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Voya Financial, Inc. (VOYA)

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Voya Financial First Quarter 2014 Earnings Conference Call. All participants will be in a listen-only mode. [Operator Instructions] After today's presentation, there'll be an opportunity to ask questions. [Operator Instructions] Participants are limited to one question and one follow-up. Please note this event is being recorded.

I would now like to turn the conference over to Darin Arita, Senior Vice President, Investor Relations. Please go ahead.

Darin C. Arita
Senior Vice President-Investor Relations, Voya Financial, Inc.

Thank you, Emily, and good morning everyone. Welcome to Voya Financial's first quarter 2014 conference call. A slide presentation for this call is available on our website at investors.voya.com or via the webcast.

Turning to slide two, on today's call, we will be making forward-looking statements. Except with respect to historical information, statements made in this conference call constitute forward-looking statements within the meaning of federal securities laws, including statements relating to trends in the company's operations and financial results and the business and the products of the company and its subsidiaries. Voya Financial's actual results may differ materially from the results anticipated in the forward-looking statements as a result of risks and uncertainties, including those from time-to-time in Voya Financial's filings with the U.S. Securities and Exchange Commission.

Voya Financial specifically disclaims the obligation to update or revise any forward-looking statements, whether as a result of new information, future developments or otherwise. Slide two also notes that the call today includes non-GAAP financial measures. In particular, all references on this call to ROE, return on equity, ROC, return on capital, or other measures containing those terms are to Ongoing Business adjusted operating return on equity or Ongoing Business adjusted operating return on capital as applicable, which are each non-GAAP financial measures.

An explanation of how we calculate these and other non-GAAP financial measures and the reasons we believe they are useful can be found in the Quarterly Investor Supplement available on our website at investors.voya.com. Reconciliations to the most directly comparable GAAP measures are included in the press release and the Quarterly Investor Supplement.

Joining me this morning on the call are Rod Martin, Chairman and Chief Executive Officer of Voya Financial; Alain Karaoglan, Chief Operating Officer; and Ewout Steenbergen, Chief Financial Officer. After their prepared remarks, we will take your questions.

With that, let's turn to slide three and I will turn the call over to Rod.

Rodney O. Martin

Chairman & Chief Executive Officer, Voya Financial, Inc.

Thank you, Darin and good morning, everyone. Welcome to our first investor presentation as Voya Financial. Five days ago, we celebrated our one year anniversary as a public company and it's been a productive 12 months for our entire organization. And while we're proud of all we've accomplished in the short-term, we continue to work hard to grow our franchise and pursue our long-term vision to be America's retirement company.

In the first quarter of 2014, we made steady progress with our transformation story. We had five significant achievements in the quarter, which I will elaborate on momentarily, and we remain on track with our plan to improve our Ongoing Business adjusted operating return on equity.

Turning to slide four, let me highlight five significant achievements from the first quarter. First, we deconsolidated from ING Group following their secondary offering which closed on March 25. ING Group's ownership stake has been reduced to approximately 43%, and our board of directors is now comprised of a majority of independent directors.

Second, we updated our capital plan by increasing our expected capital generation to more than $1.7 billion from 2013 through 2016. This increase from our prior target of $1.2 billion to $1.4 billion was driven by our capital generation in 2013.

Third, utilizing the excess capital we generated. We repurchased $265 million of common stock through April. We're pleased to deploy our capital in this way and believe that investing in our stock is an excellent use of our capital. We have authorization remaining to repurchase $35 million of additional shares, and we intend to do so opportunistically.

Fourth, our holding company officially transitioned to Voya Financial. Our brand name captures the essence of our customers' journey to retirement readiness and we're excited to start showcasing Voya in the marketplace. Our operational rebranding is ongoing and we are on track to complete the key elements by September.

Fifth, the rating agencies, Fitch and Standard & Poor's, raised their financial strength ratings outlook to positive.

In addition to these achievements, Voya Financial was named one of the world's most ethical companies by Ethisphere Institute and we're very proud of this recognition. These first quarter achievements are significant milestones in our transformation story and key contributors in our ability to create long-term value for all stakeholders.

On slide five, let me highlight our first quarter financial results, which has several areas of strength and a couple areas that require improvement. Some of the areas of strength were our solid net flows for Investment Management, Annuities, and strong sales from Employee Benefits. The areas that require improvement are net flows for Retirement and our return on capital for Individual Life.

We are transforming Voya Financial, and that's a non-linear process which was fully anticipated and contemplated in our plan. Bottom line, we remain confident in our fundamental elements of our plan and our ability to execute that plan. We achieved total after-tax operating earnings of $150 million, which is $0.57 per diluted share for the first quarter or $0.62 per diluted share excluding DAC unlocking.

We generated net income available to common shareholders of $258 million for the first quarter. First quarter Ongoing Business adjusted operating earnings before income taxes was $287 million, which was up slightly from the prior year. Our Ongoing Business adjusted operating return on equity on a trailing 12-month basis was unchanged from the full-year 2013 at 10.3%. We remain committed to improving our ROE to 12% to 13% by the end of 2016.

Turning to our Closed Block Variable Annuity segment, as you know our hedging program is designed to protect regulatory and rating agency capital from market volatility. Our first quarter CBVA result was in line with our expectations. In addition, we've taken our first proactive step to reduce the size of our CVBA segment. On May 2, we filed a guaranteed minimum income benefit enhanced annuitization offer with the SEC. Since we're still in the SEC registration process, we're limited in what we can say, but the offer would provide certain policy owners the option to annuitize prior to the end of the 10-year waiting period and receive additional guaranteed income. The objective of the offer is to proactively reduce the size and risk profile of our CVBA segment.

As we move to slide six, you'll see how the Voya franchise continues to leverage its leadership positions in attractive market segments to deliver diverse earnings. We delivered more than $1.2 billion in Ongoing Business adjusted operating earnings before income taxes on a trailing 12-month basis. Approximately 75% of these earnings came from Retirement Solutions and Investment Management. Retirement, Annuities and Investment Management all achieved positive net flows in the first quarter.

As we've said before, given the size of our Retirement book and our re-pricing initiatives, net flows will vary from quarter to quarter. Even as we go through our re-pricing exercise, we will continue to execute our retirement readiness initiatives to grow Retirement on both our institutional and retail sides of the business. For instance, we recently introduced a digital resource called the personal financial dashboard. The dashboard provides a whole new experience for our customers to organize and manage their financial information and has been rolled out to more than 1.5 million plan participants, who have exclusive access to this resource. This is just one example of how we're differentiating Voya Financial with our retirement readiness platform, which is helping us win new business.

For instance, we've recently announced that the California State Teachers' Retirement System, CalSTRS, chose Voya Financial as their new service provider for its supplementary defined contribution savings plan. CalSTRS is the largest educator-only retirement fund in the U.S., and one of the primary factors in winning the mandate was our ability to help their plan participants with their retirement readiness.

Another important development in the quarter for Annuities was the hiring of Carolyn Johnson as the new President of Annuities; a business segment that already had solid momentum and will benefit from her years of experience.

The remaining 25% of the earnings came from Insurance Solutions. We have new leadership in place, with CEO Mike Smith, and he is intently focused on the expansion of Employee Benefits and the repositioning of Individual Life.

We've restructured and reshaped the Individual Life product portfolio, and as we've discussed, it will take some time for the changes we're making to gain momentum. Although we had adverse mortality experience in the first quarter, we do not see any fundamental issues with overall underwriting. It was simply an adverse quarter. Individual Life is an important component to the overall value we deliver to customers and a fundamental part of their ability to achieve retirement readiness.

Employee Benefits had an exceptional quarter, with strong sales, return on capital improvements and solid operating results. In addition, we promoted Heather Lavallee to President of Employee Benefits. Across all of our businesses, our assets under management and administration grew to a record $514 billion, up from $511 billion at the end of 2013. Overall, we remain confident that our premier franchise is well-positioned in the right markets to generate steady growth.

As we move to slide seven, you will see that the Ongoing Business adjusted operating ROE was 10.3%. Excluding the effect of items that we did not expect to recur at the same levels, such as higher-than-expected alternative investment income over the past 12 months, the ROE increased to 10.1% from 9.8%. Our ROE plan is designed to generate steady improvement and we are committed to that plan. Our focus on transforming our business will allow us to achieve our long-term ROE improvement objective of 12% to 13% by the end of 2016.

I will now turn it over to Alain for more details about our ROE and ROC improvement program.

Alain M. Karaoglan

Chief Operating Officer & Executive Vice President, Voya Financial, Inc.

Thank you, Rod, and good morning. Today, I will provide details on the progress of our return on capital improvement plan. I will also highlight some examples of how we continue to execute. As a brief reminder, when we discuss each of the business segments, we focus on return on capital instead of return on equity, since we do not allocate that to each of our businesses.

Turning to slide nine, our Ongoing Business return on capital was 8.6% for the trailing 12-months ended March 31. This is consistent with our 2013 performance. When you remove items that we do not expect to recur at the same level from both periods, our return on capital increased 20 basis points from 8.2% to 8.4%. We remain focused on our more than 30 margin, growth and capital initiatives to continue to improve our return on capital in order to reach our 2016 target of 10% to 11%.

Let me provide you with some more detail on how each of our Ongoing Businesses performed this quarter. Beginning with Retirement on slide 10, return on capital was 8.7%; that is down slightly from 8.9% for 2013. Adjusting for items that we do not expect to recur at the same level, the return on capital improved slightly from 8.5% to 8.6%.

As you know, we are continuing to re-price our business to improve margins. In the first quarter, we retained over 90% of re-priced cases and at aggregate portfolio internal rates of return at or above our internal targets.

Equally important is focusing on growth, and to give you more insight into our growth initiatives, we take the tax exempt area of our Retirement business as an example. We thought it would be helpful to provide a deeper look at our re-pricing efforts and how specifically we are laying the groundwork for growth within this area.

Slide 11 illustrates how our tax-exempt business is executing on its re-pricing strategy and leveraging its rebuilt sales force. As you know, we are a leading provider of employer-sponsored savings plans for government, education, healthcare, and non-profit clients. Because of the business focus on large clients, net flows have varied significantly from quarter to quarter, and the first quarter of 2014, in particular, had net outflows as some large clients departed at the end of their contracts, since we are maintaining our pricing discipline in the renewal bidding process.

Moving forward, we expect to have additional net outflows in future quarters for this business, as a result of remaining disciplined with our pricing strategy. Having said that, you should know that in addition to re-pricing, we have been focused on new business growth and the retirement readiness of our individual customers. For example, we have taken significant actions over the past 16 months to rebuild our tax-exempt sales force to increase contribution from existing cases and to attract new clients. We increased the number of regional Vice Presidents responsible for assisting clients and recruiting and training field advisors. We also grew the team focused on new business sales, and importantly, we have made these increases while keeping our cost structure in check by streamlining roles and responsibilities.

These actions are already paying dividends in leading indicators. For example, the recruitment of Advisor Specialists is on track to grow by 10% in 2014, and this will enable us to continue to meet customer needs. Also, we are seeing increased new client activity, including notable growth in requests to bid on new business, an increase in the number of finalist presentations and the substantial rise in the new business close ratio.

Now let's turn to slide 12 to discuss our Annuities business. Here, the return on capital improved to 7.5%, up slightly from 7.3% in 2013. Adjusted for the items that we do not expect to recur at the same levels, the return on capital grew 30 basis points to 7.1%.

In Annuities, we are improving margins through the continued runoff of the annual reset and multi-year guarantee product. We also continued to grow higher-return product sales. Overall, our momentum in Annuities was solid this quarter, as we turned total net flows from outflows to positive inflows. We continue to grow sales of our mutual fund custodial product and of indexed annuity. And supporting our focus on growth has been our strategic alliance with Allstate, which was formally launched in January as scheduled. And through the first quarter, we are pleased with our performance, both in terms of agent engagement and in terms of sales.

Moving to slide 13, the operating margin for Investment Management for the trailing 12 months ended March 31 increased to 29.6%, up from 27.7% in 2013. Excluding results from investment capital, the operating margin improved to 26.3% from 24.7% in 2013. By both measures, Investment Management has continued to consistently improve its operating margin, which we focus on instead of return on capital, since Investment Management is not a capital-intensive business. This quarter, we generated substantial sub-advisor replacements totaling $4.7 billion. This inflow was driven by our strong relative investment performance in the intermediate bond, high-yield and international product offerings as well as the cross enterprise collaboration of our businesses.

Our fixed income investment performance is very strong on both a three and five-year basis. We were pleased to have the ING Intermediate Bond Fund and the ING GNMA Income Fund ranked number one in their categories by Lipper. In addition, the ING High Yield Fund was named among the best performers in the U.S. corporate bond category by Bloomberg.

Our equity performance on a three-year to five-year basis reflects slightly below benchmark performance in certain strategies over the past year. Our strong performance coming through the financial crisis has now fallen out of the five-year calculation. And while our style of equity management does not outperform in all markets, given our quality basis, we remain committed to our strategy of delivering reliable risk adjusted returns over the long-term. This approach has worked very well for us for over a decade and for our clients.

Turning to slide 14, Individual Life's return on capital was 4.4%, down from 4.9% in 2013. Adjusting for items that we do not expect to recur at the same level, the return on capital declined from 4.5% to 4.2%. This reflects unfavorable mortality, which was driven by claims severity in the first quarter of 2014. As Rod noted, Individual Life is an area that requires improvement. This quarter, we experienced an unusually high number of large dollar claims. We expect mortality experience will normalize and the ROC improvement to get back on track. In addition, we will continue to shift sales to less capital-intensive products such Indexed Universal Life, and we will continue to manage expenses and non-guaranteed elements of in force contracts.

Turning to slide 15, the return on capital of Employee Benefits grew to 20.6%, that's up 180 basis points from 18.8% in 2013. Adjusted for the items that we do not expect to recur at the same level, the return on capital was 20.1%, up from 18.1%.

Employee Benefits continues to perform well, as we focus on both increasing sales and improving margins in the business. For example, by working closely with our distribution partners, improving sales force training and hiring new sales representatives in certain regions, we were able to grow Stop Loss sales by $93 million compared to the first quarter of 2013. And we did this while maintaining solid risk selection in underwriting.

And finally, on voluntary benefits, our Compass product suite and the expanded distribution helped to grow sales significantly in this quarter.

In conclusion, we made further progress this quarter towards achieving our target return on capital improvement and initiatives. Last year results increased our confidence in achieving our target and we are continue to be very confident about achieving them.

Now, let me turn it over to Ewout, who will cover our financial results in more details. Ewout?

Ewout L. Steenbergen

Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

Thank you, Alain, and good morning everyone. Today, I will highlight some of our key financial metrics for the first quarter of 2014.

Slide 17; I will walk you through this quarter's reconciliation from Ongoing Business adjusted operating earnings to net income, and all information presented here is on an after-tax basis.

Starting on the left side of the chart, the Ongoing Business adjusted operating earnings were $187 million. After negative DAC/VOBA unlocking of $13 million, the Ongoing Business operating earnings were $174 million. Including the Corporate segment losses of $24 million, which is mostly interest expense, and an operating gain of $1 million from the Closed Block Institutional Spread Products and other Closed Blocks, we had operating earnings of $150 million in the quarter.

Moving to below the line items, our Closed Block Variable Annuity segment had a gain of $13 million, and this reflects a favorable impact from the lower volatility and non-performance risk. In addition to $37 million in net realized gains this quarter, we also had $13 million in losses in other items and $71 million attributable to the difference between the assumed 35% tax rate and our actual tax rate. And this brings our total net income available to common shareholders to $258 million.

Slide 18; we developed this waterfall to provide you with a better sense of our progress from the fourth quarter 2013 to the first quarter 2014 operating earnings. All items presented here are on a pre-tax and post-DAC basis. As you think about our earnings for the rest of the year, we have two key takeaways. First, we expect the underlying improvement in our earnings to continue to be driven by our ROC improvement initiatives. And, second, we expect several of the items that affected the first quarter results not to recur at the same levels. Let me explain this graph to you.

Starting with the left side of the chart, the fourth quarter operating earnings were $305 million. In our March S-1 filing, we disclosed items that we do not expect to recur and several items subject to significant variability that deviated from our long-term expectations. These items totaled $53 million for the fourth quarter. Subtracting these items from the fourth quarter operating earnings, we provide a starting point for the first quarter operating earnings. And then in the first quarter, we have several items that affected results, such as negative DAC/ VOBA unlocking, and seasonal expenses including payroll taxes, foundation funding and audit fees, and we expect several of the expense items that affected the first quarter, will not recur at the same levels in the second quarter.

In addition, Individual Life experienced $8 million in deterioration. This was more than offset by a $30 million improvement in our other segments. We expect debt improvement to continue, as we execute on our ROC plan.

Then slide 19. We are managing our business as you know, on the basis of three main drivers of operating revenues. Beginning with net underwriting gain, we saw a sequential decline in the first quarter, driven by unfavorable mortality as a result of claim severity in Individual Life. And this was partially offset by a sequential improvement in stop loss in the quarter. Investment spread and other investment income moderated sequentially from the fourth quarter, due to lower prepayments and alternative investment income.

Fee-based margin declined slightly from the fourth quarter, due to the absence of Investment Management performance fees and lower recordkeeping fees, partially offset by growth in fees from assets under management in Retirement and Investment Management.

Slide 20; I will briefly give you some color on our Retirement net flows which reflects our re-pricing discipline. We generated positive net flows in Corporate Markets and Individual Markets during the quarter. We did not have any large stable value wins during the quarter, so that resulted in small net outflows. Net flows were also affected in tax-exempt market by large case surrenders.

Then slide 21. As you can see, the total net flows for Annuities turned positive in the first quarter. We generated positive net flows into our Select Advantage mutual fund custodial products. And we also increased net flows for fixed indexed annuities, driven by the strength of our distribution including Allstate and a favorable interest rate environment. We remain optimistic about the flows from these products for the remainder of the year. At the same time, we show a continuation of the outflows of the low or negative margin products, such as the annual reset and the Multi-Year Guarantee Annuities. We anticipate a sizable outflow in the $500 million to $700 million range in the third quarter of 2014, as a large block comes up for renewal. As a reminder, these outflows are positive from an ROC perspective.

Then slide 22, for Investment Management, we saw solid third-party performance, where net flows were $1 billion, excluding sub-advisor replacements and variable annuity outflows. The strong flows were led by senior loans, alternatives and a CLO, and these are all higher fee asset categories. As Alain mentioned earlier, we had a record quarter of sub-advisor replacements totaling $4.7 billion. As we have previously indicated, these flows can vary significantly from quarter to quarter.

Variable annuity outflows for the funds that are managed by Investment Management were $801 million. We expect these outflows to increase in the second quarter of this year and onwards, because the majority of the $4.7 billion in sub-advisor replacements was related to variable annuities, which are running off in our Closed Block segment.

Then slide 23, Employee Benefits sales in Group Life, Stop Loss and Voluntary Products in the first quarter was $242 million, driven by our strong performance in Stop Loss during the January renewal period. As this chart illustrates, sales in this business are seasonal with the majority of sales occurring in the January and July renewal periods. For the quarter, our Group Life loss ratio was 82.0%. This loss ratio is typically highest during the first quarter of every year, and our Stop Loss loss ratio was very strong at 72.4%.

Then slide 24, in the Closed Block Variable Annuity, our hedge program largely offset the change in statutory reserves liability as a consequence of the equity market and interest rate movements during the quarter. Our hedge program continues to perform well in protecting regulatory and rating agency capital from market movements.

The estimated available resources for the CBVA segment were $4.6 billion as of the end of March, and that is including $150 million contribution to occur in the second quarter of this year. The net amount at risk for the living benefits increased by roughly $500 million during the quarter to $2.6 billion as a result of the decline in interest rates, and this compares favorably with the estimated $2.7 billion in statutory reserves for the living benefits.

The net outflows of accumulation products were $1.2 billion for the quarter, which translates into a 10.5% annualized net outflow as a percentage of the beginning of period assets. At the bottom of the slide, you see the new sensitivity tables for the end of the first quarter, both for regulatory capital, as well as GAAP earnings, for equity markets and interest rate movements. In the appendix of this presentation, we have included the updated 50-year cash flow scenarios as of the year-end 2013 that we updated in March. The present values of these cash flow scenarios improved over the past year.

Then moving on to slide 25; you can see that our estimated combined risk-based capital ratio at the end of the first quarter was 525%. Positive statutory net income and a reinsurance transaction contributed to the RBC ratio increase relative to the fourth quarter. Pro forma for the effects of up-streaming approximately $800 million in ordinary dividends through the holding company our estimated combined RBC ratio would be approximately 460%.

As you can see on the right side of the slide, the debt-to-capital ratio at the end of the first quarter was flat from the fourth quarter at 23.5%, slightly better than our target of 25%. The reduction in shareholders' equity attributable to the share repurchase was offset by positive GAAP net income.

Then slide 26; you can see our holding company cash stands at $462 million as of the end of March, and that is slightly above our 24-months' liquidity target of $450 million. During the quarter, we utilized $250 million of cash to repurchase shares.

Moving to the right chart, this shows the composition of our Corporate GAAP capital as of the end of March of $2.7 billion. The largest component is $1.4 billion, which represents our estimated statutory surplus in excess of our target RBC ratio of 425% as of March 31. We have approximately $800 million in ordinary dividends available in 2014.

We will use $150 million for planned contribution into SLDI, $100 million for the repayment of intercompany cash management and $290 million for holding company payments for the next 12 months. This is followed by a $462 million in holding company liquidity, $387 million in other items such as intangibles and tax assets net of corporate liabilities, and $393 million in statutory surplus supporting other Closed Blocks.

So, in summary, we delivered steady financial results this quarter, as we continue to focus on achieving our 2016 ROE targets, running off less profitable business, solidifying our balance sheet, and ensuring our CBVA book is well protected.

And with that, I will turn it back to the operator, Emily, so we can take your questions.

QUESTION AND ANSWER SECTION

Operator: Thank you. We will now begin the question-and-answer session. [Operator Instructions] Our first question is from Erik Bass of Citigroup. Please go ahead.

Erik J. Bass
Analyst, Citigroup Global Markets Inc. (Broker)

Q

Hi. Thank you. Yes. Could you walk us through expected capital generation for 2014? And I guess is it correct to think about the starting point being the $800 million of potential insurance subsidiary dividends plus your Investment Management earnings? And then from that, should we think about subtracting $150 million for the capital contribution to SLDI interest expense and holding company expenses? I guess, are there any other pieces we should be thinking about to get at kind of a gross free cash flow number before buybacks or dividends?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Good morning, Erik. This is Ewout. Thank you for your question. So, let me walk you through the different components of our capital structure. But I think overall, your conclusion that our capital structure is strong, our capital management is moving in a strong direction is absolutely the right conclusion. So, I will provide you some of the details.

So, we are at currently $1.4 billion of excess capital over the 425% RBC ratio. I've said before, $800 million, we expect we are able to take out in terms of ordinary dividends this year. That means $600 million will remain in our operating entities. Of the $800 million, we expect to do that injection in SLDI in conjunction with some rebalancing of capital which we do every year, and we had flagged that already at year-end. Approximately $200 million in holding company interest expenses, and that is just our annual run rate over our debt structure. We have some remaining capacity of our buyback program of approximately $35 million. We have some other holding company expenses around rebranding, I think about approximately $50 million. And then we have some cash management, where we have to do some rebalancing of approximately $100 million.

So, in other words, if you deduct those items from the $800 million, that would mean that a cushion in terms of holding company capital will remain of $250 million for this year and that does not include any potential up-streaming from dividends from our Investment Management entity, that is not subject to any regulatory restrictions in terms of dividends to the holding company. So, you should think about $250 million of additional capital cushion, $600 million of excess capital above RBC in our operating entities, and on top of that, some of the operating earnings from Investment Management that will be available this year as dividends to the holding as well.

Erik J. Bass
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Thank you. That's very helpful. And I guess two just follow-ups on that. First, do you view the $800 million of dividend capacity this year as a reasonable run rate to think about or is there anything unusual reflected in this, given some of the restructuring of the entities last year?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.
A

I think if you look at the capital generation last year, the main item that was extraordinary, that is not recurring or not recurring at the same level, were some of the distributions we received from the Lehman settlement. So that was an amount slightly over $100 million. So, you should not see that as an element that is available in future years in terms of ordinary dividend capacity.

For the rest, I think you should look at the statutory earnings we generated last year as a level that is available going forward. In fact, with the ROE improvement plan, we also expect the statutory results to improve gradually over time, and in other words, we expect that the free cash flow generation, as a percentage of our GAAP earnings, which is today approximately 50%, that will gradually grow in the future.

Erik J. Bass
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Thanks. And just for Investment Management, really quickly on the capital, is the right way to think about it sort of pre-tax earnings that all of that would be potentially available as a dividend or is there some of that earnings level that you need to retain in the business?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.
A

Yeah. You should think about it – that, on an after-tax basis that is available as dividends to the holding company, as you know, the effective tax rate for the company is rather low. But if you think about dividend, think about it on an after-tax basis.

Erik J. Bass
Analyst, Citigroup Global Markets Inc. (Broker)
Q

Okay. Thank you very much.

Operator: Our next question is from Yaron Kinar of Deutsche Bank. Please go ahead.

Yaron J. Kinar
Analyst, Deutsche Bank Securities, Inc.
Q

Good morning. So, I want to go back to the Retirement segment, if I could, where I think you'd highlighted in the earnings release that there were some reinvestment – there was some reinvestment in the business. So, just to clarify, is that – if I go back to slide 11, can I read from that, that most of the reinvestments is basically in hiring of additional advisors and specialists there? Hello?

Rodney O. Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

A

Good morning. It's Rod. So, we – as Alain pointed out, we are building out the both sales and support team with our tax-exempt organization, and we've done that while very prudently managing the expenses through that process. So, it's been a balance of the renewal piece, some of which has not renewed because it has not met our expectations, and some of which have been wins that have met or exceeded our expectations, as well as building out the support to further grow our Retirement business and specifically our tax exempt support.

Yaron J. Kinar
Analyst, Deutsche Bank Securities, Inc.

Q

Okay. So as you're building that out and then looking at that at the slide presentation, I guess, Retirement net flows have been somewhat muted and that goes back probably to your statement of having some wins and some cases where – I guess the repricing or efforts just didn't lead to a win. Ultimately, I guess what I'm challenged with is thinking of the margin improvement initiative and squaring that with the growth initiative, and how ultimately do you achieve both at the same time, kind of showing both profitability growth and at the same time showing that the net flows are improving in Retirement?

Rodney O. Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

A

Let me take the first part and maybe Alain can jump in on about the margin and growth piece. One of the things that we've said to all of you from the very beginning is, we will maintain our pricing discipline as we go through this renewal block. Remind you that that renewal block is depending on five years to six years in length, and we're a little more than a third through that journey.

A number of those cases were below our pricing standards today. We are making very best efforts to renew those, but not at the expense of denigrating returns. And so, we are working very hard to renew them and we're renewing at a rate of about 90%, which is very consistent with our historic averages. But we are not sacrificing that, which is the way we will indeed accomplish the improvement in the ROC over a period of time.

I know we would all like to have that journey be quicker, but it is a four or five-year journey, and we're a third to 40% of the way through it. And that simply can't be accelerated. So, the reason that I and we have said from time to time that net flows will vary, particularly given we're in the large segments of the market in addition to the small/mid is when those do occur and they are occurring and when they do not meet pricing standards, we're not renewing them, which is what gives us confidence that we aren't adding to a book of business that is a sub-optimal return in terms of what our targets are. And as we've shared with you previously, it's 12% or better in this particular market.

Alain M. Karaoglan
Chief Operating Officer & Executive Vice President, Voya Financial, Inc.

A

And, Yaron, maybe if I could add to that. So, there's a quarterly volatility that we've been highlighting will happen. If you're going to be disciplined on writing business at certain rates of returns, what you have to be willing to give up is outflows. What we're seeing this quarter is not unexpected in terms of our plan, our expectation and our journey to improve our return on capital.

And we have been able so far to do both, increase our pricing and increase our growth on a quarterly basis that will not be linear. And maybe one of the things I would ask Ewout to address is the some of the unusual things that happens when you do that in terms of the DAC unlocking, Ewout, and the impact of that.

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Well, Yaron, let me walk you through the operating earnings over time as in how you can think about what is really happening on an underlying basis. So, the operating earnings we reported for Retirement was $115 million. And then we had a negative DAC unlocking for Retirement of $11 million. You should see that DAC unlocking in a very positive light. What is happening here is we are doing contract re-pricings. And in effect, we had a large contract, where we're able to renegotiate some of the contract conditions, especially with respect to lower guaranteed minimum interest rates.

From an accounting perspective, this is seen as a contract modification and the accounting rules required if we write off the DAC. So, the $11 million DAC unlocking – negative DAC unlocking for Retirement was in relation to that large contract re-pricing. But it is a positive, because going forward, we'll see a contract that is re-priced, has better conditions, so expected gross profits will be higher going forward and also there will not be any DAC amortization for that particular contract.

Next to that, we have some positives and negatives with respect to the prepayment fee income that was a little bit lower, the alternatives investment income a little bit higher. The net of the two was a negative of $1 million. And then the seasonal expenses, which we reported for the total Ongoing Business, approximately $8 million of that was for Retirement. So, if you put all those pieces together, the Retirement underlying operating earnings, taken in effect these elements, was more in the range of $135 million for the quarter. I hope that's helpful in respect to the pieces in the results.

Yaron J. Kinar
Analyst, Deutsche Bank Securities, Inc.

Q

Yes. Very much so. And I think I've taken enough of your time, so I'll re-queue. Thank you.

Operator: Our next question is from Chris Giovanni of Goldman Sachs. Please go ahead.

Christopher A. Giovanni
Analyst, Goldman Sachs & Co.

Q

Thanks so much. Good morning. I guess the first question just in terms of – you mentioned the GMIB buyout, and just curious what your expectations are in terms of take-up rates. We've seen a number of companies go after these strategies and a bit of mixed results in terms of take-up rates, and along those lines, what portion or size of the book is eligible for this?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Chris. Good morning. This is Ewout. We have indeed filed a, what is called, Income Enhancer rider that we'd like to add to some of our guaranteed income benefit products of our Closed Block Variable Annuity with the SEC. So, currently, this is under SEC review, and we would like to be very limited in respect of our commentary.

Conceptually, what I can say here is these are policies that are still in the 10-year waiting period. So they don't have the policyholders, don't have the option to annuitize. But we will provide them the option to annuitize earlier under this particular feature. The nice thing here is that we stick to the original purpose of the policy – that remains in the place, and the policyholders have bought those policies to convert in an income stream.

So, this is not a cash buyout enhancement. This is really an enhancement to annuitize earlier. And there will be some premium with respect to the benefit base for the policyholder. For the company, the benefit is that after the annuitization, the policies will become just regular payout annuities, no more market risk and no more policyholder behavioral risk going forward. But we cannot give you any quantification at this moment, because this is under SEC review and we will come back to you in the future when we have more information.

Christopher A. Giovanni
Analyst, Goldman Sachs & Co.

Q

Okay. So, the consumers then just giving up their kind of continued roll-up rate, I guess, earlier?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Correct; in exchange for some premium on the benefit base.

Christopher A. Giovanni
Analyst, Goldman Sachs & Co.

Q

Got it. Okay. And then in terms of the buybacks, in the quarter, you did obviously the block from ING Group. You did another sort of $8 million or so on top of that, another $7 million through April. So, how should we be thinking about kind of your expectations or the pace of buyback activity in terms of, are you going to be opportunistic around price or sort of a steady pace in terms of run rate?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Chris, as you know, we have a total buyback program authorized by our board, a total size of $300 million. So, it means we have another $35 million left under that program. And we will opportunistically buy back during the course of this year. In light of the positive developments with respect to our capital generation, we, as management, will continue to monitor the capital generation for the next period.

We will have some further deliberations over the summer, come to some conclusions, discuss that with our Board. And we expect later this year to come back to the market with some update on our capital return program. But for the time being, we will focus on the remainder of the current program that we have still outstanding.

Operator: Our next question is from Ryan Krueger of KBW. Please go ahead.

Ryan J. Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Hey. Good morning. Thanks. I guess, just a quick follow-up on the GMIB offer, I know you can't say much, but I guess, just one thing I was hoping to confirm is, is the offer for the entire GMIB Block or is it just for certain contracts that are a piece of that Block?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Ryan, good morning. I don't think we can provide to you exactly the information and details today for which part of the Block. But you should think about that these are policies that are still within the 10-year waiting period. So these are policies that are sold from 2005 and later and to which particular part of that sub-block we will provide this enhancement offer, we have not decided yet. So, we'll come back to you later during this year after we have received the feedback from the SEC review.

Ryan J. Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Understood. And then on the Individual Life mortality, how does that compare in the quarter to your own internal expectations?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

If you look at the Individual Life mortality, what we saw this quarter was especially a larger number of claims of higher face amounts. And we are looking especially at claims above $1 million in claim amount and we saw a higher frequency of claims of those higher sum insureds, especially two very large claims this quarter with very high face amounts. These were, of course, partially offset by some reinsurance recoveries.

So, if you look at what would be a more normalized underwriting result for Individual Life, if you take out some of those items of claim severity, especially those large two claims, I advise you to look back to the underwriting results we saw in the fourth quarter of last year. So approximately $13 million higher than we saw in the first quarter of this year. That is approximately the number you have to keep in mind if you would like to normalize for the claims severity.

Ryan J. Krueger
Analyst, Keefe, Bruyette & Woods, Inc.

Q

Okay. Got it. And then just last one, last one, the $500 million to $700 million fixed annuity outflow in the third quarter, should that – is that block, is that going to have – should we expect that to have a positive impact on your earnings, given some of the higher guarantees on that block?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

Correct. This is the multi-year guaranteed annuities. That's all the block that is running off where we have very low or negative margins. So, the products that are rolling off and where we see the negative outflows are in fact a positive from an earnings and especially a return on capital perspective because we see some release of capital on those particular policies.

Operator: And our next question comes from Steven Schwartz of Raymond James. Please go ahead.

Steven D. Schwartz
Analyst, Raymond James & Associates, Inc.

Q

Yeah. Chris and Ryan, just got two of them. Just a quickie, Ewout, looking at prepayment income and alternative investment income, it was high in the fourth quarter. It came down, like you said it would, in the first quarter. How would you compare the first quarter to some estimate of norm?

Ewout L. Steenbergen
Chief Financial Officer & Executive Vice President, Voya Financial, Inc.

A

So, if you look at some of the underlying items here, Steven, with respect to the alternative investments, we saw income in the quarter of $27 million for the Ongoing Business. If you look at the long-term expectation, that is a 9% assumption we have, so think about approximately $17 million. So, we were over by approximately $10 million with respect to the alternative investment income. Then with respect to prepayments, we saw $7 million for the quarter. Our long-term assumption is closer to $17 million. So, in fact, there we were approximately $10 million under for the quarter.

Steven D. Schwartz
Analyst, Raymond James & Associates, Inc.

Q

Okay. Great. Thanks a lot, guys.

Operator: And our last question today will come from Seth Weiss with Bank of America Merrill Lynch. Please go ahead.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

Yeah. Hi. Good morning. I just have a couple of questions on Investment Management. If we think about the sub-advisor replacements, was there any significant marketing push this quarter that may have led to those record amounts or is this a function of that five-year performance data rolling over?

Alain M. Karaoglan
Chief Operating Officer & Executive Vice President, Voya Financial, Inc.

A

Seth, hi. It's Alain, and thanks for the questions. These, as you've seen and you've seen on a quarterly basis, tend to be lumpy transactions. So, one of the things that, as an organization, we're doing a lot better than we were doing before, is working well cross enterprise through all these things a few years ago. And so, when you look at our capabilities, a lot of this, the $4.7 billion, primarily came from on the fixed income side. As I mentioned, two of our funds were ranked number one by Lipper. Our five-year performance has been spectacular with very good risk-adjusted returns.

And while other performance, and some of them have been more publicized and others, haven't held up and that has given us opportunities. As long as that continues to be the case, we will have additional opportunities, not to the tune of $4.7 billion, but it's all of our responsibility to make sure that our clients are getting the best returns that they could get from any of the mutual funds that are on our platform.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks. And maybe to follow-up on that, if I look at the balances that are managed by Investment Management, affiliated balances, compare this to the separate account balances of all of the affiliate sources, it seems that there is about $27 billion left, maybe of separate account assets that are managed by Voya Investment Management, how much of this realistically might be available for sub-advisor replacements or what's the way to think about how much more opportunity there is on this front?

Alain M. Karaoglan
Chief Operating Officer & Executive Vice President, Voya Financial, Inc.

A

So, Seth, it's two triggers, right. One is assets that are on our platform that are managed by others; and two, it's relative investment performance. And so, it's a little bit difficult to look at assets and just say, this is how much, because the two triggers have to be there in order for us to be able to replace the sub-advisor. We can – maybe working offline with Darin, you can get a sense of what are some of the assets under administration instead of advisor or what's the pool. But it's going to be two triggers and you won't know the two triggers until really it happens at that point in time.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

Okay. Thanks. And maybe if I could just follow-up one more just on the earnings front, staying within Investment Management, I believe first quarter tends to be a seasonally lower quarter for margins. Margins appeared quite strong this quarter relative to that expectation, maybe you could help us think about what sort of normalized level of margins and if this is a – anything that maybe impacted base level earnings positively in Investment Management?

Alain M. Karaoglan
Chief Operating Officer & Executive Vice President, Voya Financial, Inc.

A

So, thank you, Seth. We're making very, very solid progress in Investment Management and in continuing to improving our margins. As you know, our target is 30% to 34% and we expect to continue to make improvements. In this quarter, the quarter benefited from our private equity business that we closed the fund. And typically when you do close a fund, there's a catch-up in terms of fees that enhance your revenues in that particular quarter.

And so, there were some benefits and maybe we can offline focus on that in terms of what it could be, but generally speaking, our expectation is to continue to make steady progress every year in terms of our margins. And we tend to look at it both including the returns on invested capital and excluding it. Our initiatives are really focused on improving the margin, excluding the return on invested capital, and the return on invested capital will tend to be more variable, and we have a certain expectation on that going forward. So, there's a couple of points as well.

In addition, on the negative side, in terms of our margin, we were affected by some of the expenses and higher payroll taxes in the first quarter. So, that's a negative in terms of the earnings and margin as well.

Operator: And this concludes our question-and-answer session. I'd like to turn the conference back over to Rod Martin for any closing remarks.

Rodney O. Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Operator, thank you. Let me close our investor presentation by reiterating three important points. First, it was a productive overall quarter for Voya Financial and we're making steady progress with our long-term transformation story.

Second, Voya Financial is a premier franchise with leading positions in attractive markets and are investing in our growth and executing on our ROE improvement plan. We have a lot of confidence based on our track record and continued focus on execution. We have three solid businesses, quality products and services that meet our customer and clients' needs for asset accumulation, protection and distribution. We're differentiating ourselves by adding value to our customer relationships with our retirement readiness platform.

And third, we've got an exciting new brand that's vibrant and optimistic. And we look forward to investing in and showcasing our new brand with all of our stakeholders. Thank you and have a good day.

Operator: The conference is now concluded. Thank you for attending today's presentation. You may now disconnect.