinsurance arrangement, our derivative credit support annex (collateral) agreements, Futures Commission Merchant (FCM) agreements, a lending arrangement and our obligation under funding agreements with FHLB Des Moines. Since we did not relinquish ownership rights on these instruments, they are reported as mortgage loans and fixed maturities, available-for-sale, respectively, on our consolidated statements of financial position. Of the securities posted as collateral, as of March 31, 2017 and December 31, 2016, $179.9 million and $272.8 million, respectively, could be sold or repledged by the secured party.

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Balance Sheet Offsetting

Financial assets subject to master netting agreements or similar agreements were as follows:

	Gross amount of recognized assets (1)	Gross amounts not offset in the consolidated statements of financial position: Financial instruments (2)	Collateral received	Net amount
		(in millions)		
March 31, 2017				
Derivative assets	**$ 310.6**	**$ (147.1)**	**$ (161.5)**	**$ 2.0**
Reverse repurchase agreements	**40.6**		**(40.6)**	
Total	**$ 351.2**	**$ (147.1)**	**$ (202.1)**	**$ 2.0**
December 31, 2016				
Derivative assets	$ 887.2	$ (294.2)	$ (582.0)	$ 11.0
Reverse repurchase agreements	41.1		(41.1)	
Total	$ 928.3	$ (294.2)	$ (623.1)	$ 11.0

(1) The gross amount of recognized derivative and reverse repurchase agreement assets are reported with other investments and cash and cash equivalents, respectively, on the consolidated statements of financial position. The above excludes $7.5 million and $6.4 million of derivative assets as of March 31, 2017 and December 31, 2016, respectively, that are not subject to master netting agreements or similar agreements. The gross amounts of derivative and reverse repurchase agreement assets are not netted against offsetting liabilities for presentation on the consolidated statements of financial position. See Note 1, Nature of Operations and Significant Accounting Policies, under the caption Over-The-Counter Derivatives Cleared on Chicago Mercantile Exchange for details of the CME variation margin rule change that impacted the amounts presented for 2017.

(2) Represents amount of offsetting derivative liabilities that are subject to an enforceable master netting agreement or similar agreement that are not netted against the gross derivative assets for presentation on the consolidated statements of financial position.

Financial liabilities subject to master netting agreements or similar agreements were as follows:

	Gross amount of recognized liabilities (1)	Gross amounts not offset in the consolidated statements of financial position — Financial instruments (2)	Collateral pledged	Net amount
		(in millions)		
March 31, 2017				
Derivative liabilities	**$ 287.3**	**$ (147.1)**	**$ (115.5)**	**$ 24.7**
Repurchase agreements	**17.4**			**17.4**
Total	**$ 304.7**	**$ (147.1)**	**$ (115.5)**	**$ 42.1**
December 31, 2016				
Derivative liabilities	$ 567.5	$ (294.2)	$ (243.9)	$ 29.4
Repurchase agreements	9.7			9.7
Total	$ 577.2	$ (294.2)	$ (243.9)	$ 39.1

(1) The gross amount of recognized derivative liabilities are reported with other liabilities on the consolidated statements of financial position. The above excludes $347.5 million and $394.3 million of derivative liabilities as of March 31, 2017 and December 31, 2016, respectively, which are primarily embedded derivatives that are not subject to master netting agreements or similar agreements. The gross amount of recognized repurchase agreement liabilities are reported with short-term debt on the consolidated statements of financial position. The gross amounts of derivative and repurchase agreement liabilities are not netted against offsetting assets for presentation on the consolidated statements of financial position. See Note 1, Nature of Operations and Significant Accounting Policies, under the caption Over-The-Counter

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Derivatives Cleared on Chicago Mercantile Exchange for details of the CME variation margin rule change that impacted the amounts presented for 2017.

(2) Represents amount of offsetting derivative assets that are subject to an enforceable master netting agreement or similar agreement that are not netted against the gross derivative liabilities for presentation on the consolidated statements of financial position.

The financial instruments that are subject to master netting agreements or similar agreements include right of setoff provisions. Derivative instruments include provisions to setoff positions covered under the agreements with the same counterparties and provisions to setoff positions outside of the agreements with the same counterparties in the event of default by one of the parties. Derivative instruments also include collateral or variation margin provisions, which are generally settled daily with each counterparty. See Note 4, Derivative Financial Instruments, for further details.

Repurchase and reverse repurchase agreements include provisions to setoff other repurchase and reverse repurchase balances with the same counterparty. Repurchase and reverse repurchase agreements also include collateral provisions with the counterparties. For reverse repurchase agreements we require the counterparties to pledge collateral with a value greater than the amount of cash transferred. We have the right but do not sell or repledge collateral received in reverse repurchase agreements. Repurchase agreements are structured as secured borrowings for all counterparties. We pledge fixed maturities available-for-sale, which the counterparties have the right to sell or repledge. Interest incurred on repurchase agreements is reported as part of operating expenses on the consolidated statements of operations. Net proceeds related to repurchase agreements are reported as a component of financing activities on the consolidated statements of cash flows.

4. Derivative Financial Instruments

Derivatives are generally used to hedge or reduce exposure to market risks associated with assets held or expected to be purchased or sold and liabilities incurred or expected to be incurred. Derivatives are used to change the characteristics of our asset/liability mix consistent with our risk management activities. Derivatives are also used in asset replication strategies.

Types of Derivative Instruments

Interest Rate Contracts

Interest rate risk is the risk we will incur economic losses due to adverse changes in interest rates. Sources of interest rate risk include the difference between the maturity and interest rate changes of assets with the liabilities they support, timing differences between the pricing of liabilities and the purchase or procurement of assets and changing cash flow profiles from original projections due to prepayment options embedded within asset and liability contracts. We use various derivatives to manage our exposure to fluctuations in interest rates.

Interest rate swaps are contracts in which we agree with other parties to exchange, at specified intervals, the difference between fixed rate and floating rate interest amounts based upon designated market rates or rate indices and an agreed upon notional principal amount. Generally, no cash is exchanged at the outset of the contract and no principal payments are made by any party. Cash is paid or received based on the terms of the swap. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities and to mitigate the risks arising from timing mismatches between assets and liabilities (including duration mismatches). We also use interest rate swaps to hedge against changes in the value of assets we anticipate acquiring and other anticipated transactions and commitments. Interest rate swaps are used to hedge against changes in the value of the guaranteed minimum withdrawal benefit (GMWB) liability. The GMWB rider on our variable annuity products provides for guaranteed minimum withdrawal benefits regardless of the actual performance of various equity and/or fixed income funds available with the product.

Interest rate options, including interest rate caps and interest rate floors, which can be combined to form interest rate collars, are contracts that entitle the purchaser to pay or receive the amounts, if any, by which a specified market rate exceeds a cap strike interest rate, or falls below a floor strike interest rate, respectively, at specified dates. We use interest rate collars to manage interest rate risk related to guaranteed minimum interest rate liabilities in our individual annuities contracts and lapse risk associated with higher interest rates.

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A swaption is an option to enter into an interest rate swap at a future date. We purchase swaptions to offset or modify existing exposures. Swaptions provide us the benefit of the agreed-upon strike rate if the market rates for liabilities are higher, with the flexibility to enter into the current market rate swap if the market rates for liabilities are lower. Swaptions not only hedge against the downside risk, but also allow us to take advantage of any upside benefits.

In exchange-traded futures transactions, we agree to purchase or sell a specified number of contracts, the values of which are determined by the values of designated classes of securities, and to post variation margin on a daily basis in an amount equal to the difference in the daily market values of those contracts. We enter into exchange-traded futures with regulated futures commissions merchants who are members of a trading exchange. We have used exchange-traded futures to reduce market risks from changes in interest rates and to alter mismatches between the assets in a portfolio and the liabilities supported by those assets.

Foreign Exchange Contracts

Foreign currency risk is the risk we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements we issue, foreign currency-denominated fixed maturity and equity securities we invest in, capital transactions with our international operations and the financial results of our international operations. We use various derivatives to manage our exposure to fluctuations in foreign currency exchange rates.

Currency swaps are contracts in which we agree with other parties to exchange, at specified intervals, a series of principal and interest payments in one currency for that of another currency. Generally, the principal amount of each currency is exchanged at the beginning and termination of the currency swap by each party. The interest payments are primarily fixed-to-fixed rate; however, they may also be fixed-to-floating rate or floating-to-fixed rate. These transactions are entered into pursuant to master agreements that provide for a single net payment to be made by one counterparty for payments made in the same currency at each due date. We use currency swaps to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell.

Currency forwards are contracts in which we agree with other parties to deliver or receive a specified amount of an identified currency at a specified future date. Typically, the price is agreed upon at the time of the contract and payment for such a contract is made at the specified future date. We use currency forwards to reduce market risks from changes in currency exchange rates with respect to investments or liabilities denominated in foreign currencies that we either hold or intend to acquire or sell. We sometimes use currency forwards to hedge the currency risk associated with a business combination or to hedge certain net equity investments in or expected cash flows from our foreign operations.

Currency options are contracts that give the holder the right, but not the obligation to buy or sell a specified amount of the identified currency within a limited period of time at a contracted price. The contracts are net settled in cash, based on the differential in the current foreign exchange rate and the strike price. Purchased and sold options can be combined to form a foreign currency collar where we receive a payment if

the foreign exchange rate is below the purchased option strike price and make a payment if the foreign exchange rate is above the sold option strike price. We use currency options to hedge expected cash flows from our foreign operations.

Equity Contracts

Equity risk is the risk that we will incur economic losses due to adverse fluctuations in common stock prices. We use various derivatives to manage our exposure to equity risk, which arises from products in which the interest we credit is tied to an external equity index as well as products subject to minimum contractual guarantees.

We purchase equity call spreads to hedge the equity participation rates promised to contractholders in conjunction with our fixed deferred annuity and universal life products that credit interest based on changes in an external equity index. We use exchange-traded futures and equity put options to hedge against changes in the value of the GMWB liability related to the GMWB rider on our variable annuity product, as previously explained. The premium associated with certain options is paid quarterly over the life of the option contract.

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Credit Contracts

Credit risk relates to the uncertainty associated with the continued ability of a given obligor to make timely payments of principal and interest. We use credit default swaps to enhance the return on our investment portfolio by providing comparable exposure to fixed income securities that might not be available in the primary market. They are also used to hedge credit exposures in our investment portfolio. Credit derivatives are used to sell or buy credit protection on an identified name or names on an unfunded or synthetic basis in return for receiving or paying a quarterly premium. The premium generally corresponds to a referenced name s credit spread at the time the agreement is executed. In cases where we sell protection, we also buy a quality cash bond to match against the credit default swap, thereby entering into a synthetic transaction replicating a cash security. When selling protection, if there is an event of default by the referenced name, as defined by the agreement, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security in a principal amount equal to the notional value of the credit default swap.

Total return swaps are contracts in which we agree with other parties to exchange, at specified intervals, an amount determined by the difference between the previous price and the current price of a reference asset based upon an agreed upon notional principal amount plus an additional amount determined by the financing spread. We currently use futures traded on an exchange (exchange-traded) and total return swaps referencing equity indices to hedge our portfolio from potential credit losses related to systemic events.

Other Contracts

Embedded Derivatives. We purchase or issue certain financial instruments or products that contain a derivative instrument that is embedded in the financial instrument or product. When it is determined that the embedded derivative possesses economic characteristics that are not clearly or closely related to the economic characteristics of the host contract and a separate instrument with the same terms would qualify as a derivative instrument, the embedded derivative is bifurcated from the host instrument for measurement purposes. The embedded derivative, which is reported with the host instrument in the consolidated statements of financial position, is carried at fair value.

We had investment contracts in which the return was tied to a leveraged inflation index. We economically hedged the risk associated with these investment contracts.

We offer group annuity contracts that have guaranteed separate accounts as an investment option. We also offer funds with embedded fixed-rate guarantees as investment options in our defined contribution plans in Hong Kong.

We have structured investment relationships with trusts we have determined to be VIEs, which are consolidated in our financial statements. The notes issued by these trusts include obligations to deliver an underlying security to residual interest holders and the obligations contain an embedded derivative of the forecasted transaction to deliver the underlying security.

We have fixed deferred annuities and universal life contracts that credit interest based on changes in an external equity index. We also have certain variable annuity products with a GMWB rider, which allows the customer to make withdrawals of a specified annual amount, either for a fixed number of years or for the lifetime of the customer, even if the account value is fully exhausted. Declines in the equity markets may increase our exposure to benefits under contracts with the GMWB. We economically hedge the exposure in these contracts, as previously explained.

Exposure

Our risk of loss is typically limited to the fair value of our derivative instruments and not to the notional or contractual amounts of these derivatives. We are also exposed to credit losses in the event of nonperformance of the counterparties. Our current credit exposure is limited to the value of derivatives that have become favorable to us. This credit risk is minimized by purchasing such agreements from financial institutions with high credit ratings and by establishing and monitoring exposure limits. We also utilize various credit enhancements, including collateral and credit triggers to reduce the credit exposure to our derivative instruments.

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Derivatives may be exchange-traded or they may be privately negotiated contracts, which are usually referred to as OTC derivatives. Certain of our OTC derivatives are cleared and settled through central clearing counterparties (OTC cleared), while others are bilateral contracts between two counterparties (bilateral OTC). Our derivative transactions are generally documented under International Swaps and Derivatives Association, Inc. (ISDA) Master Agreements. Management believes that such agreements provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Under such agreements, in connection with an early termination of a transaction, we are permitted to set off our receivable from a counterparty against our payables to the same counterparty arising out of all included transactions. For reporting purposes, we do not offset fair value amounts of bilateral OTC derivatives for the right to reclaim cash collateral or the obligation to return cash collateral against fair value amounts recognized for derivative instruments executed with the same counterparties under master netting agreements. OTC cleared derivatives have variation margin that is legally characterized as settlement of the derivative exposure, which reduces their fair value in the consolidated statements of financial position.

We posted $192.2 million and $322.4 million in cash and securities under collateral arrangements as of March 31, 2017 and December 31, 2016, respectively, to satisfy collateral and initial margin requirements associated with our derivative credit support agreements and FCM agreements.

Certain of our derivative instruments contain provisions that require us to maintain an investment grade rating from each of the major credit rating agencies on our debt. If the ratings on our debt were to fall below investment grade, it would be in violation of these provisions and the counterparties to the derivative instruments could request immediate payment or demand immediate and ongoing full overnight collateralization on derivative instruments in net liability positions. The aggregate fair value, inclusive of accrued interest, of all derivative instruments with credit-risk-related contingent features that were in a liability position without regard to netting under derivative credit support annex agreements as of March 31, 2017 and December 31, 2016, was $279.8 million and $454.7 million, respectively. Cleared derivatives have contingent features that require us to post excess margin as required by the FCM. The terms surrounding excess margin vary by FCM agreement. With respect to derivatives containing collateral triggers, we posted collateral and initial margin of $192.2 million and $322.4 million as of March 31, 2017 and December 31, 2016, respectively, in the normal course of business, which reflects netting under derivative agreements. If the credit-risk-related contingent features underlying these agreements were triggered on March 31, 2017, we would be required to post an additional $41.8 million of collateral to our counterparties.

As of March 31, 2017 and December 31, 2016, we had received $131.7 million and $576.3 million, respectively, of cash collateral associated with our derivative credit support annex agreements and FCM agreements, for which we recorded a corresponding liability reflecting our obligation to return the collateral.

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Notional amounts are used to express the extent of our involvement in derivative transactions and represent a standard measurement of the volume of our derivative activity. Notional amounts represent those amounts used to calculate contractual flows to be exchanged and are not paid or received, except for contracts such as currency swaps. Credit exposure represents the gross amount owed to us under derivative contracts as of the valuation date. The notional amounts and credit exposure of our derivative financial instruments by type were as follows:

	March 31, 2017	December 31, 2016
	(in millions)	
Notional amounts of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 22,620.4**	$ 23,520.4
Interest rate options	**3,970.5**	4,950.5
Interest rate futures	**112.5**	96.0
Swaptions	**14.0**	77.0
Foreign exchange contracts:		
Currency forwards	**896.4**	851.3
Currency swaps	**850.7**	1,552.0
Currency options	**63.2**	
Equity contracts:		
Equity options	**3,515.1**	3,505.8
Equity futures	**338.2**	545.1
Credit contracts:		
Credit default swaps	**867.5**	961.3
Total return swaps	**80.0**	90.0
Futures	**17.0**	11.9
Other contracts:		
Embedded derivatives	**10,231.2**	10,209.5
Total notional amounts at end of period	**$ 43,576.7**	$ 46,370.8
Credit exposure of derivative instruments		
Interest rate contracts:		
Interest rate swaps	**$ 187.6**	$ 733.1
Interest rate options	**23.7**	27.3
Foreign exchange contracts:		
Currency swaps	**95.2**	106.2
Currency forwards	**7.0**	6.4
Currency options	**0.2**	
Equity contracts:		
Equity options	**15.7**	28.2
Credit contracts:		
Credit default swaps	**7.6**	7.0
Total return swaps	**0.1**	0.7
Total gross credit exposure	**337.1**	908.9
Less: collateral received	**172.2**	586.8
Net credit exposure	**$ 164.9**	$ 322.1

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The fair value of our derivative instruments classified as assets and liabilities was as follows:

	Derivative assets (1)		Derivative liabilities (2)	
	March 31, 2017	December 31, 2016	March 31, 2017	December 31, 2016
	(in millions)			
Derivatives designated as hedging instruments				
Interest rate contracts	**$ 2.3**	$ 4.4	**$ 28.0**	$ 71.3
Foreign exchange contracts	**69.1**	86.8	**20.0**	143.4
Total derivatives designated as hedging instruments	**$ 71.4**	$ 91.2	**$ 48.0**	$ 214.7
Derivatives not designated as hedging instruments				
Interest rate contracts	**$ 191.0**	$ 739.3	**$ 49.2**	$ 200.6
Foreign exchange contracts	**32.6**	27.2	**52.3**	56.2
Equity contracts	**15.6**	28.2	**138.8**	95.9
Credit contracts	**7.5**	7.7	**3.5**	5.7
Other contracts			**343.0**	388.7
Total derivatives not designated as hedging instruments	**246.7**	802.4	**586.8**	747.1
Total derivative instruments	**$ 318.1**	$ 893.6	**$ 634.8**	$ 961.8

(1) The fair value of derivative assets is reported with other investments on the consolidated statements of financial position.

(2) The fair value of derivative liabilities is reported with other liabilities on the consolidated statements of financial position, with the exception of certain embedded derivative liabilities. Embedded derivative liabilities with a fair value of $119.6 million and $176.5 million as of March 31, 2017 and December 31, 2016, respectively, are reported with contractholder funds on the consolidated statements of financial position.

Credit Derivatives Sold

When we sell credit protection, we are exposed to the underlying credit risk similar to purchasing a fixed maturity security instrument. The majority of our credit derivative contracts sold reference a single name or reference security (referred to as single name credit default swaps). The remainder of our credit derivatives reference either a basket or index of securities. These instruments are either referenced in an OTC credit derivative transaction or embedded within an investment structure that has been fully consolidated into our financial statements.

These credit derivative transactions are subject to events of default defined within the terms of the contract, which normally consist of bankruptcy, failure to pay, or modified restructuring of the reference entity and/or issue. If a default event occurs for a reference name or security, we are obligated to pay the counterparty an amount equal to the notional amount of the credit derivative transaction. As a result, our maximum future payment is equal to the notional amount of the credit derivative. In certain cases, we also have purchased credit protection with identical underlyings to certain of our sold protection transactions. As of March 31, 2017 and December 31, 2016, we did not purchase credit protection relating to our sold protection transactions. In certain circumstances, our potential loss could also be reduced by any amount recovered in the default proceedings of the underlying credit name.

We purchased an investment structure with embedded credit features that is fully consolidated into our financial statements. This consolidation results in recognition of the underlying credit derivatives and collateral within the structure, typically high quality fixed maturities that are owned by a special purpose vehicle. These credit derivatives reference several names in a basket structure. In the event of default, the collateral within the structure would typically be liquidated to pay the claims of the credit derivative counterparty.

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The following tables show our credit default swap protection sold by types of contract, types of referenced/underlying asset class and external agency rating for the underlying reference security. The maximum future payments are undiscounted and have not been reduced by the effect of any offsetting transactions, collateral or recourse features described above.

	March 31, 2017			
	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
		(in millions)		
Single name credit default swaps				
Corporate debt				
AAA	$ 30.0	$ 0.5	$ 30.0	2.0
AA	94.0	0.7	94.0	0.9
A	105.0	0.8	105.0	1.1
BBB	310.0	3.2	310.0	1.8
B	20.0	(0.3)	20.0	2.6
CCC	10.0	0.5	10.0	2.7
Government/municipalities				
AA	30.0	0.4	30.0	2.1
Sovereign				
AA	10.0	0.2	10.0	2.5
BBB	55.0	0.4	55.0	3.1
Total single name credit default swaps	664.0	6.4	664.0	1.8
Basket and index credit default swaps				
Government/municipalities				
AA	30.0	(0.3)	30.0	0.5
Structured finance				
AAA	0.9		0.9	0.7
AA	2.1		2.1	0.5
Total basket and index credit default swaps	33.0	(0.3)	33.0	0.5
Total credit default swap protection sold	$ 697.0	$ 6.1	$ 697.0	1.7

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	December 31, 2016			
	Notional amount	Fair value	Maximum future payments	Weighted average expected life (in years)
		(in millions)		
Single name credit default swaps				
Corporate debt				
AAA	$ 30.0	$ 0.6	$ 30.0	2.2
AA	94.0	0.8	94.0	1.2
A	145.0	1.2	145.0	1.3
BBB	290.0	2.3	290.0	2.1
B	20.0	(1.8)	20.0	2.8
Near default	10.0	0.2	10.0	3.0
Government/municipalities				
AA	30.0	0.4	30.0	2.3
Sovereign				
AA	10.0	0.1	10.0	2.7
BBB	40.0	0.3	40.0	2.7
Total single name credit default swaps	669.0	4.1	669.0	1.9
Basket and index credit default swaps				
Corporate debt				
Near default (1)	82.3	(1.6)	82.3	0.2
Government/municipalities				
AA	30.0	(0.4)	30.0	0.7
Structured finance				
AA	3.5		3.5	0.8
Total basket and index credit default swaps	115.8	(2.0)	115.8	0.4
Total credit default swap protection sold	$ 784.8	$ 2.1	$ 784.8	1.7

(1) Includes $60.0 million as of December 31, 2016, notional of derivatives in consolidated collateralized private investment vehicle VIEs where the credit risk is borne by third party investors.

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We also have invested in fixed maturities classified as trading that contain credit default swaps. These securities are subject to the credit risk of the issuer, normally a special purpose vehicle, which consists of the underlying credit default swaps and high quality fixed maturities that serve as collateral. A default event occurs if the cumulative losses exceed a specified attachment point, which is typically not the first loss of the portfolio. If a default event occurs that exceeds the specified attachment point, our investment may not be fully returned. We would have no future potential payments under these investments. The following tables show, by the types of referenced/underlying asset class and external rating, our fixed maturities with embedded credit derivatives.

	March 31, 2017		
	Amortized cost	**Carrying value**	**Weighted average expected life (in years)**
		(in millions)	
Structured finance			
AA	**$ 10.3**	**$ 10.3**	**0.5**
Total structured finance	**10.3**	**10.3**	**0.5**
Total fixed maturities with credit derivatives	**$ 10.3**	**$ 10.3**	**0.5**

	December 31, 2016		
	Amortized cost	**Carrying value**	**Weighted average expected life (in years)**
		(in millions)	
Structured finance			
AA	$ 14.1	$ 14.1	0.6
BBB	3.5	3.5	0.8
BB	2.3	2.3	0.8
CCC	4.7	4.7	1.2
Total structured finance	24.6	24.6	0.8
Total fixed maturities with credit derivatives	$ 24.6	$ 24.6	0.8

Fair Value Hedges

We use fixed-to-floating rate interest rate swaps to more closely align the interest rate characteristics of certain assets and liabilities. In general, these swaps are used in asset and liability management to modify duration, which is a measure of sensitivity to interest rate changes.

We enter into currency exchange swap agreements to convert certain foreign denominated assets and liabilities into U.S. dollar floating-rate denominated instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in fair value hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

Hedge effectiveness testing for fair value relationships is performed utilizing a regression analysis approach for both prospective and retrospective evaluations. This regression analysis will consider multiple data points for the assessment that the hedge continues to be highly effective in achieving offsetting changes in fair value. In certain periods, the comparison of the change in value of the derivative and the change in the value of the hedged item may not be offsetting at a specific period in time due to small movements in value. However, any amounts recorded as fair value hedges have shown to be highly effective in achieving offsetting changes in fair value both for present and future periods.

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The following table shows the effect of derivatives in fair value hedging relationships and the related hedged items on the consolidated statements of operations. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in fair value hedging relationships	Amount of gain (loss) recognized in net income on derivatives for the three months ended March 31, (1) 2017	2016	Hedged items in fair value hedging relationships	Amount of gain (loss) recognized in net income on related hedged item for the three months ended March 31, (1) 2017	2016
	(in millions)			*(in millions)*	
Interest rate contracts	**$ 2.0**	$ (7.9)	Fixed maturities, available-for-sale	**$ (2.0)**	$ 7.9
Interest rate contracts	**(0.7)**	2.9	Investment contracts	**0.6**	(2.8)
Total	**$ 1.3**	$ (5.0)	Total	**$ (1.4)**	$ 5.1

(1) The gain (loss) on both derivatives and hedged items in fair value relationships is reported in net realized capital gains (losses) on the consolidated statements of operations. The net amount represents the ineffective portion of our fair value hedges.

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in fair value hedging relationships.

Hedged item	Amount of gain (loss) for the three months ended March 31, 2017	2016
	(in millions)	
Fixed maturities, available-for-sale (1)	**$ (3.2)**	$ (13.1)
Investment contracts (2)	**0.4**	0.7

(1) Reported in net investment income on the consolidated statements of operations.

(2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

Cash Flow Hedges

We utilize floating-to-fixed rate interest rate swaps to eliminate the variability in cash flows of recognized financial assets and liabilities and forecasted transactions.

We enter into currency exchange swap agreements to convert both principal and interest payments of certain foreign denominated assets and liabilities into U.S. dollar denominated fixed-rate instruments to eliminate the exposure to future currency volatility on those items.

The net interest effect of interest rate swap and currency swap transactions for derivatives in cash flow hedges is recorded as an adjustment to income or expense of the underlying hedged item in our consolidated statements of operations.

The maximum length of time we are hedging our exposure to the variability in future cash flows for forecasted transactions, excluding those related to the payments of variable interest on existing financial assets and liabilities, is 3.2 years. As of March 31, 2017, we had $11.8 million of net gains reported in AOCI on the consolidated statements of financial position related to active hedges of forecasted transactions. If a hedged forecasted transaction is no longer probable of occurring, cash flow hedge accounting is discontinued. If it is probable that the hedged forecasted transaction will not occur, the deferred gain or loss is immediately reclassified from AOCI into net income. During the three months ended March 31, 2017 and 2016, we did not have any reclassifications from AOCI into net realized capital gains (losses) as a result of the determination that hedged cash flows were probable of not occurring.

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The following table shows the effect of derivatives in cash flow hedging relationships on the consolidated statements of operations and consolidated statements of financial position. All gains or losses on derivatives were included in the assessment of hedge effectiveness.

Derivatives in cash flow hedging relationships	Related hedged item	Amount of gain (loss) recognized in AOCI on derivatives (effective portion) for the three months ended March 31, 2017	2016	Location of gain (loss) reclassified from AOCI into net income (effective portion)	Amount of gain (loss) reclassified from AOCI on derivatives (effective portion) for the three months ended March 31, 2017	2016
		(in millions)			*(in millions)*	
Interest rate contracts	Fixed maturities, available-for-sale	**$ (32.3)**	$ 28.6	Net investment income	**$ 5.2**	$ 4.6
				Net realized capital losses	**(0.7)**	
Interest rate contracts	Investment contracts		1.1	Benefits, claims and settlement expenses		
Interest rate contracts	Debt			Operating expense	**(2.6)**	(2.2)
Foreign exchange contracts	Fixed maturities, available-for-sale	**(20.2)**	(5.4)	Net realized capital gains	**10.6**	0.6
Foreign exchange contracts	Investment contracts		2.6	Benefits, claims and settlement expenses		
Total		**$ (52.5)**	$ 26.9	Total	**$ 12.5**	$ 3.0

The following table shows the periodic settlements on interest rate contracts and foreign exchange contracts in cash flow hedging relationships.

Hedged item	Amount of gain (loss) for the three months ended March 31, 2017	2016
	(in millions)	
Fixed maturities, available-for-sale (1)	**$ 1.8**	$ 1.5
Investment contracts (2)	**(0.8)**	(5.0)

(1) Reported in net investment income on the consolidated statements of operations.

(2) Reported in benefits, claims and settlement expenses on the consolidated statements of operations.

The ineffective portion of our cash flow hedges is reported in net realized capital gains (losses) on the consolidated statements of operations. The net gain resulting from the ineffective portion of foreign currency contracts in cash flow hedging relationships was $0.0 million and $0.0 million

for the three months ended March 31, 2017 and 2016, respectively.

We expect to reclassify net gains of $15.7 million from AOCI into net income in the next 12 months, which includes both net deferred gains on discontinued hedges and net losses on periodic settlements of active hedges. Actual amounts may vary from this amount as a result of market conditions.

Derivatives Not Designated as Hedging Instruments

Our use of futures, certain swaptions and swaps, collars, options and forwards are effective from an economic standpoint, but they have not been designated as hedges for financial reporting purposes. As such, periodic changes in the market value of these instruments, which includes mark-to-market gains and losses as well as periodic and final settlements, primarily flow directly into net realized capital gains (losses) on the consolidated statements of operations.

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The following table shows the effect of derivatives not designated as hedging instruments, including fair value changes of embedded derivatives that have been bifurcated from the host contract, on the consolidated statements of operations.

Derivatives not designated as hedging instruments	Amount of gain (loss) recognized in net income on derivatives for the three months ended March 31, 2017	2016
	(in millions)	
Interest rate contracts	**$ (24.8)**	$ 187.7
Foreign exchange contracts	**11.1**	27.6
Equity contracts	**(64.4)**	8.5
Credit contracts	**7.8**	18.8
Other contracts	**54.8**	(37.7)
Total	**$ (15.5)**	$ 204.9

5. Insurance Liabilities

Liability for Unpaid Claims

The liability for unpaid claims is reported in future policy benefits and claims within our consolidated statements of financial position. Activity associated with unpaid claims was as follows:

	For the three months ended March 31, 2017	2016
	(in millions)	
Balance at beginning of period	**$ 2,001.3**	$ 1,872.2
Less reinsurance recoverable	**340.3**	314.1
Net balance at beginning of period	**1,661.0**	1,558.1
Incurred:		
Current year	**301.0**	280.7
Prior years	**11.3**	6.5
Total incurred	**312.3**	287.2
Payments:		
Current year	**140.4**	127.2
Prior years	**143.9**	130.2
Total payments	**284.3**	257.4
Net balance at end of period	**1,689.0**	1,587.9
Plus reinsurance recoverable	**345.9**	323.8

Balance at end of period	**$**	**2,034.9**	$	1,911.7
Amounts not included in the rollforward above:				
Claim adjustment expense liabilities	**$**	**50.0**	$	59.9

Incurred liability adjustments relating to prior years, which affected current operations during 2017 and 2016, resulted in part from developed claims for prior years being different than were anticipated when the liabilities for unpaid claims were originally estimated. These trends have been considered in establishing the current year liability for unpaid claims.

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6. Income Taxes

Effective Income Tax Rate

Our provision for income taxes may not have the customary relationship of taxes to income. A reconciliation between the U.S. corporate income tax rate and the effective income tax rate was as follows:

	For the three months ended March 31,	
	2017	2016
U.S. corporate income tax rate	**35 %**	35 %
Dividends received deduction	**(10)**	(9)
Impact of equity method presentation	**(4)**	(2)
Tax credits	**(3)**	(2)
Merger of Brazilian legal entities		(3)
Other	**(3)**	(3)
Effective income tax rate	**15 %**	16 %

7. Employee and Agent Benefits

Components of Net Periodic Benefit Cost

	Pension benefits For the three months ended March 31,		Other postretirement benefits For the three months ended March 31,	
	2017	2016	2017	2016
	(in millions)			
Service cost	**$ 16.8**	$ 16.2	**$**	$ 0.6
Interest cost	**31.1**	33.7	**1.0**	1.7
Expected return on plan assets	**(36.0)**	(38.7)	**(6.9)**	(8.1)
Amortization of prior service benefit	**(0.6)**	(0.6)	**(8.6)**	(5.1)
Recognized net actuarial loss	**17.0**	19.3		0.1
Net periodic benefit cost (income)	**$ 28.3**	$ 29.9	**$ (14.5)**	$ (10.8)

Contributions

Our funding policy for our qualified pension plan is to fund the plan annually in an amount at least equal to the minimum annual contribution required under the Employee Retirement Income Security Act (ERISA) and, generally, not greater than the maximum amount that can be deducted for federal income tax purposes. It is too early to determine, but we do not anticipate that we will be required to fund a minimum required contribution under ERISA. Regardless, it is possible that we may fund the qualified and nonqualified pension plans in 2017 for a combined total of up to $125.0 million. During the three months ended March 31, 2017, we contributed $35.2 million to these plans.

8. Contingencies, Guarantees and Indemnifications

Litigation and Regulatory Contingencies

We are regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming us as a defendant ordinarily arises out of our business operations as a provider of asset management and accumulation products and services; individual life insurance, specialty benefits insurance and our investment activities. Some of the lawsuits may be class actions, or purport to be, and some may include claims for unspecified or substantial punitive and treble damages.

We may discuss such litigation in one of three ways. We accrue a charge to income and disclose legal matters for which the chance of loss is probable and for which the amount of loss can be reasonably estimated. We may disclose contingencies for which the chance of loss is reasonably possible and provide an estimate of the possible loss or range of loss or a statement that such an estimate cannot be made. Finally, we may voluntarily disclose loss contingencies for which the chance of loss is remote in order to provide information concerning matters that potentially expose us to possible losses.

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In addition, regulatory bodies such as state insurance departments, the SEC, the Financial Industry Regulatory Authority, the Department of Labor (DOL) and other regulatory agencies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, ERISA and laws governing the activities of broker-dealers. We receive requests from regulators and other governmental authorities relating to industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

On December 30, 2015, Mary Ventura, William Littlejohn and Ryan Kadota filed a lawsuit in the United States District Court for the Southern District of Iowa against Principal Management Corporation (PMC). The lawsuit alleges PMC breached its fiduciary duty under Section 36(b) of the Investment Company Act by charging excessive fees on the LargeCap Growth I Fund, SmallCap Growth I Fund, SmallCap Fund, High Yield Fund, MidCap Fund and the MidCap Value III Fund. PMC is aggressively defending the lawsuit.

On August 29, 2013, American Chemicals & Equipment, Inc. 401(k) Retirement Plan (ACE) filed a lawsuit in the United States District Court for the Northern District of Alabama against PMC and Principal Global Investors, LLC (the ACE Defendants). The lawsuit alleged the ACE Defendants breached their fiduciary duty under Section 36(b) of the Investment Company Act by charging excessive fees on certain of the LifeTime series target date funds. Principal Global Investors, LLC was dismissed from the case on December 29, 2015. PMC was granted summary judgment on February 8, 2016, and the case was dismissed. ACE has appealed the grant of summary judgment and subsequent dismissal to the Eighth Circuit Court of Appeals. PMC continues to aggressively defend the lawsuit.

In 2008, Principal Life received approximately $440.0 million in connection with the termination of certain structured transactions and the resulting prepayment of Principal Life s investment in those transactions. The transactions involved Lehman Brothers Special Financing Inc. and Lehman Brothers Holdings Inc. (collectively, Lehman) in various capacities. Subsequent to Lehman s 2008 bankruptcy filing, its bankruptcy estate initiated several lawsuits seeking to recover from numerous sources significant amounts to which it claims entitlement under various theories. We are one of a large group of defendants to this action. The estate s claim against Principal Life, including interest, was approximately $600.0 million. On June 28, 2016, the bankruptcy court granted the Defendants motion to dismiss directed at common issues and dismissed with prejudice all claims against Principal Life. Lehman has appealed the bankruptcy court s decision to the U.S. District Court for the Southern District of New York.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe any such matter will have a material adverse effect on our business or financial position. As of March 31, 2017, we had no estimated losses accrued related to the legal matters discussed above because we believe the chance of loss from these matters is not probable and the amount of loss cannot be reasonably estimated.

We believe all of the litigation contingencies discussed above involve a chance of loss that is either remote or reasonably possible. Unless otherwise noted, all of these matters involve unspecified claim amounts, in which the respective plaintiffs seek an indeterminate amount of damages. To the extent such matters present a reasonably possible chance of loss, we are generally not able to estimate the possible loss or range of loss associated therewith.

The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible such outcomes could require us to pay damages or make other expenditures or establish accruals in amounts we could not estimate as of March 31, 2017.

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Guarantees and Indemnifications

In the normal course of business, we have provided guarantees to third parties primarily related to former subsidiaries and joint ventures. The terms of these agreements range in duration and often are not explicitly defined. The maximum exposure under these agreements as of March 31, 2017, was approximately $142.0 million. At inception, the fair value of such guarantees was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. Should we be required to perform under these guarantees, we generally could recover a portion of the loss from third parties through recourse provisions included in agreements with such parties, the sale of assets held as collateral that can be liquidated in the event performance is required under the guarantees or other recourse generally available to us; therefore, such guarantees would not result in a material adverse effect on our business or financial position. While the likelihood is remote, such outcomes could materially affect net income in a particular quarter or annual period.

We manage mandatory privatized social security funds in Chile. By regulation, we have a required minimum guarantee on the funds relative return. Because the guarantee has no limitation with respect to duration or amount, the maximum exposure of the guarantee in the future is indeterminable.

We are also subject to various other indemnification obligations issued in conjunction with divestitures, acquisitions and financing transactions whose terms range in duration and often are not explicitly defined. Certain portions of these indemnifications may be capped, while other portions are not subject to such limitations; therefore, the overall maximum amount of the obligation under the indemnifications cannot be reasonably estimated. At inception, the fair value of such indemnifications was insignificant. In addition, we believe the likelihood is remote that material payments will be required. Therefore, any liability accrued within our consolidated statements of financial position is insignificant. While we are unable to estimate with certainty the ultimate legal and financial liability with respect to these indemnifications, we believe that performance under these indemnifications would not result in a material adverse effect on our business or financial position. While the likelihood is remote, performance under these indemnifications could materially affect net income in a particular quarter or annual period.

9. Stockholders Equity

Reconciliation of Outstanding Common Shares

	For the three months ended March 31,	
	2017	**2016**
	(in millions)	
Beginning balance	**287.7**	291.4

Shares issued	**2.7**	1.9
Treasury stock acquired	**(2.3)**	(2.9)
Ending balance	**288.1**	290.4

In October 2015, our Board of Directors authorized a share repurchase program of up to $150.0 million of our outstanding common stock, which was completed in March 2016. In February 2016, our Board of Directors authorized a share repurchase program of up to $400.0 million of our outstanding common stock. Shares repurchased under these programs are accounted for as treasury stock, carried at cost and reflected as a reduction to stockholders equity.

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Other Comprehensive Income

	For the three months ended March 31, 2017		
	Pre-Tax	Tax	After-Tax
		(in millions)	
Net unrealized gains on available-for-sale securities during the period	$ 303.7	$ (102.8)	$ 200.9
Reclassification adjustment for losses included in net income (1)	42.7	(14.9)	27.8
Adjustments for assumed changes in amortization patterns	(15.6)	5.4	(10.2)
Adjustments for assumed changes in policyholder liabilities	(78.6)	24.0	(54.6)
Net unrealized gains on available-for-sale securities	252.2	(88.3)	163.9
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	1.5	(0.5)	1.0
Adjustments for assumed changes in amortization patterns	(0.2)	0.1	(0.1)
Adjustments for assumed changes in policyholder liabilities	(0.3)	0.1	(0.2)
Noncredit component of impairment losses on fixed maturities, available-for-sale (2)	1.0	(0.3)	0.7
Net unrealized losses on derivative instruments during the period	(10.4)	3.2	(7.2)
Reclassification adjustment for gains included in net income (3)	(12.5)	4.5	(8.0)
Adjustments for assumed changes in amortization patterns	1.5	(0.5)	1.0
Adjustments for assumed changes in policyholder liabilities	2.9	(0.9)	2.0
Net unrealized losses on derivative instruments	(18.5)	6.3	(12.2)
Foreign currency translation adjustment	68.0	(3.6)	64.4
Amortization of prior service cost and actuarial loss included in net periodic benefit cost (4)	7.8	(3.5)	4.3
Net unrecognized postretirement benefit obligation	7.8	(3.5)	4.3
Other comprehensive income	$ 310.5	$ (89.4)	$ 221.1

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	For the three months ended March 31, 2016		
	Pre-Tax	Tax	After-Tax
		(in millions)	
Net unrealized gains on available-for-sale securities during the period	$ 911.9	$ (312.9)	$ 599.0
Reclassification adjustment for losses included in net income (1)	55.3	(19.4)	35.9
Adjustments for assumed changes in amortization patterns	(56.1)	19.6	(36.5)
Adjustments for assumed changes in policyholder liabilities	(293.1)	99.1	(194.0)
Net unrealized gains on available-for-sale securities	618.0	(213.6)	404.4
Noncredit component of impairment losses on fixed maturities, available-for-sale during the period	(7.5)	2.6	(4.9)
Adjustments for assumed changes in amortization patterns	0.8	(0.2)	0.6
Adjustments for assumed changes in policyholder liabilities	0.1		0.1
Noncredit component of impairment losses on fixed maturities, available-for-sale (2)	(6.6)	2.4	(4.2)
Net unrealized gains on derivative instruments during the period	5.7	(2.0)	3.7
Reclassification adjustment for gains included in net income (3)	(3.0)	0.9	(2.1)
Adjustments for assumed changes in amortization patterns	(1.4)	0.5	(0.9)
Adjustments for assumed changes in policyholder liabilities	1.0	(0.4)	0.6
Net unrealized gains on derivative instruments	2.3	(1.0)	1.3
Foreign currency translation adjustment	138.9	(9.2)	129.7
Amortization of prior service cost and actuarial loss included in net periodic benefit cost (4)	13.7	(5.7)	8.0
Net unrecognized postretirement benefit obligation	13.7	(5.7)	8.0
Other comprehensive income	$ 766.3	$ (227.1)	$ 539.2

(1) Pre-tax reclassification adjustments relating to available-for-sale securities are reported in net realized capital gains (losses) on the consolidated statements of operations.

(2) Represents the net impact of (1) unrealized gains resulting from reclassification of previously recognized noncredit impairment losses from OCI to net realized capital gains (losses) for fixed maturities with bifurcated OTTI that had additional credit losses or fixed maturities that previously had bifurcated OTTI that have now been sold or are intended to be sold and (2) unrealized losses resulting from reclassification of noncredit impairment losses for fixed maturities with bifurcated OTTI from net realized capital gains (losses) to OCI.

(3) See Note 4, Derivative Financial Instruments Cash Flow Hedges, for further details.

(4) Pre-tax amortization of prior service cost and actuarial loss included in net periodic benefit cost, which is comprised of amortization of prior service cost (benefit) and recognized net actuarial (gain) loss, is reported in operating expenses on the consolidated statements of operations. See Note 7, Employee and Agent Benefits Components of Net Periodic Benefit Cost, for further details.

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Accumulated Other Comprehensive Loss

	Net unrealized gains on available-for-sale securities	Noncredit component of impairment losses on fixed maturities available-for-sale	Net unrealized gains on derivative instruments	Foreign currency translation adjustment	Unrecognized postretirement benefit obligation	Accumulated other comprehensive loss
			(in millions)			
Balances as of January 1, 2016	$ 732.1	$ (86.0)	$ 69.8	$ (1,148.2)	$ (450.2)	$ (882.5)
Other comprehensive income during the period, net of adjustments	368.5	(4.2)	3.4	126.2		493.9
Amounts reclassified from AOCI	35.9		(2.1)		8.0	41.8
Other comprehensive income	404.4	(4.2)	1.3	126.2	8.0	535.7
Purchase of subsidiary shares from noncontrolling interest				(9.3)		(9.3)
Balances as of March 31, 2016	$ 1,136.5	$ (90.2)	$ 71.1	$ (1,031.3)	$ (442.2)	$ (356.1)
Balances as of January 1, 2017	**$ 831.2**	**$ (89.5)**	**$ 85.3**	**$ (1,093.8)**	**$ (408.4)**	**$ (675.2)**
Other comprehensive income during the period, net of adjustments	**136.1**		**(4.2)**	**63.4**		**195.3**
Amounts reclassified from AOCI	**27.8**	**0.7**	**(8.0)**		**4.3**	**24.8**
Other comprehensive income	**163.9**	**0.7**	**(12.2)**	**63.4**	**4.3**	**220.1**
Balances as of March 31, 2017	**$ 995.1**	**$ (88.8)**	**$ 73.1**	**$ (1,030.4)**	**$ (404.1)**	**$ (455.1)**

Noncontrolling Interest

Interests held by unaffiliated parties in consolidated entities are reflected in noncontrolling interest, which represents the noncontrolling partners share of the underlying net assets of our consolidated subsidiaries. Noncontrolling interest that is not redeemable is reported in the equity section of the consolidated statements of financial position.

The noncontrolling interest holders in certain of our consolidated entities maintain an equity interest that is redeemable at the option of the holder, which may be exercised on varying dates. Since redemption of the noncontrolling interest is outside of our control, this interest is presented on the consolidated statements of financial position line item titled Redeemable noncontrolling interest. Our redeemable noncontrolling interest primarily relates to consolidated sponsored investment funds for which interests are redeemed at fair value from the net assets of the funds.

For our redeemable noncontrolling interest related to other consolidated subsidiaries, redemptions are required to be purchased at fair value or a value based on a formula that management intended to reasonably approximate fair value based on a fixed multiple of earnings over a measurement period. The carrying value of the redeemable noncontrolling interest is compared to the redemption value at each reporting period. Any adjustments to the carrying amount of the redeemable noncontrolling interest for changes in redemption value prior to exercise of the redemption option are determined after the attribution of net income or loss of the subsidiary and are recognized in the redemption value as they occur. Adjustments to the carrying value of redeemable noncontrolling interest result in adjustments to additional paid-in capital and/or retained earnings. Adjustments are recorded in retained earnings to the extent the redemption value of the redeemable noncontrolling interest exceeds its fair value and will impact the numerator in our earnings per share calculations. All other adjustments to the redeemable noncontrolling interest are recorded in additional paid-in capital.

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Following is a reconciliation of the changes in the redeemable noncontrolling interest (in millions):

Balance as of January 1, 2016	$	85.7
Net loss attributable to redeemable noncontrolling interest		(0.2)
Redeemable noncontrolling interest of newly consolidated entities (1)		179.5
Contributions from redeemable noncontrolling interest		22.1
Distributions to redeemable noncontrolling interest		(17.1)
Purchase of subsidiary shares from redeemable noncontrolling interest		(8.1)
Change in redemption value of redeemable noncontrolling interest		(3.1)
Other comprehensive income attributable to redeemable noncontrolling interest		2.1
Balance as of March 31, 2016	$	260.9
Balance as of January 1, 2017	**$**	**97.5**
Net income attributable to redeemable noncontrolling interest		**2.8**
Redeemable noncontrolling interest of deconsolidated entities (2)		**(1.5)**
Contributions from redeemable noncontrolling interest		**4.7**
Distributions to redeemable noncontrolling interest		**(9.5)**
Change in redemption value of redeemable noncontrolling interest		**0.5**
Other comprehensive income attributable to redeemable noncontrolling interest		**0.6**
Balance as of March 31, 2017	**$**	**95.1**

(1) Effective January 1, 2016, certain sponsored investment funds were consolidated as a result of the implementation of new accounting guidance.

(2) We deconsolidated certain sponsored investment funds as they no longer met the requirements for consolidation.

10. Fair Value Measurements

We use fair value measurements to record fair value of certain assets and liabilities and to estimate fair value of financial instruments not recorded at fair value but required to be disclosed at fair value. Certain financial instruments, particularly policyholder liabilities other than investment contracts, are excluded from these fair value disclosure requirements.

Valuation Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety considering factors specific to the asset or liability.

- **Level 1** Fair values are based on unadjusted quoted prices in active markets for identical assets or liabilities. Our Level 1 assets and liabilities primarily include exchange traded equity securities, mutual funds and U.S. Treasury bonds.

- **Level 2** Fair values are based on inputs other than quoted prices within Level 1 that are observable for the asset or liability, either directly or indirectly. Our Level 2 assets and liabilities primarily include fixed maturities (including public and private bonds), equity securities, cash equivalents, derivatives and other investments.

- **Level 3** Fair values are based on at least one significant unobservable input for the asset or liability. Our Level 3 assets and liabilities primarily include fixed maturities, real estate and commercial mortgage loan investments of our separate accounts, complex derivatives and embedded derivatives.

Determination of Fair Value

The following discussion describes the valuation methodologies and inputs used for assets and liabilities measured at fair value on a recurring basis or disclosed at fair value. The techniques utilized in estimating the fair value of financial instruments are reliant on the assumptions used. Care should be exercised in deriving conclusions about our business, its value or financial position based on the fair value information of financial instruments presented below.

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Fair value estimates are made based on available market information and judgments about the financial instrument at a specific point in time. Such estimates do not consider the tax impact of the realization of unrealized gains or losses. In addition, the disclosed fair value may not be realized in the immediate settlement of the financial instrument. We validate prices through an investment analyst review process, which includes validation through direct interaction with external sources, review of recent trade activity or use of internal models. In circumstances where broker quotes are used to value an instrument, we generally receive one non-binding quote. Broker quotes are validated through an investment analyst review process, which includes validation through direct interaction with external sources and use of internal models or other relevant information. We did not make any significant changes to our valuation processes during 2017.

Fixed Maturities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain non-redeemable preferred securities. When available, the fair value of fixed maturities is based on quoted prices of identical assets in active markets. These are reflected in Level 1 and primarily include U.S. Treasury bonds and actively traded redeemable corporate preferred securities.

When quoted prices of identical assets in active markets are not available, our first priority is to obtain prices from third party pricing vendors. We have regular interaction with these vendors to ensure we understand their pricing methodologies and to confirm they are utilizing observable market information. Their methodologies vary by asset class and include inputs such as estimated cash flows, benchmark yields, reported trades, broker quotes, credit quality, industry events and economic events. Fixed maturities with validated prices from pricing services, which includes the majority of our public fixed maturities in all asset classes, are generally reflected in Level 2. Also included in Level 2 are corporate bonds when quoted market prices are not available, for which an internal model using substantially all observable inputs or a matrix pricing valuation approach is used. In the matrix approach, securities are grouped into pricing categories that vary by sector, rating and average life. Each pricing category is assigned a risk spread based on studies of observable public market data from the investment professionals assigned to specific security classes. The expected cash flows of the security are then discounted back at the current Treasury curve plus the appropriate risk spread. Although the matrix valuation approach provides a fair valuation of each pricing category, the valuation of an individual security within each pricing category may actually be impacted by company specific factors.

If we are unable to price a fixed maturity security using prices from third party pricing vendors or other sources specific to the asset class, we may obtain a broker quote or utilize an internal pricing model specific to the asset utilizing relevant market information, to the extent available and where at least one significant unobservable input is utilized. These are reflected in Level 3 in the fair value hierarchy and can include fixed maturities across all asset classes. As of March 31, 2017, less than 1% of our total fixed maturities were Level 3 securities valued using internal pricing models.

The primary inputs, by asset class, for valuations of the majority of our Level 2 investments from third party pricing vendors or our internal pricing valuation approach are described below.

U.S. Government and Agencies/Non-U.S. Governments. Inputs include recently executed market transactions, interest rate yield curves, maturity dates, market price quotations and credit spreads relating to similar instruments.

States and Political Subdivisions. Inputs include Municipal Securities Rulemaking Board reported trades, U.S. Treasury and other benchmark curves, material event notices, new issue data and obligor credit ratings.

Corporate. Inputs include recently executed transactions, market price quotations, benchmark yields, issuer spreads and observations of equity and credit default swap curves related to the issuer. For private placement corporate securities valued through the matrix valuation approach inputs include the current Treasury curve and risk spreads based on sector, rating and average life of the issuance.

RMBS, CMBS, Collateralized Debt Obligations and Other Debt Obligations. Inputs include cash flows, priority of the tranche in the capital structure, expected time to maturity for the specific tranche, reinvestment period remaining and performance of the underlying collateral including prepayments, defaults, deferrals, loss severity of defaulted collateral and, for RMBS, prepayment speed assumptions. Other inputs include market indices and recently executed market transactions.

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Equity Securities

Equity securities include mutual funds, common stock, non-redeemable preferred stock and required regulatory investments. Fair values of equity securities are determined using quoted prices in active markets for identical assets when available, which are reflected in Level 1. When quoted prices are not available, we may utilize internal valuation methodologies appropriate for the specific asset that use observable inputs such as underlying share prices or the net asset value (NAV), which are reflected in Level 2. Fair values might also be determined using broker quotes or through the use of internal models or analysis that incorporate significant assumptions deemed appropriate given the circumstances and consistent with what other market participants would use when pricing such securities, which are reflected in Level 3.

Derivatives

The fair values of exchange-traded derivatives are determined through quoted market prices, which are reflected in Level 1. Exchange-traded derivatives include futures that are settled daily, which reduces their fair value in the consolidated statements of financial position. The fair values of OTC cleared derivatives are determined through market prices published by the clearinghouses, which are reflected in Level 2. The clearinghouses may utilize the overnight indexed swap (OIS) curve in their valuation. Beginning in 2017, variation margin associated with OTC cleared derivatives is settled daily, which reduces their fair value in the consolidated statements of financial position. The fair values of bilateral OTC derivative instruments are determined using either pricing valuation models that utilize market observable inputs or broker quotes. The majority of our bilateral OTC derivatives are valued with models that use market observable inputs, which are reflected in Level 2. Significant inputs include contractual terms, interest rates, currency exchange rates, credit spread curves, equity prices and volatilities. These valuation models consider projected discounted cash flows, relevant swap curves and appropriate implied volatilities. Certain bilateral OTC derivatives utilize unobservable market data, primarily independent broker quotes that are nonbinding quotes based on models that do not reflect the result of market transactions, which are reflected in Level 3.

Our non-cleared derivative contracts are generally documented under ISDA Master Agreements, which provide for legally enforceable set-off and close-out netting of exposures to specific counterparties. Collateral arrangements are bilateral and based on current ratings of each entity. We utilize the LIBOR interest rate curve to value our positions, which includes a credit spread. This credit spread incorporates an appropriate level of nonperformance risk into our valuations given the current ratings of our counterparties, as well as the collateral agreements in place. Counterparty credit risk is routinely monitored to ensure our adjustment for non-performance risk is appropriate. Our centrally cleared derivative contracts are conducted with regulated centralized clearinghouses, which provide for daily exchange of cash collateral or variation margin equal to the difference in the daily market values of those contracts that eliminates the non-performance risk on these trades.

Interest Rate Contracts. For non-cleared contracts we use discounted cash flow valuation techniques to determine the fair value of interest rate swaps using observable swap curves as the inputs. These are reflected in Level 2. For centrally cleared contracts we use published prices from clearinghouses. These are reflected in Level 2. In addition, we have a

limited number of complex inflation-linked interest rate swaps, interest rate collars and swaptions that are valued using broker quotes. These are reflected in Level 3.

Foreign Exchange Contracts. We use discounted cash flow valuation techniques that utilize observable swap curves and exchange rates as the inputs to determine the fair value of foreign currency swaps. These are reflected in Level 2. Currency forwards and currency options are valued using observable market inputs, including forward currency exchange rates. These are reflected in Level 2. In addition, we have a limited number of non-standard currency swaps that are valued using broker quotes. These are reflected within Level 3.

Equity Contracts. We use an option pricing model using observable implied volatilities, dividend yields, index prices and swap curves as the inputs to determine the fair value of equity options. These are reflected in Level 2.

Credit Contracts. We use either the ISDA Credit Default Swap Standard discounted cash flow model that utilizes observable default probabilities and recovery rates as inputs or broker prices to determine the fair value of credit default swaps. These are reflected in Level 3. In addition, we have a limited number of total return swaps that are valued based on the observable quoted price of underlying equity indices. These are reflected in Level 2.

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Other Investments

Other investments reported at fair value include invested assets of consolidated sponsored investment funds, unconsolidated sponsored investment funds, other investment funds reported at fair value or for which the fair value option was elected, commercial mortgage loans of consolidated VIEs for which the fair value option was elected and equity method real estate investments for which the fair value option was elected.

Invested assets of consolidated sponsored investment funds include equity securities, fixed maturities and other investments, for which fair values are determined as previously described, and are reflected in Level 1 and Level 2.

The fair value of unconsolidated sponsored investment funds and other investment funds is determined using the NAV of the fund. The NAV of the fund represents the price at which we feel we would be able to initiate a transaction. Investments for which the NAV represents a quoted price in an active market for identical assets are reflected in Level 1. Investments that do not have a quoted price in an active market are reflected in Level 2.

Commercial mortgage loans of consolidated VIEs are valued using the more observable fair value of the liabilities of the consolidated collateralized financing entities (CCFEs) under the measurement alternative guidance and are reflected in Level 2. The liabilities are affiliated so are not reflected in our consolidated results.

Equity method real estate investments for which the fair value option was elected are reflected in Level 3. The equity method real estate investments consist of underlying real estate and debt. The real estate fair value is estimated using a discounted cash flow valuation model that utilizes public real estate market data inputs such as transaction prices, market rents, vacancy levels, leasing absorption, market cap rates and discount rates. The debt fair value is estimated using a discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements.

Cash Equivalents

Certain cash equivalents are reported at fair value on a recurring basis and include money market instruments and other short-term investments with maturities of three months or less. Fair values of these cash equivalents may be determined using public quotations, when available, which are reflected in Level 1. When public quotations are not available, because of the highly liquid nature of these assets, carrying amounts may be used to approximate fair values, which are reflected in Level 2.

Separate Account Assets

Separate account assets include equity securities, debt securities and derivative instruments, for which fair values are determined as previously described, and are reflected in Level 1, Level 2 and Level 3. Separate account assets also include commercial mortgage loans, for which the fair value is estimated by discounting the expected total cash flows using market rates that are applicable to the yield, credit quality and maturity of the loans. The market clearing spreads vary based on mortgage type, weighted average life, rating and liquidity. These are reflected in Level 3. Finally, separate account assets include real estate, for which the fair value is estimated using discounted cash flow valuation models that utilize various public real estate market data inputs. In addition, each property is appraised annually by an independent appraiser. The real estate included in separate account assets is recorded net of related mortgage encumbrances for which the fair value is estimated using discounted cash flow analysis based on our incremental borrowing rate for similar borrowing arrangements. The real estate within the separate accounts is reflected in Level 3.

Investment Contracts

Certain annuity contracts and other investment contracts include embedded derivatives that have been bifurcated from the host contract and are measured at fair value on a recurring basis, which are reflected in Level 3. The key assumptions for calculating the fair value of the embedded derivative liabilities are market assumptions (such as equity market returns, interest rate levels, market volatility and correlations) and policyholder behavior assumptions (such as lapse, mortality, utilization and withdrawal patterns). Risk margins are included in the policyholder behavior assumptions. The assumptions are based on a combination of historical data and actuarial judgment. The embedded derivative liabilities are valued using stochastic models that incorporate a spread reflecting our own creditworthiness.

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The assumption for our own non-performance risk for investment contracts and any embedded derivatives bifurcated from certain annuity and investment contracts is based on the current market credit spreads for debt-like instruments we have issued and are available in the market.

Other Liabilities

Certain obligations reported in other liabilities include embedded derivatives to deliver underlying securities of structured investments to third parties. The fair value of the embedded derivatives is calculated based on the value of the underlying securities that are valued based on prices obtained from third party pricing vendors as utilized and described in our discussion of how fair value is determined for fixed maturities, which are reflected in Level 2.

As of December 31, 2016, obligations of consolidated VIEs for which the fair value option was elected were included in other liabilities. The VIEs unaffiliated obligations were valued utilizing internal pricing models, which were reflected in Level 3.

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Assets and liabilities measured at fair value on a recurring basis were as follows:

	March 31, 2017				
	Assets/ (liabilities) measured at fair value	**Amount measured at net asset value (5)**	**Fair value hierarchy level**		
			Level 1	**Level 2**	**Level 3**
			(in millions)		
Assets					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ **1,438.2**	$	$ **938.0**	$ **500.2**	$
Non-U.S. governments	**1,004.8**		**3.0**	**935.3**	**66.5**
States and political subdivisions	**5,999.5**			**5,999.5**	
Corporate	**35,565.5**		**21.1**	**35,309.1**	**235.3**
Residential mortgage-backed securities	**2,839.9**			**2,839.9**	
Commercial mortgage-backed securities	**3,862.9**			**3,800.2**	**62.7**
Collateralized debt obligations	**987.9**			**960.4**	**27.5**
Other debt obligations	**5,290.4**			**5,283.9**	**6.5**

Total fixed maturities, available-for-sale	**56,989.1**		**962.1**	**55,628.5**	**398.5**
Fixed maturities, trading	**278.0**			**278.0**	
Equity securities, available-for-sale	**114.0**		**68.6**	**42.7**	**2.7**
Equity securities, trading	**1,506.3**		**466.1**	**1,039.6**	**0.6**
Derivative assets (1)	**318.1**			**287.3**	**30.8**
Other investments (2)	**545.2**	**93.3**	**226.3**	**187.3**	**38.3**
Cash equivalents (3)	**989.6**		**56.8**	**932.8**	
Sub-total excluding separate account assets	**60,740.3**	**93.3**	**1,779.9**	**58,396.2**	**470.9**
Separate account assets	**146,374.7**		**83,140.8**	**55,976.3**	**7,257.6**
Total assets	**$ 207,115.0**	**$ 93.3**	**$ 84,920.7**	**$ 114,372.5**	**$ 7,728.5**
Liabilities					
Investment contracts (4)	**$ (119.6)**	**$**	**$**	**$**	**$ (119.6)**
Derivative liabilities (1)	**(291.7)**			**(273.6)**	**(18.1)**
Other liabilities (4)	**(224.5)**			**(224.5)**	
Total liabilities	**$ (635.8)**	**$**	**$**	**$ (498.1)**	**$ (137.7)**
Net assets	**$ 206,479.2**	**$ 93.3**	**$ 84,920.7**	**$ 113,874.4**	**$ 7,590.8**

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	December 31, 2016				
	Assets/ (liabilities) measured at fair value	Amount measured at net asset value (5)	Fair value hierarchy level		
			Level 1	Level 2	Level 3
			(in millions)		
Assets					
Fixed maturities, available-for-sale:					
U.S. government and agencies	$ 1,433.0	$	$ 996.5	$ 436.5	$
Non-U.S. governments	893.6		3.0	828.5	62.1
States and political subdivisions	5,569.2			5,569.2	
Corporate	34,192.4		21.2	33,912.1	259.1
Residential mortgage-backed securities	2,834.7			2,834.7	
Commercial mortgage-backed securities	4,096.5			4,025.4	71.1
Collateralized debt obligations	758.6			725.0	33.6
Other debt obligations	5,068.1			4,976.6	91.5
Total fixed maturities, available-for-sale	54,846.1		1,020.7	53,308.0	517.4
Fixed maturities, trading	398.4			305.5	92.9
Equity securities, available-for-sale	98.9		55.2	41.0	2.7
Equity securities, trading	1,413.4		445.7	967.7	
Derivative assets (1)	893.6			859.7	33.9
Other investments (2)	470.0	92.7	169.8	170.6	36.9
Cash equivalents (3)	1,947.1		51.2	1,895.9	
Sub-total excluding separate account assets	60,067.5	92.7	1,742.6	57,548.4	683.8
Separate account assets	139,832.6		79,688.1	52,789.7	7,354.8
Total assets	$ 199,900.1	$ 92.7	$ 81,430.7	$ 110,338.1	$ 8,038.6
Liabilities					
Investment contracts (4)	$ (176.5)	$	$	$	$ (176.5)
Derivative liabilities (1)	(573.0)			(550.4)	(22.6)
Other liabilities (4)	(272.2)			(212.3)	(59.9)
Total liabilities	$ (1,021.7)	$	$	$ (762.7)	$ (259.0)
Net assets	$ 198,878.4	$ 92.7	$ 81,430.7	$ 109,575.4	$ 7,779.6

(1) Within the consolidated statements of financial position, derivative assets are reported with other investments and derivative liabilities are reported with other liabilities. Refer to Note 4, Derivative Financial Instruments, for further information on fair value by class of derivative instruments. Our derivatives are primarily Level 2, with the exception of certain credit default swaps and other swaps that are Level 3.

(2) Primarily includes sponsored investment funds, other investment funds, equity method investments reported at fair value and commercial mortgage loans of consolidated VIEs.

(3) Includes money market instruments and short-term investments with a maturity date of three months or less when purchased.

(4) Includes bifurcated embedded derivatives that are reported at fair value within the same line item in the consolidated statements of financial position in which the host contract is reported. As of December 31, 2016, other liabilities also include obligations of consolidated VIEs reported at fair value.

(5) Certain investments are measured at fair value using the NAV per share (or its equivalent) practical expedient and have not been classified in the fair value hierarchy. These consist of certain fund interests that are restricted until maturity with unfunded commitments totaling $56.5 million and $57.6 million as of March 31, 2017 and December 31, 2016, respectively.

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Changes in Level 3 Fair Value Measurements

The reconciliation for all assets and liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) was as follows:

	For the three months ended March 31, 2017							
		Total realized/unrealized gains (losses)						
	Beginning asset/ (liability) balance as of December 31, 2016	Included in net income (1)	Included in other comprehensive income	Net purchases, sales, issuances and settlements (3)	Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of March 31, 2017	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
				(in millions)				
Assets								
Fixed maturities, available-for-sale:								
Non-U.S. governments	$ 62.1	$ (0.1)	$ 0.3	$ 4.2	$	$	$ 66.5	$ (0.1)
Corporate	259.1	(1.8)	0.4	(27.0)	4.6		235.3	(0.2)
Commercial mortgage-backed securities	71.1	(1.2)	2.6	(1.0)	0.7	(9.5)	62.7	(1.2)
Collateralized debt obligations	33.6		(0.7)	(5.4)			27.5	
Other debt obligations	91.5	(0.1)	0.1	(0.3)		(84.7)	6.5	
Total fixed maturities, available-for-sale	517.4	(3.2)	2.7	(29.5)	5.3	(94.2)	398.5	(1.5)
Fixed maturities, trading	92.9	(2.4)		(92.4)	1.9			(2.4)
Equity securities, available-for-sale	2.7						2.7	
Equity securities, trading		(0.1)			0.7		0.6	(0.1)
Derivative assets	33.9	(3.2)		0.1			30.8	(3.1)
Other investments	36.9	1.2		0.2			38.3	1.2
Separate account assets (2)	7,354.8	163.8	(0.3)	(259.8)		(0.9)	7,257.6	167.7
Liabilities								
Investment contracts	(176.5)	52.6	0.1	4.2			(119.6)	51.6

Derivative liabilities	**(22.6)**	**4.6**	**(0.1)**	**(18.1)**	**3.1**
Other liabilities	**(59.9)**	**(0.1)**	**60.0**		

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	For the three months ended March 31, 2016							
		Total realized/unrealized gains (losses)						
	Beginning asset/ (liability) balance as of December 31, 2015	Included in net income (1)	Included in other comprehensive income	Net purchases, sales, issuances and settlements (3)	Transfers into Level 3	Transfers out of Level 3	Ending asset/ (liability) balance as of March 31, 2016	Changes in unrealized gains (losses) included in net income relating to positions still held (1)
				(in millions)				
Assets								
Fixed maturities, available-for-sale:								

(1) Both realized gains (losses) and mark-to-market unrealized gains (losses) are generally reported in net realized capital gains (losses) within the consolidated statements of operations. Realized and unrealized gains (losses) on certain fixed maturities, trading and certain derivatives used in relation to certain trading portfolios are reported in net investment income within the consolidated statements of operations.

(2) Gains and losses for separate account assets do not impact net income as the change in value of separate account assets is offset by a change in value of separate account liabilities. Foreign currency translation adjustments related to the Principal International segment separate account assets are recorded in AOCI and are offset by foreign currency translation adjustments of the corresponding separate account liabilities.

(3) Gross purchases, sales, issuances and settlements were:

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	For the three months ended March 31, 2017				
	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
Assets					
Fixed maturities, available-for-sale:					
Non-U.S. governments	$ 21.8	$ (17.3)	$	$ (0.3)	$ 4.2
Corporate	18.0	(37.8)		(7.2)	(27.0)
Commercial mortgage-backed securities				(1.0)	(1.0)
Collateralized debt obligations				(5.4)	(5.4)
Other debt obligations				(0.3)	(0.3)
Total fixed maturities, available-for-sale	39.8	(55.1)		(14.2)	(29.5)
Fixed maturities, trading				(92.4)	(92.4)
Derivative assets	0.3	(0.2)			0.1
Other investments	0.2				0.2
Separate account assets (4)	58.6	(310.5)	(71.3)	63.4	(259.8)
Liabilities					
Investment contracts			0.2	4.0	4.2
Derivative liabilities	(0.2)	0.1			(0.1)
Other liabilities				60.0	60.0

	For the three months ended March 31, 2016				
	Purchases	Sales	Issuances (in millions)	Settlements	Net purchases, sales, issuances and settlements
Assets					
Fixed maturities, available-for-sale:					
Non-U.S. governments	$ 16.7	$	$	$ (0.4)	$ 16.3
Corporate	23.9	(9.3)		(11.4)	3.2
Commercial mortgage-backed securities				(0.1)	(0.1)
Other debt obligations				(0.4)	(0.4)
Total fixed maturities, available-for-sale	40.6	(9.3)		(12.3)	19.0
Derivative assets		0.4			0.4
Other investments	0.2				0.2
Separate account assets (4)	56.2	(60.7)	(92.8)	24.3	(73.0)
Liabilities					
Investment contracts			1.1	1.6	2.7
Derivative liabilities		0.3			0.3

(4) Issuances and settlements include amounts related to mortgage encumbrances associated with real estate in our separate accounts.

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Transfers

Transfers of assets and liabilities measured at fair value on a recurring basis between fair value hierarchy levels were as follows:

	For the three months ended March 31, 2017					
	Transfers out of Level 1 into Level 2	Transfers out of Level 1 into Level 3	Transfers out of Level 2 into Level 1	Transfers out of Level 2 into Level 3	Transfers out of Level 3 into Level 1	Transfers out of Level 3 into Level 2
	(in millions)					
Assets						
Fixed maturities, available-for-sale:						
Corporate	$	$	$	$ 4.6	$	$
Commercial mortgage-backed securities				0.7		9.5
Other debt obligations						84.7
Total fixed maturities, available-for-sale				5.3		94.2
Fixed maturities, trading				1.9		
Equity securities, trading				0.7		
Separate account assets	0.7					0.9

	For the three months ended March 31, 2016					
	Transfers out of Level 1 into Level 2	Transfers out of Level 1 into Level 3	Transfers out of Level 2 into Level 1	Transfers out of Level 2 into Level 3	Transfers out of Level 3 into Level 1	Transfers out of Level 3 into Level 2
	(in millions)					
Assets						
Fixed maturities, available-for-sale:						
Corporate	$	$	$	$	$	$ 1.7
Commercial mortgage-backed securities						2.3
Total fixed maturities, available-for-sale						4.0
Separate account assets	26.2		4.5	0.8		

Transfers between fair value hierarchy levels are recognized at the beginning of the reporting period.

Separate account assets transferred between Level 1 and Level 2 during the three months ended March 31, 2016, primarily related to foreign equity securities. When these securities are valued at the local close price of the exchange where the assets traded, they are reflected in Level 1.

When events materially affecting the value occur between the close of the local exchange and the New York Stock Exchange, we use adjusted prices determined by a third party pricing vendor to update the foreign market closing prices and the fair value is reflected in Level 2.

Assets transferred into Level 3 during the three months ended March 31, 2017 and 2016, primarily included those assets for which we are now unable to obtain pricing from a recognized third party pricing vendor as well as assets that were previously priced using a matrix valuation approach that may no longer be relevant when applied to asset-specific situations.

Assets transferred out of Level 3 during the three months ended March 31, 2017 and 2016, included those for which we are now able to obtain pricing from a recognized third party pricing vendor or from internal models using substantially all market observable information.

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Quantitative Information about Level 3 Fair Value Measurements

The following table provides quantitative information about the significant unobservable inputs used for recurring fair value measurements categorized within Level 3, excluding assets and liabilities for which significant quantitative unobservable inputs are not developed internally, which primarily consists of those valued using broker quotes or the measurement alternative for CCFEs. Refer to Assets and liabilities measured at fair value on a recurring basis for a complete valuation hierarchy summary.

	March 31, 2017				
	Assets / (liabilities) measured at fair value *(in millions)*	**Valuation technique(s)**	**Unobservable input description**	**Input/range of inputs**	**Weighted average**
Assets					
Fixed maturities, available-for-sale:					
Non-U.S. governments	$ **7.2**	Discounted cash flow	Discount rate (1)	2.4%	2.4%
			Illiquidity premium	50 basis points (bps)	50bps
			Comparability adjustment	(25)bps	(25)bps
Corporate	**52.3**	Discounted cash flow	Discount rate (1)	0.9%-7.4%	3.8%
			Illiquidity premium	0bps-60bps	27bps
			Comparability adjustment	0bps-80bps	20bps
Commercial mortgage-backed securities	**43.1**	Discounted cash flow	Discount rate (1)	2.6%-14.8%	9.9%
			Probability of default	0.0%-10.0%	7.0%
			Potential loss severity	0.0%-98.0%	36.6%
Other debt obligations	**6.5**	Discounted cash flow	Discount rate (1)	5.0%	5.0%
			Illiquidity premium	500bps	500bps
Other investments	**38.3**	Discounted cash flow - equity method real estate	Discount rate (1)	7.5%	7.5%

investments			
	Terminal capitalization rate	6.8%	6.8%
	Average market rent growth rate	2.7%	2.7%
Discounted cash flow - equity method real estate investments - debt	Loan to value	49.9%	49.9%
	Credit spread rate	2.0%	2.0%

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	March 31, 2017				
	Assets / (liabilities) measured at fair value *(in millions)*	**Valuation technique(s)**	**Unobservable input description**	**Input/range of inputs**	**Weighted average**
Separate account assets	**7,100.8**	Discounted cash flow - mortgage loans	Discount rate (1)	1.6%-5.9%	3.9%
			Illiquidity premium	0bps-60bps	13bps
			Credit spread rate	72bps-502bps	224bps
		Discounted cash flow - real estate	Discount rate (1)	5.8%-17.2%	6.9%
			Terminal capitalization rate	4.3%-9.3%	6.0%
			Average market rent growth rate	1.9%-4.4%	2.9%
		Discounted cash flow - real estate debt	Loan to value	11.8%-68.0%	46.3%
			Credit spread rate	3.2%-5.2%	3.8%
Liabilities					
Investment contracts	**(119.6)**	Discounted cash flow	Long duration interest rate	2.6%-2.7% (2)	
			Long-term equity market volatility	15.0%-43.5%	
			Non-performance risk	0.3%-1.6%	
			Utilization rate	See note (3)	
			Lapse rate	0.5%-14.1%	
			Mortality rate	See note (4)	

	December 31, 2016				
	Assets / (liabilities) measured at fair value *(in millions)*	**Valuation technique(s)**	**Unobservable input description**	**Input/range of inputs**	**Weighted average**
Assets					
Fixed maturities, available-for-sale:					
Non-U.S. governments	$ 7.6	Discounted cash flow	Discount rate (1)	2.3%	2.3%
			Illiquidity premium	50bps	50bps
			Comparability adjustment	(25)bps	(25)bps
Corporate	49.8	Discounted cash flow	Discount rate (1)	1.5%-7.6%	4.0%

	Illiquidity premium	0bps-60bps	27bps
	Comparability adjustment	0bps-20bps	6bps

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	December 31, 2016				
	Assets / (liabilities) measured at fair value *(in millions)*	**Valuation technique(s)**	**Unobservable input description**	**Input/range of inputs**	**Weighted average**
Commercial mortgage-backed securities	49.3	Discounted cash flow	Discount rate (1)	3.1%-12.8%	10.2%
			Probability of default	0.0%-10.0%	7.8%
			Potential loss severity	0.0%-99.5%	39.5%
Collateralized debt obligations	0.2	Discounted cash flow	Discount rate (1)	95.1%	95.1%
			Probability of default	100.0%	100.0%
			Potential loss severity	91.2%	91.2%
Other debt obligations	6.8	Discounted cash flow	Discount rate (1)	5.0%	5.0%
			Illiquidity premium	500bps	500bps
Fixed maturities, trading	10.5	Discounted cash flow	Discount rate (1)	2.3%-9.0%	2.7%
			Illiquidity premium	0bps-300bps	240bps
Other investments	36.9	Discounted cash flow - equity method real estate investments	Discount rate (1)	7.6%	7.6%
			Terminal capitalization rate	6.8%	6.8%
			Average market rent growth rate	2.9%	2.9%
		Discounted cash flow - equity method real estate investments - debt	Loan to value	52.5%	52.5%
			Credit spread rate	2.1%	2.1%

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	December 31, 2016				
	Assets / (liabilities) measured at fair value *(in millions)*	**Valuation technique(s)**	**Unobservable input description**	**Input/range of inputs**	**Weighted average**
Separate account assets	7,225.4	Discounted cash flow - mortgage loans	Discount rate (1)	1.4%-5.3%	3.7%
			Illiquidity premium	0bps-60bps	13bps
			Credit spread rate	83bps-472bps	227bps
		Discounted cash flow - real estate	Discount rate (1)	5.8%-16.2%	7.0%
			Terminal capitalization rate	4.3%-9.3%	6.1%
			Average market rent growth rate	1.8%-4.3%	2.9%
		Discounted cash flow - real estate debt	Loan to value	6.3%-69.7%	47.0%
			Credit spread rate	3.3%-4.6%	3.9%
Liabilities					
Investment contracts	(176.5)	Discounted cash flow	Long duration interest rate	2.6%-2.7% (2)	
			Long-term equity market volatility	16.0%-45.9%	
			Non-performance risk	0.3%-1.7%	
			Utilization rate	See note (3)	
			Lapse rate	0.5%-14.1%	
			Mortality rate	See note (4)	

(1) Represents market comparable interest rate or an index adjusted rate used as the base rate in the discounted cash flow analysis prior to any credit spread, illiquidity or other adjustments, where applicable.

(2) Represents the range of rate curves used in the valuation analysis that we have determined market participants would use when pricing the instrument. Derived from interpolation between various observable swap rates.

(3) This input factor is the number of contractholders taking withdrawals as well as the amount and timing of the withdrawals and a range does not provide a meaningful presentation.

(4) This input is based on an appropriate industry mortality table and a range does not provide a meaningful presentation.

Market comparable discount rates are used as the base rate in the discounted cash flows used to determine the fair value of certain assets. Increases or decreases in the credit spreads on the comparable assets could cause the fair value of the assets to significantly decrease or increase, respectively. Additionally, we may adjust the base discount rate or the modeled price by applying an illiquidity premium given the highly structured nature of certain assets. Increases or decreases in this illiquidity premium could cause significant decreases or increases, respectively, in the fair value of the asset.

Embedded derivatives can be either assets or liabilities within the investment contracts line item, depending on certain inputs at the reporting date. Increases to an asset or decreases to a liability are described as increases to fair value. Increases or decreases in market volatilities could cause significant decreases or increases, respectively, in the fair value of embedded derivatives in investment contracts. Long duration interest rates are used as the mean return when projecting the growth in the value of associated account value and impact the discount rate used in the discounted future cash flows valuation. The amount of claims will increase if account value is not sufficient to cover guaranteed withdrawals. Increases or decreases in risk free rates could cause the fair value of the embedded derivative to significantly increase or decrease,

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respectively. Increases or decreases in our own credit risks, which impact the rates used to discount future cash flows, could significantly increase or decrease, respectively, the fair value of the embedded derivative. All of these changes in fair value would impact net income.

Decreases or increases in the mortality rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. Decreases or increases in the overall lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The lapse rate assumption varies dynamically based on the relationship of the guarantee and associated account value. A stronger or weaker dynamic lapse rate assumption could cause the fair value of the embedded derivative to decrease or increase, respectively. The utilization rate assumption includes how many contractholders will take withdrawals, when they will take them and how much of their benefit they will take. Increases or decreases in the assumption of the number of contractholders taking withdrawals could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take withdrawals earlier or later could cause the fair value of the embedded derivative to decrease or increase, respectively. Assuming contractholders take more or less of their benefit could cause the fair value of the embedded derivative to decrease or increase, respectively.

Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

Certain assets are measured at fair value on a nonrecurring basis. During the three months ended March 31, 2017, certain mortgage loans had been marked to fair value of $1.1 million. The net impact of write-downs of loans reclassified to held-for-sale, impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of $0.3 million for the three months ended March 31, 2017, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

During the three months ended March 31, 2016, certain mortgage loans had been marked to fair value of $0.5 million. The net impact of write-downs of loans reclassified to held-for-sale, impairments and improvements in estimated fair value of previously impaired loans resulted in a net loss of $0.1 million for the three months ended March 31, 2016, that was recorded in net realized capital gains (losses) as part of the mortgage loan valuation allowance. This includes the impact of certain loans no longer on our books. These collateral-dependent mortgage loans are a Level 3 fair value measurement, as fair value is based on the fair value of the underlying real estate collateral, which is estimated using appraised values that involve significant unobservable inputs.

Fair Value Option

We elected fair value accounting for:

- Certain commercial mortgage loans of consolidated VIEs for which it was not practicable for us to determine the carrying value. In addition, as of December 31, 2016, we had certain obligations of consolidated VIEs for which it was not practicable for us to determine the carrying value.

- Certain real estate ventures that are subject to the equity method of accounting because the nature of the investments is to add value to the properties and generate income from the operations of the properties. Other equity method real estate investments are not fair valued because the investments mainly generate income from the operations of the underlying properties.

- Certain investment funds for which we do not have enough influence to account for under the equity method in order to reflect the economics of the investment in the financial statements. We do not elect the fair value option for other similar investments as these investments are generally accounted for under the equity method of accounting.

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The following tables present information regarding the assets and liabilities for which the fair value option was elected.

	March 31, 2017		December 31, 2016	
	(in millions)			
Commercial mortgage loans of consolidated VIEs (1) (2)				
Fair value	**$**	**11.5**	$	12.4
Aggregate contractual principal		**11.1**		12.0
Obligations of consolidated VIEs (3)				
Fair value				59.9
Aggregate unpaid principal				60.0
Real estate ventures (1)				
Fair value		**38.3**		36.9
Investment funds (1)				
Fair value		**37.6**		36.9

(1) Reported with other investments in the consolidated statements of financial position.

(2) None of the loans were more than 90 days past due or in non-accrual status.

(3) Reported with other liabilities in the consolidated statements of financial position.

	For the three months ended March 31,			
	2017		2016	
	(in millions)			
Commercial mortgage loans of consolidated VIEs				
Change in fair value pre-tax loss (1) (2)	**$**	**(0.1)**	$	(0.2)
Interest income (3)		**0.2**		0.3
Obligations of consolidated VIEs				
Change in fair value pre-tax loss - instrument specific credit risk (2) (4)		**(0.1)**		(5.0)
Change in fair value pre-tax loss (2)		**(0.1)**		(5.0)
Interest expense (5)		**0.3**		0.3
Real estate ventures				
Change in fair value pre-tax gain (6)		**1.2**		0.5

Investment funds		
Change in fair value pre-tax gain (loss) (6) (7)	**1.2**	(0.3)
Dividend income (6)		0.3

(1) None of the change in fair value related to instrument-specific credit risk.

(2) Reported in net realized capital gains (losses) on the consolidated statements of operations.

(3) Reported in net investment income on the consolidated statements of operations and recorded based on the effective interest rates as determined at the closing of the loan.

(4) Estimated based on credit spreads and quality ratings.

(5) Reported in operating expenses on the consolidated statements of operations.

(6) Reported in net investment income on the consolidated statements of operations.

(7) Absent the fair value election, the change in fair value on the investments would be reported in OCI.

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Financial Instruments Not Reported at Fair Value

The carrying value and estimated fair value of financial instruments not recorded at fair value on a recurring basis but required to be disclosed at fair value were as follows:

	March 31, 2017				
			Fair value hierarchy level		
	Carrying amount	Fair value	Level 1	Level 2	Level 3
			(in millions)		
Assets (liabilities)					
Mortgage loans	$ 13,388.1	$ 13,681.3	$	$	$ 13,681.3
Policy loans	819.6	1,001.0			1,001.0
Other investments	266.3	272.6		190.6	82.0
Cash and cash equivalents	545.1	545.1	504.5	40.6	
Investment contracts	(31,219.3)	(30,754.0)		(5,398.6)	(25,355.4)
Short-term debt	(59.5)	(59.5)		(59.5)	
Long-term debt	(3,126.2)	(3,286.8)		(3,286.8)	
Separate account liabilities	(133,618.1)	(132,410.5)			(132,410.5)
Bank deposits	(2,206.6)	(2,203.3)	(1,601.5)	(601.8)	
Cash collateral payable	(136.1)	(136.1)	(136.1)		

	December 31, 2016				
			Fair value hierarchy level		
	Carrying amount	Fair value	Level 1	Level 2	Level 3
			(in millions)		
Assets (liabilities)					
Mortgage loans	$ 13,230.2	$ 13,453.2	$	$	$ 13,453.2
Policy loans	823.8	1,011.0			1,011.0
Other investments	230.3	236.8		157.7	79.1
Cash and cash equivalents	772.5	772.5	731.4	41.1	
Investment contracts	(31,089.4)	(30,622.6)		(5,400.8)	(25,221.8)
Short-term debt	(51.4)	(51.4)		(51.4)	
Long-term debt	(3,125.7)	(3,242.0)		(3,242.0)	
Separate account liabilities	(127,452.1)	(126,282.0)			(126,282.0)
Bank deposits	(2,199.8)	(2,204.1)	(1,585.1)	(619.0)	
Cash collateral payable	(575.7)	(575.7)	(575.7)		

Mortgage Loans

Fair values of commercial and residential mortgage loans are primarily determined by discounting the expected cash flows at current treasury rates plus an applicable risk spread, which reflects credit quality and maturity of the loans. The risk spread is based on market clearing levels for loans with comparable credit quality, maturities and risk. The fair value of mortgage loans may also be based on the fair value of the underlying real estate collateral less cost to sell, which is estimated using appraised values. These are reflected in Level 3.

Policy Loans

Fair values of policy loans are estimated by discounting expected cash flows using a risk-free rate based on the Treasury curve. The expected cash flows reflect an estimate of timing of the repayment of the loans. These are reflected in Level 3.

Other Investments

The fair value of commercial loans and certain consumer loans included in other investments is calculated by discounting expected cash flows through the estimated maturity date using market interest rates that reflect the credit and interest rate risk inherent in the loans. The estimate of term to maturity is based on historical experience, adjusted as required, for current economic and lending conditions. The effect of non-performing loans is considered in assessing the credit risk inherent in the fair value estimate. These are reflected in Level 3. The fair value of certain tax credit investments are estimated by discounting

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expected future tax benefits using estimated investment return rates. These are reflected in Level 3. The carrying value of the remaining investments reported in this line item approximate their fair value. These are reflected in Level 2.

Cash and Cash Equivalents

Certain cash equivalents not reported at fair value include short-term investments with maturities of three months or less for which public quotations are not available to use in determining fair value. Because of the highly liquid nature of these assets, carrying amounts are used to approximate fair value, which are reflected in Level 2. The carrying amount of the remaining cash approximates its fair value, which is reflected in Level 1 given the nature of cash.

Investment Contracts

The fair values of our reserves and liabilities for investment contracts are determined via a third party pricing vendor or using discounted cash flow analyses when we are unable to find a price from third party pricing vendors. Third party pricing on various outstanding medium-term notes and funding agreements is based on observable inputs such as benchmark yields and spreads based on reported trades for our medium-term notes and funding agreement issuances. These are reflected in Level 2. The discounted cash flow analyses for the remaining contracts is based on current interest rates, including non-performance risk, being offered for similar contracts with maturities consistent with those remaining for the investment contracts being valued. These are reflected in Level 3. Investment contracts include insurance, annuity and other policy contracts that do not involve significant mortality or morbidity risk and are only a portion of the policyholder liabilities appearing in the consolidated statements of financial position. Insurance contracts include insurance, annuity and other policy contracts that do involve significant mortality or morbidity risk. The fair values for our insurance contracts, other than investment contracts, are not required to be disclosed.

Short-Term Debt

The carrying amount of short-term debt approximates its fair value because of the relatively short time between origination of the debt instrument and its maturity, which is reflected in Level 2.

Long-Term Debt

Long-term debt includes senior note issuances for which the fair values are determined using inputs that are observable in the market or that can be derived from or corroborated with observable market data. These are reflected in Level 2.

Separate Account Liabilities

Fair values of separate account liabilities, excluding insurance-related elements, are estimated based on market assumptions around what a potential acquirer would pay for the associated block of business, including both the separate account assets and liabilities. As the applicable separate account assets are already reflected at fair value, any adjustment to the fair value of the block is an assumed adjustment to the separate account liabilities. To compute fair value, the separate account liabilities are originally set to equal separate account assets because these are pass-through contracts. The separate account liabilities are reduced by the amount of future fees expected to be collected that are intended to offset upfront acquisition costs already incurred that a potential acquirer would not have to pay. The estimated future fees are adjusted by an adverse deviation discount and the amount is then discounted at a risk-free rate as measured by the yield on Treasury securities at maturities aligned with the estimated timing of fee collection. These are reflected in Level 3.

Bank Deposits

The fair value of deposits of our Principal Bank subsidiary with no stated maturity is equal to the amount payable on demand (i.e., their carrying amounts). These are reflected in Level 1. The fair value of certificates of deposit is based on the discounted value of contractual cash flows. The discount is estimated using the rates currently offered for deposits of similar remaining maturities. These are reflected in Level 2.

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Cash Collateral Payable

The carrying amount of the payable associated with our obligation to return the cash collateral received under derivative credit support annex (collateral) agreements approximates its fair value, which is reflected in Level 1.

11. Segment Information

We provide financial products and services through the following segments: Retirement and Income Solutions, Principal Global Investors, Principal International and U.S. Insurance Solutions. In addition, we have a Corporate segment. The segments are managed and reported separately because they provide different products and services, have different strategies or have different markets and distribution channels.

The Retirement and Income Solutions segment provides retirement and related financial products and services primarily to businesses, their employees and other individuals.

The Principal Global Investors segment provides asset management services to our asset accumulation business, our insurance operations, the Corporate segment and third party clients. This segment also includes our mutual fund business.

The Principal International segment has operations in Latin America (Brazil, Chile and Mexico) and Asia (China, Hong Kong Special Administrative Region, India and Southeast Asia). We focus on locations with large middle classes, favorable demographics and growing long-term savings, ideally with voluntary or mandatory pension markets. We entered these locations through acquisitions, start-up operations and joint ventures.

The U.S. Insurance Solutions segment provides specialty benefits insurance, which consists of group dental and vision insurance, individual and group disability insurance, group life insurance and non-medical fee-for-service claims administration, and individual life insurance, which provides solutions for the business market as well as our retail customers throughout the United States.

Our Corporate segment manages the assets representing capital that has not been allocated to any other segment. Financial results of the Corporate segment primarily reflect our financing activities (including financing costs), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other adjustments not allocated to the segments based on the nature of such items. Results of Principal Securities, Inc., our retail broker-dealer and registered investment advisor, and our exited group medical and long-term care insurance businesses are reported in this segment.

Management uses segment pre-tax operating earnings in evaluating performance, which is consistent with the financial results provided to and discussed with securities analysts. We determine segment pre-tax operating earnings by adjusting U.S. GAAP income before income taxes for pre-tax net realized capital gains (losses), as adjusted, pre-tax other adjustments that management believes are not indicative of overall operating trends and certain adjustments related to equity method investments and noncontrolling interest. Pre-tax net realized capital gains (losses), as adjusted, are net of related changes in the amortization pattern of DAC and related actuarial balances, recognition of deferred front-end fee revenues for sales charges on retirement and life insurance products and services, amortization of hedge accounting book value adjustments for certain discontinued hedges, net realized capital gains and losses distributed, certain adjustments related to equity method investments, certain adjustments related to sponsored investment funds and certain market value adjustments to fee revenues. Pre-tax net realized capital gains (losses), as adjusted, exclude periodic settlements and accruals on derivative instruments not designated as hedging instruments and exclude certain market value adjustments of embedded derivatives and realized capital gains (losses) associated with our exited group medical insurance business. Segment operating revenues exclude net realized capital gains (losses) (except periodic settlements and accruals on derivatives not designated as hedging instruments), including their impact on recognition of front-end fee revenues, certain market value adjustments to fee revenues, certain adjustments related to equity method investments, certain adjustments related to sponsored investment funds and amortization of hedge accounting book value adjustments for certain discontinued hedges; certain adjustments related to equity method investments, pre-tax other adjustments management believes are not indicative of overall operating trends and revenue from our exited group medical insurance business. While these items may be significant components in understanding and assessing the consolidated financial performance, management believes the presentation of segment pre-tax operating earnings enhances the understanding of our results of operations by highlighting pre-tax earnings attributable to the normal, ongoing operations of the business.

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The accounting policies of the segments are consistent with the accounting policies for the consolidated financial statements, with the exception of: (1) pension and other postretirement employee benefit (OPEB) cost allocations and (2) income tax allocations. For purposes of determining operating earnings, the segments are allocated the service component of pension and other postretirement benefit costs. The Corporate segment reflects the non-service components of pension and other postretirement benefit costs as assumptions are established and funding decisions are managed from a company-wide perspective. The Corporate segment functions to absorb the risk inherent in interpreting and applying tax law. For purposes of determining operating earnings, the segments are allocated tax adjustments consistent with the positions we took on tax returns. The Corporate segment results reflect any differences between the tax returns and the estimated resolution of any disputes.

The following tables summarize select financial information by segment, including operating revenues for our products and services, and reconcile segment totals to those reported in the consolidated financial statements:

	March 31, 2017	December 31, 2016
	(in millions)	
Assets:		
Retirement and Income Solutions	**$ 158,505.5**	$ 152,721.7
Principal Global Investors	**1,866.8**	1,952.1
Principal International	**47,440.1**	45,118.3
U.S. Insurance Solutions	**23,553.3**	23,144.2
Corporate	**4,130.3**	5,078.0
Total consolidated assets	**$ 235,496.0**	$ 228,014.3

	For the three months ended March 31,	
	2017	2016
	(in millions)	
Operating revenues by segment:		
Retirement and Income Solutions:		
Retirement and Income Solutions Fee	**$ 450.4**	$ 413.3
Retirement and Income Solutions Spread	**1,032.2**	1,050.7
Total Retirement and Income Solutions (1)	**1,482.6**	1,464.0
Principal Global Investors (2)	**345.9**	309.5
Principal International	**321.3**	286.6
U.S. Insurance Solutions:		
Specialty benefits insurance	**528.5**	482.9
Individual life insurance	**427.9**	408.0
Total U.S. Insurance Solutions	**956.4**	890.9
Corporate	**(1.5)**	(13.1)
Total segment operating revenues	**3,104.7**	2,937.9
Net realized capital gains (losses), net of related revenue adjustments	**(32.6)**	113.6
Adjustments related to equity method investments	**(22.7)**	(14.9)
Total revenues per consolidated statements of operations	**$ 3,049.4**	$ 3,036.6

Pre-tax operating earnings (losses) by segment:				
Retirement and Income Solutions	**$**	**244.2**	$	181.4
Principal Global Investors		**100.0**		79.7
Principal International		**100.9**		68.0
U.S. Insurance Solutions		**86.2**		80.5
Corporate		**(58.5)**		(53.3)
Total segment pre-tax operating earnings		**472.8**		356.3
Pre-tax net realized capital gains (losses), as adjusted (3)		**(38.8)**		96.8
Adjustments related to equity method investments and noncontrolling interest		**(20.0)**		(13.3)
Income before income taxes per consolidated statements of operations	**$**	**414.0**	$	439.8

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(1) Reflects inter-segment revenues of $95.1 million and $89.2 million for the three months ended March 31, 2017 and 2016, respectively.

(2) Reflects inter-segment revenues of $59.9 million and $54.3 million for the three months ended March 31, 2017 and 2016, respectively.

(3) Pre-tax net realized capital gains (losses), as adjusted, is derived as follows:

	For the three months ended March 31,			
	2017		**2016**	
	(in millions)			
Net realized capital gains (losses):				
Net realized capital gains (losses)	**$**	**(16.6)**	$	136.6
Derivative and hedging-related adjustments		**(17.6)**		(24.3)
Market value adjustments to fee revenues				(0.7)
Adjustments related to equity method investments		**0.6**		0.3
Adjustments related to sponsored investment funds		**1.2**		1.4
Recognition of front-end fee revenue		**(0.2)**		0.3
Net realized capital gains (losses), net of related revenue adjustments		**(32.6)**		113.6
Amortization of deferred acquisition costs and other actuarial balances		**9.1**		(46.3)
Capital (gains) losses distributed		**(17.1)**		27.1
Market value adjustments of embedded derivatives		**1.8**		2.4
Pre-tax net realized capital gains (losses), as adjusted (a)	**$**	**(38.8)**	$	96.8

(a) As adjusted before noncontrolling interest capital gains (losses).

12. Stock-Based Compensation Plans

As of March 31, 2017, we had the 2014 Stock Incentive Plan, the Employee Stock Purchase Plan, the 2014 Directors Stock Plan, the Long-Term Performance Plan, the Amended and Restated 2010 Stock Incentive Plan, the 2005 Directors Stock Plan, the Stock Incentive Plan and the Directors Stock Plan (Stock-Based Compensation Plans). As of May 20, 2014, no new grants will be made under the Amended and Restated 2010 Stock Incentive Plan or the 2005 Directors Stock Plan. No grants have been made under the Stock Incentive Plan, the Directors Stock Plan or the Long-Term Performance Plan since at least 2005. Under the terms of the 2014 Stock Incentive Plan, grants may be nonqualified stock options, incentive stock options qualifying under Section 422 of the Internal Revenue Code, restricted stock, restricted stock units, stock appreciation rights, performance shares, performance units or other stock-based awards. The 2014 Directors Stock Plan provides for the grant of

nonqualified stock options, restricted stock, restricted stock units or other stock-based awards to our nonemployee directors. To date, we have not granted any incentive stock options, restricted stock or performance units under any plans.

As of March 31, 2017, the maximum number of new shares of common stock available for grant under the 2014 Stock Incentive Plan and the 2014 Directors Stock Plan was 9.1 million.

For awards with graded vesting, we use an accelerated expense attribution method. The compensation cost that was charged against income for stock-based awards granted under the Stock-Based Compensation Plans was as follows:

	For the three months ended March 31,			
	2017		**2016**	
	(in millions)			
Compensation cost	**$**	**22.0**	$	17.9
Related income tax benefit		**7.5**		5.5
Capitalized as part of an asset		**0.6**		0.6

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Nonqualified Stock Options

Nonqualified stock options were granted to certain employees under the 2014 Stock Incentive Plan. Total options granted were 0.7 million for the three months ended March 31, 2017. The fair value of stock options is estimated using the Black-Scholes option pricing model. The following is a summary of the assumptions used in this model for the stock options granted during the period:

	For the three months ended March 31, 2017
Expected volatility	**27.6%**
Expected term (in years)	**7.0**
Risk-free interest rate	**2.2%**
Expected dividend yield	**2.87%**
Weighted average estimated fair value per common share	**$ 15.31**

As of March 31, 2017, we had $11.4 million of total unrecognized compensation cost related to nonvested stock options. The cost is expected to be recognized over a weighted-average service period of approximately 1.5 years.

Performance Share Awards

Performance share awards were granted to certain employees under the 2014 Stock Incentive Plan. Total performance share awards granted were 0.2 million for the three months ended March 31, 2017. The performance share awards granted represent initial target awards and do not reflect potential increases or decreases resulting from the final performance results to be determined at the end of the performance period. The actual number of common shares to be awarded at the end of each performance period will range between 0% and 150% of the initial target awards. The fair value of performance share awards is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these performance share awards granted was $62.78 per common share.

As of March 31, 2017, we had $13.0 million of total unrecognized compensation cost related to nonvested performance share awards granted. The cost is expected to be recognized over a weighted-average service period of approximately 1.4 years.

Restricted Stock Units

Restricted stock units were issued to certain employees and agents pursuant to the 2014 Stock Incentive Plan and non-employee directors pursuant to the 2014 Directors Stock Plan. Total restricted stock units granted were 0.8 million for the three months ended March 31, 2017. The fair value of restricted stock units is determined based on the closing stock price of our common shares on the grant date. The weighted-average grant date fair value of these restricted stock units granted was $62.78 per common share.

As of March 31, 2017, we had $79.5 million of total unrecognized compensation cost related to nonvested restricted stock unit awards granted. The cost is expected to be recognized over a weighted-average period of approximately 2.1 years.

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Principal Financial Group, Inc.

Notes to Consolidated Financial Statements (continued)

March 31, 2017

(Unaudited)

13. Earnings Per Common Share

The computations of the basic and diluted per share amounts were as follows:

	For the three months ended March 31,			
	2017		2016	
	(in millions, except per share data)			
Net income	**$**	**353.6**	$	369.2
Subtract:				
Net income attributable to noncontrolling interest		**4.7**		1.2
Total	**$**	**348.9**	$	368.0
Weighted-average shares outstanding:				
Basic		**288.3**		291.5
Dilutive effects:				
Stock options		**1.9**		1.0
Restricted stock units		**2.0**		1.6
Performance share awards		**0.2**		0.2
Diluted		**292.4**		294.3
Net income per common share:				
Basic	**$**	**1.21**	$	1.26
Diluted	**$**	**1.19**	$	1.25

The calculation of diluted earnings per share for the three months ended March 31, 2017 and 2016, excludes the incremental effect related to certain outstanding stock-based compensation grants due to their anti-dilutive effect.

14. Condensed Consolidating Financial Information

Principal Life has established special purpose entities to issue secured medium-term notes. Under the program, the payment obligations of principal and interest on the notes are secured by funding agreements issued by Principal Life. Principal Life s payment obligations on the funding agreements are fully and unconditionally guaranteed by PFG. All of the outstanding stock of Principal Life is indirectly owned by PFG and PFG is the only guarantor of the payment obligations of the funding agreements.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) Principal Life, (iii) Principal Financial Services, Inc. (PFS) and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of March 31, 2017 and December 31, 2016, and for the three months ended March 31, 2017 and 2016.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG s interest in all direct subsidiaries of PFG, (ii) Principal Life s interest in all direct subsidiaries of Principal Life and (iii) PFS s interest in Principal Life even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent s investment and earnings. All intercompany balances and transactions, including elimination of the parent s investment in subsidiaries, between PFG, Principal Life and PFS and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Financial Position

March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$	$ 50,606.8	$ 6,748.6	$ (366.3)	$ 56,989.1
Fixed maturities, trading		101.0	177.0		278.0
Equity securities, available-for-sale		89.5	24.5		114.0
Equity securities, trading		5.2	1,501.1		1,506.3
Mortgage loans		12,604.9	1,338.6	(555.4)	13,388.1
Real estate		4.4	1,428.9		1,433.3
Policy loans		779.4	40.2		819.6
Investment in unconsolidated entities	12,951.8	2,003.4	6,544.7	(20,674.1)	825.8
Other investments	9.8	4,348.6	1,897.1	(3,797.7)	2,457.8
Cash and cash equivalents	962.6	330.5	1,783.7	(1,542.1)	1,534.7
Accrued investment income		548.2	79.0	(2.0)	625.2
Premiums due and other receivables		1,619.6	3,014.8	(3,187.4)	1,447.0
Deferred acquisition costs		3,222.3	208.5		3,430.8
Property and equipment		631.5	87.3		718.8
Goodwill		54.3	978.6		1,032.9
Other intangibles		23.1	1,299.5		1,322.6
Separate account assets		108,065.0	38,309.7		146,374.7
Other assets	519.4	971.1	3,667.5	(3,960.7)	1,197.3
Total assets	$ 14,443.6	$ 186,008.8	$ 69,129.3	$ (34,085.7)	$ 235,496.0
Liabilities					
Contractholder funds	$	$ 35,597.1	$ 2,813.8	$ (336.8)	$ 38,074.1
Future policy benefits and claims		24,931.0	5,546.6	(787.1)	29,690.5
Other policyholder funds		806.3	118.4	(2.0)	922.7
Short-term debt			59.5		59.5
Long-term debt	3,126.8		530.6	(531.2)	3,126.2
Income taxes currently payable			94.2	(79.2)	15.0
Deferred income taxes		455.9	1,256.7	(664.5)	1,048.1
Separate account liabilities		108,065.0	38,309.7		146,374.7
Other liabilities	700.7	7,750.4	7,374.6	(10,420.5)	5,405.2
Total liabilities	3,827.5	177,605.7	56,104.1	(12,821.3)	224,716.0
Redeemable noncontrolling interest			95.1		95.1
Stockholders equity					
Common stock	4.7	2.5		(2.5)	4.7
Additional paid-in capital	9,780.5	5,297.1	9,008.9	(14,306.0)	9,780.5

Retained earnings	**7,937.4**	**2,241.1**	**3,869.5**	**(6,110.6)**	**7,937.4**
Accumulated other comprehensive income (loss)	**(455.1)**	**862.4**	**(21.9)**	**(840.5)**	**(455.1)**
Treasury stock, at cost	**(6,651.4)**				**(6,651.4)**
Total stockholders equity attributable to PFG	**10,616.1**	**8,403.1**	**12,856.5**	**(21,259.6)**	**10,616.1**
Noncontrolling interest			**73.6**	**(4.8)**	**68.8**
Total stockholders equity	**10,616.1**	**8,403.1**	**12,930.1**	**(21,264.4)**	**10,684.9**
Total liabilities and stockholders equity	**$ 14,443.6**	**$ 186,008.8**	**$ 69,129.3**	**$ (34,085.7)**	**$ 235,496.0**

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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(Unaudited)

Condensed Consolidating Statements of Financial Position

December 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$	$ 48,672.1	$ 6,559.9	$ (385.9)	$ 54,846.1
Fixed maturities, trading		135.6	262.8		398.4
Equity securities, available-for-sale		96.3	2.6		98.9
Equity securities, trading		8.2	1,405.2		1,413.4
Mortgage loans		12,460.7	1,289.4	(519.9)	13,230.2
Real estate		4.4	1,364.4		1,368.8
Policy loans		784.8	39.0		823.8
Investment in unconsolidated entities	12,597.9	2,071.1	6,493.7	(20,389.5)	773.2
Other investments	9.8	4,740.0	1,783.0	(3,650.1)	2,882.7
Cash and cash equivalents	882.6	675.1	2,082.8	(920.9)	2,719.6
Accrued investment income		513.7	74.5	(7.6)	580.6
Premiums due and other receivables		1,538.0	2,836.0	(3,012.1)	1,361.9
Deferred acquisition costs		3,184.2	196.0		3,380.2
Property and equipment		610.4	88.6		699.0
Goodwill		54.3	966.5		1,020.8
Other intangibles		23.5	1,301.8		1,325.3
Separate account assets		103,661.9	36,170.7		139,832.6
Other assets	573.7	969.5	3,507.7	(3,792.1)	1,258.8
Total assets	$ 14,064.0	$ 180,203.8	$ 66,424.6	$ (32,678.1)	$ 228,014.3
Liabilities					
Contractholder funds	$	$ 35,337.7	$ 2,949.2	$ (333.3)	$ 37,953.6
Future policy benefits and claims		24,392.6	5,312.1	(704.0)	29,000.7
Other policyholder funds		780.7	111.0	(1.3)	890.4
Short-term debt			51.4		51.4
Long-term debt	3,126.4		495.1	(495.8)	3,125.7
Income taxes currently payable			124.3	(111.4)	12.9
Deferred income taxes		533.6	1,111.9	(673.1)	972.4
Separate account liabilities		103,661.9	36,170.7		139,832.6
Other liabilities	710.3	7,300.9	7,425.9	(9,653.8)	5,783.3
Total liabilities	3,836.7	172,007.4	53,751.6	(11,972.7)	217,623.0
Redeemable noncontrolling interest			97.5		97.5
Stockholders equity					
Common stock	4.7	2.5		(2.5)	4.7
Additional paid-in capital	9,686.0	5,305.6	9,010.9	(14,316.5)	9,686.0

Retained earnings		7,720.4		2,139.9		3,724.3		(5,864.2)		7,720.4
Accumulated other comprehensive income (loss)		(675.2)		748.4		(230.9)		(517.5)		(675.2)
Treasury stock, at cost		(6,508.6)								(6,508.6)
Total stockholders equity attributable to PFG		10,227.3		8,196.4		12,504.3		(20,700.7)		10,227.3
Noncontrolling interest						71.2		(4.7)		66.5
Total stockholders equity		10,227.3		8,196.4		12,575.5		(20,705.4)		10,293.8
Total liabilities and stockholders equity	$	14,064.0	$	180,203.8	$	66,424.6	$	(32,678.1)	$	228,014.3

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Operations

For the three months ended March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$	$ 1,145.9	$ 102.1	$	$ 1,248.0
Fees and other revenues	7.8	514.7	519.6	(101.5)	940.6
Net investment income	1.8	592.8	517.2	(234.4)	877.4
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		(160.8)	173.7	(0.7)	12.2
Net other-than-temporary impairment losses on available-for-sale securities		(27.1)	(0.2)		(27.3)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income		(1.0)	(0.5)		(1.5)
Net impairment losses on available-for-sale securities		(28.1)	(0.7)		(28.8)
Net realized capital gains (losses)		(188.9)	173.0	(0.7)	(16.6)
Total revenues	9.6	2,064.5	1,311.9	(336.6)	3,049.4
Expenses					
Benefits, claims and settlement expenses		1,477.7	182.3	(2.7)	1,657.3
Dividends to policyholders		34.9			34.9
Operating expenses	50.8	508.8	468.1	(84.5)	943.2
Total expenses	50.8	2,021.4	650.4	(87.2)	2,635.4
Income (loss) before income taxes	(41.2)	43.1	661.5	(249.4)	414.0
Income taxes (benefits)	(16.5)	(38.3)	115.3	(0.1)	60.4
Equity in the net income (loss) of subsidiaries	373.6	172.5	(169.5)	(376.6)	
Net income	348.9	253.9	376.7	(625.9)	353.6
Net income attributable to noncontrolling interest			4.7		4.7
Net income attributable to PFG	$ 348.9	$ 253.9	$ 372.0	$ (625.9)	$ 348.9
Net income	$ 348.9	$ 253.9	$ 376.7	$ (625.9)	$ 353.6
Other comprehensive income	217.7	112.6	245.1	(354.3)	221.1
Comprehensive income	$ 566.6	$ 366.5	$ 621.8	$ (980.2)	$ 574.7

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Operations

For the three months ended March 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$	$ 1,205.2	$ 77.2	$	$ 1,282.4
Fees and other revenues		471.5	478.6	(94.2)	855.9
Net investment income	0.7	552.8	489.0	(280.8)	761.7
Net realized capital gains, excluding impairment losses on available-for-sale securities		93.9	90.8		184.7
Net other-than-temporary impairment losses on available-for-sale securities		(54.7)	(0.9)		(55.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income		7.6	(0.1)		7.5
Net impairment losses on available-for-sale securities		(47.1)	(1.0)		(48.1)
Net realized capital gains		46.8	89.8		136.6
Total revenues	0.7	2,276.3	1,134.6	(375.0)	3,036.6
Expenses					
Benefits, claims and settlement expenses		1,502.5	158.8	(2.8)	1,658.5
Dividends to policyholders		38.8			38.8
Operating expenses	56.8	557.7	365.3	(80.3)	899.5
Total expenses	56.8	2,099.0	524.1	(83.1)	2,596.8
Income (loss) before income taxes	(56.1)	177.3	610.5	(291.9)	439.8
Income taxes (benefits)	(22.8)	18.6	75.0	(0.2)	70.6
Equity in the net income (loss) of subsidiaries	401.3	132.0	(134.7)	(398.6)	
Net income	368.0	290.7	400.8	(690.3)	369.2
Net income attributable to noncontrolling interest			1.2		1.2
Net income attributable to PFG	$ 368.0	$ 290.7	$ 399.6	$ (690.3)	$ 368.0
Net income	$ 368.0	$ 290.7	$ 400.8	$ (690.3)	$ 369.2
Other comprehensive income	532.0	356.6	515.4	(864.8)	539.2
Comprehensive income	$ 900.0	$ 647.3	$ 916.2	$ (1,555.1)	$ 908.4

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Cash Flows

For the three months ended March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined *(in millions)*	Eliminations	Principal Financial Group, Inc. Consolidated
Operating activities					
Net cash provided by (used in) operating activities	$ 37.1	$ 1,498.3	$ (19.1)	$ (993.4)	$ 522.9
Investing activities					
Available-for-sale securities:					
Purchases		(3,933.1)	(373.9)		(4,307.0)
Sales		205.5	146.5	(18.3)	333.7
Maturities		2,189.4	271.4		2,460.8
Mortgage loans acquired or originated		(445.0)	(91.4)	62.6	(473.8)
Mortgage loans sold or repaid		298.5	57.1	(26.3)	329.3
Real estate acquired			(90.8)		(90.8)
Real estate sold			47.1		47.1
Net purchases of property and equipment		(35.9)	(7.9)		(43.8)
Dividends and returns of capital received from unconsolidated entities	249.9	0.4	174.9	(425.2)	
Net change in other investments	(5.0)	(175.9)	(295.1)	389.5	(86.5)
Net cash provided by (used in) investing activities	244.9	(1,896.1)	(162.1)	(17.7)	(1,831.0)
Financing activities					
Issuance of common stock	70.8				70.8
Acquisition of treasury stock	(142.8)				(142.8)
Proceeds from financing element derivatives		0.1			0.1
Payments for financing element derivatives		(20.9)			(20.9)
Dividends to common stockholders	(130.0)				(130.0)
Issuance of long-term debt			61.6	(61.6)	
Principal repayments of long-term debt			(26.3)	26.3	
Net proceeds from short-term borrowings			7.6		7.6
Dividends and capital paid to parent		(174.9)	(250.3)	425.2	
Investment contract deposits		2,536.0	93.1		2,629.1
Investment contract withdrawals		(2,293.5)	(10.4)		(2,303.9)
Net increase in banking operation deposits			6.8		6.8
Other		6.4			6.4
Net cash provided by (used in) financing activities	(202.0)	53.2	(117.9)	389.9	123.2
Net increase (decrease) in cash and cash equivalents	80.0	(344.6)	(299.1)	(621.2)	(1,184.9)
Cash and cash equivalents at beginning of period	882.6	675.1	2,082.8	(920.9)	2,719.6

Cash and cash equivalents at end of period	**$**	**962.6**	**$**	**330.5**	**$**	**1,783.7**	**$**	**(1,542.1)**	**$**	**1,534.7**

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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(Unaudited)

Condensed Consolidating Statements of Cash Flows

For the three months ended March 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Life Insurance Company Only	Principal Financial Services, Inc. and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Operating activities					
Net cash provided by (used in) operating activities	$ (3.4)	$ 998.3	$ 212.4	$ (311.8)	$ 895.5
Investing activities					
Available-for-sale securities:					
Purchases		(3,374.1)	(186.7)	2.2	(3,558.6)
Sales		134.8	70.7		205.5
Maturities		1,486.4	129.6		1,616.0
Mortgage loans acquired or originated		(430.2)	(56.0)	10.3	(475.9)
Mortgage loans sold or repaid		420.4	60.5	(1.6)	479.3
Real estate acquired		(0.1)	(44.4)		(44.5)
Real estate sold		3.5	11.5		15.0
Net purchases of property and equipment		(33.3)	(10.9)		(44.2)
Dividends and returns of capital received from (contributed to) unconsolidated entities	369.8	0.8	319.8	(690.4)	
Net change in other investments	(4.9)	(47.4)	(284.9)	291.3	(45.9)
Net cash provided by (used in) investing activities	364.9	(1,839.2)	9.2	(388.2)	(1,853.3)
Financing activities					
Issuance of common stock	10.0				10.0
Acquisition of treasury stock	(105.6)				(105.6)
Payments for financing element derivatives		(21.3)			(21.3)
Excess tax benefits from share-based payment arrangements	0.1	1.8	3.1		5.0
Purchase of subsidiary shares from noncontrolling interest			(2.3)		(2.3)
Dividends to common stockholders	(110.4)				(110.4)
Issuance of long-term debt			11.8	(8.6)	3.2
Principal repayments of long-term debt			(1.6)	1.6	
Net repayments of short-term borrowings			(59.9)		(59.9)
Dividends and capital paid to parent		(319.8)	(370.6)	690.4	
Investment contract deposits		3,903.7	72.6		3,976.3
Investment contract withdrawals		(3,161.9)	(4.4)		(3,166.3)
Net increase in banking operation deposits			4.0		4.0
Other		3.2			3.2
Net cash provided by (used in) financing activities	(205.9)	405.7	(347.3)	683.4	535.9
	155.6	(435.2)	(125.7)	(16.6)	(421.9)

Net increase (decrease) in cash and cash equivalents					
Cash and cash equivalents at beginning of period	578.7	1,127.9	1,253.7	(395.5)	2,564.8
Cash and cash equivalents at end of period	$ 734.3	$ 692.7	$ 1,128.0	$ (412.1)	$ 2,142.9

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Principal Financial Group, Inc.
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On May 7, 2014, our shelf registration statement was filed with the SEC and became effective, replacing the shelf registration that had been in effect since May 2011. Under our current shelf registration, we have the ability to issue, in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration.

The following tables set forth condensed consolidating financial information of (i) PFG, (ii) PFS, (iii) Principal Life and all other direct and indirect subsidiaries of PFG on a combined basis and (iv) the eliminations necessary to arrive at the information for PFG on a consolidated basis as of March 31, 2017 and December 31, 2016, and for the three months ended March 31, 2017 and 2016.

In presenting the condensed consolidating financial statements, the equity method of accounting has been applied to (i) PFG s interest in all direct subsidiaries of PFG and (ii) PFS s interest in Principal Life and all other subsidiaries, where applicable, even though all such subsidiaries meet the requirements to be consolidated under U.S. GAAP. Earnings of subsidiaries are, therefore, reflected in the parent s investment and earnings. All intercompany balances and transactions, including elimination of the parent s investment in subsidiaries, between PFG, PFS and Principal Life and all other subsidiaries have been eliminated, as shown in the column Eliminations. These condensed consolidating financial statements should be read in conjunction with the consolidated financial statements. The financial information may not necessarily be indicative of results of operations, cash flows or financial position had the subsidiaries operated as independent entities.

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
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(Unaudited)

Condensed Consolidating Statements of Financial Position

March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$	$	$ 56,989.1	$	$ 56,989.1
Fixed maturities, trading			278.0		278.0
Equity securities, available-for-sale			114.0		114.0
Equity securities, trading			1,506.3		1,506.3
Mortgage loans			13,388.1		13,388.1
Real estate			1,433.3		1,433.3
Policy loans			819.6		819.6
Investment in unconsolidated entities	12,951.8	13,007.0	739.5	(25,872.5)	825.8
Other investments	9.8	143.6	2,304.4		2,457.8
Cash and cash equivalents	962.6	1,170.6	1,435.8	(2,034.3)	1,534.7
Accrued investment income			625.2		625.2
Premiums due and other receivables		0.4	1,579.6	(133.0)	1,447.0
Deferred acquisition costs			3,430.8		3,430.8
Property and equipment			718.8		718.8
Goodwill			1,032.9		1,032.9
Other intangibles			1,322.6		1,322.6
Separate account assets			146,374.7		146,374.7
Other assets	519.4	188.1	1,211.5	(721.7)	1,197.3
Total assets	$ 14,443.6	$ 14,509.7	$ 235,304.2	$ (28,761.5)	$ 235,496.0
Liabilities					
Contractholder funds	$	$	$ 38,074.1	$	$ 38,074.1
Future policy benefits and claims			29,690.5		29,690.5
Other policyholder funds			922.7		922.7
Short-term debt			136.2	(76.7)	59.5
Long-term debt	3,126.8	133.3	(0.6)	(133.3)	3,126.2
Income taxes currently payable			71.7	(56.7)	15.0
Deferred income taxes			1,692.9	(644.8)	1,048.1
Separate account liabilities			146,374.7		146,374.7
Other liabilities	700.7	1,519.9	5,068.1	(1,883.5)	5,405.2
Total liabilities	3,827.5	1,653.2	222,030.3	(2,795.0)	224,716.0
Redeemable noncontrolling interest			95.1		95.1
Stockholders equity					
Common stock	4.7		17.8	(17.8)	4.7

Additional paid-in capital		**9,780.5**		**9,008.9**		**10,040.2**		**(19,049.1)**		**9,780.5**
Retained earnings		**7,937.4**		**3,869.5**		**3,191.0**		**(7,060.5)**		**7,937.4**
Accumulated other comprehensive loss		**(455.1)**		**(21.9)**		**(137.0)**		**158.9**		**(455.1)**
Treasury stock, at cost		**(6,651.4)**				**(2.0)**		**2.0**		**(6,651.4)**
Total stockholders equity attributable to PFG		**10,616.1**		**12,856.5**		**13,110.0**		**(25,966.5)**		**10,616.1**
Noncontrolling interest						**68.8**				**68.8**
Total stockholders equity		**10,616.1**		**12,856.5**		**13,178.8**		**(25,966.5)**		**10,684.9**
Total liabilities and stockholders equity	**$**	**14,443.6**	**$**	**14,509.7**	**$**	**235,304.2**	**$**	**(28,761.5)**	**$**	**235,496.0**

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Financial Position

December 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Assets					
Fixed maturities, available-for-sale	$	$	$ 54,846.1	$	$ 54,846.1
Fixed maturities, trading			398.4		398.4
Equity securities, available-for-sale			98.9		98.9
Equity securities, trading			1,413.4		1,413.4
Mortgage loans			13,230.2		13,230.2
Real estate			1,368.8		1,368.8
Policy loans			823.8		823.8
Investment in unconsolidated entities	12,597.9	12,532.4	697.5	(25,054.6)	773.2
Other investments	9.8	135.9	2,737.0		2,882.7
Cash and cash equivalents	882.6	1,203.4	2,114.8	(1,481.2)	2,719.6
Accrued investment income		0.1	580.5		580.6
Premiums due and other receivables		0.3	1,503.1	(141.5)	1,361.9
Deferred acquisition costs			3,380.2		3,380.2
Property and equipment			699.0		699.0
Goodwill			1,020.8		1,020.8
Other intangibles			1,325.3		1,325.3
Separate account assets			139,832.6		139,832.6
Other assets	573.7	185.6	1,200.9	(701.4)	1,258.8
Total assets	$ 14,064.0	$ 14,057.7	$ 227,271.3	$ (27,378.7)	$ 228,014.3
Liabilities					
Contractholder funds	$	$	$ 37,953.6	$	$ 37,953.6
Future policy benefits and claims			29,000.7		29,000.7
Other policyholder funds			890.4		890.4
Short-term debt			127.9	(76.5)	51.4
Long-term debt	3,126.4	142.1	(0.8)	(142.0)	3,125.7
Income taxes currently payable			68.3	(55.4)	12.9
Deferred income taxes			1,619.3	(646.9)	972.4
Separate account liabilities			139,832.6		139,832.6
Other liabilities	710.3	1,411.3	4,962.1	(1,300.4)	5,783.3
Total liabilities	3,836.7	1,553.4	214,454.1	(2,221.2)	217,623.0
Redeemable noncontrolling interest			97.5		97.5
Stockholders equity					
Common stock	4.7		17.8	(17.8)	4.7

Additional paid-in capital	9,686.0	9,010.9	10,045.9	(19,056.8)	9,686.0
Retained earnings	7,720.4	3,724.3	2,940.2	(6,664.5)	7,720.4
Accumulated other comprehensive loss	(675.2)	(230.9)	(348.7)	579.6	(675.2)
Treasury stock, at cost	(6,508.6)		(2.0)	2.0	(6,508.6)
Total stockholders equity attributable to PFG	10,227.3	12,504.3	12,653.2	(25,157.5)	10,227.3
Noncontrolling interest			66.5		66.5
Total stockholders equity	10,227.3	12,504.3	12,719.7	(25,157.5)	10,293.8
Total liabilities and stockholders equity	$ 14,064.0	$ 14,057.7	$ 227,271.3	$ (27,378.7)	$ 228,014.3

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Operations

For the three months ended March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$	$	$ 1,248.0	$	$ 1,248.0
Fees and other revenues	7.8	0.1	934.0	(1.3)	940.6
Net investment income (loss)	1.8	(0.4)	874.1	1.9	877.4
Net realized capital gains, excluding impairment losses on available-for-sale securities		2.3	9.9		12.2
Net other-than-temporary impairment losses on available-for-sale securities			(27.3)		(27.3)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified from other comprehensive income			(1.5)		(1.5)
Net impairment losses on available-for-sale securities			(28.8)		(28.8)
Net realized capital gains (losses)		2.3	(18.9)		(16.6)
Total revenues	9.6	2.0	3,037.2	0.6	3,049.4
Expenses					
Benefits, claims and settlement expenses			1,657.3		1,657.3
Dividends to policyholders			34.9		34.9
Operating expenses	50.8	22.9	870.5	(1.0)	943.2
Total expenses	50.8	22.9	2,562.7	(1.0)	2,635.4
Income (loss) before income taxes	(41.2)	(20.9)	474.5	1.6	414.0
Income taxes (benefits)	(16.5)	(9.3)	86.2		60.4
Equity in the net income of subsidiaries	373.6	383.6		(757.2)	
Net income	348.9	372.0	388.3	(755.6)	353.6
Net income attributable to noncontrolling interest			4.7		4.7
Net income attributable to PFG	$ 348.9	$ 372.0	$ 383.6	$ (755.6)	$ 348.9
Net income	$ 348.9	$ 372.0	$ 388.3	$ (755.6)	$ 353.6
Other comprehensive income	217.7	206.5	212.7	(415.8)	221.1
Comprehensive income	$ 566.6	$ 578.5	$ 601.0	$ (1,171.4)	$ 574.7

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Operations

For the three months ended March 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Revenues					
Premiums and other considerations	$	$	$ 1,282.4	$	$ 1,282.4
Fees and other revenues		0.1	859.1	(3.3)	855.9
Net investment income	0.7	6.6	752.8	1.6	761.7
Net realized capital gains (losses), excluding impairment losses on available-for-sale securities		(6.0)	190.5	0.2	184.7
Net other-than-temporary impairment losses on available-for-sale securities			(55.6)		(55.6)
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to other comprehensive income			7.5		7.5
Net impairment losses on available-for-sale securities			(48.1)		(48.1)
Net realized capital gains (losses)		(6.0)	142.4	0.2	136.6
Total revenues	0.7	0.7	3,036.7	(1.5)	3,036.6
Expenses					
Benefits, claims and settlement expenses			1,658.5		1,658.5
Dividends to policyholders			38.8		38.8
Operating expenses	56.8	3.8	842.1	(3.2)	899.5
Total expenses	56.8	3.8	2,539.4	(3.2)	2,596.8
Income (loss) before income taxes	(56.1)	(3.1)	497.3	1.7	439.8
Income taxes (benefits)	(22.8)	(20.4)	113.8		70.6
Equity in the net income of subsidiaries	401.3	382.3		(783.6)	
Net income	368.0	399.6	383.5	(781.9)	369.2
Net income attributable to noncontrolling interest			1.2		1.2
Net income attributable to PFG	$ 368.0	$ 399.6	$ 382.3	$ (781.9)	$ 368.0
Net income	$ 368.0	$ 399.6	$ 383.5	$ (781.9)	$ 369.2
Other comprehensive income	532.0	519.8	537.1	(1,049.7)	539.2
Comprehensive income	$ 900.0	$ 919.4	$ 920.6	$ (1,831.6)	$ 908.4

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Cash Flows

For the three months ended March 31, 2017

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Operating activities					
Net cash provided by operating activities	$ 37.1	$ 141.5	$ 942.5	$ (598.2)	$ 522.9
Investing activities					
Available-for-sale securities:					
Purchases			(4,307.0)		(4,307.0)
Sales			333.7		333.7
Maturities			2,460.8		2,460.8
Mortgage loans acquired or originated			(473.8)		(473.8)
Mortgage loans sold or repaid			329.3		329.3
Real estate acquired			(90.8)		(90.8)
Real estate sold			47.1		47.1
Net purchases of property and equipment			(43.8)		(43.8)
Dividends and returns of capital received from unconsolidated entities	249.9	76.6		(326.5)	
Net change in other investments	(5.0)	7.8	(125.8)	36.5	(86.5)
Net cash provided by (used in) investing activities	244.9	84.4	(1,870.3)	(290.0)	(1,831.0)
Financing activities					
Issuance of common stock	70.8				70.8
Acquisition of treasury stock	(142.8)				(142.8)
Proceeds from financing element derivatives			0.1		0.1
Payments for financing element derivatives			(20.9)		(20.9)
Dividends to common stockholders	(130.0)				(130.0)
Issuance of long-term debt		1.0		(1.0)	
Principal repayments of long-term debt		(9.8)		9.8	
Net proceeds from short-term borrowings			7.8	(0.2)	7.6
Dividends and capital paid to parent		(249.9)	(76.6)	326.5	
Investment contract deposits			2,629.1		2,629.1
Investment contract withdrawals			(2,303.9)		(2,303.9)
Net increase in banking operation deposits			6.8		6.8
Other			6.4		6.4
Net cash provided by (used in) financing activities	(202.0)	(258.7)	248.8	335.1	123.2
Net increase (decrease) in cash and cash equivalents	80.0	(32.8)	(679.0)	(553.1)	(1,184.9)
	882.6	1,203.4	2,114.8	(1,481.2)	2,719.6

Cash and cash equivalents at beginning of period										
Cash and cash equivalents at end of period	**$**	**962.6**	**$**	**1,170.6**	**$**	**1,435.8**	**$**	**(2,034.3)**	**$**	**1,534.7**

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Principal Financial Group, Inc.
Notes to Consolidated Financial Statements (continued)
March 31, 2017
(Unaudited)

Condensed Consolidating Statements of Cash Flows

For the three months ended March 31, 2016

	Principal Financial Group, Inc. Parent Only	Principal Financial Services, Inc. Only	Principal Life Insurance Company and Other Subsidiaries Combined	Eliminations	Principal Financial Group, Inc. Consolidated
			(in millions)		
Operating activities					
Net cash provided by (used in) operating activities	$ (3.4)	$ 67.2	$ 866.8	$ (35.1)	$ 895.5
Investing activities					
Available-for-sale securities:					
Purchases			(3,558.6)		(3,558.6)
Sales			205.5		205.5
Maturities			1,616.0		1,616.0
Mortgage loans acquired or originated			(475.9)		(475.9)
Mortgage loans sold or repaid			479.3		479.3
Real estate acquired			(44.5)		(44.5)
Real estate sold			15.0		15.0
Net purchases of property and equipment			(44.2)		(44.2)
Dividends and returns of capital received from unconsolidated entities	369.8	220.4		(590.2)	
Net change in other investments	(4.9)	23.7	(94.1)	29.4	(45.9)
Net cash provided by (used in) investing activities	364.9	244.1	(1,901.5)	(560.8)	(1,853.3)
Financing activities					
Issuance of common stock	10.0				10.0
Acquisition of treasury stock	(105.6)				(105.6)
Payments for financing element derivatives			(21.3)		(21.3)
Excess tax benefits from share-based payment arrangements	0.1		4.9		5.0
Purchase of subsidiary shares from noncontrolling interest			(2.3)		(2.3)
Dividends to common stockholders	(110.4)				(110.4)
Issuance of long-term debt		3.0	3.2	(3.0)	3.2
Principal repayments of long-term debt		(10.0)		10.0	
Net repayments of short-term borrowings			(49.3)	(10.6)	(59.9)
Dividends and capital paid to parent		(369.8)	(220.4)	590.2	
Investment contract deposits			3,976.3		3,976.3
Investment contract withdrawals			(3,166.3)		(3,166.3)
Net increase in banking operation deposits			4.0		4.0
Other			3.2		3.2
Net cash provided by (used in) financing activities	(205.9)	(376.8)	532.0	586.6	535.9
	155.6	(65.5)	(502.7)	(9.3)	(421.9)

Net increase (decrease) in cash and cash equivalents										
Cash and cash equivalents at beginning of period		578.7		730.5		2,413.3		(1,157.7)		2,564.8
Cash and cash equivalents at end of period	$	734.3	$	665.0	$	1,910.6	$	(1,167.0)	$	2,142.9

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following analysis discusses our financial condition as of March 31, 2017, compared with December 31, 2016, and our consolidated results of operations for the three months ended March 31, 2017 and 2016, prepared in conformity with U.S. GAAP. The discussion and analysis includes, where appropriate, factors that may affect our future financial performance. The discussion should be read in conjunction with our Form 10-K, for the year ended December 31, 2016, filed with the SEC and the unaudited consolidated financial statements and the related notes to the financial statements and the other financial information included elsewhere in this Form 10-Q.

Forward-Looking Information

Our narrative analysis below contains forward-looking statements intended to enhance the reader s ability to assess our future financial performance. Forward-looking statements include, but are not limited to, statements that represent our beliefs concerning future operations, strategies, financial results or other developments, and contain words and phrases such as anticipate, believe, plan, estimate, expect, intend similar expressions. Forward-looking statements are made based upon management s current expectations and beliefs concerning future developments and their potential effects on us. Such forward-looking statements are not guarantees of future performance.

Actual results may differ materially from those included in the forward-looking statements as a result of risks and uncertainties including, but not limited to, the following: (1) adverse capital and credit market conditions may significantly affect our ability to meet liquidity needs, as well as our access to capital and cost of capital; (2) conditions in the global capital markets and the economy generally may materially and adversely affect our business and results of operations; (3) volatility or declines in the equity, bond or real estate markets could reduce our assets under management (AUM) and may result in investors withdrawing from the markets or decreasing their rates of investment, all of which could reduce our revenues and net income; (4) changes in interest rates or credit spreads or a sustained low interest rate environment may adversely affect our results of operations, financial condition and liquidity, and our net income can vary from period to period; (5) our investment portfolio is subject to several risks that may diminish the value of our invested assets and the investment returns credited to customers, which could reduce our sales, revenues, AUM and net income; (6) our valuation of investments and the determinations of the amount of allowances and impairments taken on our investments may include methodologies, estimations and assumptions which are subject to differing interpretations and, if changed, could materially adversely affect our results of operations or financial condition; (7) any impairments of or valuation allowances against our deferred tax assets could adversely affect our results of operations and financial condition; (8) we may face losses if our actual experience differs significantly from our pricing and reserving assumptions; (9) the pattern of amortizing our DAC asset and other actuarial balances on our universal life-type insurance contracts, participating life insurance policies and certain investment contracts may change, impacting both the level of our DAC asset and other actuarial balances and the timing of our net income; (10) we may not be able to protect our intellectual property and may be subject to infringement claims; (11) our ability to pay stockholder dividends and meet our obligations may be constrained by the limitations on dividends Iowa insurance laws impose on Principal Life; (12) changes in laws or regulations may reduce our profitability; (13) changes in accounting standards may reduce the transparency of our reported profitability and financial condition; (14) results of litigation and regulatory investigations may affect our financial strength or reduce our profitability; (15) from time to time we may become subject to tax audits, tax litigation or similar proceedings, and as a result we may owe additional taxes, interest and penalties in amounts that may be material; (16) applicable laws and our certificate of incorporation and by-laws may discourage takeovers and business combinations that some stockholders might consider in their best interests; (17) competition from companies that may have greater financial resources, broader arrays of products, higher ratings and stronger financial performance may impair our ability to retain existing customers, attract new customers and maintain our profitability; (18) Damage to our reputation may adversely affect our revenues and profitability; (19) a downgrade in our financial strength or credit ratings may increase policy surrenders and withdrawals, reduce new sales and terminate relationships with distributors, impact existing liabilities and increase our cost of capital, any of which could adversely affect our profitability and financial condition; (20)

client terminations or withdrawals or changes in investor preferences may lead to a reduction in revenues for our asset management and accumulation businesses; (21) guarantees within certain of our products that protect policyholders may decrease our earnings or increase the volatility of our results of operations or financial position under U.S. GAAP if our hedging or risk management strategies prove ineffective or insufficient; (22) if we are unable to attract and retain qualified employees and sales representatives and develop new distribution sources, our results of operations, financial condition and sales of our products may be adversely impacted; (23) our international businesses face political, legal, operational and other risks that could reduce our profitability in those businesses; (24) we may need to fund deficiencies in our Closed Block assets; (25) a pandemic, terrorist attack, military action or other catastrophic event could adversely affect our net income; (26) our reinsurers could default on their obligations or increase their rates, which could adversely impact our net income and financial condition; (27) we face risks arising from acquisitions of businesses; (28) a computer system failure or security breach could disrupt our business, damage our reputation and adversely impact our profitability; (29) loss of key vendor relationships or failure of a vendor to protect information of our customers or employees could adversely affect our business or result in losses; (30) our enterprise risk management framework may not be fully

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effective in identifying or mitigating all of the risks to which we are exposed and (31) our financial results may be adversely impacted by global climate changes.

Overview

We provide financial products and services through the following reportable segments:

- Retirement and Income Solutions is organized into Retirement and Income Solutions Fee, which includes full service accumulation, trust services and individual variable annuities; and Retirement and Income Solutions Spread, which includes individual fixed annuities, investment only, full service payout and banking services. We offer a comprehensive portfolio of products and services for retirement savings and retirement income:

- To businesses of all sizes with a concentration on small and medium-sized businesses, we offer products and services for defined contribution plans, including 401(k) and 403(b) plans, defined benefit pension plans, nonqualified executive benefit plans, employee stock ownership plan services and pension closeout services. For more basic retirement services, we offer SIMPLE Individual Retirement Accounts (IRA) and payroll deduction plans;

- To large institutional clients, we also offer investment only products, including investment only guaranteed investment contracts (GICs); and

- To employees of businesses and other individuals, we offer the ability to accumulate savings for retirement and other purposes through mutual funds, individual annuities and bank products, along with retirement income options.

- Principal Global Investors, which includes our mutual fund business, manages assets for sophisticated investors around the world, using a multi-boutique strategy that provides diverse investment capabilities including equity, fixed income, real estate and other alternative investments. We also have experience in asset allocation, stable value management and other structured investment strategies. We focus on providing services to our other segments in addition to our retail mutual fund and third party institutional clients.

- Principal International, which offers pension accumulation products and services, mutual funds, asset management, income annuities and life insurance accumulation products through operations in Latin America (Brazil, Chile and Mexico) and Asia (China, Hong Kong Special Administrative Region, India and Southeast Asia).

- U.S. Insurance Solutions provides specialty benefits insurance, which consists of group dental and vision insurance, individual and group disability insurance, group life insurance and non-medical fee-for-service claims administration, and individual life insurance, which provides solutions for the business market as well as our retail customers in the U.S. Our individual life insurance products include universal life, variable universal life, indexed universal life and traditional life insurance.

- Corporate, which manages the assets representing capital that has not been allocated to any other segment.

Financial results of the Corporate segment primarily reflect our financing activities (including financing costs), income on capital not allocated to other segments, inter-segment eliminations, income tax risks and certain income, expenses and other adjustments not allocated to the segments based on the nature of such items. Results of Principal Securities, Inc., our retail broker-dealer and registered investment advisor, and our exited group medical and long-term care insurance businesses are reported in this segment.

Factor Affecting Comparability of Results of Operations

Fluctuations in Foreign Currency to U.S. Dollar Exchange Rates

Fluctuations in foreign currency to U.S. dollar exchange rates for countries in which we have operations can affect reported financial results. In years when foreign currencies weaken against the U.S. dollar, translating foreign currencies into U.S. dollars results in fewer U.S. dollars to be reported. When foreign currencies strengthen, translating foreign currencies into U.S. dollars results in more U.S. dollars to be reported.

Foreign currency exchange rate fluctuations create variances in our financial statement line items. The most significant impact occurs within our Principal International segment where pre-tax operating earnings were positively impacted $6.3 million for the three months ended March 31, 2017, as a result of fluctuations in foreign currency to U.S. dollar exchange rates. This impact was calculated by comparing (a) the difference between current year results and prior year results to (b) the difference between current year results and prior year results translated using current year exchange rates for both periods. We use this approach to calculate the impact of exchange rates on all revenue and expense line items. For a discussion of our approaches to managing foreign currency exchange rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Foreign Currency Risk.

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Regulatory Change

On April 6, 2016, the DOL released its final fiduciary definition regulation package. The regulation broadens the definition of a fiduciary under ERISA to include persons providing investment advice to an employee benefit plan or an IRA for a fee or other compensation. The DOL also released two new prohibited transaction class exemptions and amendments to current prohibited transaction exemptions. Broker-dealers and advisors are in various stages of determining the implications of the regulations on their business models, and how they proceed could impact our business. Even with this fluid environment, our assessment of the regulation s impact to our business and future financial results indicates the costs will not have a significant effect on our financial condition or results of operations.

Recent Accounting Changes

For recent accounting changes, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 1, Nature of Operations and Significant Accounting Policies under the caption, Recent Accounting Pronouncements.

Results of Operations

The following table presents summary consolidated financial information for the periods indicated:

	For the three months ended March 31,		
	2017	**2016**	**Increase (decrease)**
		(in millions)	
Revenues:			
Premiums and other considerations	**$ 1,248.0**	$ 1,282.4	$ (34.4)
Fees and other revenues	**940.6**	855.9	84.7
Net investment income	**877.4**	761.7	115.7
Net realized capital gains, excluding impairment losses on available-for-sale securities	**12.2**	184.7	(172.5)
Net other-than-temporary impairment losses on available-for-sale securities	**(27.3)**	(55.6)	28.3
Other-than-temporary impairment losses on fixed maturities, available-for-sale reclassified to (from) other comprehensive income	**(1.5)**	7.5	(9.0)
Net impairment losses on available-for-sale securities	**(28.8)**	(48.1)	19.3
Net realized capital gains (losses)	**(16.6)**	136.6	(153.2)
Total revenues	**3,049.4**	3,036.6	12.8
Expenses:			
Benefits, claims and settlement expenses	**1,657.3**	1,658.5	(1.2)
Dividends to policyholders	**34.9**	38.8	(3.9)
Operating expenses	**943.2**	899.5	43.7
Total expenses	**2,635.4**	2,596.8	38.6
Income before income taxes	**414.0**	439.8	(25.8)

Income taxes		**60.4**		70.6		(10.2)
Net income		**353.6**		369.2		(15.6)
Net income attributable to noncontrolling interest		**4.7**		1.2		3.5
Net income attributable to Principal Financial Group, Inc.	**$**	**348.9**	$	368.0	$	(19.1)

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Income Before Income Taxes

Income before income taxes decreased largely due to a $153.2 million change in net realized capital gains (losses), which was partially offset by $116.5 million of higher segment pre-tax operating earnings due to growth in the businesses.

Total Revenues

Premiums decreased $69.9 million for the Retirement and Income Solutions segment primarily due to lower sales of single premium group and individual annuities with life contingencies. The single premium group annuity product, which is typically used to fund defined benefit plan terminations, can generate large premiums from very few customers and therefore

premiums tend to vary from period to period. This decrease was partially offset by a $40.1 million increase in premiums for the U.S. Insurance Solutions segment primarily due to growth in the business.

Fees and other revenues increased for the Principal Global Investors segment primarily due to $26.5 million higher management fee revenue as a result of increased AUM and a $5.3 million increase in performance fees primarily realized in our real estate business. Fees and other revenues increased $25.7 million for the Retirement and Income Solutions segment primarily due to higher fees stemming from an increase in monthly account values, which resulted from an increase in the daily average equity markets compared to first quarter of 2016. Fees and other revenues increased $12.1 million for the U.S. Insurance Solutions segment primarily due to growth in the business.

Net investment income increased primarily due to $51.5 million attributable to higher average invested assets in our U.S. operations, a $37.9 million increase in variable investment income and $17.6 million favorable relative market performance on our required regulatory investments in the pension funds of our Latin America business. For additional information, see Investments Investment Results.

Net realized capital gains (losses) can be volatile due to other-than-temporary impairments of invested assets, mark-to-market adjustments of certain invested assets and our decision to sell invested assets. We had net realized capital losses in 2017 as compared to net realized capital gains in 2016 primarily due to change in derivatives not designated as hedging instruments of $212.2 million. This decrease was partially offset by a $44.5 increase from equity securities, trading primarily due to mark-to-market changes. For additional information, see Investments Investment Results.

Total Expenses

Benefits, claims and settlement expenses decreased $56.1 million for the Retirement and Income Solutions segment primarily due to a decrease in reserves resulting from lower sales of single premium group and individual annuities with life contingencies. Benefits, claims and settlement expenses increased $48.0 million for the U.S. Insurance Solutions segment primarily due to growth in the business. Benefits, claims and settlement expenses increased $7.9 million for the Principal International segment primarily in Latin America due to the strengthening of the Chilean peso against the U.S. dollar.

Operating expenses increased for the Corporate segment primarily due to a $29.0 million increase in amounts credited to employee accounts in a nonqualified contribution pension plan, which was offset by a corresponding $29.0 million increase in net realized capital gains related to the assets backing this nonqualified plan and a $20.0 million fee resulting from our election to discontinue an arrangement with one of our financing counterparties in the first quarter of 2017.

Income Taxes

The effective income tax rates were 15% and 16% for the three months ended March 31, 2017 and 2016, respectively. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 6, Income Taxes.

Results of Operations by Segment

For results of operations by segment see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 11, Segment Information.

Retirement and Income Solutions Segment

Retirement and Income Solutions Segment Summary Financial Data

Net revenue is a key metric used to understand Retirement and Income Solutions earnings growth. Net revenue is defined as operating revenues less benefits, claims and settlement expenses less dividends to policyholders. Net revenue from Retirement and Income Solutions Fee is primarily fee based and is impacted by changes in the equity markets. Net revenue from Retirement and Income Solutions Spread is driven by the difference between investment income earned on the underlying general account assets and the interest rate credited to the contracts.

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The following table presents the Retirement and Income Solutions net revenue for the periods indicated:

	For the three months ended March 31,		
	2017	2016	Increase (decrease)
		(in millions)	
Retirement and Income Solutions Fee	**$ 403.5**	$ 363.7	$ 39.8
Retirement and Income Solutions Spread	**143.9**	114.7	29.2
Total Retirement and Income Solutions	**$ 547.4**	$ 478.4	$ 69.0

The following table presents certain summary financial data relating to the Retirement and Income Solutions segment for the periods indicated:

	For the three months ended March 31,		
	2017	2016	Increase (decrease)
		(in millions)	
Operating revenues:			
Premiums and other considerations	**$ 624.7**	$ 694.6	$ (69.9)
Fees and other revenues	**336.0**	311.0	25.0
Net investment income	**521.9**	458.4	63.5
Total operating revenues	**1,482.6**	1,464.0	18.6
Expenses:			
Benefits, claims and settlement expenses, including dividends to policyholders	**935.2**	985.6	(50.4)
Operating expenses	**303.2**	297.0	6.2
Total expenses	**1,238.4**	1,282.6	(44.2)
Pre-tax operating earnings	**$ 244.2**	$ 181.4	$ 62.8

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Pre-Tax Operating Earnings

Pre-tax operating earnings increased in our Spread business primarily due to an $18.1 million increase in variable investment income and an $8.8 million increase due to growth in the business. Pre-tax operating earnings in our Fee business primarily increased due to $24.5 million in higher fees stemming from an increase in monthly account values, which resulted from an increase in the daily average equity markets compared to first quarter of 2016, and a $10.0 million increase in variable investment income. In addition, the segment continues to diligently manage expenses and focus on achieving operational efficiencies where possible.

Net Revenue

Net revenue increased in our Fee business primarily due to $24.5 million in higher fees stemming from an increase in monthly account values, which resulted from an increase in the daily average equity markets compared to first quarter of 2016, and a $10.0 million increase in variable investment income. Net revenue increased in our Spread business primarily due to an $18.1 million increase in variable investment income and an $8.8 million increase due to growth in the business.

Operating Expenses

Operating expenses increased $9.1 million in our Fee business primarily due to an increase in non-deferrable commission expense, which resulted from higher sales. Operating expenses decreased $2.9 million in our Spread business primarily due to a decrease in non-deferrable commission expense, which resulted from lower sales on commission based products. In addition, the segment continues to diligently manage expenses and focus on achieving operational efficiencies where possible.

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Principal Global Investors Segment

Principal Global Investors Segment Summary Financial Data

AUM is a key indicator of earnings growth for the Principal Global Investors segment, as AUM is the base by which we generate revenues. Net cash flow and market performance are the two main drivers of AUM growth. Net cash flow reflects our ability to attract and retain client deposits. Market performance reflects equity, fixed income, real estate and other alternative investment market performance. The percentage growth in revenues of the segment will generally track with the percentage growth in AUM. This trend may vary due to changes in business and/or product mix.

The following table presents the AUM rollforward for assets managed by Principal Global Investors for the periods indicated:

	For the three months ended March 31,	
	2017	**2016**
	(in billions)	
AUM, beginning of period	**$ 390.5**	$ 360.8
Net cash flow		0.7
Investment performance (1)	**12.7**	5.4
Other (2)	**(0.2)**	1.4
AUM, end of period	**$ 403.0**	$ 368.3

(1) Variations in investment performance are primarily the result of fluctuations in market performance over time.

(2) Primarily reflects the transfer of assets between managers and the effect of exchange rates.

The following table presents certain summary financial data relating to the Principal Global Investors segment for the periods indicated:

	For the three months ended March 31,		
	2017	**2016**	**Increase (decrease)**
		(in millions)	
Operating revenues:			
Fees and other revenues	**$ 344.7**	$ 311.1	$ 33.6
Net investment income (loss)	**1.2**	(1.6)	2.8
Total operating revenues	**345.9**	309.5	36.4
Expenses:			
Total expenses	**244.4**	228.6	15.8
Pre-tax operating earnings attributable to noncontrolling interest	**1.5**	1.2	0.3
Pre-tax operating earnings	**$ 100.0**	$ 79.7	$ 20.3

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Pre-Tax Operating Earnings

Pre-tax operating earnings increased primarily due to $26.5 million higher management fee revenue as a result of increased AUM and a $5.3 million increase in performance fees primarily realized in our real estate business. These increases were partially offset by a $15.8 million increase in expenses to support our business.

Principal International Segment

Principal International Segment Summary Financial Data

AUM is generally a key indicator of earnings growth for the segment, as AUM is the base by which we can generate local currency profits. The Cuprum business in Chile differs in that the majority of fees are collected with each deposit by the mandatory retirement customers, based on a capped salary level, as opposed to asset levels. Net customer cash flow and market performance are the two main drivers of local currency AUM growth. Net customer cash flow reflects our ability to attract and retain client deposits. Market performance reflects the investment returns on our underlying AUM. Our financial results are also impacted by fluctuations of the foreign currency to U.S. dollar exchange rates for the countries in which we

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have business. AUM of our foreign subsidiaries is translated into U.S. dollar equivalents at the end of the reporting period using the spot foreign exchange rates. Revenue and expenses for our foreign subsidiaries are translated into U.S. dollar equivalents at the average foreign exchange rates for the reporting period.

The following table presents the Principal International segment AUM rollforward for the periods indicated:

	For the three months ended March 31,	
	2017	2016
	(in billions)	
AUM, beginning of period	**$ 137.1**	$ 109.9
Net cash flow	**1.3**	0.9
Investment performance (1)	**5.8**	2.2
Effect of exchange rates	**3.2**	8.2
Other	**(0.1)**	(0.2)
AUM, end of period	**$ 147.3**	$ 121.0

(1) Variations in investment performance are primarily the result of fluctuations in market performance over time.

Net revenue is a key metric used to understand the earnings growth for the Principal International segment. The following table presents the net revenue of the Principal International segment for the periods indicated.

	For the three months ended March 31,		
	2017	2016	Increase (decrease)
		(in millions)	
Net revenue	**$ 197.0**	$ 158.7	$ 38.3

The following table presents certain summary financial data relating to the Principal International segment for the periods indicated:

	For the three months ended March 31,		
	2017	2016	Increase (decrease)
		(in millions)	
Operating revenues:			
Premiums and other considerations	**$ 52.0**	$ 56.6	$ (4.6)
Fees and other revenues	**102.6**	98.3	4.3
Net investment income	**166.7**	131.7	35.0

Total operating revenues		**321.3**		286.6		34.7
Expenses:						
Benefits, claims and settlement expenses		**124.3**		127.9		(3.6)
Operating expenses		**95.0**		90.4		4.6
Total expenses		**219.3**		218.3		1.0
Pre-tax operating earnings attributable to noncontrolling interest		**1.1**		0.3		0.8
Pre-tax operating earnings	**$**	**100.9**	$	68.0	$	32.9

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Pre-Tax Operating Earnings

Pre-tax operating earnings increased $27.1 million in Latin America primarily due to $17.2 million favorable relative market performance on our required regulatory investments and $14.2 million higher earnings in our equity method investment in Brazil, of which $6.7 million is due to the strengthening of the Brazilian real against the U.S. dollar. Asia increased $7.3 million due to growth in the business.

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Net Revenue

Net revenue increased $32.9 million in Latin America primarily due to $17.6 million favorable relative market performance on our required regulatory investments and $14.2 million higher earnings in our equity method investment in Brazil, of which $6.7 million is due to the strengthening of the Brazilian real against the U.S. dollar.

U.S. Insurance Solutions Segment

U.S. Insurance Solutions Segment Summary Financial Data

Premium and fees are a key metric for growth in the U.S. Insurance Solutions segment. We receive premiums on our specialty benefits insurance products as well as our traditional life insurance products. Fees are generated from our specialty benefits fee-for-service products as well as our universal life, variable universal life and indexed universal life insurance products.

In our specialty benefits insurance business, premium and fees growth is a result of strong retention and sales, as well as continued in-group growth. In our individual life insurance business, premium and fees growth is driven by strong sales with a focus on maintaining an optimal balance within our product portfolio.

The following table presents the U.S. Insurance Solutions segment premium and fees for the periods indicated:

	For the three months ended March 31,		
	2017	**2016**	**Increase (decrease)**
		(in millions)	
Premium and fees:			
Specialty benefits insurance	**$ 487.6**	$ 449.7	$ 37.9
Individual life insurance	**270.0**	255.2	14.8

The following table presents certain summary financial data relating to the U.S. Insurance Solutions segment for the periods indicated:

	For the three months ended March 31,		
	2017	**2016**	**Increase (decrease)**
		(in millions)	
Operating revenues:			
Premiums and other considerations	**$ 571.3**	$ 531.2	$ 40.1

Fees and other revenues		**186.3**		173.7		12.6
Net investment income		**198.8**		186.0		12.8
Total operating revenues		**956.4**		890.9		65.5
Expenses:						
Benefits, claims and settlement expenses		**585.9**		535.4		50.5
Dividends to policyholders		**34.9**		38.6		(3.7)
Operating expenses		**249.4**		236.4		13.0
Total expenses		**870.2**		810.4		59.8
Pre-tax operating earnings	**$**	**86.2**	$	80.5	$	5.7

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Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Pre-Tax Operating Earnings

Pre-tax operating earnings increased in our specialty benefits insurance business due to a $6.3 million increase in variable investment income, $3.7 million lower operating expenses driven by benefits of scale and $3.2 million increase associated with growth in the business. These increases were partially offset by a $5.5 million assessment associated with the Penn Treaty liquidation.

Revenues

Premiums and fees increased primarily due to growth in the business.

Net investment income increased $7.7 million in our specialty benefits insurance business primarily due to an increase in variable investment income. Net investment income increased $5.1 million in our individual life insurance business primarily due to an increase in average invested assets.

Total Expenses

Benefits, claims and settlement expenses increased primarily due to growth in the business.

Operating expenses increased in our specialty benefits insurance business due to $12.3 million growth in the business and a $5.5 million assessment associated with the Penn Treaty liquidation, which was partially offset by $3.7 million lower expenses driven by benefits of scale.

Corporate Segment

Corporate Segment Summary Financial Data

The following table presents certain summary financial data relating to the Corporate segment for the periods indicated:

	For the three months ended March 31,		
	2017	**2016**	**Increase (decrease)**
		(in millions)	
Operating revenues:			
Total operating revenues	**$ (1.5)**	$ (13.1)	$ 11.6
Expenses:			
Total expenses	**56.9**	40.1	16.8
Pre-tax operating earnings attributable to noncontrolling interest	**0.1**	0.1	
Pre-tax operating losses	**$ (58.5)**	$ (53.3)	$ (5.2)

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Pre-Tax Operating Losses

Pre-tax operating losses increased primarily due to a $20.0 million fee resulting from our election to discontinue an arrangement with one of our financing counterparties in the first quarter of 2017. This was partially offset by a $12.9 million decrease in operating losses due to a reduction in pension and OPEB expense.

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Liquidity and Capital Resources

Liquidity and capital resources represent the overall strength of a company and its ability to generate strong cash flows, borrow funds at a competitive rate and raise new capital to meet operating and growth needs. Our legal entity structure has an impact on our ability to meet cash flow needs as an organization. Following is a simplified organizational structure.

Liquidity

Our liquidity requirements have been and will continue to be met by funds from consolidated operations as well as the issuance of commercial paper, common stock, debt or other capital securities and borrowings from credit facilities. We believe the cash flows from these sources are sufficient to satisfy the current liquidity requirements of our operations, including reasonably foreseeable contingencies.

We maintain a level of cash and securities which, combined with expected cash inflows from investments and operations, is believed to be adequate to meet anticipated short-term and long-term payment obligations. We will continue our prudent capital management practice of regularly exploring options available to us to maximize capital flexibility, including accessing the capital markets and careful attention to and management of expenses.

We perform rigorous liquidity stress testing to ensure our asset portfolio includes sufficient high quality liquid assets that could be utilized to bolster our liquidity position under increasingly stressed market conditions. These assets could be utilized as collateral for secured borrowing transactions with various third parties or by selling the securities in the open market if needed.

We also manage liquidity risk by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times. For example, as of March 31, 2017, approximately $9.7 billion, or 99%, of our institutional guaranteed investment contracts and funding agreements cannot be redeemed by contractholders prior to maturity. Our individual annuity liabilities also contain surrender charges and other provisions limiting early surrenders.

The following table summarizes the withdrawal characteristics of our domestic general account investment contracts as of March 31, 2017.

		Contractholder funds	Percentage
		(in millions)	
Not subject to discretionary withdrawal	$	**10,734.2**	**35.1%**
Subject to discretionary withdrawal with adjustments:			
Specified surrender charges		**7,055.2**	**23.0**
Market value adjustments		**6,226.2**	**20.3**
Subject to discretionary withdrawal without adjustments		**6,606.0**	**21.6**
Total domestic investment contracts	$	**30,621.6**	**100.0%**

Universal life insurance and certain traditional life insurance policies are also subject to discretionary withdrawals by policyholders. However, life insurance policies tend to be less susceptible to withdrawal than our investment contracts because policyholders may be subject to a new underwriting process in order to obtain a new life insurance policy. In addition, our life insurance liabilities include surrender charges to discourage early surrenders.

As of March 31, 2017 and December 31, 2016, we had short-term credit facilities with various financial institutions in an aggregate amount of $905.0 million and $1,005.0 million, respectively. As of March 31, 2017 and December 31, 2016, we had $59.5 million and $51.4 million, respectively, of outstanding borrowings, with no assets pledged as support. During the first

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quarter of 2017, we extended or renewed $789.0 million of our revolving credit facilities. The facilities and their new maturity dates include a $600.0 million 5-year facility with PFG, PFS and Principal Life as co-borrowers that matures March 2022 and a $200.0 million 5-year credit facility, with PFG, PFS, Principal Life and Principal Financial Services V (UK) LTD as co-borrowers, of which $11.0 million matures March 2020 and $189.0 million matures March 2022. The revolving credit facilities are committed and provide 100% back-stop support for our commercial paper program. The $600.0 million facility is supported by seventeen banks and the $200.0 million facility is supported by fifteen banks through March 2020, reduced to $189.0 million supported by fourteen banks thereafter. Most of the banks have other relationships with us. In addition to the revolving credit facilities, Principal International Chile has the capacity to access up to $60.0 million in unsecured lines of credit offered by Chilean financial institutions and Principal Life has a $45.0 million unsecured line of credit. Due to the financial strength and the strong relationships we have with these providers, we are comfortable we have very low risk the financial institutions would be unable or unwilling to fund these facilities.

The Holding Companies: Principal Financial Group, Inc. and Principal Financial Services, Inc. The principal sources of funds available to our parent holding company, PFG, to meet its obligations, including the payments of dividends on common stock, debt service and the repurchase of stock, are dividends from subsidiaries as well as its ability to borrow funds at competitive rates and raise capital to meet operating and growth needs. The declaration and payment of common stock dividends by us is subject to the discretion of our Board of Directors and will depend on our overall financial condition, results of operations, capital levels, cash requirements, future prospects, receipt of dividends from Principal Life (as described below), risk management considerations and other factors deemed relevant by the Board. No significant restrictions limit the payment of dividends by PFG, except those generally applicable to corporations incorporated in Delaware. Dividends from Principal Life, our primary subsidiary, are limited by Iowa law.

Under Iowa law, Principal Life may pay dividends only from the earned surplus arising from its business and must receive the prior approval of the Commissioner of Insurance of the State of Iowa (the Commissioner) to pay stockholder dividends or make any other distribution if such dividends or distributions would exceed certain statutory limitations. Iowa law gives the Commissioner discretion to disapprove requests for distributions in excess of these limitations. Extraordinary dividends include those made, together with dividends and other distributions, within the preceding twelve months that exceed the greater of (i) 10% of Principal Life s statutory policyholder surplus as of the previous year-end or (ii) the statutory net gain from operations from the previous calendar year, not to exceed earned surplus. Based on December 31, 2016, statutory results, the dividend limitation for Principal Life is approximately $1,143.2 million in ordinary dividends in 2017 without prior regulatory approval. However, because the dividend test is based on dividends previously paid over rolling 12-month periods, if paid before a specified date during 2017, some or all of such dividends may be extraordinary and require regulatory approval.

Total stockholder dividends paid by Principal Life to its parent as of March 31, 2017, were $150.0 million, all of which was extraordinary and approved by the Commissioner. As of March 31, 2017, we had $1,200.5 million of cash and liquid assets held in our holding companies and other subsidiaries which is available for corporate purposes.

On May 1, 2017, Principal Life sold its ownership interest in Principal Global Investors, LLC to Principal Life s direct parent, PFS, in connection with a corporate reorganization designed to better utilize and allocate capital internally. Subsequent to the sale, Principal Life paid an extraordinary dividend of $1.1 billion to its parent, which was approved by the Commissioner, primarily from proceeds received from the sale.

Operations. Our primary consolidated cash flow sources are premiums from insurance products, pension and annuity deposits, asset management fee revenues, administrative services fee revenues, income from investments and proceeds

from the sales or maturity of investments. Cash outflows consist primarily of payment of benefits to policyholders and beneficiaries, income and other taxes, current operating expenses, payment of dividends to policyholders, payments in connection with investments acquired, payments made to acquire subsidiaries, payments relating to policy and contract surrenders, withdrawals, policy loans, interest payments and repayment of short-term debt and long-term debt. Our investment strategies are generally intended to provide adequate funds to pay benefits without forced sales of investments. For a discussion of our investment objectives and strategies, see Investments.

Cash Flows. Activity, as reported in our consolidated statements of cash flows, provides relevant information regarding our sources and uses of cash. The following discussion of our operating, investing and financing portions of the cash flows excludes cash flows attributable to the separate accounts.

Net cash provided by operating activities was $522.9 million and $895.5 million for the three months ended March 31, 2017 and 2016, respectively. Our insurance business typically generates positive cash flows from operating activities, as premiums collected from our insurance products and income received from our investments exceed acquisition costs, benefits paid, redemptions and operating expenses. These positive cash flows are then invested to support the obligations of our

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insurance and investment products and required capital supporting these products. Our cash flows from operating activities are affected by the timing of premiums, fees and investment income received and benefits and expenses paid. The decrease in cash provided by operating activities in 2017 compared to 2016 was the result of fluctuations in receivables and payables associated with the timing of settlements.

Net cash used in investing activities was $1,831.0 million and $1,853.3 million for the three months ended March 31, 2017 and 2016, respectively. Cash used in investing activities remained relatively flat in 2017 compared to 2016 with decreased net purchases of available-for-sale securities, offset by increased net purchases of mortgage loans.

Net cash provided by financing activities was $123.2 million and $535.9 million for the three months ended March 31, 2017 and 2016, respectively. The decrease in cash provided by financing activities was the result of lower net investment contract deposits in 2017 as compared to 2016 primarily in the pension business.

Shelf Registration. Under our current shelf registration, we have the ability to issue in unlimited amounts, unsecured senior debt securities or subordinated debt securities, junior subordinated debt, preferred stock, common stock, warrants, depository shares, stock purchase contracts and stock purchase units of PFG, trust preferred securities of three subsidiary trusts and guarantees by PFG of these trust preferred securities. Our wholly owned subsidiary, PFS, may guarantee, fully and unconditionally or otherwise, our obligations with respect to any non-convertible securities, other than common stock, described in the shelf registration.

Short-Term Debt. The components of short-term debt were as follows:

	March 31, 2017	December 31, 2016
	(in millions)	
Other recourse short-term debt	**$ 59.5**	$ 51.4
Total short-term debt	**$ 59.5**	$ 51.4

The short-term credit facilities are used for general corporate purposes and borrowings outstanding can fluctuate as part of working capital management.

Long-Term Debt. As of March 31, 2017, there have been no significant changes to long-term debt since December 31, 2016.

Stockholders Equity. The following table summarizes our dividends to stockholders and repurchase of common stock.

	For the three months ended March 31, 2017	For the year ended December 31, 2016
	(in millions)	
Dividends to stockholders	**$ 130.0**	$ 464.9
Repurchase of common stock	**142.8**	277.3
Total cash returned to common stockholders	**$ 272.8**	$ 742.2

For additional stockholders equity information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 9, Stockholders Equity.

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Capitalization

The following table summarizes our capital structure:

	March 31, 2017	December 31, 2016
	($ in millions)	
Debt:		
Short-term debt	**$ 59.5**	$ 51.4
Long-term debt	**3,126.2**	3,125.7
Total debt	**3,185.7**	3,177.1
Equity excluding AOCI	**11,071.2**	10,902.5
Total capitalization excluding AOCI	**$ 14,256.9**	$ 14,079.6
Debt to equity excluding AOCI	**29%**	29%
Debt to capitalization excluding AOCI	**22%**	23%

Contractual Obligations and Contractual Commitments

As of March 31, 2017, there have been no significant changes to contractual obligations and contractual commitments since December 31, 2016.

Off-Balance Sheet Arrangements

Variable Interest Entities. We have relationships with various types of special purpose entities and other entities where we have a variable interest as described in Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 2, Variable Interest Entities.

Guarantees and Indemnifications. As of March 31, 2017, there have been no significant changes to guarantees and indemnifications since December 31, 2016. For guarantee and indemnification information, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Contingencies, Guarantees and Indemnifications under the caption, Guarantees and Indemnifications.

Financial Strength and Credit Ratings

Our ratings are influenced by the relative ratings of our peers/competitors as well as many other factors including our operating and financial performance, capital levels, asset quality, liquidity, asset/liability management, overall portfolio mix, financial leverage (i.e., debt), risk exposures, operating leverage and other factors.

In April 2017, S&P affirmed PFG s credit ratings and the financial strength ratings of Principal Life and Principal National Life Insurance Company (PNLIC) at A+ . The outlook remains stable for all ratings. Principal Life s enterprise risk management rating was affirmed as Strong The rating affirmation reflects S&P s view that we have a very strong competitive position as a leader in the U.S. small to midsize 401(k) market, with strong asset management and insurance solution capabilities.

In January 2017, A.M. Best affirmed the financial strength ratings of Principal Life and PNLIC at A+ . The outlook remains stable for all ratings. The affirmation reflects continued solid risk-adjusted capitalization, well-managed balance sheet, strong business profile and consistently favorable operating results.

In November 2016, Moody s affirmed the financial strength ratings of Principal Life and PNLIC at A1 . The outlook remains stable . The affirmation is based on the leading, broad-based position of Principal Life in the U.S. group pension market, with earnings diversification from retail life and annuity businesses.

In October 2016, Fitch affirmed the financial strength ratings of Principal Life and PNLIC at AA- . The outlook remains stable . The affirmation reflects PFG s strong capitalization and stable, balanced operating profitability, partially offset by above-average exposure to direct mortgages, structured mortgage securities and direct real estate investments.

A.M. Best, Moody s and Fitch have changed their outlook on the U.S. life insurance sector to negative from stable . Continued low interest rates, an uncertain regulatory environment, exposure to asset management and international risks and low domestic growth are pressuring the sector. S&P maintains a stable outlook on the U.S. life insurance sector. S&P s view is that

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insurers have strong levels of capital that will offset credit quality impacts from the interest rate environment. Any deterioration in capitalization will not be to a level that will impact near-term ratings.

The following table summarizes our significant financial strength and debt ratings from the major independent rating organizations. The debt ratings shown are indicative ratings. Outstanding issuances are rated the same as indicative ratings unless otherwise noted. Actual ratings can differ from indicative ratings based on contractual terms. A security rating is not a recommendation to buy, sell or hold securities. Such a rating may be subject to revision or withdrawal at any time by the assigning rating agency. Each rating should be evaluated independently of any other rating.

	A.M. Best	Fitch	S&P Global	Moody s
Principal Financial Group				
Senior Unsecured Debt (1)	a-		BBB+	Baa2
Junior Subordinated Debt (2)	bbb+		BBB	Baa3
Principal Financial Services				
Senior Unsecured Debt	a-		BBB+	Baa1
Principal Life Insurance Company				
Insurer Financial Strength	A+	AA-	A+	A1
Issuer Credit Rating	aa-			
Commercial Paper	AMB-1+		A-1+	P-1
Enterprise Risk Management Rating			Strong	
Principal National Life Insurance Company				
Insurer Financial Strength	A+	AA-	A+	A1

(1) Principal Financial Group s senior debt issuance has been rated Baa1 by Moody s.

(2) Principal Financial Group s junior subordinated debt issuance has been rated BBB- by S&P Global and Baa2 by Moody s.

Fair Value Measurement

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value into three levels. The fair value hierarchy gives the highest priority (Level 1) to unadjusted quoted prices in active markets for identical assets or liabilities and gives the lowest priority (Level 3) to unobservable inputs. The level in the fair value hierarchy within which the fair value measurement in its entirety falls is determined based on the lowest level input that is significant to the fair value measurement in its entirety considering factors specific to the asset or liability. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Fair Value Measurements for further details, including a reconciliation of changes in Level 3 fair value measurements.

As of March 31, 2017, 41% of our net assets (liabilities) were Level 1, 55% were Level 2 and 4% were Level 3. Excluding separate account assets as of March 31, 2017, 3% of our net assets (liabilities) were Level 1, 96% were Level 2 and 1% were Level 3.

As of December 31, 2016, 41% of our net assets (liabilities) were Level 1, 55% were Level 2 and 4% were Level 3. Excluding separate account assets as of December 31, 2016, 3% of our net assets (liabilities) were Level 1, 96% were Level 2 and 1% were Level 3.

Changes in Level 3 Fair Value Measurements

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of March 31, 2017, were $7,590.8 million as compared to $7,779.6 million as of December 31, 2016. The decrease was primarily related to net sales of our separate account assets and the transfer of certain structured fixed maturities from level 3 to level 2. These decreases were partially offset by gains in our separate account assets.

Net assets (liabilities) measured at fair value on a recurring basis using significant unobservable inputs (Level 3) as of March 31, 2016, were $7,399.9 million as compared to $7,318.6 million as of December 31, 2015. The increase was primarily related to gains in our separate account assets. The increase was partially offset by net sales of our separate account assets.

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Investments

We had total consolidated assets as of March 31, 2017, of $235,496.0 million, of which $77,812.0 million were invested assets. The rest of our total consolidated assets are comprised primarily of separate account assets for which we do not bear investment risk; therefore, the discussion and financial information below does not include such assets.

Overall Composition of Invested Assets

Invested assets as of March 31, 2017, were predominantly high quality and broadly diversified across asset class, individual credit, industry and geographic location. Asset allocation is determined based on cash flow and the risk/return requirements of our products. As shown in the following table, the major categories of invested assets are fixed maturities and commercial mortgage loans. The remainder is invested in other investments, equity securities, real estate and residential mortgage loans. In addition, policy loans are included in our invested assets.

	March 31, 2017		December 31, 2016	
	Carrying amount	% of total	Carrying amount	% of total
	($ in millions)			
Fixed maturities:				
Public	**$ 40,561.3**	**52%**	$ 39,170.3	52%
Private	**16,705.8**	**21**	16,074.2	21
Equity securities	**1,620.3**	**2**	1,512.3	2
Mortgage loans:				
Commercial	**12,137.7**	**16**	12,027.8	16
Residential	**1,250.4**	**2**	1,202.4	1
Real estate held for sale	**141.6**		130.7	
Real estate held for investment	**1,291.7**	**2**	1,238.1	2
Policy loans	**819.6**	**1**	823.8	1
Other investments	**3,283.6**	**4**	3,655.9	5
Total invested assets	**77,812.0**	**100%**	75,835.5	100%
Cash and cash equivalents	**1,534.7**		2,719.6	
Total invested assets and cash	**$ 79,346.7**		$ 78,555.1	

Investment Results

Net Investment Income

The following table presents the yield and investment income, excluding net realized capital gains and losses, for our invested assets for the periods indicated. We calculate annualized yields using a simple average of asset classes at the beginning and end of the reporting period. The yields for available-for-sale fixed maturities and available-for-sale equity securities are calculated using amortized cost and cost, respectively. All other yields are calculated using carrying amounts.

	For the three months ended March 31,					
	2017		2016		Increase (decrease)	
	Yield	Amount	Yield	Amount	Yield	Amount
			($ in millions)			
Fixed maturities	**4.2%**	**$ 577.2**	4.4%	$ 549.7	(0.2)%	$ 27.5
Equity securities	**8.6**	**33.8**	5.4	18.1	3.2	15.7
Mortgage loans - commercial	**4.1**	**125.0**	4.5	125.2	(0.4)	(0.2)
Mortgage loans - residential	**5.0**	**15.2**	5.4	15.0	(0.4)	0.2
Real estate	**15.0**	**52.4**	5.3	19.6	9.7	32.8
Policy loans	**5.5**	**11.3**	5.5	11.3		
Cash and cash equivalents	**1.1**	**5.7**	0.6	3.7	0.5	2.0
Other investments	**9.0**	**77.9**	4.4	39.7	4.6	38.2
Total	**4.7**	**898.5**	4.3	782.3	0.4	116.2
Investment expenses	**(0.1)**	**(21.1)**	(0.1)	(20.6)		(0.5)
Net investment income	**4.6%**	**$ 877.4**	4.2%	$ 761.7	0.4%	$ 115.7

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Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Net investment income increased primarily due to higher average invested assets in our U.S. operations and an increase in variable investment income primarily related to the sale of certain real estate and higher income from other alternative investments. Additionally, net investment income increased due to favorable relative market performance on our required regulatory investments in the pension funds of our Latin America business.

Net Realized Capital Gains (Losses)

The following table presents the contributors to net realized capital gains and losses for the periods indicated.

	For the three months ended March 31,					
		2017		**2016**		**Increase (decrease)**
				(in millions)		
Fixed maturities, available-for-sale credit impairments (1)	**$**	**(28.8)**	**$**	(48.1)	**$**	19.3
Commercial mortgages credit impairments		**(0.3)**		0.4		(0.7)
Other credit impairments		**(0.1)**		2.1		(2.2)
Fixed maturities, available-for-sale and trading noncredit		**(3.9)**		9.6		(13.5)
Derivatives and related hedge activities		**(18.5)**		193.7		(212.2)
Other gains (losses)		**35.0**		(21.1)		56.1
Net realized capital gains (losses)	**$**	**(16.6)**	**$**	136.6	$	(153.2)

(1) Includes credit impairments as well as losses on sales of fixed maturities to reduce credit risk, net of realized credit recoveries on the sale of previously impaired securities. Credit gains on sales, excluding associated foreign currency fluctuations that are included in derivatives and related hedging activities, resulted in a net gain of $0.0 million for both the three months ended March 31, 2017 and 2016.

Three Months Ended March 31, 2017 Compared to Three Months Ended March 31, 2016

Derivatives and related hedge activities had net losses in 2017 as compared to net gains in 2016 primarily due to losses in 2017 versus gains in 2016 on interest rate swap derivatives not designated as hedging instruments due to changes in interest rates and on the GMWB embedded derivatives, including changes in the spread reflecting our own creditworthiness, and related hedging instruments.

Other gains (losses) reflected gains in 2017 as compared to losses in 2016 primarily due to gains in 2017 versus losses in 2016 on equity securities, trading related to mark-to-market changes.

U.S. Investment Operations

Of our invested assets, $70,408.7 million were held by our U.S. operations as of March 31, 2017. Our U.S. invested assets are managed primarily by our Principal Global Investors segment. Our primary investment objective is to maximize after-tax returns consistent with acceptable risk parameters. We seek to protect customers benefits by optimizing the risk/return relationship on an ongoing basis, through asset/liability matching, reducing the credit risk, avoiding high levels of investments that may be redeemed by the issuer, maintaining sufficiently liquid investments and avoiding undue asset concentrations through diversification. We are exposed to two primary sources of investment risk:

- credit risk, relating to the uncertainty associated with the continued ability of an obligor to make timely payments of principal and interest and
- interest rate risk, relating to the market price and/or cash flow variability associated with changes in market yield curves.

Our ability to manage credit risk is essential to our business and our profitability. We devote considerable resources to the credit analysis of each new investment. We manage credit risk through industry, issuer and asset class diversification. Our Investment Committee, appointed by our Board of Directors, is responsible for establishing all investment policies and approving or authorizing all investments, except the Executive Committee of the Board must approve any investment transaction exceeding $500.0 million. As of March 31, 2017, twelve members served on the Investment Committee, one of whom is a

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member of our Board of Directors. The remaining members were senior management members representing various areas of our company.

We purchase credit default swaps to hedge certain credit exposures in our investment portfolio and total return swaps and futures to hedge a portion of our investment portfolio from credit losses. We economically hedged credit exposure in our portfolio by purchasing credit default swaps with a notional amount of $170.5 million and $176.5 million, total return swaps with a notional of $80.0 million and $90.0 million, and futures with a notional of $17.0 million and $11.9 million as of March 31, 2017 and December 31, 2016, respectively. We sell credit default swaps to offer credit protection to investors when entering into synthetic replicating transactions. When selling credit protection, if there is an event of default by the referenced name, we are obligated to pay the counterparty the referenced amount of the contract and receive in return the referenced security. For further information on credit derivatives sold, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 4, Derivative Financial Instruments under the caption, Credit Derivatives Sold.

We also seek to manage call or prepayment risk arising from changes in interest rates. We assess and price for call or prepayment risks in all of our investments and monitor these risks in accordance with asset/liability management policies.

The amortized cost and weighted average yield, calculated using amortized cost, of non-structured fixed maturity securities that will be callable at the option of the issuer, excluding securities with a make-whole provision, were $2,410.6 million and 3.6%, respectively, as of March 31, 2017 and $2,075.9 million and 3.5%, respectively, as of December 31, 2016. In addition, the amortized cost and weighted average yield of residential mortgage-backed pass-through securities, residential collateralized mortgage obligations, and asset-backed securities - home equity with material prepayment risk were $5,076.3 million and 3.2%, respectively, as of March 31, 2017 and $4,891.3 million and 3.2%, respectively, as of December 31, 2016.

Our Fixed Income Securities Committee, consisting of fixed income securities senior management members, approves the credit rating for the fixed maturities we purchase. Teams of security analysts, organized by industry, analyze and monitor these investments. In addition, we have teams who specialize in RMBS, CMBS, ABS, municipals and below investment grade securities. Our analysts monitor issuers held in the portfolio on a continuous basis with a formal review documented annually or more frequently if material events affect the issuer. The analysis includes both fundamental and technical factors. The fundamental analysis encompasses both quantitative and qualitative analysis of the issuer. The qualitative analysis includes an assessment of both accounting and management aggressiveness of the issuer. In addition, technical indicators such as stock price volatility and credit default swap levels are monitored.

Our Fixed Income Securities Committee also reviews private transactions on a continuous basis to assess the quality ratings of our privately placed investments. We regularly review our investments to determine whether we should re-rate them, employing the following criteria:

- material changes in the issuer s revenues or margins;
- significant management or organizational changes;
- significant changes regarding the issuer s industry;
- debt service coverage or cash flow ratios that fall below industry-specific thresholds;

- violation of financial covenants and
- other business factors that relate to the issuer.

Our use of derivatives exposes us to counterparty risk, or the risk that the counterparty fails to perform the terms of the derivative contract. We actively manage this risk by:

- obtaining approval of all new counterparties by the Investment Committee;
- establishing exposure limits that take into account non-derivative exposure we have with the counterparty as well as derivative exposure;
- performing similar credit analysis prior to approval on each derivatives counterparty that we do when lending money on a long-term basis;
- diversifying our risk across numerous approved counterparties;
- implementing credit support annex (collateral) agreements (CSAs) for over-the-counter derivative transactions or similar agreements with a majority of our counterparties to further limit counterparty exposures, which provide for netting of exposures;
- limiting exposure to A credit or better for over-the-counter derivative counterparties without CSAs;
- conducting stress-test analysis to determine the maximum exposure created during the life of a prospective transaction;
- daily monitoring of counterparty credit ratings, exposures and associated collateral levels and

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- trading mandatorily cleared contracts through centralized clearinghouses.

We manage our exposure on a net basis, whereby we net positive and negative exposures for each counterparty with agreements in place. For further information on derivative exposure, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments under the caption, Balance Sheet Offsetting.

A dedicated risk management team is responsible for centralized monitoring of the commercial mortgage loan portfolio. We apply a variety of strategies to minimize credit risk in our commercial mortgage loan portfolio. When considering new commercial mortgage loans, we review the cash flow fundamentals of the property, make a physical assessment of the underlying security, conduct a comprehensive market analysis and compare against industry lending practices. We use a proprietary risk rating model to evaluate all new and substantially all existing loans within the portfolio. The proprietary risk model is designed to stress projected cash flows under simulated economic and market downturns. Our lending guidelines are typically 75% or less loan-to-value ratio and a debt service coverage ratio of at least 1.2 times. We analyze investments outside of these guidelines based on cash flow quality, tenancy and other factors. The following table presents loan-to-value and debt service coverage ratios for our brick and mortar commercial mortgages, excluding Principal Global Investors segment mortgages:

	Weighted average loan-to-value ratio		**Debt service coverage ratio**	
	March 31, 2017	**December 31, 2016**	**March 31, 2017**	**December 31, 2016**
New mortgages	**56%**	52%	**2.4X**	2.6X
Entire mortgage portfolio	**46%**	46%	**2.7X**	2.7X

Our investment decisions and objectives are a function of the underlying risks and product profiles of each primary business operation. In addition, we diversify our product portfolio offerings to include products that contain features that will protect us against fluctuations in interest rates. Those features include adjustable crediting rates, policy surrender charges and market value adjustments on liquidations. For further information on our management of interest rate risk, see Item 3. Quantitative and Qualitative Disclosures About Market Risk Interest Rate Risk.

Overall Composition of U.S. Invested Assets

As shown in the following table, the major categories of U.S. invested assets are fixed maturities and commercial mortgage loans. The remainder is invested in other investments, real estate, residential mortgage loans and equity securities. In addition, policy loans are included in our invested assets. The following discussion analyzes the composition of U.S. invested assets, but excludes invested assets of the separate accounts.

	March 31, 2017		**December 31, 2016**	
	Carrying amount	**% of total**	**Carrying amount**	**% of total**
		($ in millions)		
Fixed maturities:				
Public	**$ 36,766.0**	**52%**	$ 35,524.8	52%
Private	**16,692.4**	**24**	16,065.2	23
Equity securities	**349.0**	**1**	342.6	1
Mortgage loans:				

Commercial		**12,049.3**	**17**		11,940.5	17
Residential		**723.8**	**1**		680.5	1
Real estate held for sale		**139.6**			128.7	
Real estate held for investment		**1,290.0**	**2**		1,236.5	2
Policy loans		**795.9**	**1**		800.7	1
Other investments		**1,602.7**	**2**		2,088.7	3
Total invested assets		**70,408.7**	**100%**		68,808.2	100%
Cash and cash equivalents		**1,356.4**			2,335.5	
Total invested assets and cash	**$**	**71,765.1**		$	71,143.7	

Fixed Maturities

Fixed maturities include bonds, ABS, redeemable preferred stock and certain non-redeemable preferred securities. Included in the privately placed category as of March 31, 2017 and December 31, 2016, were $11.9 billion and $11.2 billion, respectively, of securities subject to certain holding periods and resale restrictions pursuant to Rule 144A of the Securities Act of 1933.

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Fixed maturities were diversified by category of issuer, as shown in the following table for the periods indicated.

	March 31, 2017		December 31, 2016	
	Carrying amount	Percent of total	Carrying amount	Percent of total
	($ in millions)			
U.S. government and agencies	**$ 1,420.9**	**3%**	$ 1,415.7	3%
States and political subdivisions	**6,035.9**	**11**	5,625.6	11
Non-U.S. governments	**612.5**	**1**	542.0	1
Corporate - public	**20,102.0**	**38**	19,117.9	37
Corporate - private	**12,332.1**	**23**	12,140.2	23
Residential mortgage-backed pass-through securities	**2,847.0**	**5**	2,842.5	5
Commercial mortgage-backed securities	**3,833.4**	**7**	4,070.2	8
Residential collateralized mortgage obligations	**2,016.7**	**4**	1,827.8	4
Asset-backed securities	**4,257.9**	**8**	4,008.1	8
Total fixed maturities	**$ 53,458.4**	**100%**	$ 51,590.0	100%

We believe it is desirable to hold residential mortgage-backed pass-through securities due to their credit quality and liquidity as well as portfolio diversification characteristics. Our portfolio is comprised of Government National Mortgage Association, Federal National Mortgage Association and Federal Home Loan Mortgage Corporation pass-through securities. In addition, our residential collateralized mortgage obligation portfolio offers structural features that allow cash flows to be matched to our liabilities.

We purchase CMBS to diversify the overall credit risks of the fixed maturities portfolio and to provide attractive returns. The primary risks in holding CMBS are structural and credit risks. Structural risks include the security s priority in the issuer s capital structure, the adequacy of and ability to realize proceeds from the collateral and the potential for prepayments. Credit risks involve collateral and issuer/servicer risk where collateral and servicer performance may deteriorate. CMBS are predominantly comprised of large pool securitizations that are diverse by property type, borrower and geographic dispersion. The risks to any CMBS deal are determined by the credit quality of the underlying loans and how those loans perform over time. Another key risk is the vintage of the underlying loans and the state of the markets during a particular vintage. In the CMBS market, there is a material difference in the outlook for the performance of loans originated in 2004 and earlier relative to loans originated in 2005 through 2008. For loans originated prior to 2005, underwriting assumptions were more conservative regarding required debt service coverage and loan-to-value ratios. For the 2005 through 2008 vintages, real estate values peaked and the underwriting expectations were that values would continue to increase, which makes those loan values more sensitive to market declines. The 2009 and later vintages represent a return to debt service coverage ratios and loan-to-value ratios that more closely resemble loans originated prior to 2005.

Similar to CMBS, we purchase ABS for diversification and to provide attractive returns. The primary risks in holding ABS are also structural and credit risks, which are similar to those noted above for CMBS. Our ABS portfolio is diversified by type of asset, issuer, and vintage. We actively monitor holdings of ABS to recognize adverse changes in the risk profile of each security. Prepayments in the ABS portfolio are, in general, insensitive to changes in interest rates or are insulated from such changes by call protection features. In the event we are subject to prepayment risk, we monitor the factors that impact the level of prepayment and prepayment speed for those ABS. In addition, we hold a diverse class of securities, which limits our exposure to any one security.

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The international exposure held in our U.S. operation s fixed maturities portfolio was 21% of total fixed maturities as of both March 31, 2017 and December 31, 2016. It is comprised of corporate and foreign government fixed maturities. The following table presents the carrying amount of our international exposure for our U.S. operation s fixed maturities portfolio for the periods indicated.

	March 31, 2017	December 31, 2016
	(in millions)	
European Union, excluding UK	**$ 3,467.2**	$ 3,419.4
United Kingdom	**2,298.5**	2,282.4
Asia-Pacific	**1,533.8**	1,517.1
Australia/New Zealand	**1,376.0**	1,338.4
Latin America	**956.0**	950.4
Europe, non-European Union	**770.3**	740.4
Middle East and Africa	**380.2**	365.3
Other (1)	**253.6**	261.7
Total	**$ 11,035.6**	$ 10,875.1

(1) Includes exposure from two countries and various supranational organizations as of both March 31, 2017, and December 31, 2016.

International fixed maturities exposure is determined by the country of domicile of the parent entity of an individual asset. All international fixed maturities held by our U.S. operations are either denominated in U.S. dollars or have been swapped into U.S. dollar equivalents. Our international investments are analyzed internally by country and industry credit investment professionals. We control concentrations using issuer and country level exposure benchmarks, which are based on the credit quality of the issuer and the country. Our investment policy limits total international fixed maturities investments and we are within those internal limits. Exposure to Canada is not included in our international exposure. As of March 31, 2017 and December 31, 2016, our investments in Canada totaled $1,710.4 million and $1,604.5 million, respectively.

Fixed Maturities Credit Concentrations. One aspect of managing credit risk is through industry, issuer and asset class diversification. Our credit concentrations are managed to established limits. The following table presents our top ten exposures as of March 31, 2017.

	Amortized cost
	(in millions)
Mars, Incorporated	**$ 252.3**
Berkshire Hathaway Inc.	**214.1**
Wells Fargo & Company	**210.2**
Duke Energy Corporation	**190.5**
Province of Quebec	**184.7**
Comcast Corporation	**173.9**
Bank of America Corporation	**165.3**
Verizon Communications Inc.	**164.1**
Exelon Corporation	**162.6**
General Electric Company	**161.8**

Total top ten exposures	$	1,879.5

Fixed Maturities Valuation and Credit Quality. Valuation techniques for the fixed maturities portfolio vary by security type and the availability of market data. The use of different pricing techniques and their assumptions could produce different financial results. See Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 10, Fair Value Measurements for further details regarding our pricing methodology. Once prices are determined, they are reviewed by pricing analysts for reasonableness based on asset class and observable market data. Investment analysts who are familiar with specific securities review prices for reasonableness through direct interaction with external sources, review of recent trade activity or use of internal models. All fixed maturities placed on the watch list are periodically analyzed by investment analysts or analysts that focus on troubled securities (Workout Group). This group then meets with the Chief Investment Officer and the Portfolio Managers to determine reasonableness of prices. The valuation of impaired bonds for which there is no quoted price is typically based on the present value of the future cash flows expected to be received. Although we believe these values reasonably reflect the fair value of those securities, the key assumptions about risk premiums, performance of underlying collateral (if any) and other market factors involve qualitative and unobservable inputs.

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The Securities Valuation Office (SVO) of the National Association of Insurance Commissioners (NAIC) monitors the bond investments of insurers for regulatory capital and reporting purposes and, when required, assigns securities to one of six categories referred to as NAIC designations. Although NAIC designations are not produced to aid the investment decision making process, NAIC designations may serve as a reasonable proxy for Nationally Recognized Statistical Rating Organizations (NRSRO) credit ratings for certain bonds. For most corporate bonds, NAIC designations 1 and 2 include bonds generally considered investment grade by such rating organizations. Bonds are considered investment grade when rated Baa3 or higher by Moody s, or BBB- or higher by S&P. NAIC designations 3 through 6 include bonds generally referred to as below investment grade. Bonds are considered below investment grade when rated Ba1 or lower by Moody s, or BB+ or lower b S&P.

However, for loan-backed and structured securities, as defined by the NAIC, the NAIC designation is not always a reasonable indication of an NRSRO rating as described below. For CMBS and non-agency RMBS, Blackrock Solutions undertakes the modeling of those NAIC designations. Other loan-backed and structured securities may be subject to an intrinsic price matrix as provided by the NAIC. This may result in a final designation being higher or lower than the NRSRO credit rating.

The following table presents our total fixed maturities by NAIC designation as of the periods indicated as well as the percentage, based on fair value, that each designation comprises.

NAIC designation	March 31, 2017 Amortized cost	March 31, 2017 Carrying amount	March 31, 2017 Percent of carrying amount	December 31, 2016 Amortized cost	December 31, 2016 Carrying amount	December 31, 2016 Percent of carrying amount
	($ in millions)					
1	**$ 34,043.8**	**$ 34,965.5**	**66%**	$ 33,198.2	$ 34,031.5	66%
2	**14,513.8**	**15,174.1**	**28**	13,614.9	14,155.0	27
3	**2,597.4**	**2,659.5**	**5**	2,578.5	2,611.8	6
4	**480.6**	**462.7**	**1**	640.9	604.3	1
5	**169.6**	**144.9**		148.6	120.4	
6	**60.3**	**51.7**		80.9	67.0	
Total fixed maturities	**$ 51,865.5**	**$ 53,458.4**	**100%**	$ 50,262.0	$ 51,590.0	100%

Fixed maturities included 44 securities with an amortized cost of $559.6 million, gross gains of $1.7 million, gross losses of $8.2 million and a carrying amount of $553.1 million as of March 31, 2017, that were still pending a review and assignment of a designation by the SVO. Due to the timing of when fixed maturities are purchased, legal documents are filed and the review by the SVO is completed, we will always have securities in our portfolio that are unrated over a reporting period. In these instances, an equivalent designation is assigned based on our fixed income analyst s assessment.

Commercial Mortgage-Backed Securities. As of March 31, 2017, based on amortized cost, 97% of our CMBS portfolio had an NAIC designation of 1 and 74% was issued during the more conservative underwriting periods prior to 2005 and after 2008.

The following tables present our exposure by credit quality, based on NAIC designations, and vintage for our CMBS portfolio as of the periods indicated.

	March 31, 2017							
	2004 and prior		2005 to 2008		2009 and after		Total	
NAIC designation	**Amortized cost**	**Carrying amount**	**Amortized cost**	**Carrying amount**	**Amortized cost**	**Carrying amount**	**Amortized cost**	**Carrying amount**
	(in millions)							
1	$ **94.2**	$ **98.2**	$ **879.4**	$ **877.5**	$ **2,773.7**	$ **2,744.7**	$ **3,747.3**	$ **3,720.4**
2			**18.7**	**16.9**	**1.2**	**1.2**	**19.9**	**18.1**
3			**16.4**	**16.0**			**16.4**	**16.0**
4	**7.5**	**4.4**	**55.0**	**52.9**			**62.5**	**57.3**
5	**1.8**	**1.5**	**17.0**	**12.6**			**18.8**	**14.1**
6	**1.6**	**1.7**	**7.4**	**5.8**			**9.0**	**7.5**
Total (1)	$ **105.1**	$ **105.8**	$ **993.9**	$ **981.7**	$ **2,774.9**	$ **2,745.9**	$ **3,873.9**	$ **3,833.4**

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(1) The CMBS portfolio included agency CMBS with a $373.9 million amortized cost and a $369.5 million carrying amount.

	December 31, 2016							
	2004 and prior		2005 to 2008		2009 and after		Total	
NAIC designation	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount	Amortized cost	Carrying amount
	(in millions)							
1	$ 105.2	$ 108.9	$ 1,183.7	$ 1,180.7	$ 2,698.4	$ 2,657.6	$ 3,987.3	$ 3,947.2
2			19.8	19.3			19.8	19.3
3			16.2	14.6			16.2	14.6
4	7.7	7.3	64.8	57.1			72.5	64.4
5	2.1	1.4	16.7	13.7			18.8	15.1
6	1.8	1.9	9.7	7.7			11.5	9.6
Total (1)	$ 116.8	$ 119.5	$ 1,310.9	$ 1,293.1	$ 2,698.4	$ 2,657.6	$ 4,126.1	$ 4,070.2

(1) The CMBS portfolio included agency CMBS with a $393.3 million amortized cost and a $389.0 million carrying amount.

Fixed Maturities Watch List. We monitor any decline in the credit quality of fixed maturities through the designation of problem securities, potential problem securities and restructured securities . We define problem securities in our fixed maturity portfolio as securities: (i) with principal and/or interest payments in default or where default is perceived to be imminent in the near term, or (ii) issued by a company that went into bankruptcy subsequent to the acquisition of such securities. We define potential problem securities in our fixed maturity portfolio as securities included on an internal watch list for which management has concerns as to the ability of the issuer to comply with the present debt payment terms and which may result in the security becoming a problem or being restructured. The decision whether to classify a performing fixed maturity security as a potential problem involves significant subjective judgments by our management as to the likely future industry conditions and developments with respect to the issuer. We define restructured securities in our fixed maturity portfolio as securities where a concession has been granted to the borrower related to the borrower s financial difficulties that would not have otherwise been considered. We determine that restructures should occur in those instances where greater economic value will be realized under the new terms than through liquidation or other disposition and may involve a change in contractual cash flows. If the present value of the restructured cash flows is less than the current cost of the asset being restructured, a realized capital loss is recorded in net income and a new cost basis is established.

The following table presents the total carrying amount of our fixed maturities portfolio, as well as its problem, potential problem and restructured fixed maturities for the periods indicated.

	March 31, 2017	December 31, 2016
	($in millions)	

Total fixed maturities (public and private)	$	**53,458.4**	$	51,590.0
Problem fixed maturities (1)	$	**76.4**	$	74.1
Potential problem fixed maturities		**103.3**		154.8
Restructured fixed maturities		**1.9**		
Total problem, potential problem and restructured fixed maturities	$	**181.6**	$	228.9
Total problem, potential problem and restructured fixed maturities as a percent of total fixed maturities		**0.34 %**		0.44%

(1) The problem fixed maturities carrying amount is net of other-than-temporary impairment losses.

Fixed Maturities Impairments. We have a process in place to identify securities that could potentially have an impairment that is other than temporary. This process involves monitoring market events that could impact issuers credit ratings, business climate, management changes, litigation and government actions and other similar factors. This process also involves monitoring late payments, pricing levels, downgrades by rating agencies, key financial ratios, financial statements, revenue forecasts and cash flow projections as indicators of credit issues.

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Each reporting period, a group of individuals including the Chief Investment Officer, our Portfolio Managers, members of our Workout Group and representatives from Investment Accounting review all securities to determine whether an other-than-temporary decline in value exists and whether losses should be recognized. The analysis focuses on each issuer s ability to service its debts in a timely fashion. Formal documentation of the analysis and our decision is prepared and approved by management.

We consider relevant facts and circumstances in evaluating whether a credit or interest rate- related impairment of a security is other than temporary. Relevant facts and circumstances considered include: (1) the extent and length of time the fair value has been below cost; (2) the reasons for the decline in value; (3) the financial position and access to capital of the issuer, including the current and future impact of any specific events; (4) for structured securities, the adequacy of the expected cash flows and (5) our intent to sell the security or whether it is more likely than not we will be required to sell the security before recovery of its amortized cost which, in some cases, may extend to maturity. To the extent we determine a security is deemed to be other than temporarily impaired, an impairment loss is recognized. For additional details, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments.

We would not consider a security with unrealized losses to be other than temporarily impaired when it is not our intent to sell the security, it is not more likely than not that we would be required to sell the security before recovery of the amortized cost, which may be maturity, and we expect to recover the amortized cost basis. However, we do sell securities under certain circumstances, such as when we have evidence of a change in the issuer s creditworthiness, when we anticipate poor relative future performance of securities, when a change in regulatory requirements modifies what constitutes a permissible investment or the maximum level of investments held or when there is an increase in capital requirements or a change in risk weights of debt securities. Sales generate both gains and losses.

A number of significant risks and uncertainties are inherent in the process of monitoring impairments and determining if an impairment is other than temporary. These risks and uncertainties include: (1) the risk that our assessment of an issuer s ability to meet all of its contractual obligations will change based on changes in the credit characteristics of that issuer, (2) the risk that the economic outlook will be worse than expected or have more of an impact on the issuer than anticipated, (3) the risk that our investment professionals are making decisions based on fraudulent or misstated information in the financial statements provided by issuers and (4) the risk that new information obtained by us or changes in other facts and circumstances lead us to change our intent to not sell the security prior to recovery of its amortized cost. Any of these situations could result in a charge to net income in a future period.

The net realized loss relating to other-than-temporary credit impairments and credit related sales of fixed maturities was $28.8 million and $48.1 million for the three months ended March 31, 2017 and 2016, respectively.

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Fixed Maturities Available-for-Sale

The following tables present our fixed maturities available-for-sale by industry category and the associated gross unrealized gains and losses, including other-than-temporary impairment losses reported in AOCI, as of the periods indicated.

	March 31, 2017			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance Banking	$ 4,466.5	$ 103.0	$ 37.4	$ 4,532.1
Finance Brokerage	374.4	13.1	2.6	384.9
Finance Finance Companies	306.1	7.1	0.3	312.9
Finance Financial Other	474.5	38.0	2.7	509.8
Finance Insurance	2,489.2	219.0	7.7	2,700.5
Finance REITS	1,271.7	30.9	12.8	1,289.8
Industrial Basic Industry	1,190.1	61.0	8.6	1,242.5
Industrial Capital Goods	1,932.8	105.1	9.6	2,028.3
Industrial Communications	2,396.4	208.7	8.6	2,596.5
Industrial Consumer Cyclical	1,600.2	67.4	3.3	1,664.3
Industrial Consumer Non-Cyclical	3,603.7	152.3	26.6	3,729.4
Industrial Energy	2,731.9	195.1	24.2	2,902.8
Industrial Other	299.3	14.3	0.2	313.4
Industrial Technology	1,552.1	43.2	5.5	1,589.8
Industrial Transportation	1,428.8	52.6	21.6	1,459.8
Utility Electric	3,197.6	167.4	35.2	3,329.8
Utility Natural Gas	326.8	13.5	3.1	337.2
Utility Other	254.2	15.2	0.2	269.2
Government guaranteed	1,105.4	107.3	3.7	1,209.0
Total corporate securities	31,001.7	1,614.2	213.9	32,402.0
Residential mortgage-backed pass-through securities	2,796.6	62.3	30.7	2,828.2
Commercial mortgage-backed securities	3,873.9	29.1	69.6	3,833.4
Residential collateralized mortgage obligations	2,011.8	16.4	21.8	2,006.4
Asset-backed securities Home equity (1)	238.8	13.7	8.0	244.5
Asset-backed securities All other	3,031.3	8.3	13.6	3,026.0
Collateralized debt obligations Credit	51.9		19.9	32.0
Collateralized debt obligations CMBS	0.3	0.1		0.4
Collateralized debt obligations Loans	954.2	2.4	1.6	955.0
Total mortgage-backed and other asset-backed securities	12,958.8	132.3	165.2	12,925.9
U.S. government and agencies	1,413.1	18.8	11.0	1,420.9
States and political subdivisions	5,850.7	215.4	69.9	5,996.2
Non-U.S. governments	540.3	73.5	1.3	612.5
Total fixed maturities, available-for-sale	$ 51,764.6	$ 2,054.2	$ 461.3	$ 53,357.5

(1) This exposure is all related to sub-prime mortgage loans.

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	December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)			
Finance Banking	$ 4,214.3	$ 92.1	$ 80.0	$ 4,226.4
Finance Brokerage	333.8	12.2	2.3	343.7
Finance Finance Companies	283.9	5.8	0.4	289.3
Finance Financial Other	498.2	39.9	1.6	536.5
Finance Insurance	2,380.6	197.7	14.4	2,563.9
Finance REITS	1,141.8	28.7	13.8	1,156.7
Industrial Basic Industry	1,135.4	49.0	13.3	1,171.1
Industrial Capital Goods	1,860.6	100.4	13.3	1,947.7
Industrial Communications	2,403.5	203.7	11.7	2,595.5
Industrial Consumer Cyclical	1,525.7	67.8	4.0	1,589.5
Industrial Consumer Non-Cyclical	3,485.3	145.5	31.3	3,599.5
Industrial Energy	2,722.6	178.6	47.8	2,853.4
Industrial Other	284.9	13.7		298.6
Industrial Technology	1,292.2	40.7	5.3	1,327.6
Industrial Transportation	1,428.5	52.7	26.7	1,454.5
Utility Electric	3,189.6	167.1	44.2	3,312.5
Utility Natural Gas	322.7	13.7	2.9	333.5
Utility Other	255.0	15.5		270.5
Government guaranteed	1,182.5	100.3	8.7	1,274.1
Total corporate securities	29,941.1	1,525.1	321.7	31,144.5
Residential mortgage-backed pass-through securities	2,786.8	66.4	30.6	2,822.6
Commercial mortgage-backed securities	4,124.2	31.1	87.0	4,068.3
Residential collateralized mortgage obligations	1,822.9	14.4	23.6	1,813.7
Asset-backed securities Home equity (1)	247.6	14.0	8.8	252.8
Asset-backed securities All other	2,995.3	8.6	17.3	2,986.6
Collateralized debt obligations Credit	52.0		21.7	30.3
Collateralized debt obligations CMBS	0.3			0.3
Collateralized debt obligations Loans	727.3	2.8	2.6	727.5
Total mortgage-backed and other asset-backed securities	12,756.4	137.3	191.6	12,702.1
U.S. government and agencies	1,409.3	17.1	10.7	1,415.7
States and political subdivisions	5,460.4	192.4	86.9	5,565.9
Non-U.S. governments	475.0	71.7	4.7	542.0
Total fixed maturities, available-for-sale	$ 50,042.2	$ 1,943.6	$ 615.6	$ 51,370.2

(1) This exposure is all related to sub-prime mortgage loans.

Of the $461.3 million in gross unrealized losses as of March 31, 2017, $6.3 million in losses were attributed to securities scheduled to mature in one year or less, $22.6 million attributed to securities scheduled to mature between one to five years, $48.5 million attributed to securities scheduled to mature between five to ten years, $218.7 million attributed to securities scheduled to mature after ten years and $165.2 million related to mortgage-backed and other ABS that are not classified by maturity year. As of March 31, 2017, we were in a $1,592.9 million net unrealized gain position as compared to a $1,328.0 million net unrealized gain position as of December 31, 2016. The $264.9 million increase in net unrealized gains for the three months ended March 31, 2017, can primarily be attributed to tightening of credit spreads and an approximate 2 basis point decrease in interest rates.

Fixed Maturities Available-for-Sale Unrealized Losses. We believe our long-term fixed maturities portfolio is well diversified among industry types and between publicly traded and privately placed securities. Each year, we direct the majority of our net cash inflows into investment grade fixed maturities. Our current policy is to limit the percentage of cash flow invested in below investment grade assets to 10% of cash flow.

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We invest in privately placed fixed maturities to enhance the overall value of the portfolio, increase diversification and obtain higher yields than are possible with comparable quality public market securities. Generally, private placements provide broader access to management information, strengthened negotiated protective covenants, call protection features and, where applicable, a higher level of collateral. They are, however, generally not freely tradable because of restrictions imposed by federal and state securities laws and illiquid trading markets.

The following table presents our fixed maturities available-for-sale by investment grade and below investment grade and the associated gross unrealized gains and losses, including the other-than-temporary impairment losses reported in AOCI, as of the periods indicated.

	March 31, 2017				December 31, 2016			
	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount	Amortized cost	Gross unrealized gains	Gross unrealized losses	Carrying amount
	(in millions)							
Investment grade:								
Public	**$ 33,908.4**	**$ 1,426.9**	**$ 294.4**	**$ 35,040.9**	$ 32,818.8	$ 1,347.3	$ 368.8	$ 33,797.3
Private	**14,580.9**	**533.3**	**83.8**	**15,030.4**	13,814.6	508.1	113.2	14,209.5
Below investment grade:								
Public	**1,603.1**	**51.6**	**30.5**	**1,624.2**	1,617.5	47.0	62.0	1,602.5
Private	**1,672.2**	**42.4**	**52.6**	**1,662.0**	1,791.3	41.2	71.6	1,760.9
Total fixed maturities, available-for-sale	**$ 51,764.6**	**$ 2,054.2**	**$ 461.3**	**$ 53,357.5**	$ 50,042.2	$ 1,943.6	$ 615.6	$ 51,370.2

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, on investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

	March 31, 2017					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	**$ 2,016.6**	**$ 14.4**	**$ 1,104.1**	**$ 6.3**	**$ 3,120.7**	**$ 20.7**
Greater than three to six months	**6,218.9**	**189.5**	**2,303.8**	**43.1**	**8,522.7**	**232.6**
Greater than six to nine months	**874.9**	**47.0**	**365.5**	**8.8**	**1,240.4**	**55.8**
Greater than nine to twelve months	**4.4**		**58.6**	**0.9**	**63.0**	**0.9**
Greater than twelve to twenty-four months	**481.4**	**16.6**	**342.5**	**7.6**	**823.9**	**24.2**
Greater than twenty-four to thirty-six months	**88.6**	**3.3**	**73.8**	**2.1**	**162.4**	**5.4**
Greater than thirty-six months	**304.8**	**23.6**	**204.1**	**15.0**	**508.9**	**38.6**
Total fixed maturities, available-for-sale	**$ 9,989.6**	**$ 294.4**	**$ 4,452.4**	**$ 83.8**	**$ 14,442.0**	**$ 378.2**

	December 31, 2016					
	Public		Private		Total	
		Gross		Gross		Gross

	Carrying amount	unrealized losses	Carrying amount	unrealized losses	Carrying amount	unrealized losses
			(in millions)			
Three months or less	$ 9,056.5	$ 230.1	$ 3,335.5	$ 61.9	$ 12,392.0	$ 292.0
Greater than three to six months	985.0	55.9	512.5	18.6	1,497.5	74.5
Greater than six to nine months	79.5	1.0	58.9	0.9	138.4	1.9
Greater than nine to twelve months	93.7	7.9	176.0	6.5	269.7	14.4
Greater than twelve to twenty-four months	512.4	17.1	292.2	5.8	804.6	22.9
Greater than twenty-four to thirty-six months	108.1	4.4	38.8	3.8	146.9	8.2
Greater than thirty-six months	397.7	52.4	231.5	15.7	629.2	68.1
Total fixed maturities, available-for-sale	$ 11,232.9	$ 368.8	$ 4,645.4	$ 113.2	$ 15,878.3	$ 482.0

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The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, on below investment grade fixed maturities available-for-sale by aging category as of the periods indicated.

	March 31, 2017					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	**$ 135.0**	**$ 0.4**	**$ 199.5**	**$ 0.7**	**$ 334.5**	**$ 1.1**
Greater than three to six months	**5.8**	**0.2**	**33.3**	**0.9**	**39.1**	**1.1**
Greater than six to nine months	**10.1**	**2.1**	**34.7**	**3.2**	**44.8**	**5.3**
Greater than twelve to twenty-four months	**88.5**	**8.7**	**47.6**	**7.5**	**136.1**	**16.2**
Greater than twenty-four to thirty-six months	**113.8**	**11.0**	**79.4**	**13.6**	**193.2**	**24.6**
Greater than thirty-six months	**131.6**	**8.1**	**79.8**	**26.7**	**211.4**	**34.8**
Total fixed maturities, available-for-sale	**$ 484.8**	**$ 30.5**	**$ 474.3**	**$ 52.6**	**$ 959.1**	**$ 83.1**

	December 31, 2016					
	Public		Private		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	$ 88.2	$ 2.8	$ 168.6	$ 2.5	$ 256.8	$ 5.3
Greater than three to six months	10.9	1.3	62.2	3.8	73.1	5.1
Greater than six to nine months		0.1	6.2	0.1	6.2	0.2
Greater than nine to twelve months	3.4	0.5	1.0	0.1	4.4	0.6
Greater than twelve to twenty-four months	200.6	16.8	76.0	7.8	276.6	24.6
Greater than twenty-four to thirty-six months	147.8	17.6	93.6	22.7	241.4	40.3
Greater than thirty-six months	135.4	22.9	85.8	34.6	221.2	57.5
Total fixed maturities, available-for-sale	$ 586.3	$ 62.0	$ 493.4	$ 71.6	$ 1,079.7	$ 133.6

The following tables present the carrying amount and the gross unrealized losses, including other-than-temporary impairment losses reported in AOCI, on fixed maturities available-for-sale where the estimated fair value had declined and remained below amortized cost by 20% or more as of the periods indicated.

	March 31, 2017					
	Problem, potential problem and restructured		All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses

			(in millions)			
Three months or less	$ 5.2	$ 2.0	$ 9.4	$ 4.9	$ 14.6	$ 6.9
Greater than three to six months	4.0	1.1	6.1	2.6	10.1	3.7
Greater than six to nine months	18.0	10.6	1.6	1.4	19.6	12.0
Greater than nine to twelve months				0.1		0.1
Greater than twelve months	36.5	15.9	25.9	19.4	62.4	35.3
Total fixed maturities, available-for-sale	$ 63.7	$ 29.6	$ 43.0	$ 28.4	$ 106.7	$ 58.0

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	December 31, 2016					
	Problem, potential problem and restructured		All other fixed maturity securities		Total	
	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses	Carrying amount	Gross unrealized losses
	(in millions)					
Three months or less	$ 4.9	$ 1.2	$ 31.0	$ 8.8	$ 35.9	$ 10.0
Greater than three to six months	25.8	16.2	2.2	1.2	28.0	17.4
Greater than six to nine months			0.1	0.1	0.1	0.1
Greater than nine to twelve months	4.6	2.5	0.1	0.2	4.7	2.7
Greater than twelve months	45.7	35.4	50.6	30.6	96.3	66.0
Total fixed maturities, available-for-sale	$ 81.0	$ 55.3	$ 84.0	$ 40.9	$ 165.0	$ 96.2

Mortgage Loans

Mortgage loans consist of commercial mortgage loans on real estate and residential mortgage loans. The carrying amount of our commercial mortgage loan portfolio was $12,049.3 million and $11,940.5 million as of March 31, 2017 and December 31, 2016, respectively. The carrying amount of our residential mortgage loan portfolio was $723.8 million and $680.5 million as of March 31, 2017 and December 31, 2016, respectively.

Commercial Mortgage Loans. We generally report commercial mortgage loans on real estate at cost adjusted for amortization of premiums and accrual of discounts, computed using the interest method and net of valuation allowances.

Commercial mortgage loans play an important role in our investment strategy by:

- providing strong risk-adjusted relative value in comparison to other investment alternatives;
- enhancing total returns and
- providing strategic portfolio diversification.

As a result, we have focused on constructing a high quality portfolio of mortgages. Our portfolio is generally comprised of mortgages originated with conservative loan-to-value ratios, high debt service coverages and general purpose property types with a strong credit tenancy.

Our commercial mortgage loan portfolio consists primarily of non-recourse, fixed rate mortgages on fully or near fully leased properties. The mortgage portfolio is comprised primarily of office properties, apartments, well anchored retail properties and general-purpose industrial properties.

Our commercial mortgage loan portfolio is diversified by geography and specific collateral property type. Commercial mortgage lending in the state of California accounted for 17% and 18% of our commercial mortgage loan portfolio before valuation allowance as of March 31, 2017 and December 31, 2016, respectively. We are, therefore, exposed to potential losses resulting from the risk of catastrophes, such as earthquakes, that may affect the region. Like other lenders, we generally do not require earthquake insurance for properties on which we make commercial mortgage loans. With respect to California properties, however, we obtain an engineering report specific to each property. The report assesses the building s design specifications, whether it has been upgraded to meet seismic building codes and the maximum loss that is likely to result from a variety of different seismic events. We also obtain a report that assesses, by building and geographic fault lines, the amount of loss our commercial mortgage loan portfolio might suffer under a variety of seismic events.

The typical borrower in our commercial loan portfolio is a single purpose entity or single asset entity. As of March 31, 2017 and December 31, 2016, the total number of commercial mortgage loans outstanding was 829 and 840, of which 54% and 55% were for loans with principal balances less than $10.0 million, respectively. The average loan size of our commercial mortgage portfolio was $14.6 million and $14.2 million as of March 31, 2017 and December 31, 2016, respectively.

Commercial Mortgage Loan Credit Monitoring. For further details on monitoring and management of our commercial mortgage loan portfolio, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Credit Monitoring.

We categorize loans that are 60 days or more delinquent, loans in process of foreclosure and loans with borrowers or credit tenants in bankruptcy that are delinquent as problem loans. Valuation allowances or charge-offs have been recognized on most problem loans. We categorize loans that are delinquent less than 60 days where the default is expected to be cured and

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loans with borrowers or credit tenants in bankruptcy that are current as potential problem loans. The decision whether to classify a loan delinquent less than 60 days as a potential problem involves significant subjective judgments by management as to the likely future economic conditions and developments with respect to the borrower. We categorize loans for which the original note rate has been reduced below market and loans for which the principal has been reduced as restructured loans. We also consider loans that are refinanced more than one year beyond the original maturity or call date at below market rates as restructured.

We did not have problem, potential problem and restructured commercial mortgages as of March 31, 2017 and December 31, 2016.

Commercial Mortgage Loan Valuation Allowance. The valuation allowance for commercial mortgage loans includes loan specific reserves for loans that are deemed to be impaired as well as reserves for pools of loans with similar risk characteristics where a property risk or market specific risk has not been identified but for which we anticipate a loss may occur. For further details on the commercial mortgage loan valuation allowance, see Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 3, Investments Mortgage Loan Valuation Allowance.

The following table represents our commercial mortgage loan valuation allowance for the periods indicated.

	For the three months ended March 31, 2017		For the year ended December 31, 2016	
	($ in millions)			
Balance, beginning of period	**$**	**27.4**	$	27.5
Provision		**0.6**		1.4
Charge-offs				(1.5)
Balance, end of period	**$**	**28.0**	$	27.4
Valuation allowance as % of carrying value before reserves		**0.23%**		0.23%

Residential Mortgage Loans. The residential mortgage loan portfolio is composed of home equity mortgages with an amortized cost of $152.3 million and $165.6 million and first lien mortgages with an amortized cost of $588.2 million and $531.9 million as of March 31, 2017 and December 31, 2016, respectively. The home equity loans are generally second lien mortgages made up of closed-end loans and lines of credit. Non-performing residential mortgage loans, which are defined as loans 90 days or greater delinquent plus non-accrual loans, totaled $11.0 million and $12.2 million as of March 31, 2017 and December 31, 2016, respectively.

We establish the residential mortgage loan valuation allowance at levels considered adequate to absorb estimated probable losses within the portfolio based on management s evaluation of the size and current risk characteristics of the portfolio. Such evaluation considers numerous factors, including, but not limited to net charge-off trends, loss forecasts, collateral values, geographic location, borrower credit scores, delinquency rates, industry condition and economic trends. The changes in the valuation allowance are reported in net realized capital gains (losses) on our consolidated statements of operations.

Our residential mortgage loan portfolio, and in particular our home equity loan portfolio, experienced an increase in loss severity from sustained elevated levels of unemployment along with continued depressed collateral values beginning in 2010. While these factors continue to drive charge-offs, loss rates overall have stabilized and the home equity loan portfolio balance continues to decline. The following table represents our residential mortgage loan valuation allowance for the periods indicated.

	For the three months ended March 31, 2017	For the year ended December 31, 2016
	($ in millions)	
Balance, beginning of period	**$ 17.0**	$ 23.9
Provision		(5.7)
Charge-offs	**(1.6)**	(4.8)
Recoveries	**1.3**	3.6
Balance, end of period	**$ 16.7**	$ 17.0
Valuation allowance as % of carrying value before reserves	**2.3%**	2.4%

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Real Estate

Real estate consists primarily of commercial equity real estate. As of March 31, 2017 and December 31, 2016, the carrying amount of our equity real estate investment was $1,429.6 million, or 2%, and $1,365.2 million, or 2%, of U.S. invested assets, respectively. Our commercial equity real estate is held in the form of wholly owned real estate, real estate acquired upon foreclosure of commercial mortgage loans and majority owned interests in real estate joint ventures.

Equity real estate is categorized as either real estate held for investment or real estate held for sale. Real estate held for investment totaled $1,290.0 million and $1,236.5 million as of March 31, 2017 and December 31, 2016, respectively. The carrying value of real estate held for investment is generally adjusted for impairments whenever events or changes in circumstances indicate the carrying amount of the asset may not be recoverable. Such impairment adjustments are recorded as net realized capital losses in our consolidated results of operations. Impairment adjustments recorded for the year ended December 31, 2016 were $0.8 million. No such impairment adjustments were recorded for the three months ended March 31, 2017.

The carrying amount of real estate held for sale was $139.6 million and $128.7 million as of March 31, 2017 and December 31, 2016, respectively. Once we identify a real estate property to be sold and it is probable that it will be sold, we classify the property as held for sale. We establish a valuation allowance subject to periodic revisions, if necessary, to adjust the carrying value of the property to reflect the lower of its current carrying value or the fair value, less associated selling costs. The change in valuation allowance for the year ended December 31, 2016, was $4.5 million. The valuation allowance did not change for the three months ended March 31, 2017.

We use research, both internal and external, to recommend appropriate product and geographic allocations and changes to the equity real estate portfolio. We monitor product, geographic and industry diversification separately and together to determine the most appropriate mix.

Equity real estate is distributed across geographic regions of the country. As of March 31, 2017, our equity real estate portfolio was concentrated in the Pacific (34%), South Atlantic (17%), East North Central (14%), and West South Central (14%) regions of the United States. By property type, we had a concentration in office (42%) and apartments (31%) as of March 31, 2017.

Other Investments

Our other investments totaled $1,602.7 million as of March 31, 2017, compared to $2,088.7 million as of December 31, 2016. Derivative assets accounted for $291.6 million and $871.6 million in other investments as of March 31, 2017 and December 31, 2016, respectively. The remaining invested assets are primarily related to equity method investments, which include real estate properties owned jointly with venture partners and operated by the partners and sponsored investment funds.

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International Investment Operations

Of our invested assets, $7,403.3 million were held by our Principal International segment as of March 31, 2017. The assets are primarily managed by the local Principal International affiliate. Due to the regulatory constraints in each location, each company maintains its own investment policies. As shown in the following table, the major category of international invested assets is fixed maturities. The following table excludes invested assets of the separate accounts.

	March 31, 2017		December 31, 2016	
	Carrying amount	Percent of total	Carrying amount	Percent of total
		($ in millions)		
Fixed maturities:				
Public	$ **3,795.3**	**51%**	$ 3,645.5	52%
Private	**13.4**		9.0	
Equity securities	**1,271.3**	**17**	1,169.7	17
Mortgage loans:				
Commercial	**88.4**	**1**	87.3	1
Residential	**526.6**	**7**	521.9	7
Real estate held for sale	**2.0**		2.0	
Real estate held for investment	**1.7**		1.6	
Policy loans	**23.7**		23.1	
Other investments:				
Direct financing leases	**903.8**	**13**	875.2	13
Investment in equity method subsidiaries	**654.1**	**9**	598.7	9
Derivative assets and other investments	**123.0**	**2**	93.3	1
Total invested assets	**7,403.3**	**100%**	7,027.3	100%
Cash and cash equivalents	**178.3**		384.1	
Total invested assets and cash	$ **7,581.6**		$ 7,411.4	

Regulations in certain locations require investment in the funds we manage. These required regulatory investments are classified as equity securities, trading within our consolidated statements of financial position, with all mark-to-market changes reflected in net investment income. Our investment is primarily dictated by client activity and all investment performance is retained by us.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market Risk Exposures and Risk Management

Market risk is the risk we will incur losses due to adverse fluctuations in market rates and prices. Our primary market risk exposures are to interest rates, equity markets and foreign currency exchange rates. The active management of market risk is an integral part of our operations. We manage our overall market risk exposure within established risk tolerance ranges using several approaches, including:

- rebalancing our existing asset or liability portfolios;
- controlling the risk structure of newly acquired assets and liabilities and
- using derivative instruments to modify the market risk characteristics of existing assets or liabilities or assets expected to be purchased.

Interest Rate Risk

Interest rate risk is the risk of economic losses due to adverse changes in interest rates. Interest rate risk arises primarily from our holdings in interest sensitive assets and liabilities. Changes in interest rates impact numerous aspects of our operations, including but not limited to:

- yield on our invested assets;
- rate of interest we credit to contractholder account balances;
- timing of cash flows on assets and liabilities containing embedded prepayment options;
- cost of hedging our GMWB rider;
- discount rate used in valuing our pension and OPEB obligations;

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- estimated gross profits and the amortization of our DAC asset and related actuarial balances;
- statutory reserve and capital requirements;
- asset-based fees earned on the fixed income assets we manage;
- interest expense on our long-term borrowings;
- fair value of intangible assets in our reporting units and
- fair value of financial assets and liabilities held at fair value on our consolidated statements of financial position.

Lower interest rates generally result in lower profitability in the long-term. Conversely, higher interest rates generally result in higher profitability in the long-term.

Impact of Changes in Long-Term Interest Rate Assumptions

We use long-term interest rate assumptions to calculate reserves, DAC, other actuarial balances and benefit plan obligations in accordance with U.S GAAP. In setting these assumptions, we consider a variety of factors, including historical experience, emerging trends and future expectations. We evaluate our assumptions on at least an annual basis. Due to the long-term nature of our assumptions, we generally do not revise our assumptions in response to short-term fluctuations in market interest rates. However, we will consider revising our assumptions if a significant change occurs in the factors noted above.

A reduction in our long-term interest rate assumptions may result in increases in our reserves and/or unlocking of our DAC asset and other actuarial balances. For additional information, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Deferred Acquisition Costs and Other Actuarial Balances in our Annual Report on Form 10-K for the year ended December 31, 2016.

In addition, we have implemented reinsurance transactions utilizing affiliated reinsurers and highly rated third parties to finance a portion of the statutory reserves for our term life insurance policies and universal life insurance policies with secondary guarantees. We calculate an economic reserve, which represents an estimate of our liability associated with these contracts. The excess of the required statutory reserve over the economic reserve is secured by financing provided by highly rated third parties. The long-term interest rate assumption is a key input in the calculation of the economic reserve. A reduction in our long-term interest rate assumption would reduce the portion of the statutory reserve that can be financed through affiliated reinsurers, thus increasing the amount of invested assets we must maintain to support statutory reserves. For additional information, see Item 8. Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 15, Statutory Insurance Financial Information in our Annual Report on Form 10-K for the year ended December 31, 2016.

Impact of Changes in Interest Rates

Changes in interest rates or a sustained low interest rate environment may result in the following impacts, which would impact our financial position and results of operations:

Impact of Falling Interest Rates or Sustained Low Interest Rates	**Impact of Rising Interest Rates**
Adverse Impacts:	***Positive Impacts:***
A reduction in investment income, which may be partially offset by a reduction in the interest we credit on contractholder account balances; however, our ability to lower crediting rates may be constrained by guaranteed minimum interest rates and competitive pressures	An increase in investment income, which may be partially or fully offset by an increase in the interest we credit on contractholder account balances
An increase in the cost of hedging our GMWB rider	A decrease in the cost of hedging our GMWB rider
An increase in reserves and/or a true-up or unlocking of our DAC asset and other actuarial balances	A true-up or unlocking of our DAC asset and other actuarial balances
A reduction in the discount rate used in valuing our pension and OPEB obligations, leading to an increase in our Projected Benefit Obligation, NPPC, Accumulated Postretirement Benefit Obligation and NPBC	An increase in the discount rate used in valuing our pension and OPEB obligations, leading to a decrease in our Projected Benefit Obligation, NPPC, Accumulated Postretirement Benefit Obligation and NPBC
An increase in statutory capital we are required to hold as well as the amount of assets we must maintain to support statutory reserves	A decrease in statutory capital we are required to hold as well as the amount of assets we must maintain to support statutory reserves
An increase in prepayments or redemptions on mortgages and bonds we own, which would force us to reinvest the proceeds at lower interest rates	

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Impact of Falling Interest Rates or Sustained Low Interest Rates	**Impact of Rising Interest Rates**
Positive Impacts:	***Adverse Impacts:***
An increase in the value of the fixed income assets we manage, resulting in an increase in our fee revenue in the short-term	A decrease in the value of the fixed income assets we manage, resulting in a decrease in our fee revenue in the short-term
A decrease in the interest expense on our long-term borrowings, to the extent we are able to refinance our obligations at lower interest rates	An increase in the interest expense on our long-term borrowings, to the extent we refinance our obligations at higher interest rates
An increase in the fair value of certain financial assets held at fair value on our consolidated statements of financial position	A decrease in the fair value of certain financial assets held at fair value on our consolidated statements of financial position, as discussed below
	A reduction in the fair value of intangible assets in our reporting units, potentially leading to an impairment of goodwill or other intangible assets

We estimate a hypothetical 100 basis point immediate, parallel decrease in interest rates would reduce segment pre-tax operating earnings by less than 1% over the next 12 months excluding the impact of any potential unlocking of our DAC asset and other actuarial balances. This estimate reflects the impact of routine management actions in response to a drop in interest rates, such as reducing the interest rates we credit on contractholder account balances; however, it does not reflect the impact of other actions management may consider, such as curtailing sales of certain products. We anticipate the adverse segment pre-tax operating earnings impacts of a decrease in market interest rates will grow over time as assets mature and we are forced to reinvest at lower interest rates.

The selection of a 100 basis point immediate, parallel decrease in interest rates should not be construed as a prediction by us of future market events, but rather as an illustration of the impact of such an event. Our exposure will change as a result of ongoing portfolio transactions in response to new business, management s assessment of changing market conditions and changes in our mix of business.

If market rates increase rapidly, policy surrenders, withdrawals and requests for policy loans may increase as customers seek to achieve higher returns. This may result in unlocking of our DAC and other actuarial balances. We may be required to sell assets to raise the cash necessary to respond to such surrenders, withdrawals and loans, thereby realizing capital losses on the assets sold.

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Guaranteed Minimum Interest Rate Exposure. The following table provides detail on the differences between the interest rates being credited to contractholders as of March 31, 2017, and the respective guaranteed minimum interest rates (GMIRs). Account values are broken down by GMIR level within the Retirement and Income Solutions and U.S. Insurance Solutions segments.

	Account values (1)					
	Excess of crediting rates over GMIR:					
	At GMIR	Up to 0.50% above GMIR	0.51% to 1.00% above GMIR	1.01% to 2.00% above GMIR	2.01% or more above GMIR	Total
			($ in millions)			
Guaranteed minimum interest rate						
Retirement and Income Solutions						
Up to 1.00%	$ **546.4**	$ **746.9**	$ **5,554.6**	$ **1,798.4**	$ **309.5**	$ **8,955.8**
1.01% - 2.00%	**926.5**	**762.1**	**1.0**	**25.5**		**1,715.1**
2.01% - 3.00%	**6,049.6**	**66.2**	**0.2**	**7.7**		**6,123.7**
3.01% - 4.00%	**220.6**					**220.6**
Subtotal	**7,743.1**	**1,575.2**	**5,555.8**	**1,831.6**	**309.5**	**17,015.2**
U.S. Insurance Solutions						
Up to 1.00%		**21.2**	**7.7**			**28.9**
1.01% - 2.00%	**314.2**		**204.8**	**211.2**	**61.1**	**791.3**
2.01% - 3.00%	**1,897.5**	**996.6**	**284.8**	**95.5**	**0.1**	**3,274.5**
3.01% - 4.00%	**1,477.4**	**52.9**	**8.6**	**29.5**	**4.3**	**1,572.7**
4.01% - 5.00%	**203.8**	**34.0**	**36.1**	**36.1**		**310.0**
Subtotal	**3,892.9**	**1,104.7**	**542.0**	**372.3**	**65.5**	**5,977.4**
Total	$ **11,636.0**	$ **2,679.9**	$ **6,097.8**	$ **2,203.9**	$ **375.0**	$ **22,992.6**
Percentage of total	**50.6%**	**11.7%**	**26.5%**	**9.6%**	**1.6%**	**100.0%**

(1) Includes only the account values, net of policy loans, for products with GMIRs and discretionary crediting rates.

In addition to the domestic account values shown in the table above, Principal International had $632.6 million and $585.7 million of account values with GMIRs in Hong Kong and Brazil, respectively, as of March 31, 2017. The Brazil amount includes account values from an equity method subsidiary, adjusted to reflect the proportion of the subsidiary s results reflected in our net income. Our liabilities in Principal International are generally denominated in the functional currency of the location of operation. The pattern of interest rate movements in our international operations will likely differ from the pattern of interest rate movements in the U.S.

Impact of Rising Interest Rates on the Fair Value of Financial Assets. An increase in market interest rates may cause a decline in the value of financial assets held at fair value on our consolidated statements of financial position. Although changes in the fair value of our financial assets due to changes in interest rates may impact the amount of equity reported in our consolidated statements of financial position, these changes will not cause an economic gain or loss unless we sell investments, terminate derivative positions, determine an investment is other than temporarily impaired, or determine a derivative instrument is no longer an effective hedge.

We estimate a hypothetical 100 basis point immediate, parallel increase in interest rates would reduce the net reported fair value of our financial assets and derivatives by $3,280.8 million as of March 31, 2017, compared to $3,100.1 million as of December 31, 2016. This estimate only reflects the change in fair value for financial assets and derivatives reported at fair value on our consolidated statements of financial position. Assets and liabilities not reported at fair value on our consolidated statements of financial position including mortgage loans, liabilities relating to insurance contracts, investment contracts, debt and bank deposits are excluded from this sensitivity analysis. We believe the excluded liability items would economically serve as a partial offset to the net interest rate risk of the financial instruments included in the sensitivity analysis. Separate account assets and liabilities are also excluded from this estimate, as any interest rate risk is borne by the holder of the separate account. For more information on fair value measurements, see Item 8. Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 14, Fair Value Measurements in our Annual Report on Form 10-K for the year ended December 31, 2016.

Our selection of a 100 basis point immediate, parallel increase in interest rates is a hypothetical rate scenario we use to demonstrate potential risk. While a 100 basis point immediate, parallel increase does not represent our view of future market changes, it is a near term reasonably possible hypothetical change that illustrates the potential impact of such events. While this

sensitivity analysis provides a representation of interest rate sensitivity, it is based on our portfolio exposures at a point in time and may not be representative of future market results. These exposures will change as a result of ongoing portfolio transactions in response to new business, management s assessment of changing market conditions and available investment opportunities.

Our net estimated potential loss in fair value as of March 31, 2017, increased $180.7 million from December 31, 2016, primarily due to an increase in our invested assets and an increase in the duration of our financial assets with interest rate risk.

Interest Rate Risk Management

We manage interest rate risk through the use of an integrated risk management framework. This helps us identify, assess, monitor, report and manage our risks within established limits and risk tolerances. Our internal risk committees monitor and discuss our risk profile and identify necessary actions to mitigate impacts from interest rate risk.

The product designs within our business units result in a variety of different interest rate risk profiles. Therefore, our business units use a variety of different approaches for managing their asset and liability interest rate risks.

- *Retirement Business Stable Cash Flows* For stable and predictable cash flow liabilities, such as full service payout, full service accumulation and investment only, we use investment strategy and hedges to tightly align the cash flow run off of these asset and liability cash flows. Market value immunization and embedded value analysis are also utilized in the management of interest rate risk.

- *Retirement Business Dynamic Cash Flows* Dynamic liability cash flows, such as fixed annuities, are sensitive to policyholder behavior and the current interest rate environment. The risk and return metrics from deterministic and stochastic interest rate scenarios are used to manage the interest rate risk for these liabilities.

- *U.S. Insurance Stable Cash Flows* Our insurance businesses in many instances contain long-term guarantees with stable and predictable liability cash flows and recurring premiums. We manage the interest rate risk through duration analysis, investment strategy and product crediting rates.

- *Principal International* Our international businesses operate within local regulations and financial market conditions (e.g., derivative markets, assets available) to achieve similar asset and liability cash flow management objectives. In locations with a limited availability of long-dated assets and derivative markets, the duration gap is managed to risk tolerances specific to each location.

We also limit our exposure to interest rate risk through our business mix and strategy. We have intentionally limited our exposure to specific products where investment margins are critical to the product s profitability, and we continue to emphasize the sale of products that generate revenues in the form of fees for service or premiums for insurance coverage and expose us to minimal interest rate risk.

Prepayment risk is controlled by limiting our exposure to investments that are prepayable without penalty prior to maturity at the option of the issuer. We also require additional yield on these investments to compensate for the risk the issuer will exercise such option. Prepayment risk is also controlled by limiting the sales of liabilities with features such as puts or other options that can be exercised against the company at inopportune times. We manage the interest rate risk associated with our long-term borrowings by monitoring the interest rate environment and evaluating refinancing opportunities as maturity dates approach.

The plan fiduciaries use a Dynamic Asset Allocation strategy for our qualified defined benefit pension plan, which strategically allocates an increasing portion of the assets of the pension plan to fixed income securities as the funding status improves. The intended purpose of using the Dynamic Asset Allocation strategy is that the expected change in the value of the plan assets and the change in pension benefit obligation due to market movements are more likely to have more correlation versus a static allocation of assets between categories. For more information see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Benefit Plans and Item 8. Financial Statements and Supplementary Data, Notes to Consolidated Financial Statements, Note 11, Employee and Agent Benefits in our Annual Report on Form 10-K for the year ended December 31, 2016.

Use of Derivatives to Manage Interest Rate Risk. We use or have previously used various derivative financial instruments to manage our exposure to fluctuations in interest rates, including interest rate swaps, interest rate collars, swaptions and futures. We use interest rate swaps and futures contracts to hedge changes in interest rates subsequent to the issuance of an insurance liability, such as a guaranteed investment contract, but prior to the purchase of a supporting asset, or during periods of

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holding assets in anticipation of near term liability sales. We use interest rate swaps primarily to more closely match the interest rate characteristics of assets and liabilities. They can be used to change the sensitivity to the interest rate of specific assets and liabilities as well as an entire portfolio. We use interest rate collars to manage interest rate risk related to GMIR liabilities in our individual annuities contracts and lapse risk associated with higher interest rates. We purchase swaptions to offset or modify existing exposures.

Foreign Currency Risk

Foreign currency risk is the risk we will incur economic losses due to adverse fluctuations in foreign currency exchange rates. This risk arises from foreign currency-denominated funding agreements issued to nonqualified institutional investors in the international market, foreign currency-denominated fixed maturity and equity securities, and our international operations, including potential acquisition and divestiture activity.

We estimate as of March 31, 2017, a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we are exposed would result in no material change to the net fair value of our foreign currency-denominated instruments identified above because we effectively hedge foreign currency-denominated instruments to minimize exchange rate impacts, which is consistent with our estimate as of December 31, 2016. However, fluctuations in foreign currency exchange rates do affect the translation of segment pre-tax operating earnings and equity of our international operations into our consolidated financial statements.

For our Principal International segment, we estimate a 10% immediate unfavorable change in each of the foreign currency exchange rates to which we were exposed would have resulted in a $325.6 million, or 10%, reduction in the total equity excluding noncontrolling interests of our international operations as of March 31, 2017, as compared to an estimated $306.0 million, or 10%, reduction as of December 31, 2016. We estimate a 10% unfavorable change in the average foreign currency exchange rates to which we were exposed through our international operations would have resulted in a $12.0 million, or 12%, reduction in segment pre-tax operating earnings of our international operations for the three months ended March 31, 2017, as compared to an estimated $8.5 million, or 13%, reduction for the three months ended March 31, 2016.

The selection of a 10% immediate unfavorable change in all currency exchange rates should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. These exposures will change as a result of a change in the size and mix of our foreign operations.

Use of Derivatives to Manage Foreign Currency Risk. The foreign currency risk on funding agreements and fixed maturities in our U.S. operations is mitigated by using currency swaps that swap the foreign currency interest and principal payments to our functional currency. The notional amount of our currency swap agreements associated with foreign-denominated liabilities was $232.2 million and $881.1 million as of March 31, 2017 and December 31, 2016, respectively. The notional amount of our currency swap agreements associated with foreign-denominated fixed maturities was $395.5 million and $452.8 million as of March 31, 2017 and December 31, 2016, respectively. The notional amount of our currency forwards hedging foreign-denominated equity securities was $24.6 million and $18.9 million as of March 31, 2017 and December 31, 2016, respectively.

With regard to our international operations, in order to enhance the diversification of our investment portfolios we may invest in bonds denominated in a currency that is different than the currency of our liabilities. We use foreign exchange derivatives to economically hedge the currency mismatch. Our Principal International operations had currency swaps with a notional amount of $223.0 million and $218.1 million as of March 31, 2017 and December 31, 2016, respectively. Our Principal International operations also utilized currency forwards with a notional amount of $712.7 million and $713.5 million as of March 31, 2017 and December 31, 2016, respectively.

We sometimes use derivatives to hedge currency risk associated with expected cash flows from our foreign operations. We held currency forwards with a notional amount of $159.1 million and $118.9 million as March 31, 2017 and December 31, 2016, respectively. We also utilized currency options with a notional amount of $63.2 million and $0.0 million as of March 31, 2017 and December 31, 2016, respectively.

Equity Risk

Equity risk is the risk we will incur economic losses due to adverse fluctuations in common stock prices. As of March 31, 2017 and December 31, 2016, the fair value of our equity securities was $1,620.3 million and $1,512.3 million, respectively. We estimate a 10% decline in the prices of the equity securities would result in a decline in fair value of our equity securities of $162.0 million as of March 31, 2017, as compared to a decline in fair value of our equity securities of $151.2 million as of December 31, 2016.

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We are also exposed to the risk that asset-based fees decrease as a result of declines in assets under management due to changes in investment prices and the risk that asset management fees calculated by reference to performance could be lower. The risk of decreased asset-based and asset management fees could also impact our estimates of total gross profits used as a basis for amortizing DAC and other actuarial balances. For further discussion, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Deferred Acquisition Costs and Other Actuarial Balances in our Annual Report on Form 10-K for the year ended December 31, 2016.

We also have equity risk associated with (1) fixed deferred annuity and universal life contracts that credit interest to customers based on changes in an external equity index; (2) variable annuity contracts that have a GMWB rider that allows the customer to make withdrawals of a specified annual amount, either for a fixed number of years or for the lifetime of the customer, even if the account value is reduced to zero; (3) variable annuity contracts that have a guaranteed minimum death benefit (GMDB) that allows the death benefit to be paid, even if the account value has fallen below the GMDB amount and (4) investment contracts in which the return is subject to minimum contractual guarantees. We are also subject to equity risk based upon the assets that support our employee benefit plans. For further discussion of equity risk associated with these plans, see Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Estimates Benefit Plans in our Annual Report on Form 10-K for the year ended December 31, 2016.

We estimate an immediate 10% decline in the S&P 500 index, followed by a 2% per quarter increase would reduce our annual segment pre-tax operating earnings by approximately 4% to 6%. This estimate excludes the impact of any potential unlocking of our DAC asset and other actuarial balances. The selection of a 10% unfavorable change in the S&P 500 index should not be construed as a prediction by us of future market events, but rather as an illustration of the potential impact of such an event. Our exposure will change as a result of changes in our mix of business.

Use of Derivatives to Manage Equity Risk. We economically hedge the fixed deferred annuity and universal life products, where the interest credited is linked to an external equity index, by purchasing options that match the product s profile or selling options to offset existing exposures. We economically hedged the GMWB exposure, which includes interest rate risk and equity risk, using futures, options and interest rate swaps with notional amounts of $450.7 million, $3,135.0 million, and $3,977.8 million, respectively, as of March 31, 2017, and notional amounts of $641.1 million, $3,135.0 million, and $3,996.6 million, respectively, as of December 31, 2016. The fair value of both the GMWB embedded derivative and associated hedging instruments are sensitive to financial market conditions and the variance related to the change in fair value of these items for a given period is largely dependent on market conditions at the end of the period.

Item 4. Controls and Procedures

Changes in Internal Control Over Financial Reporting

We had no change in our internal control over financial reporting during our last fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Disclosure Controls and Procedures

In order to ensure that the information that we must disclose in our filings with the SEC is recorded, processed, summarized and reported on a timely basis, we have adopted disclosure controls and procedures. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file with or submit to the SEC is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

Our Chief Executive Officer, Daniel J. Houston, and our Chief Financial Officer, Deanna D. Strable-Soethout, have reviewed and evaluated our disclosure controls and procedures as of March 31, 2017, and have concluded our disclosure controls and procedures are effective.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

Disclosure concerning material legal proceedings can be found in Part I, Item 1. Financial Statements, Notes to Unaudited Consolidated Financial Statements, Note 8, Contingencies, Guarantees and Indemnifications under the caption, Litigation and Regulatory Contingencies, which is incorporated here by this reference.

Item 1A. Risk Factors

In addition to the other information set forth in this report, consideration should be given to the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2016. If any of those factors were to occur, they could materially adversely affect our business, financial condition or future results, and could cause actual results to differ materially from those expressed in forward-looking statements in this report. We have not had material changes with respect to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

The following table presents the amount of our common share purchase activity for the periods indicated.

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced programs	Maximum dollar value of shares that may yet be purchased under the programs (in millions) (2)
January 1, 2017 January 31, 2017	604,484	$ 57.80	596,709	$ 183.0
February 1, 2017 February 28, 2017	655,087	$ 60.57	376,814	$ 160.8
March 1, 2017 March 31, 2017	1,072,130	$ 63.19	961,667	$ 100.0
Total	2,331,701		1,935,190	

(1) Includes the number of shares of common stock utilized to execute certain stock incentive awards and shares purchased as part of publicly announced programs.

(2) In February 2016, our Board of Directors authorized an additional repurchase of up to $400.0 million of our outstanding common stock.

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Item 6. Exhibits

Exhibit Number	Description
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Daniel J. Houston
31.2	Certification of Deanna D. Strable-Soethout
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Daniel J. Houston
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Deanna D. Strable-Soethout
101	The following materials from Principal Financial Group, Inc. s Quarterly Report on Form 10-Q for the period ended March 31, 2017 formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Unaudited Consolidated Financial Statements.

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

	PRINCIPAL FINANCIAL GROUP, INC.	
Dated: May 3, 2017	By	/s/ Deanna D. Strable-Soethout Deanna D. Strable-Soethout Executive Vice President and Chief Financial Officer Duly Authorized Officer, Principal Financial Officer, and Principal Accounting Officer

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Exhibit Index

Exhibit Number	Description
12	Statement Regarding Computation of Ratio of Earnings to Fixed Charges
31.1	Certification of Daniel J. Houston
31.2	Certification of Deanna D. Strable-Soethout
32.1	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Daniel J. Houston
32.2	Certification Pursuant to Section 1350 of Chapter 63 of Title 18 of the United States Code Deanna D. Strable-Soethout
101	The following materials from Principal Financial Group, Inc. s Quarterly Report on Form 10-Q for the period ended March 31, 2017 formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Statements of Financial Position, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Statements of Stockholders Equity, (v) the Consolidated Statements of Cash Flows and (vi) the Notes to Unaudited Consolidated Financial Statements.