

FINANCIAL STATEMENTS AND SUPPLEMENTAL
INFORMATION

Principal Securities, Inc.
Year Ended December 31, 2018
With Report and Supplemental Report of
Independent Registered Public Accounting Firm

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ANNUAL AUDITED REPORT
FORM X-17A-5
PART III

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FACING PAGE

Information Required of Brokers and Dealers Pursuant to Section 17 of the
Securities Exchange Act of 1934 and Rule 17a-5 Thereunder

REPORT FOR THE PERIOD BEGINNING January 1, 2018 AND ENDING December 31, 2018
MM/DD/YY MM/DD/YY

A. REGISTRANT IDENTIFICATION

NAME OF BROKER-DEALER:

Principal Securities, Inc.

ADDRESS OF PRINCIPAL PLACE OF BUSINESS: (Do not use P.O. Box No.)

575 7th Street

(No. and Street)

Des Moines

(City)

IA

(State)

50392

(Zip Code)

NAME AND TELEPHONE NUMBER OF PERSON TO CONTACT IN REGARD TO THIS REPORT

Scott Christensen

515-248-5985

(Area Code - Telephone Number)

B. ACCOUNTANT IDENTIFICATION

INDEPENDENT PUBLIC ACCOUNTANT whose opinion is contained in this Report*

Ernst & Young LLP

(Name - if individual, state last, first, middle name)

801 Grand Avenue, Suite 3000

(Address)

Des Moines

(City)

IA

(State)

50309

(Zip Code)

CHECK ONE:

☒ Certified Public Accountant

☐ Public Accountant

☐ Accountant not resident in United States or any of its possessions.

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*Claims for exemption from the requirement that the annual report be covered by the opinion of an independent public accountant must be supported by a statement of facts and circumstances relied on as the basis for the exemption. See Section 240.17a-5(e)(2)

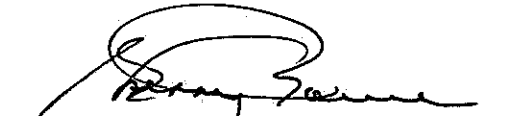
SEC 1410 (06-02)

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OATH OR AFFIRMATION

I, Scott Christensen, swear (or affirm) that, to the best of my knowledge and belief the accompanying financial statement and supporting schedules pertaining to the firm of Principal Securities, Inc., as of December 31, 2018, are true and correct. I further swear (or affirm) that neither the company nor any partner, proprietor, principal officer or director has any proprietary interest in any account classified solely as that of a customer.


Chief Financial Officer


Notary Public



This report contains:

- ☒ (X) (a) Facing Page.
- ☒ (X) (b) Statement of Financial Condition.
- ☒ (X) (c) Statement of Operations.
- ☒ (X) (d) Statement of Cash Flows.
- ☒ (X) (e) Statement of Changes in Stockholders' Equity.
- ☐ () (f) Statement of Changes in Liabilities Subordinated to Claims of Creditors.
- ☒ (X) (g) Computation of Net Capital.
- ☒ (X) (h) Computation for Determination of Reserve Requirements Pursuant to Rule 15c3-3.
- ☒ (X) (i) Information Relating to the Possession or Control Requirements Under Rule 15c3-3.
- ☐ () (j) A Reconciliation, including appropriate explanation of the Computation of Net Capital Under Rule 15c3-1 and the Computation for Determination of the Reserve Requirements Under Exhibit A of Rule 15c3-3.
- ☐ () (k) A Reconciliation between the audited and unaudited Statements of Financial Condition with respect to methods of consolidation.
- ☒ (X) (l) An Oath or Affirmation.
- ☐ () (m) A copy of the SIPC Supplemental Report.
- ☐ () (n) A report describing any material inadequacies found to exist or found to have existed since the date of the previous audit.

Principal Securities, Inc.

Financial Statements and Supplemental Information

Year Ended December 31, 2018

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Report of Independent Registered Public Accounting Firm

To the Stockholder and the Board of Directors of Principal Securities, Inc.

Opinion on the Financial Statements

We have audited the accompanying statement of financial condition of Principal Securities, Inc. (the Company) as of December 31, 2018, the related statements of operations, changes in stockholder's equity, and cash flows for the year then ended, and the related notes (collectively referred to as the "financial statements"). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company at December 31, 2018, and the results of its operations and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company's financial statements based on our audit. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audit in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. Our audit included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audit also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audit provides a reasonable basis for our opinion.

Supplemental Information

The accompanying information contained in Schedules I, II, and III has been subjected to audit procedures performed in conjunction with the audit of the Company's financial statements. Such information is the responsibility of the Company's management. Our audit procedures included determining whether the information reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information. In forming our opinion on the information, we evaluated whether such information, including its form and content, is presented in conformity with Rule 17a-5 under the Securities Exchange Act of 1934. In our opinion, the information is fairly stated, in all material respects, in relation to the financial statements as a whole.

We have served as the Company's auditor since at least 1985, but we are unable to determine the specific year.

Ernst & Young LLP

Des Moines, Iowa
February 28, 2019

Principal Securities, Inc
Statement of Financial Condition
December 31, 2018

Assets

Cash and cash equivalents	\$ 46,265,218
Receivables from:	
Affiliates	8,681,521
Others	5,178,427
Prepaid expenses	818,542
Capitalized computer software development costs (net of accumulated depreciation of \$325,421)	299,937
Income taxes receivable	2,041,194
Net deferred income taxes	2,877,982
Total assets	<u>\$ 66,162,821</u>

Liabilities and stockholder's equity

Liabilities:

Commissions payable	\$ 822,219
Unearned Revenue	7,446,429
Accounts payable	2,442,422
Payables to:	
Principal Life Insurance Company	22,477,040
Other affiliates	1,747,614
Income taxes payable	500
Total liabilities	<u>34,936,224</u>

Stockholder's equity:

Common stock, par value \$10.00 per share – authorized 50,000 shares; issued and outstanding 40,000 shares (all owned by Principal Financial Services, Inc., a wholly owned subsidiary of Principal Financial Group, Inc.)	400,000
Additional paid-in capital	74,196,516
Retained earnings (deficit)	(43,369,919)
Total stockholder's equity	<u>31,226,597</u>
Total liabilities and stockholder's equity	<u>\$ 66,162,821</u>

See accompanying notes.

Principal Securities, Inc
Statement of Operations
Year ended December 31, 2018

Brokerage revenues:	
Commissions:	
Principal Mutual Funds	\$ 6,409,061
Other mutual funds	4,126,634
Brokerage	11,510,543
Fee Based	52,731,226
Outside managed	10,811,847
Variable annuities and flexible variable life policies	80,186
Distribution fees	47,167,804
401k revenue	22,311,020
Pass Thru revenue	142,191,478
Non-Grid revenue	18,715,760
Total brokerage revenues	<u>316,055,559</u>
Less commission – related expenses:	
Principal Mutual Funds	4,974,591
Other mutual funds	3,206,297
Brokerage	9,066,045
Fee Based	44,050,487
Outside managed	9,038,205
Distribution fees	26,111,747
Other distribution expenses	9,004,121
401k expenses	16,142,777
Pass Thru expenses	142,191,478
Total commission – related expenses	<u>263,785,748</u>
Net brokerage revenues	52,269,811
Other revenues:	
Other revenue	7,380
Interest	124,521
Total other revenues	<u>131,901</u>
Operating expenses:	
Salaries and benefits	46,723,061
General and administrative expenses	29,464,291
Total operating expenses	<u>76,187,352</u>
Loss from operations before income taxes	(23,785,640)
Income tax benefit	6,824,505
Net loss	<u><u>\$ (16,961,135)</u></u>

See accompanying notes.

Principal Securities, Inc
Statement of Changes in Stockholder's Equity
Year ended December 31, 2018

	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Total
Balance at January 1, 2018	\$ 400,000	\$ 59,897,649	\$ (26,256,458)	\$ 34,041,191
Net loss	—	—	(16,961,135)	(16,961,135)
Capital contributions from Parent		12,500,000		12,500,000
Capital contribution in the form of forgiveness of allocated stock-based compensation expense	—	1,798,867	(152,326)	1,646,541
Balance at December 31, 2018	<u>\$ 400,000</u>	<u>\$ 74,196,516</u>	<u>\$ (43,369,919)</u>	<u>\$ 31,226,597</u>

See accompanying notes.

Principal Securities, Inc
Statement of Cash Flows
Year ended December 31, 2018

Operating activities

Net loss	\$ (16,961,135)
Adjustments to reconcile net loss to net cash used in operating activities:	
Allocation of stock-based compensation	1,798,867
Equity distribution in the form of common stock to employees	(152,326)
Deferred income taxes	496,927
Capitalized computer software	292,849
Changes in operating assets and liabilities:	
Due from others and prepaid expenses	(2,556,426)
Due to Principal Life Insurance Company	10,520,132
Due to/from affiliates	240,748
Unearned Revenue	(1,285,714)
Other Investments	1,431,971
Commissions payable, accounts payable, and income taxes recoverable	<u>1,433,046</u>
Net cash used in operating activities	<u>(4,741,061)</u>

Financing activities

Capital contributions from Principal Financial Services, Inc.	<u>12,500,000</u>
Net cash received in financing activities	<u>12,500,000</u>
Net increase in cash and cash equivalents	7,758,939
Cash and cash equivalents beginning of year	<u>38,506,279</u>
Cash and cash equivalents end of year	<u><u>\$ 46,265,218</u></u>

See accompanying notes.

Principal Securities, Inc.

Notes to Financial Statements

1. Organization and Nature of Business

Principal Securities, Inc. (“the Company”) is an introducing broker-dealer, that clears transactions on a fully disclosed basis, registered with the Securities and Exchange Commission (“SEC”) pursuant to Section 15(b)(11) of the Exchange Act and a member with the Financial Industry Regulatory Authority (“FINRA”). Additionally, the Company is federally registered as an Investment Adviser. The Company primarily engages in the solicitation and sale of securities-related products and services to retail investors. Such offerings may include: Brokerage Services, Advisory Services, Investment Company products, and variable products.

The Company is a wholly owned subsidiary of Principal Financial Services, Inc. (“PFSI”), who in turn is an indirect, wholly owned subsidiary of Principal Financial Group, Inc. (“PFG”), a Delaware business corporation.

2. Significant Accounting Policies

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents

The Company’s cash equivalents include demand deposits, and short-term pooled funds. The Company holds its cash in bank accounts with balances in excess of the Federal Deposit Insurance Corporation deposit insurance limits. The Company has an arrangement whereby its short-term funds are pooled with the funds of other affiliates and invested by PFSI, an affiliate. The Company has access to these funds at any time and is credited with interest based on the 30-day LIBOR index.

Principal Securities, Inc.

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Unearned Revenue

Unearned revenue represents amounts received related to the conversion of fully disclosed clearing and managed investment platforms. The \$9,000,000 amount is being amortized straight line as a contra expense over the seven-year contract period beginning October 2017. Unearned revenue as of December 31, 2018 related to this is \$7,446,429.

Revenue Recognition

Beginning January 1, 2018, the Company adopted the authoritative guidance using the modified retrospective approach. The guidance replaces all general and most industry specific revenue recognition guidance 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. The adoption of the guidance did not change the timing of revenue recognition or result in financial statement changes related to contract costs for the Company.

The Company enters into selling and distribution agreements with the obligation to sell or distribute the securities products, such as mutual funds, annuities and products sold through RIAs, to individual clients in return for front-end sales charges, 12b-1 service fees, annuity fees and asset-based fees. Front-end sales charges and annuity fees are related to a single sale and are earned at the time of sale. Some mutual funds have a daily obligation to sell and distribute. These securities products generate 12b-1 service fees which are calculated daily and received only when fully earned. The Company uses the passage of time to measure the progress of this performance obligation. The Company receives the majority of these fees monthly for satisfying the performance obligations. The Company also enters into agreements with individual customers to provide securities trade execution and custody through a brokerage services platform in return for ticket charge and other service fee revenue. These services are bundled as one single distinct service referred to as brokerage services. This revenue is related to distinct transactions and is earned at a point in time.

Principal Securities, Inc.

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

The Company also enters into agreements with individual customers to provide trade execution, clearing services, custody services and investment research services through our proprietary offered fee-based products. These services are bundled as one single distinct service referred to as advisory services. The Company receives the majority of advisory fees quarterly for satisfying the performance obligations. In addition, for outside RIA business the Company performs sales and distribution services only. The revenues are earned over time as the service is performed utilizing the output method.

A majority of our revenue is based upon contractual rates applied to the market value of the clients' portfolios and considered variable consideration that is constrained.

Costs to fulfill the contracts with customers include commissions paid to agents for sales and servicing of the related mutual funds, annuities and products sold through RIAs. Since the customers can leave at any time, they are considered to be constantly renewing their contract. As such, the contract is looked at as "day to day" and each month of service is considered a renewal. Since the commissions are commensurate along the contract term and the anticipated period of benefit, as a practical expedient the Company concludes that the renewal commission is specifically related to the renewal period and no costs are deferred.

A majority of our revenue is based upon contractual rates applied to the market value of the clients' portfolios and considered variable consideration that is constrained.

Costs to fulfill the contacts with customers include commissions paid to agents for sales and servicing of the related mutual funds, annuities and products sold through RIAs. These costs relate to performance obligations already satisfied and are expenses when incurred.

Capitalized Computer Software

Applicable internally developed, purchased or leased internal use software costs that exceed set thresholds are capitalized. The capitalization period covers the span of time from the design of the chosen alternative, through coding, testing, and putting a project into production. Capitalization ends when the software is ready for its intended use. Amortization begins when the software is ready for its intended use and is amortized over the life of the software. For GAAP reporting purposes, an estimated useful life of four years is used.

Principal Securities, Inc.

Notes to Financial Statements (continued)

2. Significant Accounting Policies (continued)

Pass Thru Revenue and Expense

Pass Thru Revenue and Pass Thru Expense within the statements of operations represents revenue the Company records that is passed directly onto other business units within PFG. The Company is the Broker Dealer that holds the contract for this revenue. The Company records the revenue and expense at the same time as the revenue is earned.

Future Adoption of New Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842). 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. The guidance is effective on January 1, 2019, but the Company does not expect an impact to financial results due to holding no leases.

Federal and State Taxes on Income

The Company is taxed as a division of PFG at corporate rates based on existing tax laws. Current income taxes are charged or credited to operations based upon amounts estimated to be payable or recoverable as a result of taxable operations for the current year. Deferred income taxes are provided for the tax effect of temporary differences in the financial reporting and income tax bases of assets and liabilities and net operating losses using enacted income tax rates and laws. The effect on deferred income tax assets and deferred income tax liabilities of a change in tax rates is recognized in operations in the period in which the change is enacted.

Subsequent Events

The Company's management has evaluated all subsequent events through the date the financial statements were issued.

Principal Securities, Inc.

Notes to Financial Statements (continued)

3. Income Taxes

Income Tax Expense

The Company's taxable income or loss is generally included in the consolidated income tax return filed by PFG, the Company's ultimate parent.

PFG has adopted the policy of allocating income tax expense and benefits to members of its consolidated group based upon their pro rata contribution of taxable income or loss. The Company received tax reimbursements from PFG of \$8,439,053 in 2018. The Company's income tax receivable balance is due from PFG.

Our income tax expense/(benefit) was as follows for the year ended December 31, 2018:

Current income taxes:

U.S. Federal	\$ (5,040,281)
State	<u>(2,281,151)</u>
Total current income taxes	(7,321,432)

Deferred income taxes:

U.S. Federal	\$ 326,492
State	<u>170,435</u>
Total deferred income taxes	<u>\$ 496,927</u>
Total income taxes	<u>\$ (6,824,505)</u>

Principal Securities, Inc.

Notes to Financial Statements (continued)

3. Income Taxes (continued)

Effective Income Tax Rate

The Company's 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 is as follows for the year ended December 31, 2018:

U.S. corporate income tax rate	21.0%
State tax	7.0
Employee Benefits	0.5
Impact of Tax Cuts and Jobs Act	0.4
Disallowed parking expenses	(0.1)
Nondeductible meals, entertainment, lobbying, etc.	(0.1)
Effective income tax rate	<u>28.7%</u>

Unrecognized Tax Benefits

The amount of unrecognized tax benefits calculated for the Company as of December 31, 2018 is not material to the Company's financial position. Therefore, the total amount of unrecognized tax benefits, that if recognized, would affect the effective income tax rate is immaterial. The Company recognizes interest expense and penalties related to income taxes in operating expenses. The Company recognized no accumulated pre-tax interest and penalties related to unrecognized tax benefits in 2018.

We do not believe there is a reasonable possibility that the total amount of unrecognized tax benefits will significantly increase or decrease in the next twelve months.

Principal Securities, Inc.

Notes to Financial Statements (continued)

3. Income Taxes (continued)

Net Deferred Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The deferred tax balances as of December 31, 2017, were remeasured as a result of the U.S. tax reform reducing the U.S. statutory tax rate from 35% to 21% effective January 1, 2018. This was because the new rate is applicable to the reversal of cumulative temporary differences thereafter. Significant components of net deferred income taxes as of December 31, 2018 were as follows:

Deferred income tax assets:

Deferred Losses	\$ 2,034,364
Stock compensation	406,376
Employee benefits	420,740
State net operating losses	240,128
Total deferred income tax assets	<u>3,101,608</u>

Deferred income tax liabilities:

Prepaid expenses	<u>(223,626)</u>
Total deferred income tax (liabilities)	<u>(223,626)</u>
Total net deferred income tax assets	<u>\$ 2,877,982</u>

In management's judgment, total deferred income tax assets are more likely than not to be realized.

Other Tax Information

Principal filed claims for refund for tax years 2006 through 2008 in 2015 and tax year 2012 in 2016. The IRS commenced audit of Principal's federal income tax return for 2009 during the fourth quarter of 2011, 2010 during the first quarter of 2012, 2011 during the first quarter of 2013, 2012 in the third quarter of 2015, and 2015-2017 in the fourth quarter 2018. The U.S. federal statute of limitations expired for years prior to 2009, except for pending audit issues. The statute was extended until June 30, 2019 for 2009 through 2012, has expired for 2013 and 2014, and remains open for years thereafter. The ultimate settlement of earlier tax years can be adjusted into subsequent tax years regardless of statute status. Principal and the Company do not expect the results of these audits, subsequent related adjustments or developments in other tax areas for all open tax years to significantly change the possible increase in the amount of unrecognized tax benefit, but the outcome of the tax reviews is uncertain and unforeseen results can occur.

Principal Securities, Inc.

Notes to Financial Statements (continued)

4. Net Capital Requirements

The Company is an introducing broker-dealer and clears certain securities transactions with and for customers on a fully disclosed basis with National Financial Services LLC (“NFS”), their current clearing broker-dealer. The Company promptly transmits all customer funds and securities to the clearing broker-dealer. In connection with this arrangement, the Company is contingently liable for its customers’ transactions.

The Company is subject to the Securities and Exchange Commission (“SEC”) Uniform Net Capital Rule (Rule 15c3-1), which requires the maintenance of minimum net capital and requires that the ratio of aggregate indebtedness to net capital, both as defined, shall not exceed 15 to 1. At December 31, 2018, the Company had defined net capital of \$13,703,997, which was \$11,382,093 in excess of its required net capital of \$2,321,904. The SEC rules related to the calculation of minimum net capital requirements require the Company to maintain capital at least equal to 6-2/3% of aggregate indebtedness, with a minimum fixed dollar amount of \$250,000.

5. Related-Party Transactions

As set forth on the statements of operations, the Company receives the following fees from PLIC and Principal Fund Distributor (PFD):

- The Company collects commissions for the sale of Principal Mutual Funds via PFD and variable annuity and flexible variable life products offered by PLIC, Principal Product Network and Principal National Life. Amounts recorded by the Company for the year ended December 31, 2018 were \$99,741,328.
- The Company receives distribution (Rule 12b-1) from Principal Mutual Funds via PFD and nonproprietary mutual funds used by other product lines offered under the Distribution and Pass-Thru revenue line items. Amounts recorded by the Company for the year ended December 31, 2018 were \$92,319,505.
- The Company receives expense reimbursements from both PFD and PLIC for amounts agreed upon annually in advance. The reimbursements are intended to offset the expenses associated with the sale of the products, but only to the extent such expenses are expected to exceed the revenues generated by the Company from the sale of those products. Any excess reimbursements shall be calculated and returned as soon as practical after the end of each calendar year. Amounts received by the Company for the year ended December 31, 2018 were, respectively, \$5,000,000 and \$28,000,000 and excess reimbursement of \$5,150,000 to PLIC was estimated and accrued as of December 31, 2018.

Principal Securities, Inc.

Notes to Financial Statements (continued)

5. Related-Party Transactions (continued)

- The Company has entered into an expense reimbursement agreement with PLIC. PLIC performs certain functions on its own behalf and on behalf of many subsidiaries, including the Company, and shares the use of certain equipment, personnel and facilities with its subsidiaries. On a monthly basis PLIC bills the subsidiaries, including the Company, for amounts due for the performance of such services and functions and the use of such equipment, personnel and facilities. Amounts billed to the Company by PLIC for the year ended December 31, 2018 were \$96,591,528.
- The Company has entered into a services agreement with PLIC. PLIC, on behalf of the Company, calculates and pays compensation to PSI registered representatives and broker-dealers unaffiliated with PSI who offer or sell variable contracts, mutual fund shares, group annuities, and other securities, certain fixed annuities, advisory services and products, and any proprietary investments available under Principal Life recordkeeping for qualified retirement plans underwritten, distributed or offered by the Company. Amounts paid by PLIC on behalf of the Company for the year ended December 31, 2018 were \$107,409,273.

PFG has allocated the expenses associated with stock-based compensation to each of its subsidiaries, with the allocation aggregating \$1,798,867 to the Company for the year ended December 31, 2018. As PFG has not required the allocation to be settled in cash, the amount has been treated as a capital contribution.

The Company receives expense reimbursements from Principal Bank for amounts agreed upon annually in advance. The reimbursements are intended to offset the expenses related to the bank sweep program on the Fidelity platform, but only to the extent such expenses are expected to exceed the revenues generated by the Company from the sweep program. Any excess reimbursements shall be calculated and returned as soon as practical after the end of each calendar year. Amounts received by the Company for the year ended December 31, 2018 were \$120,000.

The Company received capital infusions from its parent company to ensure compliance with regulatory capital requirements. Capital infusions totaled \$12,500,000 for the year ended December 31, 2018.

Principal Securities, Inc.

Notes to Financial Statements (continued)

6. Contingencies

In the ordinary course of business, the Company is involved in and subject to asserted and unasserted claims from customers and other contractual disputes. In the opinion of management, adequate provision has been made for any potential losses that may result from these actions.

The Company is regularly involved in litigation, both as a defendant and as a plaintiff, but primarily as a defendant. Litigation naming the Company as a defendant ordinarily arises out of the Company's business operations as a provider of asset management and accumulation products and services. Some of the lawsuits are class actions, or purport to be, and some include claims for punitive damages. In addition, regulatory bodies, such as, the SEC, FINRA and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning the Company's compliance with, among other things, securities laws and laws governing the activities of broker-dealers. The Company receives requests from regulators and other governmental authorities relating to other industry issues and may receive additional requests, including subpoenas and interrogatories, in the future.

While the outcome of any pending or future litigation or regulatory matter cannot be predicted, management does not believe that any pending litigation or regulatory matter will have a material adverse effect on the Company's business or financial position. The outcome of such matters is always uncertain, and unforeseen results can occur. It is possible that such outcomes could materially affect net income in a future period.

In February 2018, the Securities and Exchange Commission announced a Share Class Selection Disclosure Initiative. This initiative encouraged registered investment adviser firms to self-report to the SEC possible securities law violations relating to their failure to make adequate disclosures concerning mutual fund share classes used in advisory accounts. Like numerous other firms, The Company decided to self-report and participate in this initiative. In early February 2019 The Company signed and delivered to the SEC an Offer of Settlement, and it is anticipated that the SEC will soon issue an Order based on that. During 2018 The Company established a reserve in the amount of \$1,800,000 that will cover the amounts payable (including interest) to customers.

Supplemental Information

Principal Securities, Inc.

Schedule I – Computation of Net Capital Under SEC Rule 15c3-1

December 31, 2018

Computation of Net Capital

1. Total ownership equity from Statement of Financial Condition		\$31,226,596
2. Deduct ownership equity not allowable for Net Capital		<u>–</u>
3. Total ownership equity qualified for Net Capital		<u>31,226,596</u>
4. Add:		
A. Liabilities subordinated to claims of general creditors allowable in computation of net capital		<u>–</u>
B. Other (deductions) or allowable credits		<u>–</u>
5. Total capital and allowable subordinated liabilities		<u>31,226,596</u>
6. Deductions and/or charges:		
A. Total non-allowable assets from Statement of Financial Condition (Notes B and C)	\$17,500,947	
B. Secured demand note deficiency	<u>–</u>	
C. Commodity futures contracts and spot commodities – proprietary capital charges	<u>–</u>	
D. Other deductions and/or charges	<u>4,085</u>	<u>(17,505,032)</u>
7. Other additions and/or allowable credits		<u>–</u>
8. Net Capital before haircuts on securities positions		<u>\$13,721,564</u>
9. Haircuts on securities (computed, where applicable, pursuant to 15c3-1 (f)):		
A. Contractual securities commitments	<u>–</u>	
B. Subordinated securities borrowings	<u>–</u>	
C. Trading and investment securities:		
1. Exempted securities	<u>–</u>	
2. Debt securities	<u>–</u>	
3. Options	<u>–</u>	
4. Other securities	<u>17,567</u>	
D. Undue concentration	<u>–</u>	
E. Other	<u>–</u>	<u>(17,567)</u>
10. Net Capital		<u><u>\$13,703,997</u></u>

Principal Securities, Inc.

Schedule I – Computation of Net Capital Under SEC Rule 15c3-1

December 31, 2018

Computation of Basic Net Capital Requirement

Part A

11. Minimum net capital required (6-2/3% of line 19)	\$2,321,904
12. Minimum dollar net capital requirement of reporting broker or dealer and minimum net capital requirement of subsidiaries computed in accordance with Note (A)	250,000
13. Net capital requirement (greater of line 11 or 12)	2,321,904
14. Excess net capital (line 10 less 13)	11,382,093
15. Net Capital less greater of 10% of line 19 or 120% of line 12	10,221,142

Computation of Aggregate Indebtedness

16. Total A.I. liabilities from Statement of Financial Condition	\$34,828,548
17. Add:	
A. Drafts for immediate credit	—
B. Market value of securities borrowed for which no equivalent value is paid or credited	—
C. Other unrecorded amounts (List)	—
19. Total aggregate indebtedness	34,828,548
20. Percentage of aggregate indebtedness to net capital (line 19 divided by line 10)	254.15%
21. Percentage of debt to debt-equity total computed in accordance with Rule 15c-3-1(d)	0.00%

Notes:

- (A) The minimum net capital requirement should be computed by adding the minimum dollar net capital requirement of the reporting broker dealer and, for each subsidiary to be consolidated, the greater of:
1. Minimum dollar net capital requirement, or
 2. 2% of aggregate debits if alternative method is used.
- (B) Do not deduct the value of securities borrowed under subordination agreements or secured demand notes covered by subordination agreements not in satisfactory form and the market values of memberships in exchanges contributed for use of company (contra to item 1740) and partners' securities which were included in non-allowable assets.
- (C) For reports filed pursuant to paragraph (d) of Rule 17a-5, respondent should provide a list of material non-allowable assets.

Principal Securities, Inc.

Schedule I – Computation of Net Capital Under SEC Rule 15c3-1

December 31, 2018

There were no differences between the computation of net capital under Rule 15c3-1, which is included in this audited report, and the computation of net capital in the Company's corresponding unaudited Focus Report (Form X-17A-5 Part IIA) filing submitted to FINRA as of December 31, 2018.

Principal Securities, Inc.

Schedule II – Computation for Determination of the Reserve Requirements
Pursuant to SEC Rule 15c3-3

December 31, 2018

Exemptive Provision

If an exemption from Rule 15c3-3 is claimed, identify below the section upon which such exemption is based:

- A. (k)(1) – Limited business (mutual funds and/or variable annuities only)
- B. (k)(2)(i) – “Special Account for the Exclusive Benefit of Customers” maintained
- C. (k)(2)(ii) – All customer transactions cleared through another broker-dealer on a fully disclosed basis. Name of clearing firm: National Financial Services LLC
- D. (k)(3) – Exempted by order of the Commission

X

X

Principal Securities, Inc.

Schedule III – Information Relating to the Possession or Control Requirements
Under SEC Rule 15c3-3

December 31, 2018

The Company is exempt from SEC Rule 15c3-3 as it relates to the possession and control requirements under paragraph (k)(2)(i) and (k)(2)(ii) of that Rule.

Report of Independent Registered Public Accounting Firm
on Applying Agreed-Upon Procedures

To the Board of Directors and Management of Principal Securities, Inc.:

We have performed the procedures enumerated below, which were agreed to by the Board of Directors, management of Principal Securities, Inc. (the Company), and the Securities Investor Protection Corporation (SIPC), as set forth in the Series 600 Rules of SIPC, solely to assist the specified parties in evaluating the Company's schedule of assessments and payments is in accordance with the applicable instructions of the General Assessment Reconciliation (Form SIPC-7) for the fiscal year ended December 31, 2018. The Company's management is responsible for the Company's compliance with those requirements. The sufficiency of these procedures is solely the responsibility of those parties specified in this report. Consequently, we make no representation regarding the sufficiency of the procedures enumerated below either for the purpose for which this report has been requested or for any other purpose.

The procedures we performed and our findings are as follows:

1. Compared the assessment payments made in accordance with the General Assessment Payment Form (Form SIPC-6) and applied to the General Assessment calculation on Form SIPC-7 with respective cash disbursement record entries.
No findings were found as a result of applying the procedure.
2. Compared the amounts reported in the audited financial statements required by SEC Rule 17a-5 with the amounts reported in Form SIPC-7 for the fiscal year ended December 31, 2018.
No findings were found as a result of applying the procedure.
3. Compared any adjustments reported in Form SIPC-7 with supporting schedules and working papers supporting the adjustments.
No findings were found as a result of applying the procedure.
4. Recalculated the arithmetical accuracy of the calculations reflected in Form SIPC-7 and in the schedules and working papers supporting the adjustments.
No findings were found as a result of applying the procedure.

This agreed-upon procedures engagement was conducted in accordance with the interim attestation standards of the Public Company Accounting Oversight Board (United States) and the attestation standards established by the American Institute of Certified Public Accountants. We were not engaged to and did not conduct an examination or a review, the objective of which would be the expression of an opinion or conclusion, respectively, on whether Principal Securities Inc.'s schedule of assessments and payments is in accordance with the applicable instructions of the General Assessment Reconciliation (Form SIPC-7) for the fiscal year ended December 31, 2018. Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the information and use of the specified parties listed above and is not intended to be and should not be used by anyone other than these specified parties.

Ernst & Young LLP

Des Moines, Iowa
February 28, 2019

Report of Independent Registered Public Accounting Firm

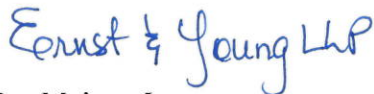
The Board of Directors and Management of Principal Securities, Inc.

We have reviewed management's statements, included in the accompanying Principal Securities, Inc. Exemption Report, in which (1) Principal Securities, Inc. (the Company) identified the following provisions of 17 C.F.R. § 15c3-3(k) under which the Company claimed an exemption from 17 C.F.R. § 240.15c3-3: (k)(2)(i) and (k)(2)(ii) (the "exemption provisions") and (2) the Company stated that it met the identified exemption provisions in 17 C.F.R. § 240.15c3-3 (k) throughout the most recent fiscal year ended December 31, 2018 except as described in its exemption report. Management is responsible for compliance with the exemption provisions and its statements.

Our review was conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States) and, accordingly, included inquiries and other required procedures to obtain evidence about the Company's compliance with the exemption provisions. A review is substantially less in scope than an examination, the objective of which is the expression of an opinion on management's statements. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to management's statements referred to above for them to be fairly stated, in all material respects, based on the provisions set forth in paragraph (k)(2)(i) and (k)(2)(ii) of Rule 15c3-3 under the Securities Exchange Act of 1934.

This report is intended solely for the information and use of the Board of Directors, management, the SEC, FINRA, other regulatory agencies that rely on Rule 17a-5 under the Securities Exchange Act of 1934 in their regulation of registered brokers and dealers, and other recipients specified by Rule 17a-5(d)(6) and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in blue ink that reads "Ernst & Young LLP".

Des Moines, Iowa
February 28, 2019

Principal Securities, Inc. Exemption Report

Covering the Period January 1 – December 31, 2018

Principal Securities, Inc. (the Company) is a registered broker-dealer subject to Rule 17a-5 promulgated by the Securities and Exchange Commission (17 C.F.R. 240.17a-5, "Reports to be made by certain brokers and dealers"). This Exemption Report was prepared as required by 17 C.F.R. 240.17a-5(d)(1). To the best of my knowledge and belief, the Company states the following:

- (1) The Company claimed an exemption from 17 C.F.R. 240.15c3-3 under the following provisions of 17 C.F.R. 240.15c3-3(k)(2)(i) – "Special Account for the Exclusive Benefit of customers" maintained.
 - (2) The Company claimed an exemption from 17 C.F.R. 240.15c3-3 under the following provisions of 17 C.F.R. 240.15c3-3(k)(2)(ii) – All Customer transactions cleared through another broker-dealer on a fully disclosed basis.
 - (3) The Company fully met the identified exemption provisions in 17 C.F.R. 240.15c3-3(k) throughout the period from January 1, 2018 to December 31, 2018, except as described in Attachment A.
-

Principal Securities, Inc.

I, Scott Christensen, affirm that, to my best knowledge and belief, this Exemption Report is true and correct.



Scott Christensen, Chief Financial Officer

February 28, 2019

ATTACHMENT A

2018 15c3-3 Exception Report

Exception Date (Approx.)	Account Type	Amount	Nature of Exception
12/27/2017*		\$1,500.00	Check was identified as not promptly forwarded by the RR's branch office. *Error related to the exception was reported in 2018.
	Brokerage		
01/18/2018	Principal Funds	\$2,500.00	Check was identified as not promptly forwarded by the RR's branch office.
01/18/2018	Principal Funds	\$2,500.00	Check was identified as not promptly forwarded by the RR's branch office.
01/19/2018	Brokerage	\$11,000.00	Check was identified as not promptly forwarded by the RR's branch office.
01/19/2018	Brokerage	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
01/23/2018	Brokerage	\$13,000.00	Check was identified as not promptly forwarded by the RR's branch office.
01/26/2018	Brokerage	\$2,000.00	Check was identified as not promptly forwarded by the RR's branch office.
02/15/2018	Brokerage	\$15,000.00	Check was identified as not promptly forwarded by the RR's branch office.
02/20/2018	Brokerage	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
02/28/2018	Brokerage	\$11,000.00	Check was identified as not promptly forwarded by the RR's branch office.
03/07/2018	Moringstar	\$80,000.00	Check was identified as not promptly forwarded by the RR's branch office.
03/07/2018	Brokerage	\$160,000.00	Account was approved, but "Not In Good Order" for check deposit.
03/14/2018	Principal Annuities	\$2,210.00	Check was identified as not promptly forwarded by the RR's branch office.
03/19/2018	Brokerage	\$5,500.00	Account was approved, but "Not In Good Order" for check deposit.
03/19/2018	Brokerage	\$40,000.00	Account was approved, but "Not In Good Order" for check deposit.
04/03/2018	529 Plan	\$6,478.00	Check was identified as not promptly forwarded by the RR's branch office.
04/10/2018	Brokerage	\$1,300.00	Check was identified as not promptly forwarded by the RR's branch office.
04/10/2018	Principal Funds	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
04/16/2018	Principal Annuities	\$64,000.00	Check was identified as not promptly forwarded by the RR's branch office.
04/17/2018	Principal Annuities	\$10,000.00	Check was identified as not promptly forwarded by the RR's branch office.
04/18/2018	Brokerage	\$58,083.33	Check was identified as not promptly forwarded by the RR's branch office.
04/25/2018	Principal Annuities	\$77,192.25	Check was identified as not promptly forwarded by the RR's branch office.
05/09/2018	Principal Annuities	\$500.00	Check was identified as not promptly forwarded by the RR's branch office.
05/10/2018	Principal Funds	\$1,000.00	Check was identified as not promptly forwarded by the RR's branch office.
05/13/2018	Brokerage	\$9,900	Account was approved, but "Not In Good Order" for check deposit.
05/17/2018	Brokerage	\$12,706.72	Check was identified as not promptly forwarded by the RR's branch office.
05/21/2018	Principal Funds	\$1,275.00	Check was identified as not promptly forwarded by the RR's branch office.
05/29/2018	Brokerage	\$10,000	Account was approved, but "Not In Good Order" for check deposit.
05/31/2018	529 Plan	\$10,000.00	Check was identified as not promptly forwarded by the RR's branch office.
05/31/2018	Principal Funds	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
05/31/2018	Brokerage	\$95,000.00	Check was identified as not promptly forwarded by the RR's branch office.
06/08/2018	Brokerage	\$5,000.00	Check was identified as not promptly forwarded by the RR's branch office.
06/14/2018	Brokerage	\$4,500.00	Check was identified as not promptly forwarded by the RR's branch office.
06/14/2018	Brokerage	\$4,500.00	Check was identified as not promptly forwarded by the RR's branch office.
06/18/2018	Brokerage	\$15,000	Account was approved, but "Not In Good Order" for check deposit.
06/22/2018	Brokerage	\$5,000.00	Check was identified as not promptly forwarded by the RR's branch office.
06/22/2018	Principal Funds	\$349,804.00	Check was identified as not promptly forwarded by the RR's branch office.
06/22/2018	Brokerage	\$12,000.00	Check was identified as not promptly forwarded by the RR's branch office.
06/25/2018	Principal Funds	\$12,500.00	Check was identified as not promptly forwarded by the RR's branch office.
06/28/2018	Principal Funds	\$12,500.00	Check was identified as not promptly forwarded by the RR's branch office.
07/02/2018	Brokerage	\$916.86	Check was identified as not promptly forwarded by the RR's branch office.
07/06/2018	Principal Funds	\$5,500.00	Check was identified as not promptly forwarded by the RR's branch office.
07/13/2018	Principal Funds	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/16/2018	529 Plan	\$2,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/16/2018	529 Plan	\$2,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/18/2018	Brokerage	\$6,500.00	Check was identified as not promptly forwarded by the RR's branch office.
07/18/2018	Brokerage	\$50,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/18/2018	Brokerage	\$250.00	Check was identified as not promptly forwarded by the RR's branch office.
07/24/2018	Brokerage	\$5,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/25/2018	Principal Funds	\$5,000.00	Check was identified as not promptly forwarded by the RR's branch office.
07/30/2018	Brokerage	\$8,280.97	Check was identified as not promptly forwarded by the RR's branch office.
08/03/2018	Brokerage	\$6,547.81	Check was identified as not promptly forwarded by the RR's branch office.
09/12/2018	Brokerage	\$3,795.94	Check was identified as not promptly forwarded by the RR's branch office.
09/24/2018	Principal Funds	\$377.00	Check was identified as not promptly forwarded by the RR's branch office.
10/05/2018	Brokerage	\$6,500.00	Check was identified as not promptly forwarded by the RR's branch office.
10/09/2018	Principal Funds	\$278.33	Check was identified as not promptly forwarded by the RR's branch office.
10/09/2018	Principal Funds	\$251.62	Check was identified as not promptly forwarded by the RR's branch office.
10/09/2018	Principal Funds	\$144.00	Check was identified as not promptly forwarded by the RR's branch office.
10/10/2018	Direct MF	\$476,795.77	Check was identified as not promptly forwarded by the RR's branch office.
10/10/2018	Direct MF	\$134,615.86	Check was identified as not promptly forwarded by the RR's branch office.
10/12/2018	Brokerage	Unknown	Check was identified as not promptly forwarded by the RR's branch office.
10/24/2018	529 Plan	\$20,000.00	Check was identified as not promptly forwarded by the RR's branch office.
11/05/2018	Brokerage	\$552.00	Check was identified as not promptly forwarded by the RR's branch office.
11/05/2018	Brokerage	\$350,000.00	Account was approved, but "Not In Good Order" for check deposit.
11/09/2018	Direct MF	\$919.68	Check was identified as not promptly forwarded by the RR's branch office.
11/09/2018	Direct MF	\$438.00	Check was identified as not promptly forwarded by the RR's branch office.
11/19/2018	Brokerage	\$544.60	Check was identified as not promptly forwarded by the RR's branch office.
11/19/2018	Brokerage	\$1,880.75	Check was identified as not promptly forwarded by the RR's branch office.
11/21/2018	Principal Funds	\$9,408.36	Check was identified as not promptly forwarded by the RR's branch office.
11/29/2018	Principal Funds	\$3,000.00	Check was identified as not promptly forwarded by the RR's branch office.
11/29/2018	Principal Funds	\$4,000.00	Check was identified as not promptly forwarded by the RR's branch office.
11/30/2018	Brokerage	Unknown	Check was identified as not promptly forwarded by the RR's branch office.
12/04/2018	Principal Annuities	\$500.00	Check was identified as not promptly forwarded by the RR's branch office.
12/06/2018	Brokerage	\$290.00	Check was identified as not promptly forwarded by the RR's branch office.
12/06/2018	Brokerage	\$18,500.00	Check was identified as not promptly forwarded by the RR's branch office.
12/13/2018	Principal Funds	\$62,525.20	Check was identified as not promptly forwarded by the RR's branch office.
12/19/2018	Brokerage	\$1,000.00	Check was identified as not promptly forwarded by the RR's branch office.
12/20/2018	Brokerage	\$6,500.00	Check was identified as not promptly forwarded by the RR's branch office.
12/26/2018	Brokerage	\$6,500.00	Check was identified as not promptly forwarded by the RR's branch office.
12/27/2018	Brokerage	\$300.00	Check was identified as not promptly forwarded by the RR's branch office.
12/28/2018	Brokerage	\$36,540.70	Check was identified as not promptly forwarded by the RR's branch office.