

LINCOLN NATIONAL CORP
Form 10-Q
April 30, 2015

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended March 31, 2015

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from to

Commission File Number: 1-6028

LINCOLN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

Indiana (State or other jurisdiction of incorporation or organization)	35-1140070 (I.R.S. Employer Identification No.)
150 N. Radnor Chester Road, Suite A305, Radnor, Pennsylvania (Address of principal executive offices)	19087 (Zip Code)

(484) 583-1400

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report.)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 27, 2015, there were 253,021,877 shares of the registrant’s common stock outstanding.

Lincoln National Corporation

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	As of March 31, 2015 (Unaudited)	As of December 31, 2014
ASSETS		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2015 – \$80,230; 2014 – \$78,609)	\$ 88,813	\$ 86,240
Variable interest entities' fixed maturity securities (amortized cost: 2015 – \$588; 2014 – \$587)	598	598
Equity securities (cost: 2015 – \$192; 2014 – \$216)	210	231
Trading securities	2,077	2,065
Mortgage loans on real estate	7,654	7,574
Real estate	19	20
Policy loans	2,664	2,670
Derivative investments	2,095	1,860
Other investments	1,885	1,709
Total investments	106,015	102,967
Cash and invested cash	3,487	3,919
Deferred acquisition costs and value of business acquired	8,156	8,207
Premiums and fees receivable	452	473
Accrued investment income	1,129	1,049
Reinsurance recoverables	5,598	5,730
Funds withheld reinsurance assets	646	649
Goodwill	2,273	2,273
Other assets	2,901	2,845
Separate account assets	127,828	125,265
Total assets	\$ 258,485	\$ 253,377
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Future contract benefits	\$ 20,468	\$ 20,057
Other contract holder funds	75,663	75,512
Short-term debt	250	250
Long-term debt	5,627	5,270
Reinsurance related embedded derivatives	165	150
Funds withheld reinsurance liabilities	717	764
Deferred gain on business sold through reinsurance	153	171

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Payables for collateral on investments	5,046	4,409
Variable interest entities' liabilities	5	13
Other liabilities	6,340	5,776
Separate account liabilities	127,828	125,265
Total liabilities	242,262	237,637

Contingencies and Commitments (See Note 8)

Stockholders' Equity		
Preferred stock – 10,000,000 shares authorized	-	-
Common stock – 800,000,000 shares authorized; 252,928,502 and 256,551,440 shares issued and outstanding as of March 31, 2015, and December 31, 2014, respectively	6,493	6,622
Retained earnings	6,077	6,022
Accumulated other comprehensive income (loss)	3,653	3,096
Total stockholders' equity	16,223	15,740
Total liabilities and stockholders' equity	\$ 258,485	\$ 253,377

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in millions, except per share data)

	For the Three Months Ended March 31,	
	2015	2014
Revenues		
Insurance premiums	\$ 790	\$ 739
Fee income	1,222	1,098
Net investment income	1,187	1,208
Realized gain (loss):		
Total other-than-temporary impairment losses on securities	(20)	(10)
Portion of loss recognized in other comprehensive income	7	7
Net other-than-temporary impairment losses on securities recognized in earnings	(13)	(3)
Realized gain (loss), excluding other-than-temporary impairment losses on securities	(35)	(15)
Total realized gain (loss)	(48)	(18)
Amortization of deferred gain on business sold through reinsurance	18	19
Other revenues	135	130
Total revenues	3,304	3,176
Expenses		
Interest credited	625	633
Benefits	1,236	1,078
Commissions and other expenses	1,013	971
Interest and debt expense	68	67
Total expenses	2,942	2,749
Income (loss) before taxes	362	427
Federal income tax expense (benefit)	62	98
Net income (loss)	300	329
Other comprehensive income (loss), net of tax	557	890
Comprehensive income (loss)	\$ 857	\$ 1,219
Net Income (Loss) Per Common Share		
Basic	\$ 1.17	\$ 1.25
Diluted	1.15	1.21

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited, in millions, except per share data)

	For the Three Months Ended March 31,	
	2015	2014
Common Stock		
Balance as of beginning-of-year	\$ 6,622	\$ 6,876
Stock compensation/issued for benefit plans	27	7
Retirement of common stock/cancellation of shares	(156)	(78)
Balance as of end-of-period	6,493	6,805
Retained Earnings		
Balance as of beginning-of-year	6,022	5,013
Net income (loss)	300	329
Retirement of common stock	(194)	(72)
Common stock dividends declared (2015 – \$0.20; 2014 – \$0.16)	(51)	(42)
Balance as of end-of-period	6,077	5,228
Accumulated Other Comprehensive Income (Loss)		
Balance as of beginning-of-year	3,096	1,563
Other comprehensive income (loss), net of tax	557	890
Balance as of end-of-period	3,653	2,453
Total stockholders' equity as of end-of-period	\$ 16,223	\$ 14,486

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in millions)

	For the Three Months Ended March 31,	
	2015	2014
Cash Flows from Operating Activities		
Net income (loss)	\$ 300	\$ 329
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads deferrals and interest, net of amortization	(42)	(95)
Trading securities purchases, sales and maturities, net	12	11
Change in premiums and fees receivable	21	(84)
Change in accrued investment income	(80)	(87)
Change in future contract benefits and other contract holder funds	162	233
Change in reinsurance related assets and liabilities	(178)	21
Change in federal income tax accruals	(28)	48
Realized (gain) loss	48	18
Amortization of deferred gain on business sold through reinsurance	(18)	(19)
Other	99	(112)
Net cash provided by (used in) operating activities	296	263
Cash Flows from Investing Activities		
Purchases of available-for-sale securities	(2,629)	(2,061)
Sales of available-for-sale securities	142	160
Maturities of available-for-sale securities	1,041	1,158
Purchases of other investments	(3,646)	(538)
Sales or maturities of other investments	3,455	645
Increase (decrease) in payables for collateral on investments	634	281
Other	(32)	(22)
Net cash provided by (used in) investing activities	(1,035)	(377)
Cash Flows from Financing Activities		
Payment of long-term debt, including current maturities	-	(500)
Issuance of long-term debt, net of issuance costs	298	-
Deposits of fixed account values, including the fixed portion of variable	2,464	2,481
Withdrawals of fixed account values, including the fixed portion of variable	(1,408)	(1,443)
Transfers to and from separate accounts, net	(657)	(743)
Common stock issued for benefit plans and excess tax benefits	12	(4)
Repurchase of common stock	(350)	(150)
Dividends paid to common stockholders	(52)	(42)
Net cash provided by (used in) financing activities	307	(401)

Net increase (decrease) in cash and invested cash	(432)	(515)
Cash and invested cash as of beginning-of-year	3,919	2,364
Cash and invested cash as of end-of-period	\$ 3,487	\$ 1,849

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Operations and Basis of Presentation

Nature of Operations

Lincoln National Corporation and its majority-owned subsidiaries (“LNC” or the “Company,” which also may be referred to as “we,” “our” or “us”) operate multiple insurance businesses through four business segments. See Note 13 for additional details. The collective group of businesses uses “Lincoln Financial Group” as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include fixed and indexed annuities, variable annuities, universal life insurance (“UL”), variable universal life insurance (“VUL”), linked-benefit UL, indexed universal life insurance (“IUL”), term life insurance, employer-sponsored retirement plans and services, and group life, disability and dental.

Basis of Presentation

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission (“SEC”) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2014 (“2014 Form 10-K”), should be read in connection with the reading of these interim unaudited consolidated financial statements.

Certain GAAP policies, which significantly affect the determination of financial position, results of operations and cash flows, are summarized in our 2014 Form 10-K.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company’s results. Operating results for the three month period ended March 31, 2015, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2015. All material inter-company accounts and transactions have been eliminated in consolidation.

2. New Accounting Standards

Adoption of New Accounting Standards

The following table provides a description of our adoption of new Accounting Standard Updates (“ASU”) issued by the Financial Accounting Standards Board (“FASB”) and the impact of the adoption on our financial statements:

Standard	Description	Date of Adoption	Effect on Financial Statements or Other Significant Matters
ASU 2014-01, Accounting for Investments in Qualified Affordable Housing Projects	This standard permits an entity to make an accounting policy to use the proportional amortization method of accounting to recognize investments in qualified affordable housing projects, if certain conditions are met. Under the proportional amortization method, an entity amortizes the initial cost of the investment in proportion to the tax credits and other tax benefits received and recognizes the net investment performance in the income statement as a component of income tax expense (benefit). Entities that previously applied the effective yield method to investments in qualified affordable housing prior to the adoption of this standard may continue to apply the effective yield method to those pre-existing investments.	January 1, 2015	The adoption of this ASU did not have an effect on our consolidated financial condition and results of operations.
ASU 2014-11, Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures	This standard eliminates a distinction in current GAAP related to certain repurchase agreements, and amends current GAAP to require repurchase-to-maturity transactions and linked repurchase financings to be accounted for as secured borrowings; consistent with the accounting for other repurchase agreements. The standard also includes new disclosure requirements related to transfers accounted for as sales that are economically similar to repurchase agreements and information about the types of collateral pledged in repurchase agreements and similar transactions accounted for as secured borrowings. The new	January 1, 2015, except for disclosures related to collateral pledged which will be adopted for the interim period ending June 30, 2015	The adoption of this ASU did not have an effect on our consolidated financial condition and results of operations.

disclosures are not required for comparative periods
before the effective date.

Future Adoption of New Accounting Standards

The following table provides a description of future adoptions of new accounting standards that may have an impact on our financial statements when adopted:

Standard	Description	Projected Date of Adoption	Effect on Financial Statements or Other Significant Matters
ASU 2014-09, Revenue from Contracts with Customers	This standard establishes the core principle of recognizing revenue to depict the transfer of promised goods and services. The amendments define a five-step process that systematically identifies the various components of the revenue recognition process, culminating with the recognition of revenue upon satisfaction of an entity's performance obligation. Retrospective application is required, and early adoption is not permitted.	January 1, 2017	We will adopt the accounting guidance in this standard for non-insurance related products and services, and are currently evaluating the impact of adoption on our consolidated financial condition and results of operations.
ASU 2014-16 Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity	This standard clarifies that when considering the nature of the host contract in a hybrid financial instrument issued in the form of a share; an entity must consider all of the stated and implied substantive terms of the hybrid instrument, including the embedded derivative feature that is being considered for separate accounting from the host contract. Early adoption of this standard is permitted and application is under a modified retrospective basis to existing hybrid financial instruments that are within the scope of the standard.	January 1, 2016	We are currently evaluating the impact of adopting this standard on our consolidated financial condition and results of operations.
ASU 2015-02, Amendments to the Consolidation Analysis	This standard is intended to improve consolidation accounting guidance related to limited partnerships, limited liability corporations and securitization structures. The new standard includes changes to existing consolidation models that will eliminate the presumption that a general partner should consolidate a limited partnership, clarify when fees paid to a decision maker should be a factor in the variable interest entities ("VIEs") consolidation evaluation and reduce the VIEs consolidation models from two to one by eliminating the indefinite deferral for certain investment funds. Early adoption is permitted including adoption in an interim period.	January 1, 2016	We are currently evaluating the impact of adopting this standard on our consolidated financial condition and results of operations.
ASU 2015-03,	Under current accounting guidance, debt issuance costs are recognized as a deferred charge in the balance sheet. This amendment requires that debt issuance costs be presented	January 1, 2016	We will appropriately classify all of our debt issuance costs in

Simplifying the Presentation of Debt Issuance Costs	in the balance sheet as a direct deduction from the carrying amount of that debt. This standard does not change the recognition and measurement requirements related to debt issuance costs. Early adoption of this standard is permitted and retrospective application is required for all periods presented in the financial statements.	accordance with this ASU as of the required effective date.
ASU 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement	This standard clarifies the accounting requirements for recognizing cloud computing arrangements. If an entity purchases a software license through a cloud computing arrangement, the software license should be accounted for in a manner consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the arrangement should be accounted for as a service contract. Early adoption of this standard is permitted and the amendments can be adopted either prospectively or retrospectively.	January 1, 2016 We are currently evaluating the impact of adopting this standard on our consolidated financial condition and results of operations.

3. Variable Interest Entities

Consolidated VIEs

See Note 4 in our 2014 Form 10-K for a detailed discussion of our consolidated VIEs, which information is incorporated herein by reference.

The following summarizes information regarding the credit-linked note (“CLN”) structures (dollars in millions) as of March 31, 2015:

	Amount and Date of Issuance	
	\$400	\$200
	December	April
	2006	2007
Original attachment point (subordination)	5.50%	2.05%
Current attachment point (subordination)	4.21%	1.48%
Maturity	12/20/2016	3/20/2017
Current rating of tranche	BBB+	BB
Current rating of underlying reference obligations	AA - B	AAA - CCC
Number of defaults in underlying reference obligations	3	2
Number of entities	123	99
	20	21

Number of
countries

The following summarizes the exposure of the CLN structures' underlying reference obligations by industry and rating as of March 31, 2015:

	AAA	AA	A	BBB	BB	B	CCC	Total
Industry								
Financial intermediaries	0.0%	2.1%	6.4%	2.1%	0.0%	0.0%	0.0%	10.6%
Telecommunications	0.0%	0.0%	3.5%	6.1%	0.9%	0.5%	0.0%	11.0%
Oil and gas	0.3%	2.1%	1.3%	3.4%	0.9%	0.0%	0.0%	8.0%
Utilities	0.0%	0.0%	1.6%	3.0%	0.0%	0.0%	0.0%	4.6%
Chemicals and plastics	0.0%	0.0%	2.3%	1.2%	0.3%	0.0%	0.0%	3.8%
Drugs	0.3%	2.2%	1.2%	0.0%	0.0%	0.0%	0.0%	3.7%
Retailers (except food and drug)	0.0%	0.0%	2.1%	0.9%	0.5%			