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Principal Financial Group, Inc. (PFG) CEO Daniel Houston on Q3 2019 Results - Earnings Call Transcript

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Q3: 10-24-19 Earnings Summary

Press Release SEC *10-Q* *Slides*

EPS of $1.23 misses by $-0.22 | Revenue of $4.52B (3.60% Y/Y) beats by $531.24M

Earning Call Audio

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Principal Financial Group, Inc. (NASDAQ:PFG) Q3 2019 Earnings Conference Call
October 25, 2019 10:00 AM ET

Company Participants

John Egan - VP, IR

Daniel Houston - Chairman, CEO & President

Deanna Strable - EVP & CFO

Luis Valdés - President & CEO, Principal International, Inc.

Timothy Dunbar - President, Principal Global Asset Management Business

Amy Friedrich - President, United States Insurance Solutions

Renee Schaaf - President, Retirement & Income Solutions (RIS)

Conference Call Participants

Ryan Krueger - KBW

Thomas Gallagher - Evercore ISI

Jamminder Bhullar - JPMorgan Chase & Co.

Humphrey Lee - Dowling & Partners Securities

Suneet Kamath - Citigroup

Erik Bass - Autonomous Research

Joshua Shanker - Deutsche Bank

Taylor Scott - Goldman Sachs Group

Operator

Good morning, and welcome to the Principal Financial Group Third Quarter 2019 Financial Results Conference Call. [Operator Instructions].

I would now like to turn the conference over to John Egan, Vice President of Investor Relations.

John Egan

Thank you, and good morning. Welcome to Principal Financial Group's third quarter conference call. As always, materials related to today's call are available on our website at principal.com\investor. As a reminder, the acquisition of the Wells Fargo Institutional Retirement & Trust business or IRT closed at the beginning of the third quarter, and the financials are reported in RIS-Fee. We are continuing to evaluate options for the best long-term financial reporting structure once the business is fully integrated.

Following a reading of the safe harbor provision, CEO Dan Houston and CFO Deanna Strable will deliver some prepared remarks, then we will open up the call for questions. Others available for the Q&A session include Renee Schaaf, Retirement and Income Solutions; Tim Dunbar, Global Asset Management; Luis Valdés, Principal International; and Amy Friedrich, U.S. Insurance Solutions.

Some of the comments made during this conference call may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act. The company does not revise or update them to reflect new information, subsequent events or changes in strategy. Risks and uncertainties that could cause actual results to differ materially from those expressed or implied are discussed in the company's most recent annual report on Form 10-K and the quarterly report on Form 10-Q filed by the company with the U.S. Securities and Exchange Commission.

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

And one other item. Please plan to join us for 2020 outlook call on Wednesday, December 11. We'll discuss business unit expectations for 2020 and provide any needed updates to long-term guidance. Dan?

Daniel Houston

Thanks, John, and welcome to everyone on the call. This morning, I'll share performance highlights and accomplishments that position us for continued growth. Deanna will follow with details on our financial results and capital deployment. In the third quarter, we reported $345 million of non-GAAP operating earnings. Excluding significant variances, which Deanna will discuss, non-GAAP operating earnings decreased 10% compared to a strong year ago quarter. For the trailing 12 months, also excluding significant variances, non-GAAP operating earnings of $1.5 billion were 5% lower than the year ago period. The decline reflects macroeconomic headwinds, ongoing fee pressure in PGI and RIS-Fee and increased investments in the business. As I reflect on our performance and progress over the first 9 months of the year, we continued to demonstrate strong business fundamentals, balanced investments in our business with expense discipline and being good stewards of shareholder capital.

We also continued to execute our customer-focused solutions-oriented strategy as we expanded our global distribution network and array of retirement, investment and protection solutions and advanced our digital business strategies to create a better customer experience and drive revenue growth while gaining operational efficiencies.

Compared to a year ago and excluding the acquired assets under administration or AUA, total company reported assets under management or AUM increased $36 billion or 5% to a record $703 billion. Year-to-date AUM is up $77 billion or 12%. As a reminder, AUM in our China joint venture of $146 billion at quarter-end isn't included in our reported AUM. Excluding the impact of foreign currency exchange, China AUM is up 2% compared to a year ago.

On a total company basis, we generated $6.9 billion of net cash flow in the third quarter, our strongest result in 3 years. This includes positive net cash flow in all of our businesses.

RIS delivered $2.8 billion of net cash flow, its seventh consecutive positive quarter. This was driven by strong sales, retention and recurring deposit growth in RIS-Fee and record pension risk transfer sales in RIS-Spread. Over the trailing 12 months, RIS has delivered over $9 billion of positive net cash flow, almost double the net cash flow in the same period a year ago. Principal International generated $1.6 billion of net cash flow, its 44th consecutive positive quarter. This primarily reflects strong flows in Brazil, where we're leading the industry in net deposits captured year-to-date. It also reflects record net cash flow in Hong Kong as increased collaboration between Principal International and Principal Global Investors drove a large platform win during the quarter. This collaboration is increasingly beneficial as private pension reform discussions advance around the world and governments recognize not only the importance of voluntary savings but also the benefit of using asset managers to improve long-term returns.

Moving to PGI. Third quarter PGI managed net cash flow was a positive $2.9 billion. The strength in this measure was broad-based, with institutional, our fund platforms and the general account all delivering positive net cash flow. PGI sourced net cash flow was a positive $1.3 billion compared to a negative $3.7 billion in the prior year quarter. This was PGI's best quarter of sourced net cash flow in 2 years. On a trailing 12-month basis, sourced deposits are up more than $3 billion or 9%, while withdrawals have stabilized as a percentage of the average AUM.

Slide 5 highlights the ongoing strength of our investment performance. At the end of the third quarter, for our Morningstar-rated funds, 81% of the fund-level AUM had a 4- or 5-star rating. 75% and 78% of our principal actively managed mutual funds, ETFs, separate accounts and collective investment trusts were above median for the 3- and 5-year performance, respectively. And 91% were above median for 10-year performance, with 63% in the top quartile. For 1-year performance, 49% were above median. This was primarily due to the underperformance in the fourth quarter 2018 of certain international equity strategies, which also impacts our target date series. These strategies have improved year-to-date. We continue to make good progress to drive sales growth and improve retention, particularly in the areas of distribution and product development.

In the third quarter, we launched more than a dozen new investment strategies across our U.S. and international platforms. Of particular note, we continued to expand our suite of multifactor ETFs in PGI. While these investments are available to the general marketplace, they were designed to give financial advisors more flexibility to allocate assets through a robust wealth of digital platform.

We had several key launches internationally as well, including the U.S. blue-chip equity fund on our UCITS platform; the first Chilean mutual fund investing in the real estate sector; and lastly, the Principal Philanthropy Social Impact Bond Fund, the first of its type in Indonesia.

Additionally, we continue to refine our investment capability structure in PGI. As client demand for emerging market fixed-income strategies continue to grow, we are bringing together a cohesive emerging market debt team by combining the Finisterre leadership with other PGI talent. This will enable us to provide a full suite of emerging market debt solutions to meet client needs. While we closed a hedge fund in Finisterre during the quarter and took an impairment, we expect the strong growth we've seen in other Finisterre solutions to continue. Our solutions and capabilities continue to resonate in the marketplace, as shown by our ongoing success adding our investment options to third-party distribution platforms, recommended list and model portfolios. Over the trailing 12 months, we've earned more than 100 total placements, with more than 50 different investment strategies on more than 3 dozen different platforms.

Now I'll provide more highlights on our business execution, starting with the IRT acquisition that closed on July 1. Some details are provided on Slide 6. It's early in the process, but the integration is on track. Revenue lapses were in line with expectations. Prior to close, we announced plans to unify the RIS leadership team by bringing on board top talent from IRT. These leaders bring a significant amount of acquisition integration experience with them as they have integrated a dozen acquisitions over the past 20 years. Together, we have the expertise and the resources needed to ensure a smooth transition while continuing to deliver organic growth in the business.

We're extremely pleased with the large number of positive interactions we've already had with clients, advisors and consultants. As expected, we are already seeing a few benefits. The acquisition adds significant scale and capabilities to our mid- and large plan presence. It strengthens our presence in key industries, including health care, manufacturing and financial services, and it amplifies our leadership position across defined contribution, defined benefit, nonqualified deferred compensation and trust and custody. In terms of technology platform, we determined we would best serve retirement customers by incorporating capabilities from the IRT platform into Principal's proprietary record-keeping platform. Similarly, we best serve the trust and custody customers by retaining SEI, IRT's existing trust accounting platform. Work is on track to integrate and enhance the infrastructure to ensure a smooth transition.

In combination with our top-tier service model and our accelerated investment in digital capabilities, we're delivering better outcomes and better experience for plan participants and plan sponsors as well as for consultants and advisors. One example is our new digital mobile participant on-boarding platform, Principal Real Start. Since the fourth quarter of 2018 launch, we've seen 250,000 participants complete the experience. Their average deferral rate is just under 8%, nearly 50% higher than traditional.

Additionally, 28% of these participants are saving at least 10% of their income, and 23% are auto-escalating to 10%, both are more than 6x the rate of other enrollment methods. This helps drive reoccurring deposit growth, but more importantly, it puts participants on the path to having enough income in retirement.

Another highlight we're proud of in U.S. Insurance Solutions, we're one of the first in the industry to debut a fully digital experience for purchasing term life insurance. More than 95% of the users now apply online with no assistance and approximately 25% completed on a mobile device. This new end-to-end digital process delivers a policy 2/3 faster on average. In many cases, we can have a policy in the client's hands in a few days, and in some cases, just a few hours after issue.

We've also updated the Principal Benefit Design Tool, which captures the knowledge we've gained from working with over 140,000 U.S. business owners on building competitive benefits packages, including retirement, dental, disability income and life insurance. Advisors and business owners can create personalized reports on how benefits compare based on size, industry and region.

Finally, I'll share some development outside the U.S. that also demonstrates our focus on delivering a better customer experience. In Mexico, we launched a partnership with Club Premier, the most recognized coalition program in the country to offer loyalty rewards to promote savings. And in Hong Kong, we launched a digital on-boarding tool for MPF members.

Deanna will cover capital in more detail, but I'll again emphasize our balanced approach to deployment. In addition to ongoing investment in organic growth through 9 months, we've deployed more than $1.8 billion of capital in total, with $1.2 billion for the IRT acquisition and $627 million returned to shareholders through common stock dividends and share buybacks. This includes resuming share buybacks in the third quarter with $44 million of repurchases.

We enjoyed some noteworthy third-party recognition during the third quarter. In our global asset management franchise, we won multiple Best Fund awards in Chile, Malaysia and Thailand. Principal Asset Management Berhad was named Investors' Choice -- Fund House of the Year 2019 by FSMOne Malaysia. And Principal Real Estate Investors earned industry recognition for leadership in sustainability and responsible property investing.

Additionally, U.S. News & World Report named Principal to the list of Best Life Insurance Companies of 2019. And Ivas & Associates ranked Principal the #1 provider of life insurance in the small-case business market based on case count and premium.

The Investment Management Education Alliance recognized Principal with 5 education awards more than any other firm, including awards for digital education and retirement communications. Lastly, Principal Chile and Cuprum both were recognized by Diario Financiero for their commitment to ethical business and integrity. Along with recognition in the first half of the year for our commitment to diversity, inclusion and ethical behavior, the recognition speaks volumes about our culture.

During the third quarter, we made clear progress in helping customers and clients achieve financial security and success. We continue to take the appropriate steps to combat competitive pressures to differentiate Principal in the marketplace and to position the company to deliver above-market growth in shareholder value over the long term.

Before turning the call over to Deanna, I want to let you know that we're closely following events in certain locations in Latin America and Asia where Principal does business. We're taking the necessary steps to help ensure the safety of our employees while continuing to meet the needs of our customers. Deanna?

Deanna Strable

Thanks, Dan. Good morning, and thank you for participating on our call. Today, I'll discuss the key contributors to our third quarter financial results, including impacts of the actuarial assumption review, and provide an update on capital deployment as well as our strong financial position. Net income attributable to Principal was $277 million for the third quarter, including minimal credit losses and a $74 million impairment of an equity method investment. The impairment was driven by the closure of a hedge fund in Finisterre, as Dan discussed earlier. Additionally, Finisterre will be fully consolidated in our financials starting in the fourth quarter. Reported non-GAAP operating earnings were $345 million or $1.23 per diluted share.

As shown on Slide 7, we had pretty significant variances during third quarter, with a net negative $41 million impact to reported non-GAAP pretax operating earnings. The significant variances included a negative $40 million impact as a result of the annual assumption review partially due to lowering our interest rate assumptions; $11 million of elevated compensation and other expenses stemming from the IRT acquisition, including $7 million of transaction costs in corporate and $4 million of integration costs in RIS-Fee;

and a $9 million net benefit in Principal International, with $13 million of higher-than-expected encaje performance partially offset by $4 million of lower-than-expected inflation, both in Latin America. As a reminder, in the year ago quarter, we had 3 significant variances with a net positive $65 million impact to reported non-GAAP pretax operating earnings. This included the annual assumption review, an accelerated PGI real estate performance fee and higher-than-expected variable investment income. This year's assumption review was impacted by economic and experience assumption changes as well as model refinements.

For economic adjustments, the most significant impact was in Individual Life from lowering our interest rate assumptions. This included a 50 basis point decrease to the assumed long-term 10-year treasury rate, lowering at 2.4%. In addition, the starting point has dropped significantly from this time last year, and we extended the length of time until we get to the ultimate rate. The 10-year treasury is one of many assumptions for investment income over the life of the business. Experience assumption changes included updates in RIS-Fee and Individual Life. RIS-Fee had the biggest impact as we updated withdrawal assumptions in variable annuities. These items were partially offset by a benefit for model refinements in Specialty Benefits and Principal International. The most significant was in Specialty Benefits, where we updated our models to capitalize acquisition costs in our group benefits business. This will not have a significant impact to annual pretax operating earnings but will slightly impact the quarterly pattern of earnings. Looking forward, we expect these changes will decrease pretax operating earnings in Individual Life by $2 million to $3 million per quarter and have an immaterial impact in the other business units.

While not a significant variances quarter, variable investment income was slightly below our expectations on a total company basis. Slightly higher prepayment fees and in-line real estate returns were offset by lower-than-expected alternative income. Variable investment income was $9 million lower in RIS-Spread as it has a greater allocation of investment income from alternatives. This was primarily offset by a slight positive in Individual Life and Specialty Benefits, which benefited from higher prepayment fees.

ROE excluding AOCI other than foreign currency translation adjustment was 12.4% on a reported basis. Excluding the impact from the assumption review, ROE was 12.7%.

The non-GAAP operating earnings effective tax rate was 17.7% for the third quarter, slightly higher than what we experienced in the first half of the year. We continue to expect the full year to be within our guided range of 16% to 20%.

Looking at macroeconomic factors. The S&P 500 Index increased over 1% during the quarter, and the daily average increased nearly 3% compared to second quarter. On a trailing 12-month basis, the daily average increased 3%, significantly less than the 16% increase in the prior period and our assumed equity market performance, impacting revenue growth in RIS-Fee and PGI. Foreign currency exchange rates were a headwind for Principal International in third quarter. Pretax operating earnings impacts were a negative $4 million versus the prior year quarter, a negative $2 million compared to second quarter 2019 and a negative $29 million on a trailing 12-month basis.

Mortality and morbidity were within our expectations in Individual Life and Specialty Benefits for third quarter. RIS-Spread mortality losses were $12 million worse than expected. Third quarter typically has a mortality loss but not to this magnitude. We are comfortable with our experience over the long term.

Turning back to Slide 6. I'll expand on Dan's comments on the IRT acquisition. As a reminder, we are operating under a transition service agreement for up to 24 months to give us time to build out additional infrastructure to ensure a seamless transition. As the acquisition closed on July 1, this is the first time we are reporting the financials, which are included in RIS-Fee. The results are largely in line with what we communicated at the acquisition announcement, but we did want to highlight a couple of items.

At the end of the third quarter, the acquired business had $876 billion of AUA. Growth in AUA since the acquisition announcement has been driven by positive equity market performance. Keep in mind that AUA is not a direct driver of revenue or earnings.

Fees and other revenues in the trust and custody business are correlated with movements in the interest on excess reserves rate or IOER. This rate has been lowered 3x since the announcement of the acquisition, and additional Federal Reserve rate cuts are being considered in fourth quarter. This has negatively impacted revenue in this portion of the business.

At close, we recorded $546 million of intangible assets from the acquisition, resulting in $7 million of additional amortization expense in RIS-Fee each quarter. This negatively impacts the operating margin but does not impact free cash flow. Excluding transaction and integration costs, the acquisition had an immaterial impact on third quarter non-GAAP operating earnings per diluted share, as we expected. Going forward, it is anticipated to have an immaterial impact for full year 2019. We'll provide updated expectations for 2020 on our outlook call. The integration is on track, as Dan said, and I'm confident that we have the right team in place to ensure a successful transition.

The following comments on business unit results exclude significant variances from both periods, including the assumption reviews. Starting with RIS-Fee on Slide 9. Pretax operating earnings of $124 million were in line with expectations and includes the immaterial impact of the IRT acquisition. Trailing 12-month net revenue growth of 3% is above our guided range as the acquisition brought on additional net revenue in third quarter. Excluding the impact of the acquisition, RIS-Fee's quarterly margin was just over 30% and slightly above the guided range. Including the acquisition, the quarterly margin declined from 33% in second quarter to 25% in the third quarter. Longer term, we expect quarterly margins to expand once the acquisition is fully integrated and the expense synergies are realized.

Importantly, the underlying fundamentals in the legacy business continue to be strong. Compared to a year ago, sales of $3.7 billion in the third quarter increased nearly 30%. Defined contribution plan count was 2% higher, and net cash flow of $1.1 billion was driven by strong sales, 10% growth in recurring deposits and low contract lapses. We expect full year net cash flow to be at the high end of the 1% to 3% of beginning-of-year account values.

Turning to Slide 10. RIS-Spread's pretax operating earnings of $83 million were lower than expected due to $12 million of worse-than-expected mortality losses and $9 million of lower-than-expected variable investment income, as I mentioned earlier. RIS-Spread's trailing 12-month net revenue growth and margin were within our guided ranges. RIS-Spread sales of $3.1 billion in the third quarter included a record $1.3 billion of pension risk transfer sales. This brings pension risk transfer sales to $2.8 billion year-to-date, more than all of 2018 sales.

As shown on Slide 11, PGI's pretax operating earnings of $123 million were in line with expectations. On a trailing 12-month basis, PGI's margin of 35% was within our guided range, but revenue growth remained below our guided range primarily due to unfavorable equity market performance in the fourth quarter of 2018.

Moving to Slide 12. Principal International's pretax operating earnings of $92 million was slightly higher than expected due to timing of prepayment fees in Chile. PI's trailing 12-month margin of 38% was within our guided range, but net revenue growth was lower than our guided range due to foreign currency headwinds. Excluding these headwinds, net revenue increased 6% over the prior year period.

Turning to Slide 13. Specialty Benefits' pretax operating earnings of $81 million were strong due to favorable claims experience and growth in the business. Strong performance continued in Specialty Benefits, with 7% growth in premium and fees on a trailing 12-month basis. This was driven by strong sales, retention and in-group growth and was within our guided range. The trailing 12-month margin of 13% was also within our guided range.

As shown on Slide 14, Individual Life's pretax operating earnings of $52 million were in line with expectations but lower than the prior year quarter as claims experience returned to expected levels. On a trailing 12-month basis, Individual Life's premium and fee growth and margin were within our guided ranges. Individual Life sales increased nearly 30% from a year ago, with over 60% from the business market.

At $95 million, corporate pretax operating losses were higher than expected. As discussed on previous calls, higher security benefit expenses as well as increased debt expense and lower net investment income related to the IRT acquisition are impacting corporate losses. We continue to expect corporate losses to be above the guided range of $300 million to $320 million for the full year.

With the recent drop in interest rates, I want to provide some details on impacts to our businesses outside of the assumption review. During the third quarter, at 3.2%, our new money yield was about 60 basis points lower than the overall portfolio yield, excluding variable investment income. However, it will take some time for the new money yield to have a meaningful impact on the overall portfolio yield. And while low rates aren't ideal for some of our businesses, the level of spread compression won't be as pronounced as in previous periods when the portfolio yield was much higher than the new money yield. As I mentioned earlier, the IRT business will impact our sensitivity to interest rates, and we plan to provide an update on our 2020 outlook call.

We remain disciplined in updating our pricing for interest rate movements. We're conservative in the products and liabilities we have exposure to, and we remain diligent around asset liability management. While higher rates are incrementally positive, our diverse business mix positions us well in the slow interest rate environment.

As shown on Slide 15, we committed and deployed over $200 million of capital during the quarter, including $153 million deployed for common stock dividends, $44 million in share repurchases and $5 million to a minority investment. With capital deployment of $1.8 billion through the third quarter of '19, we've already exceeded our $1 billion to $1.4 billion guided range for 2019.

Last night, we announced a $0.55 common stock dividend payable in the fourth quarter, a 2% increase from a year ago. Our dividend yield is approximately 4%, and on a trailing 12-month basis, we're slightly above our targeted 40% net income payout ratio.

Our capital and liquidity position remain very strong. We ended the third quarter with nearly $1 billion at the holding company, $100 million of capital in excess of a 400% RBC ratio and over $400 million of available cash in our subsidiaries. In addition, a low leverage ratio and no debt maturities until 2022 provides us significant financial flexibility. Looking ahead, I want to remind you that fourth quarter operating expenses are typically higher than other quarters as we usually see elevated branding expenses, benefit costs and variable sales expenses.

We look forward to talking with you on our 2020 outlook call on December 11. We'll provide updated expectations for each business unit for 2020 as well as any updates to long-term guidance. These will reflect the impacts of the IRT acquisition.

This concludes our prepared remarks. Operator, please open the call for questions.

Question-and-Answer Session

Operator

[Operator Instructions]. The first question will come from Ryan Krueger with KBW.

Ryan Krueger

I know you said you plan to update this on the 2020 outlook call, but is there any additional info you can give us to help understand better the potential sensitivity of the wealth business to short-term rates, maybe the balance of trust and custody assets or something of that nature that could help us frame it?

Daniel Houston

Yes. Thanks, Ryan. This is Dan. It's a good question. And as we all know, this trust and custody business is quite different than what I'll consider is the traditional full-service model. And the reality is that these short-term interest rates do matter, and it's not insignificant. But with that, I'll have Renee provide you with any short thought she might have on sensitivities going forward, if there's another downtick in short-term interest rates.

Renee Schaaf

Yes. Thank you for your question, Ryan. And as Dan pointed out, the mix of business that we are getting from IRT is a little bit different from what you might think about in terms of our traditional fee business. And there is a spread component to the trust and custody business. Generally speaking, if you were to isolate the IRT revenues, we see about 10% to 15% of the revenues as having an impact on the Fed rate that is established for the interest on excess reserves. And as we go into the earnings -- or the outlook call in December, we can give you greater detail about how you might think about that for the future. But hopefully, that gives you somewhat of a frame for this call today.

Ryan Krueger

And then a follow-up that's somewhat related. The $7 million of quarterly intangible amortization, will that continue for the foreseeable future? Or does it drop off over time?

Renee Schaaf

It will continue for the foreseeable future. That is something that you can expect to see quarter-over-quarter. The actual amount may vary according to the way that the assets are amortized, but it is a figure that you can expect to see there quarter after quarter.

Deanna Strable

Ryan, just to add on that, the large portion of the intangibles are amortized over a 23-year period, with the smaller portion amortized over 6 years. So again, over the next six years, that amortization amount will stay the same.

Operator

The next question is from Tom Gallagher with Evercore ISI.

Thomas Gallagher

The TSA that you have with Wells, Deanna, that you said is a 24-month contract, what are those expenses? Can you quantify how much that is? And should we expect to get kind of a cliff pop in earnings when that's done? Or are there pieces to that, so it's going to be more gradual?

Daniel Houston

Yes. It's a big question, and I appreciate it. Renee, do you want to go and cover those details?

Renee Schaaf

Yes, absolutely. So Tom, when we think about the transition service agreement and the expenses that are attached to that, that represents the direct costs that we are being assessed from Wells Fargo IRT to service this business. And so as the business and employees transition from IRT onto The Principal, we can expect that the TSA will decline in amount. But then commensurately, you'll see an increase in the amount of the expenses that we take on with The Principal block. So it's somewhat of just a transition of expenses over time.

Daniel Houston

But I think that it's also true to say that over a longer period of time, as we wean ourself off this system, we will see a material reduction in cost because of many of the synergies that we've discussed in getting to this point. But those will not materialize, I think the word you used, Tom, was like a cliff, in 24 months. It will take some period of time to have that materialize.

Thomas Gallagher

Got you. And then just a question about the retention of the Wells business so far. I looked at the year-end AUM disclosure 2018 and then the updated 3Q. I was sort of backing into about outflows of 10% of the book. So I guess my question is just ask directionally about what's happened thus far. And can you comment on how the retention has compared to your expectations?

Daniel Houston

So let me hit that first, and I'll toss it to Renee. The first and foremost is we're 100 days into this transition, and we frankly couldn't be more excited about the feedback we're getting from a number of different constituents, starting with employees that were previously with Wells Fargo. They're excited about joining our retirement asset management organization. The second is we have hosted many, many clients of all sizes, and the feedback has been quite positive. The third constituency is obviously the advisors, consultants, the gatekeepers, investment advisors to these plans. And again, many of those are individuals and organizations we haven't previously worked with closely. And I think they have been pleasantly surprised not only by the strategy that we're using to transition the business but, equally important, some of the capabilities that they currently don't enjoy today that they will enjoy once we transition the plans over. So with that, I'll ask Renee to speak maybe specifically to the 10% number.

Renee Schaaf

Yes, absolutely. So I think maybe what you're doing is looking at the assets under administration number and maybe trying to use that as a proxy for how to think about the lapses that we're seeing in revenue or the decline that we would anticipate seeing in revenue due to lapses. The one thing I would caution you about there is that assets under administration figure has a lot of different kind of a mix represented in there, so it's not a very good proxy for revenue. So for example, that asset under administration figure has a very large portion of it attributable to the non-retirement trust and custody business. And it will not perform similarly to what we might expect to see for defined contribution, defined benefit and nonqualified business underneath the block. So I think that's the first thing I'd want you to know.

With respect to the lapse rates, as Dan said, this is running as we had anticipated. We are not seeing anything that is surprising or concerning at this point. We have been really well received in the marketplace. We are going above and beyond to make sure that we continue to communicate fully with clients, with financial advisors and with consultants. And to that, we approach this transition process thoughtfully and with a great deal of detail so that we can ensure a very smooth transition and that we can add value to the long-term business.

Operator

The next question is from Jimmy Bhullar with JPMorgan.

Jamminder Bhullar

Just a question on PGI. You had pretty strong flows this quarter, but they've been sort of inconsistent. So what really drove that? Or was it a few large cases that you won? Or was it more broad-based than what your expectations are for flows at PGI over the next few quarters?

Daniel Houston

Yes. We're really excited about the net cash flow improving. And Pat and Tim have just done a great job getting out. And there's a lot of variables and a lot of exciting news there, but I'll throw it to Tim to provide some of those details.

Timothy Dunbar

Yes. Jimmy, thanks a lot for the question. No, what we're seeing is really a broad-based interest in a lot of our capabilities. And I would say, in part, the low interest rate environment has seen a lot of our clients and a lot of our platforms win on the fixed income side. So that would be core fixed income but also preferred securities. And emerging market debt that we have, a new total return fund with Finisterre. So we've seen a good pickup there, but as well, we've seen really good pickup in a lot of the platforms and many of our equity capabilities, like blue chip and some of our small cap, both domestic and international capabilities. And then really, systematic strategies is doing well and a lot of our asset allocation capabilities. So it's really quite broad-based. I would say, just like Dan said, Pat Halter and the team, the distribution team, have done an excellent job of creating an organizational structure that is really cohesively going after the marketplace. And so we're seeing a lot of momentum build. So we feel good about fourth quarter. Nobody knows what the macro environment is, but I think we feel good about the organizational structure we have and moving into 2020.

Jamminder Bhullar

And just fees on the assets that you've put on recently. Are those commensurate with, like, overall fees or -- because in the past, there have been instances when you've had pretty good flows, and then a few years later, we find out that a lot of these cases that came on had lower fees, especially the Japanese mandates. So any comments on, like, how the recent improvement in flows relates to fees on those assets?

Timothy Dunbar

No. I would say we haven't had any of the very large investment-grade fixed-income mandates coming the door this quarter like what maybe you'd seen in the past. And so no, the fee levels that we're seeing are really pretty good and pretty consistent. I'd also mention that our real estate capabilities have done really well, and those fees, obviously, on the alternative side are quite good. I mean many of our specialty fixed-income capabilities also have nice fees associated with them. So no, we're not seeing those really big mandates that sort of flip side us from an AUM and a fee-level perspective come in right now.

Daniel Houston

Good questions, Jimmy. Really appreciate it. The only other thing I would add to that is the strong collaboration that's occurring between PGI and PI, just a lot of good work there to partner together to build out this global asset management entity. So thank you.

Operator

The next question is from Humphrey Lee with Dowling & Partners.

Humphrey Lee

Just a follow-up question on the IRT earnings comments for 2019. When you talk about kind of immaterial for '19, should we think about that as before integration costs and before the amortization? Or is it inclusive of those 2? I just want to get a sense of how to think about that particular earnings impact from the IRT block.

Daniel Houston

Yes.

Deanna Strable

Yes, great question, Humphrey. When we say immaterial, it excludes the onetime costs but does include the amortization. And that immaterial applies to both the RIS-Fee earnings impact as well as the total company, slightly positive from an RIS-Fee perspective once you take out those onetime fees and then, again, immaterial at a total company level. So that's what it includes and how we're encompassing that going forward.

Humphrey Lee

And then is there any reason why, like, for '19, you would incur a little bit higher expenses with respect to the block? Or is it just simply the earnings emergence is largely coming from the expected expense savings to emerge over time?

Deanna Strable

Yes. I think you're right there. I think, again, a large part of that will come once we take on the business and can experience the synergies. And so that is leading, in addition to that amortization of the intangible, leading to that immaterial impact at this point.

Humphrey Lee

Okay. Got it. And then shifting gear. So on the PGI flows, you've talked about -- I think Dan talked about you're still feeling pretty good about the fourth quarter. I think in the past, you talked about second half would definitely be in positive net flows. But how should we think about the -- I guess on a full year basis, given the new Mexico mandate will come in the fourth quarter and some of the traction that you're getting, do you anticipate -- barring a market downturn, do you expect full year will be positive for PGI?

Timothy Dunbar

Yes. Thanks for the question. Yes, we do anticipate that full year net cash flow will be positive for 2019.

Operator

The next question is from Suneet Kamath with Citi.

Suneet Kamath

I just want to ask a question related to the UBS fee change on separately managed accounts. I don't know if that has a -- if you're big in that business. But I just wanted to get a sense if something like that, if that becomes a trend, could that impact PGI in terms of fee rates or economics?

Daniel Houston

Can you elaborate a little bit further on that, Suneet?

Suneet Kamath

Yes. So UBS announced a change to how they're paying asset managers in separately managed accounts, particularly their own asset manager. So just wondering if you guys have a lot in there. What percentage of your assets under management are in such separately managed account products, if any?

Daniel Houston

Yes. We'd have to get back to you on that, and we are happy to do it. But we sub-advise to a number of different platforms, including UBS and a lot of other organizations. I'm unaware of any material change to any of our partnerships, except to say that's an ongoing discussion. It never goes away. And one advantage that we do enjoy, frankly, is the fact that we're not a one-trick pony in that we have a lot of business with a lot of different organizations across retirement, across life, specialty benefits, annuities. And so those are firm-wide negotiations and discussions. But if something material changes, we'll certainly bring that to your attention. Appreciate the question.

Suneet Kamath

Yes. I just had a follow-up, if I could, just for Deanna on the assumption reviews. Should we expect any impact on your year-end statutory financials? And do you have any thoughts on AAT reserves given where we are in the interest rate environment?

Deanna Strable

What was the last part of that question?

Suneet Kamath

Just on asset adequacy testing reserves or cash flow testing reserves given current interest rate levels.

Deanna Strable

Yes. So both there, I don't expect anything from a cash flow perspective. And specific to the AR, it could have a slight negative impact but very manageable within our capital deployment plan.

Unidentified Analyst

Yes. This is John Barnidge [ph]. How should we be thinking about what's happening in Hong Kong right now impact on PI? There was a story JPMorgan recently set up a trust business in Singapore. Just trying to dimension maybe how the protest and continued friction with China maybe changing or altering where you're focusing geographically in Asia.

Daniel Houston

Yes, yes. Appreciate the question. And before I throw it over to Luis, no question around the world there. In some of these emerging markets, it's not uncommon that we'd see some of this dislocation. These still, when we think about it strategically, are very important markets. There's a lot of volatility, but frankly, with that volatility comes a lot of potential growth. And as you can see specifically in Hong Kong, we've actually seen flows remain quite strong. And that's, frankly, one of the advantages of these mandatory systems, that you're going to continue to see those flows. But Luis, you want to add some additional color on, perhaps, both Hong Kong and Chile?

Luis Valdés

Okay. Hi, John. In particular, I was in Santiago at the beginning of this week. Also, Thomas Cheong, our President for Asia, was down there as well. So we spent fair amount of time reviewing our operations and plans and contingency plans, in particular. So first of all, I'm going to repeat something that already was said by Dan. As a reminder, our Hong Kong and Chile operation are both heavily weighted towards the mandatory pension system. So as such, unlike retailers and other industries, our business is relatively well insulated from short term and medium term for this kind of -- type of market disruptions. And second, I would say that you're looking both markets. We haven't seen any major macroeconomic distress for -- neither for Hong Kong nor for Chile, Santiago, even in the very last week for Santiago. For Chile, it's a country risk, FX, interest rates and equity markets are -- I would say, they have had some minimal changes but nothing really important.

The third element, which is pretty interesting and probably very interesting for you, is that you have a well-designed and robust infrastructure contingency plan, digital platforms, investments, highly secured data centers and redundancy where it's needed. We haven't had any major distress, and our -- all our operations have been up and running 24x7 in Hong Kong and in Santiago and in Chile, and we have been able to serve our clients all the time as needed. We have some minor disruptions in some branches but nothing really important. So I would say that more to come, but I'm proud of the quality of our professionals and people and the quality of our operations in both places. So more to come, John.

In particular, in finishing your question, we have a very important operation in Hong Kong, but also, we have a very important footprint in Mainland China. So it's a highly well-diversified operation in China and certainly is very well connected, so more to come.

Unidentified Analyst

And then a follow-up question. You had strong sales in the quarter in Specialty Benefits and Individual Life. Can you kind of talk about where you're seeing that demand coming from maybe by sector or by segment within that market?

Daniel Houston

Just before I throw that over to Amy, what's also encouraging is just to see that in-plan growth just continue to materialize. It's true in our group benefits business. It's true in our retirement business, where people are hiring. And as you know, a lot of our business is small to medium-size business. And so the economy just continues to be favorable to those providers like Principal to serve the needs of small to medium-size employers. Amy?

Amy Friedrich

Yes. Thanks, Dan. Your comments are exactly right on. I think one of the things -- we talk a lot about being in the small market, but I think one of the things we don't talk about quite as much is how much that means -- our new business, our sales are driven by business owners who are making the decision to put a benefit or put some sort of a protection product in place for the first time. So a good portion of those benefits truly represent kind of new market for us, people who just haven't historically been purchasers becoming purchasers. So when you look at somewhere between 25%, 30% of our block being produced from that new market, that's exciting for us.

And I always want to come back and make sure to give our life insurance business the credit that it's due. We do some amazing things for business owners and the business market for life insurance. And so I think one of the biggest compliments I can get when I leave Principal is for our intermediaries and other partners to tell us, when we see business, market business, we come to Principal. And so that's driving a lot of our volume. That's driving a lot of our recognition, and I want to give a lot of credit to the team for building out that business market so well.

Operator

The next question is from Erik Bass with Autonomous Research.

Erik Bass

You've talked quite a bit about the investments being made in the business. I'm just wondering how are these tracking relative to your expectations and if you've identified any places where either you need to do more or you see more opportunity, particularly with the Wells block coming on board.

Daniel Houston

Yes, that's a really big question. In my prepared comments, you heard me talk about the Principal Real Start initiative, and that's having a profound impact on participants in terms of what they're setting aside for retirement. I mean it's really meaningful. The other one, in Amy's areas, that end-to-end digital life insurance solution. Again, good traction. For those people who may not have an advisor, it works very nicely. The Principal Benefit Design Tool, again, there's an absence of sort of understanding sometimes on sorting out and benchmarking against your peers by location and by industry. That's helpful. Luis, the comments down there around Mexico and the partnership with Club Premier and, again, that sense of partnering. And again, we've identified that before. And then lastly, it's Hong Kong and the digital on-boarding for the mandatory provident fund. So as we came to you a couple of years ago and talked about making investments in our digital platform, it does come with a price. We know that. We've realized that and see that in the higher expense structures.

But I'd also mention that these five items I just mentioned are about half the portfolio. There's a lot of other really exciting things happening within PGI and PI and USIS and RIS. So we think very strongly, Erik, that these investments are starting to pay off, and I look forward to talking about each one of those in more detail as we come out and visit with you.

Erik Bass

And then for RIS-Spread, can you provide a bit more color on the adverse mortality experienced this quarter and put it into context with the historical results for the business? And I guess should we expect more seasonality in the business going forward as the PRT business continues to grow?

Daniel Houston

Well, yes, I would say that the standout here is the mortality in the third quarter, which is not uncommon. But I'll have Renee add some additional color.

Renee Schaaf

And that's exactly right. We did have an unusual level of mortality this quarter, and we would expect to see some variability from quarter to quarter. But when we step back and we look at what our expectations are for mortality versus how the block of business is performing, we feel very confident and very comfortable with what we're seeing. So we're not concerned with the underlying fundamentals of the business. This was an unusual quarter, perhaps, but perhaps within a normal range of variability as we look forward.

Erik Bass

Got it. And I would think third quarter would typically be a seasonally worse quarter and first quarter, better. Is that the right way to think about it?

Renee Schaaf

That is the right way to think about it.

Daniel Houston

That's exactly right. It was just that this third quarter was slightly out of the -- what we would have thought would be the normal range.

Operator

The next question is from Josh Shanker with Deutsche.

Joshua Shanker

I don't look at your businesses as affected by the type of derivatives that people are taking your assumption reviews for, but obviously, you have one. Can you talk in rank order about the various macro factors that affected the assumption review going forward? Obviously, interests probably are #1. But did you approach the assumption review any differently this time around than you had in past years?

Daniel Houston

I think every time we go through the actuarial assumption review, the chief actuary and the rest of the financial team, everything gets interrogated because things do change. They're not static. But frankly, we did not see anything relative to an outlier in the derivatives portfolio that would cause us to think about that any differently than we have in the past. We're certainly looking at the interest rates, and Deanna had framed that accordingly for you. We think it's prudent that it would go out over the next 10 years as opposed to 7 years, and we think that a 4% number versus a 4.5% is appropriate. So again, it gets a lot of scrutiny across each one of those. And Deanna, I'll throw it to you, see if you have any additional comments.

Deanna Strable

No. I think Dan is right on. Specifically to the economic assumptions, which I think is what you are referring to, we obviously look at all of those factors. Probably equity returns and interest rates are the most significant, and all the businesses have different sensitivity to each of those. In the absence of the interest rate change, all of the other economic assumptions that were embedded within all of our actuarial models were performing in line with what we had assumed in past assumption reviews. So the only one that was really impactful this quarter was the interest rates where, again, we lowered the underlying 10-

year treasury assumption 50 basis points. The starting point declined over 100 basis points from where it was last year, and we extended the duration of when we would get to that long-term rate. It did have most significant impact within Individual Life. It had a slight impact in our other businesses, but that was the one that was the most meaningful.

Joshua Shanker

And sometimes, insurance companies say, certainly, in both silos, we're quick to acknowledge bad news but slow to acknowledge good news. If things rebound more quickly, do you think that your internal controls would be less likely to credit assumptions going forward with favorable terms than they would be to reduce assumptions when things go unfavorably your way?

Deanna Strable

Yes. My comment to that is if you look under the assumption reviews every single year, we have a number of positives and a number of negatives. Actually, interest rates, the last couple of years, had been positive to our annual assumption review as we updated the starting point and the path to get there. So no, I mean I think we are very prudent, both on the plus side and the minus side, to make sure we're determining the most appropriate assumption at that period of time. And ultimately, we'll reflect those, whether they be positive or negative.

Daniel Houston

Couldn't have said it better. That's exactly right.

Operator

The final question is from Alex Scott with Goldman Sachs.

Taylor Scott

First question I had was on RIS-Fee. And I guess I noticed the pressure was referenced in the release, and no secret that there's fee pressure in this business. But it was a little harder to sort of identify in the results because of the integration of Wells Fargo and so forth. So I'd just be interested to hear your commentary on how much fees are feeling that pressure, if there's any kind of change to how you're thinking about how that will progress over the next couple of years.

Daniel Houston

Yes, I'll take a shot at it and throw it over to Renee. But I would say absent -- if you just took out the Wells Fargo IRT acquisition and just said, was there anything substantively different in the most recent quarter than what we've experienced the last 3 or 4 years, I'd say no. I think it's very much the same drivers. And what we're committed to is ensuring that we're aligning our expenses with the revenues that we can derive. And remember, this is where you get into that lengthy conversation about the mix of business. You get into the various asset classes if someone chooses a more passive strategy, lower interest rate environment. So all of those variables come into it. But you have to look at those reoccurring deposits coming in at 10%. You look at the growth in the number of plans. All the sort of key drivers on the health of the business and our ability to get market share are intact. Now having said that, and you pointed out very well, Alex, we're still seeing pressure in that business. But I'll ask Renee to jump in here and clean that up as well.

Renee Schaaf

Yes, absolutely. So as Dan said, I think it's really important to remember and to recognize that the Principal block of business is performing very, very well. We do see strong sales. We're seeing strong recurring deposits. Our client retention is running very, very strong. All of that which, of course, leads to very strong and good fundamentals for the business, which results in a very strong net cash flow and a robust sales pipeline. But stepping back and thinking more at a more macro level, you've heard us talk about fee pressures in the fee line of business. And that fee pressure comes from several sources.

First is just the intense competitive nature of record keeping and the downward pressure you would anticipate seeing these with fees there. And the other comes from a move towards open architecture and a move towards investment asset management strategies that are lower cost in nature. And that all puts pressure onto fees. That's been a long-term trend. If we were to quantify that, we would anticipate seeing a gap between fee growth and the average account value growth of about 6% to 8%. And then there is an additional

1% to 2% fee compression that we see that comes from moving from commission basis to pay financial advisors to fee-based. And so what we see in third quarter is very much in keeping with our expectations. We're very pleased with how that quarter performed. And again, it's very strong underlying growth in the business and strong sentimentals and capped with an integration that is absolutely on track for IRT.

Taylor Scott

Got it. May I ask one follow-up quickly on...

Daniel Houston

Wait. Yes, yes.

Taylor Scott

On your actuarial review, are there any ongoing impacts to earnings I should think about, whether it's the more modestly sized block of variable annuities or the life insurance or the Specialty Benefits and some of the DAC adjustments you made? Anything that we'll kind of notice on a go-forward basis?

Daniel Houston

Deanna?

Deanna Strable

Yes. I think in my prepared remarks, we said that the only -- and I wouldn't say it's material, but the only notable run rate impact would be that you'd see about a $2 million to $3 million pretax run rate decline in the Individual Life business. Most of that will run through the DAC line, and we're really expecting immaterial impacts in any of the other lines of business.

Operator

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

Daniel Houston

Yes. Just a couple of very quick comments, the first of which is we recognize these emerging markets are volatile, but its high reward and margin growth, we think, over the long term still -- is very positive. The second is these acquisitions, we look at them through strategic lens. They're long-term in nature. And our view is that there is great scale and capabilities that is derived from acquisitions like the IRT business. Organic growth, as I pointed out, is important to us. It's fundamental to a long-term successful franchise. We'll continue to be disciplined around pricing and making sure our differentiators are known. Capital deployment, very balanced. And as Deanna had commented in her prepared comments, we feel very good about the capital deployment this year. For those of you wondering, at the end of 9/30, there was $250 million of Board authorization for share buyback. It still remains in place. And then lastly, I would say that we very much have a process improvement initiative going on to help drive revenue and take out expense, make sure that we continue to operate in the most effective and efficient manner for our shareholders.

So we look forward to December 11, when we can provide you with more outlook for 2020 and tell you where the businesses are at. But we certainly appreciate your time today. Thank you.

Operator

Thank you for participating in today's conference call. This call will be available for replay beginning at approximately 1:00 p.m. Eastern Time until end of day October 31, 2019. 5193169 is the access code for the replay. The number to dial for the replay is 855-859-2056 U.S. and Canadian callers or 404-537-3406 international callers.