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Voya Financial, Inc. (VOYA)

Q2 2014 Earnings Call

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MANAGEMENT DISCUSSION SECTION

Operator: Good morning and welcome to the Voya Financial Second 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 Arita
Senior Vice President-Investor Relations, Voya Financial, Inc.

Thank you, Emily and good morning everyone. Welcome to Voya Financial's second 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.

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Voya Financial specifically disclaims any 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 go to slide three, and I will turn the call over to Rod.

Rod Martin

Chairman & Chief Executive Officer, Voya Financial, Inc.

Thank you, Darin and good morning. We appreciate you joining us today to discuss our second quarter results. We've made further progress toward our 2016 targets and we remain focused on driving greater shareholder value.

Let's begin on slide four with some key developments. First, we made further progress toward our 2016 ROE target of 12% to 13%. Our Ongoing Business adjusted operating ROE for the 12-month ended June 30 grew 40 basis points from March 31 to 10.7%.

Second, we continue to return capital to our shareholders. As of June 30, we'd utilized $289 million of our original $300 million share repurchase authorization. As we announced today, the board increased our share repurchase authorization by an additional $500 million. This new authorization expires on June 30, 2015. We believe repurchasing shares is an effective way to manage capital and demonstrates our confidence in our improvement plan. We will remain prudent and opportunistic with share repurchases. We expect to utilize the additional authorization over a period of time, rather than a single point in time.

Third, we continue to proactively manage our Closed Block Variable Annuity segment. Let me highlight two examples for you. On July 21, the prospectus supplement for the guaranteed minimum income benefit enhanced annuitization offer was declared effective by the SEC. Ewout will cover this in more detail shortly. Another example is our agreement to outsource the actuarial valuation, modeling, and hedging functions for the Closed Block Variable Annuity segment to Milliman. This is a proactive and innovative approach to achieving a more variable cost structure for this run-off block.

The fourth key development is that both Moody's and A.M. Best have raised our ratings outlook to positive. This follows similar moves by Standard & Poor's and Fitch earlier this year, and further recognizes our financial strength and leading market positions.

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Finally, we are initiating an advertising program for our rebranding. We're planning to invest approximately $100 million in advertising over the next 2.5 years to raise awareness of our new brand. We're eager to establish Voya Financial as America's Retirement Company, while articulating our vision, mission, and core values.

One of our core values is that we care. In support of this, almost 3,000 of our employees recently volunteered over 9,000 hours in community service in our first-ever Voya Financial National Day of Service. This effort was tremendous. It was inspirational and it demonstrates our commitment to social responsibility.

Moving to slide five, let's look at our second quarter financial highlights. We achieved total after-tax operating earnings of $213 million or $0.83 per diluted share. Excluding DAC unlocking, results were $0.81 per diluted share.

Net income available to common shareholders was $246 million and this was driven by strong operating earnings from our Ongoing Business. Specifically, Ongoing Business adjusted operating earnings before income taxes were $346 million, up 14% from the second quarter of 2013. As I noted a moment ago, we increased our Ongoing Business adjusted operating ROE on a trailing 12-month basis to 10.7%. For our Closed Block Variable Annuity segment, we continue to protect regulatory and rating agency capital for market volatility.

Moving to slide six, you will see our diverse earnings profile. Our Ongoing Business generated more than $1.2 billion in pre-tax adjusted operating earnings for the 12-month ended June 30. For that period, 74% of the earnings came from Retirement Solutions and Investment Management, while 26% from Insurance Solutions. In addition, total assets under management and administration increased to $525 billion as of June 30. With our leadership positions in retirement, investments, and insurance, we remain well-positioned to help Americans with their retirement readiness.

As captured on slide seven, our Ongoing Business is just one of Voya Financial's three key sources of value. The others are the potential value in our Closed Block Variable Annuity segment and our tax benefits. Creating shareholder value remains a primary focus for us. We are equally focused on providing value for our customers. In a moment, Alain will discuss some examples of how we're investing in our value proposition.

As we move forward, we will continue to execute on our long-term improvement plan, make effective use of our excess capital and focus on achieving our vision to be America's Retirement Company.

With that, let me turn it over to Alain for some details on our performance of our Ongoing Business.

Alain Karaoglan

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

Thank you, Rod, and good morning. Turning to slide nine, our Ongoing Business adjusted return on equity and return on capital remain on track to meet our 2016 targets. Our Ongoing Business return on equity was 10.7% for the trailing 12 months ended June 30, that's up 40 basis points from 10.3% in 2013.

When you remove items that we do not expect to recur at the same levels, our return on equity improved 50 basis points to 10.3%. For the trailing 12 months ended June 30, our Ongoing Business return on capital was 8.9%, up 30 basis points from 8.6% in 2013. When you remove items that we do not expect to recur at the same level, our return on capital increased 40 basis points to 8.6%.

We are benefiting from our diverse portfolio of businesses, each of which has a role to play in our plan. Let me highlight some examples of our initiatives to reach our 2016 targets. Starting with Retirement on slide 10, the

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return on capital was 8.6%. That is down 30 basis points from 8.9% for 2013. Adjusting for items that we do not expect to recur at the same level, the return on capital was unchanged from 8.5% in 2013. As we have discussed, our path to reach our return on capital targets will not be linear. We are committed to our plan and we are confident that we can achieve our 2016 target return on capital of 10% to 11%. In the second quarter, we retained 89% of re-priced cases at aggregate portfolio internal rate of returns at or above our targets.

We also completed an agreement with the third-party reinsurer for a block of deferred fixed annuities that will free up capital on a low return block with a high guaranteed minimum interest rate. Specifically, this transaction will improve Retirement's return on capital by approximately 10 basis points over the next four quarters.

In addition to effectively managing our capital, we are making investments that will support our business growth while helping our customers with their retirement readiness. As we discussed last quarter, we launched the Personal Financial Dashboard. This is a secure web-based tool that is prefilled with retirement account data. It enables users to organize, to integrate and to manage all of their financial information and accounts on one digital platform.

In addition, we just announced the launch of myOrangeMoney, the new centerpiece for the participant websites of our institutional clients. myOrangeMoney is designed to transform the way our more than five million retirement plan customers manage, engage and interact with their accounts, while also shifting their focus to understanding how accumulated savings translate into monthly retirement income.

You can learn more about myOrangeMoney on our Investor Relations website where we have a brief video highlighting its features, and I would really encourage you to do so. These two digital tools are the latest in our expanding suite of retirement readiness capabilities which support our value proposition and differentiate Voya Financial in the marketplace. Most important, they help Americans at all life stages and income levels gain control of their finances.

Now let's turn to slide 11 to discuss our Annuities segment. The return on capital improved to 7.8%, that is up 50 basis points from 7.3% in 2013. Adjusted for items that we do not expect to recur at the same levels, the return on capital increased 70 basis points to 7.5%. We are focused on the profitable growth of our Annuities business. Our sales are benefiting from our expanded distribution and we continue to build our product suite.

Complementing our fixed index annuity and our mutual fund custodial products soon will be a new product that is often referred to as a structured product annuity. Called Potential Plus, this annuity will help meet an important consumer need by offering opportunities to strike a balance of growth potential with limited downside protection.

Moving to slide 12, the operating margin for Investment Management for the trailing 12 months ended June 30 increased to 31.1%; that is up from 27.7% in 2013. Excluding results from investment capital, the operating margin improved to 27.7% from 24.7% in 2013. Investment Management has continued to drive a higher operating margin, which we focus on instead of return on capital since this is not a capital-intensive business. We are benefiting from our strong investment performance, while remaining committed to our reliable investing approach.

As a firm, we are research-driven and take a bottom-up approach to help our clients generate reliable, risk-adjusted returns over the long-term. As of June 30, 99% of fixed income assets and 84% of equity assets have outperformed benchmark or peer median returns on a five-year basis; our three-year numbers are also strong. And moving forward, we will continue to leverage our strong performance and reinvest in the business to support future growth.

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Turning to slide 13, Individual Life's return on capital was 4.8%, down slightly from 4.9% in 2013. Adjusting for items that we do not expect to recur at the same level, the return on capital improved by 20 basis points to 4.7%. We continue to refocus the Individual Life business, including, as we did in the second quarter, shifting our sales to our universal life product portfolio.

Last month, we announced a new expedited underwriting process called Orange Pass. Our new process enables us to issue index universal life policies to certain customers in as few as five business days.

Turning to slide 14, the return on capital of Employee Benefits increased to 21.8%. Adjusted for items that we do not expect to recur at the same levels, the return on capital was 21.5%, that is up 340 basis points. We are very pleased with the significant return on capital that we have achieved. As you know, we are focused on the growth of this business, and more importantly, it does enables us to help Americans with their asset protection needs.

Recently, we launched a pilot of new stop loss and group life renewal packet. This packet provides clients with better insights into proposed plan changes, enables a consistent renewal process and frees up our sales representatives to focus more of their time on selling.

On the distribution side, we are expanding our capabilities with consultants, with brokers, and technology firm to drive growth in voluntary products. We remain focused on profitably growing the business, while also maintaining underwriting and expense discipline.

So as you can see, we are making strong progress in our Ongoing Business. We remain focused on executing on our more than 30 margin growth and capital initiatives to improve results and achieve our 2016 targets. We also will continue to invest in profitable growth opportunities.

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

Ewout Steenbergen

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

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

Slide 16, you can see the items that impacted second quarter results relative to the first quarter for our five business segments. In Retirement, there were several items that affected earnings this quarter. First, there were temporary items that include the timing of expenses and the level of prepayment and alternative investment income. Adjusting for these items, a more normalized quarterly earnings level would be approximately $132 million. Second, the reinsurance transaction, that Alain discussed, reduced second quarter earnings by $2 million. We expect to grow our earnings off its $132 million normalized level, driven by the continued execution of our ROC improvement initiatives.

In Annuities, higher prepayment income and favorable mortality results helped the results. In Investment Management, we earned higher fee income, due to higher assets under management. In Individual Life, we experienced favorable mortality, driven by a lower severity, and this was a nice reversal from the experience in the first quarter. In Employee Benefits, group life mortality improved from the seasonally high first quarter and the loss ratio for stop loss continue to be favorable.

Looking ahead, there are some factors worth noting that we expect to impact our individual segments. As we mentioned before, in Annuities, we anticipate a $500 million to $700 million block of multi-year guaranteed

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annuities to flow out in the third quarter of 2014, when the block comes up for renewal. And this is a positive event from an ROC perspective, as this block has low return. In Investment Management, in the second half of 2014, we plan on making some modest disciplined investments in the business to position it for further growth.

And slide 17. I will briefly give you some color on our retirement net flows, which reflect our discipline around re-pricing for the value that we are providing to our customers. We generated positive net flows in corporate markets and individual markets during the quarter, slightly offset by net outflows in tax-exempt markets. We had net outflows in stable value due to the absence of any large stable value wins during the quarter to offset the normal level of outflows. The stable value market has become more competitive recently, as competitors have reentered to the market.

We will remain disciplined with our pricing and seek to grow this business opportunistically. As a reminder, we are significant participant in the large institutional space across our retirement markets. Therefore, net flows will vary significantly quarter-to-quarter, as we execute on re-pricing the business and delivering to our customers, value-added services such as myOrangeMoney and the Personal Financial Dashboard.

Then, slide 18. We have continued to generate positive net flows in our Select Advantage mutual fund custodial products and in our fixed indexed annuities. This continued momentum reflects the strength of our distribution. We also continue to run off our low or negative margin products, such as the annual reset and the multi-year guaranteed annuities. As I mentioned earlier, these outflows are a positive from an ROC perspective.

Then, slide 19. Our Investment Management source net flows were negatively impacted by the departure of an $800 million account with low fees. The flows were also affected by lower institutional business, senior loans, and alternative flows, which can be lumpy. We do not expect this quarter's Investment Management source net flows to be a trend. Variable Annuity outflows for the funds that are managed by Investment Management were $900 million, which continue to be a headwind for Investment Management, and at the same time, is a positive for the company as a whole.

Then slide 20. We are experiencing success with the realignment of our sales in Individual Life to focus on less capital-intensive products. Although there was no material change in the sales volume, there was a significant shift in the composition. The indexed universal life product portfolio accounted for 53% of total sales in the second quarter, and that is up from 25% a year ago. Moreover, we continue to actively manage our administrative expenses, to better align them with the size of our book of business.

Turning to slide 21, the loss ratios for group life and stop loss came in better than our expected range of 77% to 80%. As I mentioned earlier, group life loss ratio improved from the seasonally high first quarter, and in stop loss, we continue to see favorable claims experience.

Then slide 22. In the Closed Block Variable Annuity, our hedge program continued to perform well, as it offset the effects of market movements. In addition, our net outflow rates continue to increase as illustrated on the right side of the slide. The annualized net outflow rate was 11.5%, which was up from the 10.5% in the first quarter.

Slide 23; you can see a few of our actions to proactively manage this block. As Rod mentioned earlier, the SEC declared effective our enhanced Annuitization offer prospectus supplement in July. The offer applies to the 2005 Guaranteed Minimum Income Benefit Rider Series, which represents roughly 25% of our total GMIB book. We will be offering a 10% premium enhancement, if the contract owner elects to annuitize during the offer window. We will notify contract owners of the offer in the early fall and those who accept the offer will annuitize in the mid of November. During the second quarter, we also entered into an outsourcing agreement with Milliman, a leading actuarial firm, and this proactive approach creates a more variable cost structure for managing this Closed Block.

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Then moving to slide 24; our estimated combined risk-based capital ratio remained very robust in the second quarter at 501%. We upstreamed $722 million in ordinary dividends during the quarter to the holding company and we partially replenished this capital by generating positive statutory net income. Excluding the impact of the dividends, our RBC ratio would have been 552%. On the right side of slide, the debt-to-capital ratio at the end of the second quarter improved from the first quarter to 23.2%, better than our target of 25%.

And then slide 25, our holding company liquidity stood at $879 million as of June 30 and this is well above our 24-month liquidity target. Moving to the middle chart; this shows the composition of our corporate GAAP capital as of June 30, 2014 of $2.8 billion. The largest component is $1.1 billion, which represents our estimated statutory surplus in excess of our target RBC ratio of 425% as of the end of the second quarter.

The chart on the right shows that we repurchased $31 million of our shares at an average price of approximately $35 per share during the second quarter. This brings our total usage of our $300 million share repurchase authorization to $289 million as of June 30. We also announced today that our board of directors authorized a further $500 million share repurchase program, available through June 2015.

In summary, we delivered strong financial results this quarter, as we continue to focus on achieving our 2016 ROE goal, running off lower return businesses, generating and returning excess capital, and taking proactive steps to manage our CBVA segment.

And with that, I will turn the call back to our 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] And our first question comes from Seth Weiss of Bank of America Merrill Lynch. Please go ahead.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch
Q

Hi, good morning. Thank you for taking my question. And I wanted to talk about the $500 million additional authorization in the context of capital generation. And I suppose as I think about it, you've mentioned $1.7 billion of excess capital generation between now and 2016, which I believe would be available for distribution between now and 2017. So given that capital generation was originally going to be more back-end weighted, I guess I'm a bit surprised that you're able to do nearly half of this or about $800 million by the middle of next year. So, maybe you could just help me think about capital generation versus capital deployment, and if I'm thinking about that correctly?

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

Seth, good morning. This is Ewout, and thank you for your question and we very much appreciate your acknowledgement of the positive development regarding the capital position of the company. And just to give you a few of the components, so if you look at the holding company cash position at the end of the second quarter, we were at $880 million. So that is approximately $430 million over our 24-months holding company liquidity target, which is $450 million. So clearly, the holding company cash position is strong at this moment, and that is already post the $289 million buyback we have done so far this year.

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And on top of that, what you have seen is that the RBC ratio also has developed favorably this quarter. So we ended up at 501%, which is post the dividends that came from the operating entities to the holding company. I mentioned that during the speaker notes, that was $722 million. And if you look at that number, then we are a little bit over $1 billion in excess over our 425% RBC level, we run our operating entities.

So if you look at all of those elements, we are still very comfortable with the target. By the way, the target we have set is more than $1.7 billion. So it is not $1.7 billion, but we have said more than $1.7 billion, and clearly we are making good progress to achieve that target.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

And in terms of just thinking about timing of deployment versus capital generation, is that the right way to think about it, that the excess capital generation is available for deployment between now and 2017, if I add in the $300 million that you've already done?

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

A

Yeah. That is a correct understanding. So we were speaking about generating capital for the periods up to and including 2016. But there is always a delay because, at the moment, we can take ordinary dividends out of our operating entities is after we file the blue books for our statutory entity, so that is the spring of the following year.

So in terms of the availability of capital, you should think more about a period up to the mid of 2017. So with respect to ordinary dividends, we have taken that $722 million out so far this year. We still have a little bit of ordinary dividend left for the remainder of this year. There is approximately $90 million we can still do in ordinary dividends in December of this year for our Connecticut company, but then the rest of the excess RBC is available in the spring of 2015 and the same applies for the following years.

Seth M. Weiss
Analyst, Bank of America Merrill Lynch

Q

Okay. That's helpful. Thank you. And if I could just follow up on the capital front and thinking about your debt capacity, your leverage ratio at 23.2%, there's obviously room there to the 25%. My quick calculation I get about $400 million of room. How do we think about where you're planning to go with the leverage ratio, at least in the short-term?

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

A

Seth, that's a great question. We are very comfortable with the current debt structure we have on our balance sheet. Obviously, when we do buybacks, that will drive the leverage ratio up again. So for that reason, there is no need for additional leverage on the balance sheet, and we are comfortable where we are today. So we are not planning to raise additional capital and increase the leverage ratio on that basis.

Operator: Our next question is from Tom Gallagher of Credit Suisse. Please go ahead.

Tom G. Gallagher
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

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Good morning. My first question is, I guess, a reporting question. So you report operating earnings assuming a 35% tax rate. But when I look at your 10-K disclosure, it shows that you had a DRD benefit, a pretty meaningful one in 2013, that would have lowered your effective tax rate to 20%.

Now I realize you have a tax loss carryforward, which doesn't make this particularly meaningful right now from a cash standpoint, but it does matter a lot in terms of how you report versus peers, all of whom include their DRD benefit into GAAP earnings. Just curious on your thoughts as to why you don't show the lower tax rate when you define earnings? That's my first question.

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

A

Tom, good morning. This is Ewout. I think probably if you recall the presentations we did around the company, around the IPO of Voya Financial in May of last year, we were speaking about different sources of value. And when we were speaking about one of the source of value, it was the benefits of our tax assets. And the way we presented that value was on the net present value basis of the cash benefits of lower actual payments we have to do to the IRS.

So we have been always very careful to double count the tax benefit. So you're right, the actual tax rate for the company is at this moment very low. It was in fact 1.5%, was the effective tax rate during the second quarter, which is very different than the 35% we use as a tax rate in our ROE, ROC calculations and the EPS calculations and so on.

So we are careful not to double count and because we've started to present tax benefit on a cash basis – the present value of cash basis, we have always been sticking to the 35%. You could ask the question, of course, why 35% and not lower, because you can include the DRD in that number? There is a few complications there. One element here is that a part of the dividends received deduction relates to the Closed Block Variable Annuity. So we have to back that out because if you look at after-tax ROCs or ROEs for the Ongoing Business, of course we cannot take the benefit of the DRD for the Closed Block.

So maybe in the future when the tax position and the tax reporting of the company will change, we might reconsider this and really look at the DRD only for the Ongoing Business. But at this moment, we believe this is the correct approach, it's very transparent. But I just want to reemphasize what you said, there is a clear benefit of the tax position of the company and the DRD position of the company, and again the effective tax rate this quarter was just 1.5%.

Tom G. Gallagher
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

That all makes sense, Ewout. My follow-up is, how much of the – I think it was a little over $100 million was the DRD benefit as your 10-Q spelled out for 2013. How much of that would have been VA – CBVA versus your other separate account businesses like 401(k), you were able to distinguish how much is Closed Block versus Open Block related to the DRD?

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

A

Approximately two-third relates to the Closed Block and one-third relates to the remainder of the business.

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Tom G. Gallagher
Analyst, Credit Suisse Securities (USA) LLC (Broker)

Q

Okay. That's helpful. And then just last question, on the Retirement business, the reinsurance deal, I think that's going to reduce earnings going forward, but can you talk about how that improves the ROE. I assume that's, because it's lowering required capital, can you explain the mechanics of that?

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

A

Tom, so let me give you some of the statistics around this. This is a block of business with $910 million of assets, 40,000 policies. The majority of those policies have a guaranteed minimum interest rate of 3%. So that is one of the reasons why we like this reinsurance transaction. And the return on capital on this particular block before was approximately 5%.

So what you see is this quarter, the impact was approximately $2 million on the Retirement results. On an annualized basis, it is more in the neighborhood of $5 million and we have freed up approximately $72 million of capital by this block. So think about a 5% return, $5 million of pre-tax operating earnings, $72 million of capital, and therefore, it will help to drive up the Retirement ROC going forward by 10 basis points.

Operator: Our next question is from Erik Bass of Citigroup. Please go ahead.

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

Q

Hi, thank you. Just wanted to dig into the Retirement earnings and margins a little bit more, I guess adjusting for the items that you disclosed in the release, Retirement earnings, it sounds were up slightly year-over-year, but the assets under management are up 12% over that period. Just curious why this business hasn't seen more operating leverage and margin improvement, particularly given the strong equity market over the past year?

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

A

Erik, good morning. This is Ewout. Let me give you some of the numbers to give you some perspective of what is happening year-over-year with the operating earnings of the Retirement business. And then I hand it over to Rod, and Rod will supplement that with some of the strategic perspectives. So first, if you look at the result of $129 million year-over-year compared to the second quarter of 2013, we see that the fee-based revenue increased by $6 million. If you dive one level deeper, in fact, there was an $13 million increase in the fee income from full service and individual markets, but this was partially offset by the reduction in the fee income from our recordkeeping business, there was a $7 million reduction in fee income from recordkeeping business.

You can probably remember that we were speaking in the past about high level of change orders we got in 2013, that we did not expect to recur, and that is what you see in that recordkeeping fee level coming down. And those positive fee developments were offset by two other factors. We saw lower investment spread in other investment income, $6 million, this was driven by lower investment income due to the level of the yields that have developed and the reinvestments in our portfolio, as well as administrative expenses compared to last year were $4 million higher, and that is a very deliberate management decision, because we're investing in the technology infrastructure of the company. We don't expect those expenses to recur in the future, but that was a particular item that has also affected the results from last year to this year.

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

Thanks. And I guess that you'd talked about using sort of $132 million as the run rate. How should we think about the earnings growth potential for the Retirement business, if I guess it's not as tightly linked to AUM? And maybe at what point do you expect the overall margins to start to improve, given some of the actions you've taken on repricing as well as other actions?

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

I think the way to think about it Erik is, really we're managing this business to improve our return on capital going forward, and we're one-third of our way in the repricing of that. We are very confident in achieving our targeted return on capital in 2016 of 10% to 11%. So the operating earnings for example, you saw them were affected by $2 million of a reinsurance transaction this quarter, that's clearly beneficial from a capital point of view. Over time, the assets under management growth and the net flows will help the growth in earning in that business. But remember, our goal is to improve the return on capital on that business.

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

And it's Rod. Let me just add a piece. As you've heard us talk in previous earnings calls, we're about a third of the way through this five-year journey on the repricing process, and that's both repricing and derisking the existing block of business at IRRs that meet or exceed our targets, as Alain and Ewout has talked about. As previously mentioned, the second quarter, we've retained 89% of our full-service clients that were repriced for both our corporate and tax-exempt markets that's consistent with what we've previously experienced historically.

We remain confident in our ability to reprice this on the journey through the rest of this path. We are making choices, as we've discussed previously, in select situations, to trade lower fee revenue for lower GMIRs, which is a positive contributor in the longer-term from an ROE – ROC perspective. It's important to note, however, that lower fee revenue is immediate. It shows up right away, but the benefit of lower GMIRs will emerge over time as credited rates are reduced through the period.

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

Great. Thank you. That's helpful.

Operator: Our next question is from Eric Berg of RBC Capital Markets. Please go ahead.

Eric N. Berg
Analyst, RBC Capital Markets LLC
Q

Thank you, and good morning to everyone. My one question relates to the Life Insurance business. Certainly you've made progress, I see a 20 basis point improvement in the ROC in this year's June quarter on a trailing 12 month basis versus all of 2013, and 2013 in turn was better than 2012. But here is my question, given that the returns remain very challenged, I can't imagine anyone would want to invest in a Life Insurance business earning 4.5%. And given that two years from now, your goal is also for a significant improvement from here, but still I think a modest goal, a 7% return, might the capital backing this business be used more productively elsewhere?

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

Eric, good morning, it's Rod. Excellent question, and thank you for recognizing the progress that has been made, because Mike Smith and the team has done a very good job and we continue to feel very comfortable with the progress, we're making. That said, as you just pointed out, we laid out at the point in time of the RPO (sic) [IPO], that our ROC targets for this business would be 6% to 8%. And I remain confident in our ability to hit that range of targets. The piece that I would call to your and other's attention on the call is that the diversification benefit this provides the enterprise, a, and b, it's a very important component of our retirement readiness thesis about asset accumulation, asset protection, and ultimately asset distribution.

And, Eric, you've been doing this a long time as have I, we've been through cycles with companies where I think having a life insurance benefit of business properly priced, properly managed, is a very good and effective piece to manage the other two businesses that we're in. So we remain vigilant on the activities to make progress and I think you'll see more progress over the next two years towards that target. When we laid out our 12% to 13%, just as a reminder, that included the 6% to 8% from that segment and we will naturally keep you and others posted about the progress.

Eric N. Berg
Analyst, RBC Capital Markets LLC
Q

All right then. Thank you.

Operator: Our next question is from Steven Schwartz of Raymond James. Please go ahead.

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

Hey, good morning, everybody. First a follow-up, Ewout, am I thinking about this correctly that the give-up of free tax earnings is $5 million from the reinsurance deal, you're freeing up $72 million in capital, so basically the cost is around 6.9%?

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

So think about it in the following way, $5 million pre-tax, $3.5 million after-tax over $72 million of capital, so a 5% returnish kind of business we give up and we can use that freed up capital for other purposes. We think it's more useful, you see the RBC going up. It helps with the confidence in our excess capital generation and the buyback authorization. So I think that is how you should see why we take those actions. And maybe just to elaborate on that a bit, this is really a kind of activity we're very focused on as management. We're looking for blocks of business with low returns, where we can free-up capital and where we can reinvest the capital in the business, where we can see higher growth, better returns or look for opportunities to return to shareholders. So this is an approach we definitely like to do, and there might be other opportunities as well going forward.

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

Okay. Great. Ewout, do you have – I don't know if you're willing to or not, but do you an updated value on the DTA?

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

We will publish that in our 10-Q at the end of the week. But what you will see there is that our current tax valuation allowance at the end of the second quarter was $2.7 billion, to offset the deferred tax assets that is not netted by the deferred tax liability. So $2.7 billion is the total tax valuation allowance we still have on the balance sheet.

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

Okay. And then one more if I may. Just on the Investment Management business, I was wondering if you could, maybe, talk about one-year performance, if you knew those numbers, and also kind of spell out what was behind the large single outflow?

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

So in terms of the single outflow, it was a large institutional account we can refer to that sort of legacy account, that was distributed by affiliates and the economics were shared with the affiliates, and it was $800 million that were out-flowed this quarter.

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

Was this – Alain, was this performance-related, was this somebody to trying to passive, do you know?

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

No, no, actually it was – the performance was quite good and in fact, we received nice performance fees on that account as they exited. I cannot tell you the decision – the mindset of their decision. But it's something that, if you think about it is – we had distributed through our relationship with our parents historically.

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

Okay. And then any insight into one-year numbers? Yeah.

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

Yeah. On the one year fixed-income performance, it's been very strong. On the equity, it's been a very good improvement, especially in the last six months. If you recall, what we had talked about last year, is on the equity side, given our style of quality, of reliable investing, when markets are overheated and go up 30% plus, we don't tend to do as well relatively speaking, because everything is correlated and stock picking isn't as important. But in the first half of this year, we've made, relatively speaking, a nice comeback. So when you look at the year results, it's quite good.

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

Okay. Thanks, guys.

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

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

Q

Good morning. And thanks for taking my questions. I think I noticed basically a doubling of the ad spend on rebranding over the next couple of years and was curious what lead to that. And if you're comfortable with the current numbers or maybe there is potential for additional increases over the next few quarters?

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

A

Yes. Good morning. It's Rod. I'll start and then hand to Alain. So just to clarify, what we've talked previously was the operational rebranding expense. And if you recall, that was a total of $50 million and I think that may be how you are getting to the doubling. And if you think about that, it's truly the – what we refer internally to the wiring and plumbing that has to occur, when you take a company that was part of a multinational company and disconnect it and then reconnect it as a stand-alone public company. And so, it has literally been an equivalent activity to Y2K as we went through that. That was all of those activities.

What we hadn't commented previously until this call, was what we were going to invest in our new brand, and that number, as I commented earlier, was $100 million over the next two and a half years. And Alain, if you'd like to add to that?

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

A

Rod, I think you've covered that this is sort of the advertising that's related to rebranding of Voya Financial. We've been doing business as ING, and we're changing the name commercially to Voya Financial. In May of this year, we changed our Investment Management and Employee Benefits business, starting doing business as Voya. In September 1 of 2014 will be when all the rest of the businesses will start commercially be rebranded as Voya. And as Rod said, the approximate amount to be spent over the next two and a half years in our efforts to rebrand the company and these costs are non-operating costs.

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

Q

Okay. And then, another question on the CBVA, so you're basically handing over the actuarial work to Milliman here. And I understand that since it's no longer an Ongoing Business, outsourcing it makes sense from a certain perspective. But at the same time, given that there is such focus, at least from the investment community, on this Closed Block, I guess from an outsider's perspective, seeing the reins to that given over to an outside company just begs the question of how comfortable we should be with kind of managing those actuarial assumptions and the expertise that's in-house with a block of business that clearly is going to still drive the valuation of the overall company. And just wanted to see how you thought about the strategic decision of moving that over to Milliman?

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

A

Terrific question. And I'll begin and then Ewout will jump in. So first I want to make it very clear to all listeners, we assume all responsibility for this business in every capacity including what we're outsourcing and none of that has changed as a result of this. This is a way to more proactively reduce our costs over time with a very high-

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quality business partner and I'll underline the point of partner. So by outsourcing this, in no way are we removing ourselves from both a responsibility in any capacity for the risk management and management of this.

And in fact, if anything, we put heightened governance around it. Milliman is a terrific partner. We've gone at this very, very thoughtfully. This was with many, many, many months in the kind of incubation stage of is this possible and practical? It is a Closed Block. We have the responsibility of this Closed Block until there is no longer a block of business, and we take that every bit as actively from a responsibility perspective on this as we do our Ongoing Business. And, Ewout, maybe anything else to add?

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

Yaron, good morning. Maybe the best way to illustrate that is that the assumption setting behind all of those calculations will remain fully the responsibility of Voya Financial. So what is happening is we will use very sophisticated systems of Milliman for hedging, for the valuation calculations. They will help us to make those calculations in the future. But the outcome of those calculations and the underlying assumptions remain fully our responsibility, and we take and remain fully responsible because that ultimately rolls up in all of our financial statements.

Clearly the reason why we decided on this partnership with Milliman was that this is a Closed Block. It is in run-off, the block is getting smaller and smaller. We emphasize the 11.5% run-off we saw off the block in the second quarter. So at some point, it will be very hard to keep up with the investments in those very sophisticated hedging and valuation systems, and also on the staffing side. So therefore, to create a variable cost structure, we thought it was strategically a good step to partner with Milliman.

Operator: And 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. Just wanted to follow up on the question about Milliman and the variable cost structure and potential savings associated with that. And I guess the questions are really, you don't report operating earnings for CBVA. So really, how should we think or sort of assess the economic benefit of this partnership? And then wondering if you would expect this to drive any change in your hedging strategy or policyholder behavior assumptions?

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

Good morning, Chris. This is Ewout. So two questions you have asked. First, what is the expense benefit of this partnership with Milliman? I think how you should look at it is that there is not a direct immediate cost reduction we should expect and a material cost reduction out of this partnership. What we expect more is that with a smaller block in the future and the same level of investments we have to keep up in our systems that, over time, it is more a cost avoidance we are doing in this new partnership than that there is an immediate expense benefit this year or next year.

Regarding do we expect any differences in our hedging approach or results? The answer is no. The hedge strategy, the programmatic approach, all the hedge parameters are all set by the company. We will run in parallel for certain period to make sure that we are sufficiently testing that the results that are our coming out of the Milliman systems are exactly the same, as what is coming out of our own systems. And when we are comfortable that there

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is not going to be any hiccup or change from moving from one to the other, we will really switch the – that we make the switch and move fully to the Milliman approach.

So you should not see any change in the approach or the results of the company as a consequence of this partnership. But what it shows, really this partnership is the proactive approach what we're doing to run-off the Closed Block Variable Annuity and in order to really make sure that over time, we can provide the benefits out of this block, and hopefully, some potential of some capital release to our shareholders.

Christopher A. Giovanni Q
Analyst, Goldman Sachs & Co.

Okay. And those comments are related to both hedging as well as policyholder behavior?

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

Yes. Absolutely.

Christopher A. Giovanni Q
Analyst, Goldman Sachs & Co.

Okay. And then just one another quick one just on VA, and then I had one more, any kind of thoughts as you kind of went through the SEC process, around the enhanced annuitization offer, any preliminary feedback you've had from distributors and what that potentially leads you to for an expectation for take-up rates?

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

It's Rod. Let me start – as Ewout talked about, the offer is going to be in the fall. And so we really don't know. And we won't know until we go through that journey. I think you should look at this as another proactive step in managing this book of business. We will learn a lot from this first step, and we will adjust and modify like any company would, and apply that to kind of future aspirations as we go forward, but it is simply, totally premature to speculate on how policyholders may behave.

We were very pleased with how we moved through the journey with the SEC, and we've got an offer that we think is attractive and aligned for both customers as well as the company. And then, we're going to learn what we're going to learn and adjust and modify as we go forward. So as Ewout talked about, it will really not be until the end of the third quarter that we'll have insight into this first round of reaction to policyholder behavior and that will inform what we do as we go forward.

Christopher A. Giovanni Q
Analyst, Goldman Sachs & Co.

Helpful. And then the last one just, the new business policy applications, in the Life business, saw some sequential improvement for the first time in really a while. So wondering if you feel like you've maybe turned the corner and the sales growth could gain some momentum and accelerate or improve some of the ROC improvement you've already seen?

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

Yeah. Thanks for that – for recognizing that and for the question. So there are two things that I'd comment there. One, we've made some very significant changes in our approach to how we're approaching the market and the

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distribution in our Life Insurance business. We've dramatically reduced the amount of business that we – when I arrived, we were north of $300 million of new business. We're in the $100 million to $120 million range of new business, and our approach to the distribution fees. We have targeted our offerings broadly around our indexed universal life portfolio, which we believe is very attractive as well as what I would refer to as a middle market term portfolio. The initiative that Alain announced was just a reinforcement of that.

And so, we're very pleased with the initial reaction to our offerings and our strategy in the marketplace, and are encouraged that it will continue, but I don't want to speculate what that might be right now. Our overarching objective is to be good stewards of capital in that business, with less capital intensive products as we discussed previously.

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

Rod Martin

Chairman & Chief Executive Officer, Voya Financial, Inc.

Emily, thank you. We're excited about our continued transformation. We've made tremendous progress over the last few years, and we continue to have confidence in both our plan and our ability to execute it. We are leveraging our leading positions in attractive markets, as we execute on our ROE improvement plan. Our solid foundation is providing value for both shareholders and our customers, and we look forward to continuing to discuss our progress with all of you.

Thank you and good day.

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

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