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CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

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

INTRODUCTION

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

All right. Thanks, everyone, for joining us. I am Ryan Krueger and I head up KBW's Life Insurance Research in the U.S. Very pleased to have Voya Financial with us for the first time. With us from Voya today, we have Rod Martin, who is Chairman and CEO; and Ewout Steenbergen, who is the CFO. We are also joined by Darin Arita, who heads up Investor Relations. So you guys want to join me up here and we will get started with the Q&A session.

QUESTION AND ANSWER SECTION

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

All right Rod I thought maybe we would just kickoff – if you could just give some – just a brief background on Voya, since it's a relatively new public company, having IPO'd about a year and a half ago?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Sure. Good morning.

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

Good morning.

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Good morning to you all. Voya is a retirement-focused organization. About three-quarters of our earnings come from Retirement Solutions or Investment Management and the remaining 25%-or-so come from Insurance Solutions and that's made up of both our Life Insurance as well as our Employee Benefit platform.

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

All right, thank you. So, you outlined some target ROEs when you did the IPO a year and half ago. You've made a lot of good progress here. Your Ongoing Business ROE has increased from 8.3% in 2012 to 10.7%. Today when you think about the path towards the 12% to 13% Ongoing Business ROE target for 2016, what areas have done better than you expected so far, and what areas have been more challenging than your original plan?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Sure. We, I think as many of you know, laid out a 400 to 500 basis point ROE improvement plan or ROE walk. And we are a little ahead of schedule at this point in aggregate. We said repeatedly on calls and in meetings like this, it's a non-linear process, you should expect about 100 basis points to 110 basis points of improvement per year. Three of our businesses have, in fact, met their 2016 target, that's Employee Benefits, Investment Management, and Annuities. Life Insurance is the only business that's behind schedule right now, and our Retirement business is pretty much on schedule.

So we feel very good about the progress. We're focused on, in the ROE walk, 30 initiatives that are built around capital management, margin expansion and growth. And not all of those hit in every single quarter in a co-equal way, but we're, as I mentioned, ahead of schedule in terms of the 8.3% to 10.7%, and we feel good about the progress. We announced just recently, by way of example, a reinsurance transaction in our Life Insurance business that helped improve the aggregate ROE by 70 basis points.

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

For the Individual Life business, the return on capital by 70 basis points; for the aggregate ongoing business, the return on capital by 35 basis points, and that is unlevered. So if you add leverage to the ROE for the Ongoing Businesses, it is closer to a 50 basis point or so improvement by this transaction.

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

Maybe follow up on that point. Do you see additional opportunities in the Individual Life business for other capital efficient transactions like the one you just did?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Let me answer it even more broadly than that. We announced quite recently a reinsurance transaction with our Retirement business. And I think what we should take away from that is that we're actively looking at all of our blocks of business in ways that we can improve the outcome. And so whether that's in our Retirement business, whether that's in our insurance business, or frankly any other piece.

So these are large and complex. They take a period of time to focus on. We were very pleased with the most recent transaction in our Life Insurance space. And you just heard from Ewout and myself about the impact. So we will continue to look and manage the capital in a way that's very efficient for the shareholder.

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

Okay, great. Switching to Retirement a little bit, it's your biggest business; you've had a lot of return improvement from 2011 to 2013. And you mentioned that improvement will not be linear, but results have been kind of more flat in the first half of 2014. So I guess I was hoping you could touch up on some of the reasons for that and if there has been some specific headwinds that have impacted results this year in Retirement?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Sure. Let me start with a big picture perspective. We're one of the few players in the U.S. to play both in the small-mid and large corporate space as well as all the tax-exempt. And we do record-keeping kind of end-to-end in the Retirement space. So there's a number of businesses that make up our Retirement Solutions platform.

One of the pieces we talk about frequently on our quarterly meetings and in meetings like this – our quarterly earnings call and in meetings like this is the fact that we've got an existing book of business. If Alain were here, his view is that we are punching below their weight from a return standpoint. And the duration of that block of business is roughly six years.

We're about a third of the way, maybe a little bit more than a third of the way through that journey. And so there's a repricing of that book of business that just happens as it moves through the pipeline. And we're replacing it for returns that are at or above our targeted IRRs.

We wish we could simply snap our fingers and be through with that process. That simply isn't the nature of that business. And because of that, we've commented frequently about two things. One, net flows will be or will vary from period to period, simply because we play in the large corporate space. And if you have a case that you don't renew because of pricing, that's $1 billion. That will simply going to be reflected in the net flow outcome.

We're measuring the success, coming back to the two metrics that you've heard Ewout, Alain and I talk about from the very beginning – our ROE and ROC in the businesses. And in our businesses, we don't allocate debt to the businesses. So we very much focus on the Return On Capital. And in return, as you pointed out, we've made very good progress to date. It's not going to be linear, so it's not going to be 25 basis points a quarter, but we're on or ahead of schedule in aggregate and we're working our way through that process.

Ewout Steenbergen

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

And maybe we'll add a few other pieces, because if you look at the Retirement result, it's important to look a few layers underneath the puts and takes of the results itself to understand the underlying dynamics. So to give you some of the pieces you have to keep in mind, so if we look at the fee income year-over-year, that is going up very nicely. In fact, last year, we had some record-keeping change order fees that we have highlighted already last year that were not recurring. So even if you correct for that, the underlying fee increase is much better than what you see at the surface.

And then, if you look at the investment income last year, especially the investment income, the alternatives and also the prepayment fee income were much higher than this year. So you have to also look through that particular element. Then on the expense side, last year we had a release of an expense accrual that was a one-time benefit on the expense side so we are staying very strict and disciplined to keep the expenses flat. And we had a very small, very deliberate decision to invest in that part of the business. So that was an additional expense this year that we don't expect to recur.

And then the last element you have to take into account is the reinsurance transaction of the deferred fixed annuities. We already spoke about that element that is having an impact on the operating earnings in the second quarter itself that was $3 million on the annualized basis, and it is closer to $5 million pre-tax, but it is releasing capital, so you should more look at the return effect than at the pure operating earnings effect itself. So if you look at all those elements and look underneath, we feel very comfortable that we are on the right growth path and that our returns are growing step by step towards our targets in 2016.

Rod Martin

Chairman & Chief Executive Officer, Voya Financial, Inc.

And Ryan maybe if I can add to that, we've recently introduced, and please take a look at our new voya.com website or our investor relations website, a number of tools in the Retirement business that are very much enabling us to get further attraction. I call to your attention one that is Personal Financial Dashboard, and the second one is myOrangeMoney. Both of these have been very relevant in both competing in and winning mandates.

A very recent example of that was CALSTRS, but I'm not trying to single out a given case and I'm talking more about how this is growing interest, involvement, and commitment from the plan sponsor and the institutional level about helping their plan participants be more retirement ready and looking for tangible ways to measure that outcome. And these tools really enabling us to make further progress in that research, but they are in the early stages and I want to be very clear about that they recently introduced. But the receptivity in what we rolled out to both existing participants and new plan opportunities and we are very encouraged about the early results of that.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you. As a follow-up, on the second quarter earnings call you discussed certain things and one thing you hadn't mentioned too much in the past which is on some of the renegotiation on the retirement contracts that you have traded lower fee revenue for lower guaranteed minimum crediting rate and that there some timing kind of consideration for how that impacts your earnings. Can you delve into that in a little bit more detail?

Ewout Steenbergen

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

Sure. So if you look at renegotiation or re-pricing of businesses sometimes that is interpreted as, okay, you just ask higher fee per participant and that is the negotiation. In fact, what is happening is far more detailed, far more nuanced in terms of the renegotiation, and what is happening. So in many cases, we are looking at guaranteed minimum interest rates that are applicable in the contracts on the fixed account part of the investment options. And if you see very high guaranteed minimum interest rates we would like to see them being lowered in the future because that will give us room if interest rate stayed low to reduce crediting rates down and in order to keep up the investment margin in the future.

So for us it is very important to lower guaranteed minimum interest rates. It guarantees the lowest levels of rates we can apply in those contracts that we can bring them down in those contract negotiations. Sometimes we have to give up in those negotiations in terms of a trade-off that we give up some of the fee margin in terms of basis points of fees we get on the variable account in order for the exchange. We have to keep in mind that the fixed account capital requirement is much higher than the variable account capital requirement.

So we are looking here at the possibility to optimize insurance to keep in the capital requirement one investment option versus the other. And what we are doing in other words is, maybe giving up a little bit of the fee income in exchange for having more room to reduce the pricing rate if that is needed in the future, and to really balance out the capital requirements of both elements. So what you see more is the immediate effect on the fee income but from our perspective we give ourselves room and we give ourselves options in order to keep up the returns on the contracts and to improve over time based on more of the fixed account element of those contracts.

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

Do you find that plan sponsors are more sensitive to, I guess the fees versus the crediting rates? Is that part of the consideration in this?

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

In general terms, what we see is that plan sponsors are very realistic about the rate environment. They know that the rate environment is very different, then four to five years ago, when those contracts came up last time for renewal. The rate environment is very different. Guaranteed minimum interest rates, for example, 3% is not very realistic in the current timeframe anymore if you look where new money rates are and where credit spreads are at this point in time.

So plan sponsors and their advisors are realistic. They are very open to having a discussion about what is the right level of minimum interest rates, going forward. And their exchange for variable fee levels is absolutely when they have an open mind and are willing to make the tradeoff.

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

Thanks. I guess shifting to the growth environment for the Retirement business. Can you just talk generally about how is the environment in the corporate and tax event markets for growth these days, I guess thinking about both plan sponsor activity and plan participant activity within the plans. And I guess also just touching on competitive conditions in the market today?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Sure. I've commented a number of times on our quarterly earnings call, but we've asked frequently a question that's similar to that one – where do you see the most pressure in the market from a competitor perspective, and largely that shouldn't be a surprise. I wouldn't describe it as anymore than we've seen historically but it isn't less. That's simply one piece that we plan for and where we have played well. We had a significant win late last year that we called out on an earnings call, but I think it's worthy to use as an answer to your question about that space.

And that was ADP, it was a $2 billion case 57,000 participants, 2,800 little entities rolled up, and it really played too – we're one of the few companies that can have the Fortune 100 capabilities and also serve the small and mid piece, and have the technology to kind of wrap it all around that. It was a $2 billion mandate, $1 billion of which on its merit was won by our Investment Management group. And it was a marquee case and a terrific win but it really underscores the capabilities that we've got.

We've had a very good year this year in our small-mids, by the way, we are in tax-exempt and we're one of the significant players there. We're going through the same kind of pricing renewal process in tax-exempt that we've been doing in the larger Retirement piece. And you've seen that reflected in the net flows where we cannot get the return, we've been very disciplined about the renewal component of that.

Our pipeline in terms of inventory, we're very encouraged about for the latter part of this year, and going in the next year, so I think we've made very good progress there and that's why we laid out a four-year plan. We didn't say we do this in two, we said we do it in four and we're broadly half way through. Some businesses are a little bit ahead, some businesses a little bit behind but we're feeling very good about our position at this point, particularly with the introduction of these new tools that I referenced a moment ago.

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

Do you – I think – yeah, I know you're one of the largest players in the tax-exempt market. Are there other players there? Are there kind of differences in competitive conditions between the two different markets?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Yeah, and if you think about the tax-exempt, there's both K-to-12, higher ed and other organizations. So you really need to get a subset of that, so if you think about K-to-12, we would be a competitor in that space. VALIC, a part of the AIG companies, would be a competitor in this space. TIAA-CREF – in the K-to-12 or in the higher ed, certainly TIAA-CREF would be a competitor, and some others.

So it's really quite different by those segments. What is happening generally, we're well-positioned for this and those other two competitors I mentioned. They are going to less payroll spots in terms of how many companies they are allowing. We're one of the ones that have a unique position in that regard and that has served us well. But you're seeing less companies involved in other spaces because they simply want fewer companies doing larger amounts of business in the given platforms.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Thank you. I guess shifting to the Investment Management business. On the call, you talked about some higher expenses in the second half of the year due to some investment initiatives. Can you talk about what type of initiatives you're targeting for the back half of the year and if you can any kind of quantification on how we should think about the expenses?

Ewout Steenbergen

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

Sure. And let me first clarify when we are speaking about some higher expenses. We're talking about very disciplined, very modest kind of additional expenses. So don't see that we go overboard in terms of the expense side. And they will be very targeted, very disciplined, some additional expenses. And where are we investing in this business.

But what you've seen in the Investment Management business over the last few quarters is a business with very positive momentum. The flows are very positive; the new money that is coming in is very strong, that disposed to the third party side. It has to do with the takeover business. The investment performance is strong. We see the margins going up. And really the operating leverage of the additional fees and assets over the existing platform is really going to pay off, so very positive business in a very good momentum.

The targeted investments we're doing are really to keep up that momentum. And we're investing in some of the investment engines, especially some of more the international capabilities to think about emerging markets, fixed income, where we're going to do some investments, and also the international distribution. International distribution is important because we were a part as you know of the larger ING Group infrastructure, but that is now the past, so we have to make sure that we have the infrastructure with respect to distribution, globally going forward as well.

So another part of the investments will be around distribution in other parts of the world. We have announced some partnerships recently in Australia and we're trying to expand those kinds of opportunities going forward. So very specific investments in growing those capabilities in order to make sure that that business will keep up the positive momentum and that you will see an improvement in the performance going forward as well.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Is there anything you can help us with in terms of framing kind of the amounts we should be – magnitudes we should be thinking about.

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

I will prefer not to disclose that at this moment.

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

Understood. I guess you had a lot of success with subadvisor replacement flows. They are very lumpy, I know, by nature, but just curious if you get more opportunities to get subadvisor replacement?

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

I think there is and it is as you commented Ryan, lumpy by nature. So let's just think about how this works for a minute. These are funds managed through mutual fund boards that by their very nature and mandate have to be independent. And they are assessing whatever funds are in place and whether they are performing or not performing and if they are not performing, making adjustments about who might be exiting and who might be entering.

And so there is a long discussion that goes into these pieces. There's a fully independent mutual fund board and decision process that has to occur. But I think two outcomes we've had some very good takeover flows as you commented about, but it is lumpy and it will be lumpy, as we go through this. As long as our performance, and we're very pleased with that as Ewout has just talked about, continues to be there, and it has in a very significant way.

I think those opportunities will continue to be presented to ourselves, so we're encouraged about it. And we do expect this from period to period overtime. And it's a direct outcome of the continued very good investment performance in the – as a categories that make up, what we call Investment Management.

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

In terms of third party flows, can you talk about what – I guess about asset classes you guys have kind of seen the best momentum in terms of flows and where you've had the most challenges over the last year or so?

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

If we look at the asset classes in the third party, so that is business that our asset manager, Voya Investment Management, is winning by themselves, third party mandates have got nothing to do with the affiliates with any of the insurance or the retirement businesses. So those are really third party standalone mandates. Those have been won in several different asset classes. Certainly, fixed income performance is very strong.

The five-year track record is now really top notch and that is an area where we won strong mandates. Also on the equity side, we are doing very well both in the large cap and the mid cap area. And then we have some specialty asset classes where we see also some clear wins. One is in private equity. We own a private equity company called Pomona. Every now and then, some new fund launches and that is really helping the flows.

We also see in the bank loans, the CLOs, a lot of activity at this moment, so that is helping the flows. And we have also other specialty classes like some private placements. So overall, all of the asset classes are doing well, but especially those I mentioned, those special areas, we see very good interest from the market in terms of the capabilities we can offer.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

And can you give some perspectives on how your performance has been in Asset Management? You know over, say, the last one and maybe three year period.

Rod Martin

Chairman & Chief Executive Officer, Voya Financial, Inc.

Sure. It has been. It's the key reason that frankly Investment Management is growing in the way that is growing. So we – not in every category naturally like any asset manager, but in the majority of the categories of the – that Ewout just described or one, three and five and in some cases ten-year records are have been very strong, particularly in fixed income. We have one of the best fixed income platforms in the market today, our equity platform historically has got a very solid ten-year record that has been very strong.

The bank loan piece as Ewout just talked about, particularly over the last couple of years has been served as exceedingly well both domestically as well as internationally. And certainly in target date funds. So, again, we're not going to hit on every fund, every quarter, every time but our investment philosophy is very much aligned with our retirement focus and that's over the long-term and it's serving the organization very well.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

And we touched a little bit on Individual Life and the transaction you did. I wanted you to discuss another, I guess, initiative you guys have to improve returns which is trying to raise non-guaranteed pricing elements on legacy policies. I know it can be somewhat controversial sometimes from a regulatory standpoint. So can you talk about how far along you are in that process and what type of regulatory risk you see associated with it?

Ewout Steenbergen

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

Ryan, let me first talk about Individual Life and what we do in terms of the overall strategy and then I will come specifically back to the non-guaranteed elements. So Individual Life as most of you probably know is typically a business with a very long-term nature. So if you have returns that are subpar, that is not something you change overnight. You have lots of business that stays with you 20 years, 30 years and those returns are embedded in those blocks.

And we are looking at opportunities to improve those returns over time. So what are the ways, how we do that? We have really cut that in, especially the capital, in terms of the kind of Individual Life products. So we are focusing mostly on the indexed universal life that is less capital in terms of where more of the investment return risk is staying with the policy holder and where the returns are very attractive. So we are clearly shifting from more capital intensive products to less capital intensive products. And over time by adding new business to our book we should see that returns go up by itself by the shift of the mix of the business in our books.

At the same time with the change in the sales levels and we have especially seen sales levels coming down, as a deliberate choice and a consequence of the strategic direction we moved this business we are also taking expenses out of this business. So the expense reduction is also helping to improve the returns over time.

And then as we already have explained we are looking at some blocks of business where we see a clear opportunity to do an external transaction to release capital and to improve the returns much faster. And the transaction we have announced few weeks ago with RGA was clear example, because that business had basically a zero return, we were not making at this moment any significant operating earnings on that block. And we are able to release approximately $200 million of capital after this transaction.

And with the release of the capital we can reinvest that in our businesses or release it and return it to shareholders in any particular form. So clearly an opportunity to accelerate the change of the book to improve the returns to unlock some of the lower term businesses and to improve the ROE much faster for the Individual Life.

With respect to a non-guaranteed element, that is an area we are still investigating. That's an area we are looking at like anybody else in the industry but it is a particular area that is very complicated and we haven't made any decisions with respect to non-guaranteed element at this moment. Of course, we will keep you updated and once we have taken any decisions, we will let you know immediately

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Okay, so that process – it hasn't occurred yet. It is something that you are considering.

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

We are looking at it. We are analyzing it. We are considering it. But no decision has been taken.

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

Got it, okay. Shifting to capital management of the popular topic for you guys, and last night, you did buy back $300 million of stock from ING Group. Earlier this year, you increased kind of your capital generation guidance from $1.4 billion through 2016 to over $1.7 billion. Since you announced that you had a couple of capital transactions, you freed up the $200 million from the Individual Life transaction. You freed up $70 million from Retirement. Should we view those as incremental to that $1.7 billion guidance or was that already – those types of things already embedded?

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

Ryan, I think we deliberately have phrased our new target as more than $1.7 billion, so clearly, we've given ourselves a bit of room, so we haven't given the point estimate, we haven't given a range, but we have clearly set more than $1.7 billion. And we're very comfortable, we feel very good about the progress, we're making to overstep the target as you said.

Last evening, we repurchased $300 million of our own shares from ING Group for the offering that happened after the market closed yesterday. That brings our total buy back for this year to approximately $590 million. We still have $210 million of authorization left. And that is an authorization up to the middle of next year. And if you look at the RBC level at the end of the second quarter, we're north of $1 billion in excess over our RBC level target of 425%.

So overall, if you add up the pieces, the capital development of the company is clearly very favorable. We would like to be careful not to set new targets every quarter. We don't think that is very usual. We're not running a company on a quarter-by-quarter basis. We have a long-term perspective. We have set a target at the IPO in May of last year. We have reset the capital targets at the beginning of this year. At some point in time, we will reset that again when we think that's appropriate. And then, we'll give you a new target for the next few years.

So we're not at that point yet, so we don't want to give any new guidance at this moment. But what you should see is we're very comfortable. We are making very strong progress towards the current target. And once we've hit it, we will give you a new target for the next few years.

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

Okay, thanks.

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

And in fact, may be just to reinforce that point for those of you that are perhaps a little new in following us. In the original IPO, we said from the Ongoing Business, $1.2 billion-$1.4 billion for the Ongoing Business, excess capital at the end of 2016. As Ewout pointed out, quite clearly, at the end of the first quarter, we raised that guidance to more than $1.7 billion. We feel very good about what we have done this year, with the buybacks that we have done.

Group's ownership is now down to, with the transaction that occurred last evening, 32%, so that is very much ahead of schedule and again, just to reinforce the point, we said we – these original targets that we established are 12% to 13% ROE, with a point-in-time estimate. It wasn't the ceiling. And we think a very good company model to follow that we've looked at in studying and building this was the Prudential, when they went public. And they laid out a four-year target. When they accomplished it, they raised the target, when they accomplished that a couple of years later and so on or so far.

So if we happen to hit these targets sooner, I mean there's nothing magical about that. End of 2016 and believe me, we talked internally about the potential of accomplishing that sooner than the end of 2016. I'm not predicting that, I'm simply saying it's a point-in-time estimate and we'll then re-evaluate and communicate as Ewout just pointed out, new targets at that point.

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

So in the closed variable annuity block, lapse rates do seem to be trending higher this year, which is – it is a good thing. Can you talk about – does that increase your confidence, I guess in your policyholder behavior assumptions as we head into the annual actuarial review testing period?

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

Ryan, let me answer your question in the following ways. If you look at the lapse rates on the book, we have seen that they are going up as you already said. We went a little bit over 10% lapse rates last year, and it has been growing now to 11.5% approximate lapse rate on an annualized basis during the second quarter, so a very healthy run-off of the book, in fact quite interesting. If you see, the account values more or less stay flat over the last period.

But the number of policyholders have been in other words to the level of the account values of the remaining policyholders have gone up and the in moneyness levels per policyholder have come down significantly, so a very, very positive healthy development for the book. If you look at our expectation in assumptions with respect to a lapse rate, there are many factors that we have to take into account. We look at the age of the policyholder, when the policy was sold, the size of the policy, if it's before or after the surrender charge periods but also the in the moneyness level of the policy.

And that is before what we call dynamic lapse assumptions because we assume that if the policies are less in the money, we see higher lapses and when the policies are more in the money, we see lower lapses. So in other words, there is a direct correlation we expect between in the moneyness levels and lapse level of the policies. We see lapse is going up because equity markets go up. So that is in line with that sensitivity.

The question is more what is the slope of the line? Is the sensitivity in line with what we expected or are lapses going up faster or slower with an improvement of the equity market compared to what we have in our assumptions? So that is a process we are analyzing over since third quarter of every year. So we actually are going thru to that process as we speak right now, and not only with respect to lapse assumptions this is all our actuarial assumptions, all our macro economic assumptions and we do that for all our businesses. That is a normal course of business.

We review all of our assumptions during the third quarter of every year. And we will come back to you after the end of the third quarter with results of the assumption review. So I cannot give a specific answer if it is better or worse than the current assumption, we will come back to you but in aggregate what we have always said in terms of our guidance for the closed variable annuity expect an ordinary course of business. In terms of the assumption impact for a size of the book we have and impact in a range of plus or minus $150 million, we have been in that range for the last two years and that is what we expect in an ordinary course of business for a size of the book like this in aggregate the impact over an assumption update.

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

Thanks. Why don't we open up potential questions for the audience if there are any? We have got one in the front here.

Audience Member

Keeping in tune with the CBVA, what would be a tail risk scenario? Let's say the market – did you have stress parameters – if the equity market declined by X amount or interest rate stay low for long, what type of risk are you exposed to. I understand you are hedged, but is there some sort of breakage or risk there?

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

That's the great question. Let me explain a little bit more, the hedge program, what it is tailored at and what is more important the long-term nature of this business. So the hedge program is stated around protecting regulatory and rating agency capital, short-term for the impacts of certain market movements. So if equity market only drop. We have to post more resources both on the statutory basis as well. The requirements of the rating agency will go up.

Our hedge program is tailored around offsetting these additional requirements. So short-term we are hedged both for rates as well as equity market movements in order to offset that immediate impact. There is a second order impact if market would turn to the negative and that is more that over time there will be an impact in many factors. Let me explain that to you in the following way.

We have updated this at the IPO, but also again at the beginning of this year, 50-year cash flow projections. And the 50-year cash flow projections on the four different scenarios are showing our starting resources. So we had very significant resources put aside on this book. At the end of the second quarter, $4.6 billion of resources – hard assets we have put aside to back the liabilities on this book.

And we hope over time, of course, that part of that is not needed and can be released and re-distributed to our shareholders and that will be on top of more than $1.7 billion, we have been speaking about. Over time we collect fees, if the equity markets will go down and we will have lower fees in the future – lower fee income. If the equity margin goes down, we have to expand its program so you will see that we have higher hedging costs and also policyholders should be staying longer with us.

So we already spoke about the lapses, so if the market will go down, policyholders stay longer with us and we have more claims to pay over time in the future. If you look at the four different cash flow scenarios, we had a very negative scenario where the equity markets we dropped by 25% and never recovered for the next 50 years. Well, clearly, if that is happening, there are a couple of other large problems in the world. But that was a kind of extreme scenario where rates would never go up from the current levels for the next 50 years and also compare to our already existing policyholders' behavioral assumptions, that some of them will be even more negative than what we have in our assumptions today.

And we showed there is an impact on the cash flow basis. As well as the scenario where the equity markets will go up, modestly an equity market go up more in line with long-term efforts as well as interest rates follow more the forward curve. What you see is except for that very extreme scenario, in normal scenarios the net position, the present value of the cash flows over the 50-year period are positive – are significantly positive with a year-over-year improvement from the cash flow projections from last year and this is very encouraging.

So overall, we believe under normal market scenarios where the market behaves more aligned with long-term efforts, is a potential for capital release and return. But we have always said don't expect that in the next few years. That is more something you should expect what we said that at the time of the IPO was five years out so where we speak today and may be three and half years out, for the closed block when we would be comfortable and have to think about a capital release and return.

Ryan Krueger

Analyst, Keefe, Bruyette & Woods, Inc.

Ewout, so you are kind of in the process of initiating an enhanced annuitization offer on about a quarter of your GMIB book, should – how should we think – if this succeeds, how should we think about the potential impact to your cash flow scenarios? In other words, is it kind of the type of thing that would narrow the range of outcomes? Or could it actually improve the scenarios in kind of the better cases?

Ewout Steenbergen

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

Let me explain a bit what is exactly the offer that we are going to provide to a portion of our CBVA policyholders. So this is a part of the book. We are starting with the 2005 vintage of the guaranteed minimum income benefits products. And those are policyholders that are still in a same crediting period. They brought those policies for the income benefits with the option to annuitize, which means at some point, they are looking to guaranteed value and then the annuitize and convert policies to just straight out payout annuity.

At that point, there won't be any market risk, there won't be hedging, it just a straight a pay out annuity from the movement of annuitization. Policyholders cannot annuitize in the first 10 years. So these are policies as we speak today are still in that crediting period. Policyholders get a letter over a next few weeks of that 2005 year where we allow them to annuitize earlier. And we get them 10% premium on their benefit base on the current guaranteed value if they want to accept that offer at this point in time. What they will give up is some years of future roll up.

So some of those policies still have roll ups to go up to their reached cap. So in exchange for the 10% premium they will give up some of the roll ups. In terms of the capital impact, what we expect from that, from that over, you should think about that the immediate capital impact will be rather minimal so not a lot of capital impact at this point in time. But once those policies have been converted to straight payout annuities, we expect that there will be a capital benefit and especially statutory income year over year based on those payout annuities.

So don't expect a big capital implication at the point of this offer right now but over time we expect to see positive income from these converted policies. This is our first step in managing this book in this way and we are very much looking at this somewhat as a beta test. And we are going to learn a lot from this exercise and we are trying to strike a balance between that efficient space where the incentive we offered is appropriate and fair. But it recognizes again, the resources we put aside against this block of business.

So we are going to learn from this exercise and the outcome will know the response from this by mid to late November and will be able to provide an update at that point in time and you should think about the fact that we will take that learning, whatever their learning is and apply that again to other pieces of our closed block as we proactively manage this to ultimately release capital to shareholders from this book of business.

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

Looks like – I think we have reached the end of the allotted timeslot. So thanks both – thank you for attending. We really appreciate it.

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

Thank you.

Rod Martin
Chairman & Chief Executive Officer, Voya Financial, Inc.

Thank you. Have a great day.