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# Lincoln National Corp. (LNC)

## Q3 2020 Earnings Call

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# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning and thank you for joining Lincoln Financial Group's Third Quarter 2020 Earnings Conference Call. At this time, all lines are in a listen-only mode. Later, we will announce the opportunity for questions and instructions will be given at that time. [Operator Instructions]

Now, I'd like to turn the conference over to the Corporate Treasurer, Chris Giovanni. Please go ahead, sir.

## Christopher A. Giovanni

*Senior Vice President-Investor Relations & Treasurer, Lincoln National Corp.*

Thank you, Catherine. Good morning and welcome to Lincoln Financial's third quarter earnings call. Before we begin, I have an important reminder.

Any comments made during the call regarding future expectations, trends and market conditions, including comments about sales and deposits, expenses, income from operations, share repurchases, and liquidity and capital resources are forward-looking statements under the Private Securities Litigation Reform Act of 1995. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from current expectations. These risks and uncertainties include those described in the cautionary statement disclosures in our earnings release issued yesterday, as well as those detailed in our 2019 Annual Report on Form 10-K, most recent quarterly reports on Form 10-Q, and from time to time, in our other filings with the SEC. These forward-looking statements are made only as of today and we undertake no obligation to update or revise any of them to reflect events or circumstances that occur after this date.

We appreciate your participation today and invite you to visit Lincoln's website, www.lincolnfinancial.com, where you can find our press release and statistical supplement, which include full reconciliations to the non-GAAP measures used on the call, including adjusted return on equity and adjusted income from operations, or adjusted operating income to the most comparable GAAP measures.

Presenting on today's call are Dennis Glass, President and Chief Executive Officer; and Randal Freitag, Chief Financial Officer and Head of Individual Life. After their prepared remarks, we will move to the question-and-answer portion of the call.

I would now like to turn the call over to Dennis.

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**Dennis R. Glass**

*President, Chief Executive Officer & Director, Lincoln National Corp.*

Thank you, Chris. Good morning, everyone. Lincoln is responding well to the health, economic and capital market challenges, ensuring we maintain our competitive advantages and capitalizing on opportunities become stronger.

Third quarter adjusted operating results, after normalizing for our annual review, recovered significantly from the second quarter, consistent with our expectations. Returns on the alternatives investment portfolio were strong in the quarter at nearly 7% compared to our targeted return of 2.5% or 10% annually. And while we continue to see effects from the pandemic related to elevated claims in our Life and Group Protection businesses, ultimately, we expect claims return to normal levels after the pandemic.

Low long-term interest rates are a headwind, but we are solving this through profitable top line growth, in-force management and expense efficiencies. Our underlying earnings are firmly intact and we are positioned for growth. We're taking actions to sustain market leadership positions across our businesses and on our terms, by expanding product breadth and strengthening our world-class distribution.

Specifically, we continue to aggressively execute our reprice, shift and add new product strategy to bolster our businesses with enduring and all-weather product portfolios. Year-to-date, we have taken 86 different pricing actions across our product suite and we plan to introduce eight new products during the first half of next year.

This strategy will enable us to capitalize on the breadth of our existing product portfolio at appropriate returns while adding new products that increase consumer choice and expand customer value propositions. This combination will position us well to improve sales volumes and drive long-term top and bottom line growth. As we expand our portfolio of customer solutions, we are focused on designing more capital efficient products, which will ultimately help improve our free cash flow.

In addition to these top line initiatives, we are taking actions that are enabling us to achieve expense savings and increased productivity while improving the customer experience by leveraging and accelerated digital capabilities. Notably, we see further and meaningful expense saving opportunities, given the increased digital adoption by both advisors and customers.

Lastly, we continue to focus on maintaining a strong balance sheet to maximize our financial flexibility. We have increased our RBC ratio, added to our sources of capital and liquidity, and reduced risk in the investment portfolio. We are executing well on these initiatives as illustrated by several third quarter highlights including, operating revenue increased across all our businesses, G&A expense decreased mid-single digits across all our businesses.

Over 90% of all Life Insurance policies and our top annuity partners have adopted electronic applications and delivery. And our strong balance sheet, which when combined with this quarter's solid underlying earnings and our current business outlook that is more positive into 2021 is leading to our decision to resume buybacks for the fourth quarter.

In our Annuities business, we continue to add products that are resonating in the marketplace and achieving good returns. Sales of our indexed variable annuity, which is the market leader and the fastest growing segment of the annuity market, more than doubled over the prior year third quarter, surpassing $1.5 billion. This led to positive variable annuity net flows compared to outflows in the prior year period.

As expected, total Annuity sales were down as we reduced benefits on VAs with living benefits and we continue to deemphasize fixed annuity sales. We expect similar sales trends to persist into the fourth quarter. As we look to 2021, we are leveraging product innovation to create additional consumer value propositions, expanding our already broad product portfolio.

Within the Life Insurance business, sales declined due to repricing. The industry has started following suit on our pricing strategy, improving our competitive position on our existing product portfolio heading into next year. Additionally, we are focused on offering consumers more solutions and alternative value propositions, such as reduced guarantees, but with the potential to meaningfully increase total benefits. By enhancing products with separate account investment engines, we see an opportunity to provide consumers with more upside in some of our core products, such as MoneyGuard, where we will be introducing a new product in the first half of next year.

While we expect sales to be meaningfully lower in the fourth quarter, in part due to record sales in the prior year quarter, we will be entering 2021 with solutions that provide greater market reach. As we've done in the past, we will utilize our broad and expanding product portfolio and the strongest distribution platform in the industry to position us for growth in 2021.

In Retirement Plan Services, our digitally-focused model where high-tech enables high-touch is excelling in the current virtual environment. Our sales and retention teams have seamlessly shifted to more virtual platforms, driving strong new sales growth and outstanding retention results. First year sales were up 20% and total deposits increased 6% over the prior year quarter, and client retention was excellent at 98%.

While we continue to see some headwinds related to the economic environment and the pandemic, including employers reducing or eliminating matching contributions and workforce reductions, the impact has been manageable and lessened due to the markets we serve, particularly our prominent position in the healthcare sector.

Net flows were once again positive as our focus on retention has been a key driver of account value growth. Looking forward, we continue to expect sales of YourPath, our alternative to target date funds to remain strong. Also, as a result of the SECURE Act, we see significant long-term opportunities related to simplified in-plan guarantees and pooled employer plan solutions in the defined contribution space.

Lastly on Group Protection, strong persistency more than offset lower sales and the contraction in covered lives due to the economic and employment environment, which led to a 3% increase in premiums compared to the prior year quarter. Sales in the quarter decreased over the prior year period due to delayed quote activity and the timing of when cases close. We have seen activity resume, which should benefit our sales in the seasonally strong fourth quarter.

We continue to expand our focus on growth from in-force customers by cross-selling our suite of complementary employee-paid products. This has resulted in 56% of year-to-date sales being generated from employee-paid, up 11 percentage points. While the pandemic has put near-term pressure on earnings, it has increased employee awareness of the importance of our protection products. We are taking actions to enhance our margins to the upper hands of our targeted range and we expect this to emerge as the pandemic subsides.

So bottom line, as expected, we saw decreased sales in most segments as a result of our aggressive and disciplined repricing strategy that ensures we achieve appropriate returns on capital and best positions Lincoln for long-term profitable growth. That said, I would emphasize several important points.

First, because we led the industry in repricing and are starting to see competitors follow course, we expect sales to bottom out in the fourth quarter, particularly for our Annuity and Life businesses, with growth reemerging in 2021 and beyond based on our strategic actions.

Second, as we enter the fourth quarter, we are now achieving at least a 12% return on new business based on the forward curve across all our businesses. Third, market demand and pricing changes has resulted in the sales of non-guaranteed products to exceed 80% of total sales, a trend we expect to continue.

And finally, distribution has been and will continue to be an advantage that distinguishes Lincoln. Our distribution model is growing and operating effectively in the current environment. For example, we have added over 8,000 new producers year-to-date and hosted over 1,400 virtual group meetings, which were attended by more than 50,000 advisors.

Regarding other strategic areas of focus, as you know, expense management remains a key focus with all near-term targets, including Liberty synergies, digital savings and our additional $100 million program for this year on track. Since our second quarter earnings call, we have identified opportunities to preserve this year's saving program in 2021 predominantly through virtual sales effectiveness and capabilities along with acceleration in digital adoption. Looking forward, we expect even further run rate savings opportunities, but this could require some incremental investment.

Since the onset of the pandemic, we have successfully focused on protecting and further improving balance sheet. For example, our RBC ratio and cash at the holding company have both increased. We have also enhanced our financial flexibility with our next debt maturity not due until September 2023. And in the third quarter, we completed a contingent capital facility.

Within the investment portfolio, de-risking actions and benefits of various government support programs have led to benign RBC impacts from credit losses and downgrades. Experience to-date is more favorable than our expectations at the onset of the pandemic and we expect that to continue as our credit outlook has improved.

In closing, we recognize potential industry headwinds that are responding. We're well on our way towards restoring sales growth in 2021 after actively repricing products to achieve appropriate returns and preserve capital. We have targeted programs to reduce expenses and are committed to further improving efficiencies and lowering costs while enhancing the customer experience. We entered this crisis well prepared and have continued to strengthen our balance sheet and reduce risk in our investment portfolio, while our variable annuity hedge program has performed exceptionally well.

And we've acted to accelerate capital deployment. Recall, we were one of the first companies to reinsure annuity blocks, both fixed and variable, and have improved our free cash flow over time by reducing new business strengths. As a result of confidence in our balance sheet and capital position, solid underlying earnings and our more positive business outlook as we move into 2021, we are pleased that the board of directors approved a 5% increase in our quarterly common stock dividend and that we will be returning to the buy market with an opportunity to buy our shares at a price that we believe presents an exceptional value. I couldn't be more confident about the actions that we are taking to execute our plans and deliver long-term value for our shareholders.

I will now turn the call over to Randy.

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## Randal J. Freitag

*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

Thank you, Dennis. Last night, we reported a third quarter adjusted operating loss of $133 million or $0.72 per share. As we noted in the earnings release, results included net unfavorable notable items of $552 million, or $2.84 per share, predominantly from this year's annual review of DAC and reserve assumptions. This year's annual review resulted in a net charge of $489 million, with negative $547 million included within adjusted operating income and positive $58 million in non-operating.

Included in adjusted operating income was negative $524 million related to interest rates with approximately one-third of the impact coming from a 50 basis point reductions in our long-term ultimate interest rate assumption to 3%, and two-thirds from a nearly 170 basis point decline in new money rates.

It is important to note that this is a non-cash charge, does not impact our RBC ratio and does not change our view on the potential impact of statutory capital from reserve strengthening if rates stay low, where we expect no impact at the end of this year.

Outside of interest rates, there was a $23 million net unfavorable impact within adjusted operating income with policyholder behavior in the life business coming in negative, partially offset by favorable policyholder behavior in Annuity business. Beyond these factors, all other components of the annual review had an immaterial impact.

As part of this year's review, we did not unlock a reversion to the mean corridor, which still provides an approximate $155 million pre-tax cushion against declines in the equity markets. In addition to the significant impacts from the annual assumption review, this quarter was also impacted by a few items.

First, COVID-19 related claims reduced earnings by approximately $101 million or $0.52 per share, which included a $95 million mortality impact and $6 million from disability claims. Mortality component for the company was above the $10 million for every 10,000 deaths we have discussed, but we may see volatility quarter-to-quarter, we believe, this represents a good proxy for the expected impact.

Second, in addition to the direct COVID-19 impacts, our Group life results also included $28 million or $0.14 per share from elevated mortality, which we believe is related to broader trends in US population mortality arising from the pandemic. Third, results benefited from strong performance in the alternatives investment portfolio, which boosted earnings by $56 million or $0.29 per share relative to our targeted annual return of 10%.

Net income totaled $398 million or $2.01 per share, with the largest driver being an update to our non-performance risk calculation to more align with peer practices. As a reminder, while we think of movements in NPR is largely non-economic, this change did have a positive impact and increased net income by $475 million.

Other positives included in net income were the $58 million favorable non-operating result from the annual review and $50 million from a reduction in our CECL reserves. Lastly, the variable annuity hedge program performed exceptionally well with 100% effectiveness in the quarter.

Moving to the performance of key financial metrics, consolidated adjusted operating revenue increased over the prior year period. Average account values increased 7%. Total G&A expenses net of amounts capitalized decreased 3% year-over-year, and when combined with revenue growth, the expense ratio improved 50 basis points. And book value per share excluding AOCI, stands at $71.10, up 3%.

Now turning to segment results, starting with Annuities. Reported operating income for the quarter was $196 million, which included a $101 million unfavorable impact from our annual review, primarily related to interest rates. Adjusting for normal items in both periods, operating income increased 13% from the prior year quarter, driven by higher average account values and favorable alternative investment income.

Average account values of $144 billion increased 8% on both a year-over-year and sequential basis. Return metrics, excluding notable items, remains strong, with a ROA of 82 basis points and a ROE of 22%. Risk metrics on our VA book continue to demonstrate the quality of our business as the increase in account values reduced net amount at risk to 1.5% of account values for living benefits and approximately 50 basis points for death benefits.

Consistently strong returns, favorable risk metrics and solid hedging results are evidence what a well-run annuity business can deliver, something we believe is not rewarded by the marketplace.

Base spreads, excluding variable investment income, decreased compared to the prior year, but increased on a sequential basis as we continue to actively manage crediting rates. G&A expenses net of amounts capitalized decreased 6% year-over-year, with expense management remaining a focus across the organization.

Looking ahead to the fourth quarter, we expect continued strong performance in the Annuities business, with alternative investment results returning to more normal levels.

Retirement Plan Services reported operating income of $50 million compared to $44 million in the prior year, with the increase driven by alternative investment performance and expense management. Our annual review had a net unfavorable impact to operating income of $3 million in the current quarter and no impact in the prior year period.

Net flows totaled $362 million in the quarter, which when combined with favorable equity markets drove average account values to $80 billion, up 7%. A 5% decrease in G&A expenses, combined with 4% revenue growth, resulted in a 230 basis point year-over-year improvement in the expense ratio.

Base spreads, excluding variable investment income, compressed 22 basis points versus the prior year, which was above normal, primarily due to lower yields on floating rate securities where the crediting rate on the matched liability adjusts less quickly. However, ROA was strong in the quarter at 25 basis points. The Retirement business had a strong quarter with good expense discipline and organic growth remaining key drivers going forward.

Turning to Life Insurance, we reported an operating loss for the quarter of $311 million, which included a $440 million net unfavorable impact from our annual review, largely related to interest rates. Adjusting for notable items in both periods, operating income increased over the prior year quarter, primarily driven by favorable alternative investment performance compared to unfavorable results in the prior year, which more than offset elevated mortality related to COVID-19 of approximately $70 million.

Underlying earnings drivers continued to show growth with average account values up 5% and average Life Insurance in-force up 10%. G&A expenses decreased 4% year-over-year, which led to a 40 basis point improvement in the expense ratio. Base spreads declined 14 basis points compared to the prior year, above our 5 to 10 basis point expectations. Looking forward, we continue to expect headwinds from COVID-19 related mortality; however, the pandemic will eventually be behind us and key growth drivers remain solid.

Group Protection reported operating income of $6 million compared to $61 million in the prior year, with the decrease driven by unfavorable pandemic-related mortality. Our annual reserve assumption review had a net unfavorable impact to operating income of $3 million in the current quarter compared to a net favorable impact of $10 million in the prior year period. The total loss ratio was 83.2% in the quarter, up 9 percentage points compared to the prior year period with the increase predominantly driven by Group Life loss experience.

This quarter's direct impact from COVID-19 mortality claims was $25 million. And as I noted upfront, total mortality for the Group Life business was elevated as we have also seen excess mortality emerge over the course of the pandemic.

Our disability performance was good in the quarter, as the loss ratio was consistent with recent periods, while incident rates were flat compared to the prior year. In the dental business, utilization and the loss ratio returned to more normal levels, consistent with our expectations, following very favorable dental experience in the second quarter.

G&A expenses decreased 4% even with increased staffing in our claims organization to maintain high levels of customer service during this period of elevated claim activity. While the pandemic pressured this quarter's earnings and will continue to have an impact, we are encouraged by our premium growth, expense management and good performance from our disability book despite the obvious pressures in the economy.

Turning to capital and capital management, continuing with this year's trends, statutory capital and the RBC ratio increased to $9.8 billion and 445%, respectively, while cash at the holding company stands at $756 million. In August, we executed a $500 million contingent capital facility, which provides us another tool within our capital and liquidity framework, while enhancing our financial flexibility in all market environments.

As Dennis mentioned, we plan to resume buybacks in the fourth quarter and expect to deploy approximately $50 million towards buybacks over the remainder of the year. We will update you on our outlook for 2021 capital return on next quarter's earnings call, consistent with our historical practice.

To conclude, third quarter earnings included a large impact from our annual assumption review due to the significant decrease in interest rates, and we continue to experience headwinds from pandemic-related mortality.

Looking through those items, we continue to see strong underlying earnings and this quarter's results had several positives, including revenue growth in all four businesses. Excellent expense management as G&A was done across the company. Capital continue to grow and we are increasing our return to shareholder with an announced 5% increase in our quarterly dividend and the resumption of buybacks.

With that, let me turn the call back over to Chris.

### Christopher A. Giovanni
*Senior Vice President-Investor Relations & Treasurer, Lincoln National Corp.*

Thank you, Dennis and Randy. We will now begin the question-and-answer portion of the call. As a reminder, we ask that you please limit yourself to one question and only one follow-up and then re-queue if you have additional questions.

With that, let me turn the call over to Catherine to begin Q&A

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] Our first question comes from Ryan Krueger with KBW. Your line is open

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

Q

Hey, good morning. First question was on the Group life mortality. We haven't really seen, I guess, non-COVID related elevated – elevated levels of non-COVID mortality referenced by other companies. So I was hoping you can provide a little bit more detail on what you're seeing? And if you think it will continue as COVID continues or if you think it's more of a one quarter anomaly.

### Randal J. Freitag
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Hey, Ryan. Yeah. Thanks for the questions. Yeah. We've seen a fair amount of time analyzing this broadly. We've looked at a number of industry studies. I think SOA does a good work of aggregating information from across the industry. We participate, a number of our peer companies, I think there's roughly 20 companies that participate. And as we've analyzed that data, the data that's come in over the course of the year, you've really seen this emergence of what we've described as pandemic-related mortality.

So I think as you think about expectations for the near-term, I think it's reasonable to think that that will continue in the near-term, but I think it's also reasonable to think that it will go away once we've developed a virus and figured out a way to manage the pandemic in a better way. In broader terms, Ryan, if you think about the overall impact of COVID-19 on the company, inside the Individual Life business, we continue run in online with our original rule of thumb. I think as you think about that, I think it's probably – and once again, I'm just having to hypothesize because you're not going to get exact information on this. But if you go back to when we established our $8 million per 10,000 rule of thumb at the beginning – at the beginning of the pandemic, all the evidence was, this was something that was going to impact. Although aged individuals death rates were relatively high, we established our rule of thumb. It worked for the second quarter. It worked for the third quarter. I think underneath that, once again, you're never going to know for sure there probably is some trend because we've done a better job, we brought death rates down with treatments.

You've seen us do a better job, I think, of protecting older age people. So inside of the $8 million that we continue to experience, there probably have been some shift from pure COVID to sort of this other pandemic-related, but it still is working in total. And that's a little different than the Group business. If you think about when we established original rule of thumb, there really was not much evidence that COVID-19 was going to become a significant issue for the working age population.

But as this has gone on in America, and it's spread into other aspects of the population besides older age, you started to see that, and in addition to that, you started to see the emergence of this, what we're calling pandemic-related. When we look at that study, we see it across all causes of death. We see heart disease up 35% year-over-year. Cancer up roughly 12% year-over-year. Other respiratory, up 42%.

So I would expect – Ryan, that was a long answer to your original question. Yeah, I would expect it to continue for the near-term

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

Q

Thanks, appreciate that. And then just one quick one, do you – just given relatively large assumption review impact, would you expect much of an ongoing impact to earnings power within the Life Insurance business from this?

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**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Yeah. I think it's similar, Ryan, to previous years and answering these questions. I think every time we've made these sort of assumption changes around interest rates, it has had a bit of an ongoing negative impact. It's been something that we've worked to overcome. And if you think about over the years, we've done this, what, four or five times, and it hasn't really been something that has made a material impact going forward.

So similar to last time, Ryan, yeah, it does have a bit of a negative impact, but not something we're going to specifically spike out. And we'll work hard to overcome that impact.

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

Q

Okay, great. Thank you.

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**Operator**: Thank you. Our next question comes from Humphrey Lee with Dowling & Partners. Your line is now open.

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**Humphrey Hung Fai Lee**
*Analyst, Dowling & Partners Securities LLC*

Q

Good morning, and thank you for taking my questions. Just looking at the ROA, especially the normalized ROA for Annuities in RPS, both were pretty strong in the third quarter. Clearly, the market had an impact. But do you see kind of these lessor kind of sustainable going forward assuming the market continues to cooperate?

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**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Yeah, Humphrey, thanks for the question. I think in the Annuity business, we've been reporting an ROA in or around 80 basis points for about as long as I can remember, maybe as long as I've been sitting in this seat, and we were at 82 basis points in the quarter. So, yeah, I think all evidence would indicate that an ROA in or around that range is right in line with our expectations.

And I think I mentioned in the Retirement business, it was a strong quarter. They did have some benefit from the strong alternatives. It's roughly $4 million in the quarter. So I think 25 basis points is sort of at the upper end of what you'd expect to see them in a normal quarter, so probably a little above their ongoing ROA.

**Humphrey Hung Fai Lee**
*Analyst, Dowling & Partners Securities LLC*

Q

Got it. And then in terms of kind of the default Group Protection, I think the industry wide has definitely seen some headwinds for premium growth or top line growth, given the economy and the employment condition. I guess, can you elaborate on your thinking about how the top line will trend, especially as we enter into the enrollment periods?

**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

Yeah, Humphrey, it's Dennis. Just the statistics. We're up 5%, third quarter year-to-date versus last year's third quarter year-to-date. Some of that has been that premium increases we've discussed is driven by good retention. Some of it's driven by new sales. And we'll have to see how those trends develop as we move into 2021, but we're pretty comfortable that we'll see premium growth.

**Humphrey Hung Fai Lee**
*Analyst, Dowling & Partners Securities LLC*

Q

Got it. Thank you.

**Operator**: Thank you. Our next question comes from Tom Gallagher with Evercore. Your line is open.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Good morning. First question, can you comment at all about what type of level of buyback you're planning on? Would it be lower than prior levels just given the environment or do you think you might get all the way back to where you were running previously?

**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Hey, Tom, it's Randy. I think as always, we really take this one quarter at a time, right? And so in our prepared remarks, as I mentioned, we're planning on $50 million in the fourth quarter and then we'll talk to you about 2021 as we get into the next quarters and beyond.

So – but when you think about fourth quarter, buybacks, returning capital to shareholders through buybacks, it starts with the balance sheet. And as I mentioned in our script, we're very comfortable with the strength of our balance sheet, the 444% RBC ratio, the $756 million of cash. At the holding company, the fact that we've prefunded debt maturities through 2023 and the fact that we added, to our toolkit, a contingent capital facility of $500 million in the third quarter. So the strength of the balance sheet is definitely there.

So then you might ask, well, why aren't you going back at your historic level, which is more in range with $150 million a quarter, which is what we've done historically on average. So when you think about that, I would just point out a couple of things.

First, the credit expectations have come down substantially from where they were back in March. But if you look at that expectation, I think it's fair to say that the confidence interval around that's still relatively wide or wider than it is than in normal. So I think, we're reflecting the fact that credit has improved significantly, but there still is some uncertainty in the environment.

And the other thing I would point out, Tom, is that just from capital generation, we still are being impacted in the quarter, as I mentioned, $101 million by COVID, and then another $28 million, so roughly $130 million from mortality-related claims across our business.

So, eventually that will be behind us, but in the near-term, we still are being negatively impacted by this pandemic.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Okay. Thanks. Thanks, Randy. And then just my follow-up on – you obviously had a competitor announcing a variable annuity risk transfer deal. Curious what your thoughts are there, if that's something you'd be willing to consider, particularly given that it was kind of a deep in the money block that effectively freed up and capitalized that block at about an 8 P/E, well above where Lincoln and the rest of the sector's trading? Does that give you a new data point to consider and would you move down that path or how are you thinking about that?

**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

Tom, this is Dennis. Let me take that. Let me answer your specific questions and add a couple of more comments. When we say a deal like that capital in the market in the way that – and that transaction, that's positive overall. As we've said, we remain in the flow for opportunities to sell either – any of our blocks of any of our business – if it makes economic sense. So just on the point, good for the marketplace, we're staying in the flow. And if we can do something that makes sense economically, we will do that.

I'd also like to remind you that we've done block transactions in the past, focused on VA and fixed annuities. You recall that we reinsured the living benefit guarantee risk on 50% of a $13 billion block of VA, and that remains in place. We also did a pure fixed annuity block reinsurance deal. And we've had flow deals. So, we've demonstrated a lot of creativity in the marketplace over the years and we'll continue to participate where it makes economic sense.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Thanks, Dennis. Would you – but would you say more broadly, you'd be open to doing something more transformational or I guess those other deals were kind of more at the margin?

**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

I'm not exactly sure, Tom, what you mean by transformational. Let's look at our strategy in the VA market. First, we'll start with, most of the folks on the phone know that we have the least risk of most in-force blocks in business across the industry. And so – and Randy's already pointed out – that we've been making 18% to 20% return on equity with no blowups in that business for years. So, we think it's a very good business for Lincoln. At the moment, we're seeing strong returns across our block.

Part of the reason our VA guaranteed business is so strong, from a risk perspective, is that we remained in the market consistently. We've hedged every rider from day one. And so, we're very comfortable with the risk profile and earnings capability of, in particular, living benefit block.

Again, as I said, looking forward, we're pricing all of our products to get the appropriate return. And so, even though lowering the benefits on the guaranteed living benefit business has reduced demand, that's fine. We continue to sell it and we continue to get great rates of return on the capital deployed. At the moment, the returns on our indexed VA block are also very strong. And we're happy to see that block grow the way it's been growing.

So I think, historically, we've demonstrated that we've managed the VA business, the fixed annuity business well and it's showing up in the earnings and returns.

**Thomas Gallagher**
*Analyst, Evercore Group LLC*

Q

Appreciate the comments, Dennis. Thanks.

**Operator**: Thank you. Our next question comes from Erik Bass with Autonomous Research. Your line is open.

**Erik Bass**
*Analyst, Autonomous Research LLP*

Q

Hi, thank you. Given your forecast of recovery in sales next year, do you anticipate your free cash flow generation returning to more normal levels? Or did the product changes that you've talked about reduce the expected strain and – I guess the strain on new sales?

**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Hey, Erik, it's Randy. Yeah, I don't think we see a significant change in the overall free cash flow profile. I think definitively, the new product designs have lower capital needs. But as we mentioned, we expect to grow sales beyond where we are here in 2020. And so, you'll have sort of capital usage per dollar of sales coming down while sales go up, maybe holding relatively level. So, no big change to our expectations for levels of cash flow, even though the amount of capital used per dollar of sales will be coming down.

**Erik Bass**
*Analyst, Autonomous Research LLP*

Q

Got it. And maybe following up on that, I mean, you've mentioned how the buffered annuity product is less capital intensive than guaranteed VAs. How much difference is there in the amount of capital you have to hold as a percentage of liabilities and what does that mean in terms of the capital strain from sales?

**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

Yeah. Without getting into the particulars, if – and if you rank ordered the Annuities in terms of their day one capital strain, it would be fixed annuities at the upper end. And that's primarily because fixed annuities get hit with a significant C4 charge in the first year. In the middle would be VA with guarantees. And then on the lower end would be IVA. And then even below that would be just a pure non-guaranteed VA product.

So without getting into the specifics, IVAs are roughly half the strain of a typical fixed indexed annuity.

**Erik Bass**
*Analyst, Autonomous Research LLP*

Q

Got it. Thank you.

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**Operator**: Thank you. Our next question comes from John Barnidge with Piper Sandler. Your line is open.

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**John Barnidge**
*Analyst, Piper Sandler & Co.*

Q

Thank you. Does the elevated non-COVID mortality that's emerging in a broader population make you think about utilizing more reinsurance because I can see that as a product that maybe grow secularly out of this?

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**Randal J. Freitag**
*Executive Vice President, Chief Financial Officer & Head-Individual Life, Lincoln National Corp.*

A

John, I think that when we think about using reinsurance, it's – every year we're looking at what is the cost of reinsurance, what are our expectations for mortality, looking forward. So that's a discrete decision we're making every single year. I think the reality is that we don't use a whole lot of reinsurance in our Group business. Remember that the average group claim is in the 50,000 to 60,000 range. So you're not talking about an expectation of using a significant amount of reinsurance in a Group type business. Obviously, we do use it more in the Individual Life business where we sell a number of larger base policies.

So I don't think the pandemic itself changes our view at this red hot moment of how we utilize reinsurance as part of our business model.

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**John Barnidge**
*Analyst, Piper Sandler & Co.*

Q

Okay. And then my follow-up, assuming we get a renewal of the hardship waiver, would you anticipate possible increased withdrawals with 2021 for Retirement? Thank you for your answers.

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**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

As I mentioned, John, in my remarks, the consequences of the government programs on our block of business have not been great this year. And that's, in part, related to our concentration in the healthcare segment. So if not knowing what those new programs might be, whatever effect it has on industry close, we think we'll be at the lower end of that because of where we sell our business. So, again, we don't think that'll be a significant effect.

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**John Barnidge**
*Analyst, Piper Sandler & Co.*

Q

Thank you for your answers.

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**Operator**: Thank you. And our next question comes from Suneet Kamath with Citi. Your line is open.

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**Suneet Kamath**
*Analyst, Citigroup Global Markets, Inc.*

Q

Thanks and good morning. Dennis, I think you had said in your prepared remarks that you're planning on launching, I think it was eight new products next year. I'm assuming that there's going to be a ramp up period of time required as you educate your distribution force on these products. Should we think about sort of sales may be picking up more in the second half of the year, given that ramp up, or how should we think about the pattern of sales growth as we move across the year?

**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

Yes, Suneet, starting from this quarter, we expect to bottom out across our businesses, mostly the Life and Annuity business in terms of new sales in the fourth quarter. And then, in 2021, a slow build, to your point, through the course of the year.

**Suneet Kamath**
*Analyst, Citigroup Global Markets, Inc.*

Q

Got it. And then I think you had also said in your prepared remarks, you're talking about maybe some incremental cost savings. So just curious if you could maybe size that for us, how it compares to some of the cost savings program that you've achieved in recent years?

**Dennis R. Glass**
*President, Chief Executive Officer & Director, Lincoln National Corp.*

A

Yeah. So if you go to the digital program, which is still underway, we had sort of $120 million target, which were net up investment. I think we're running plus $40 million and growing toward the $120 million by the end of 2021. So that's a ongoing important program.

I mentioned and Randy mentioned that we have on top of that a $100 million savings that is occurring in 2020, some of which sort of reflects things like people aren't travelling as much and those could spring back. But in 2021, in total, we can keep that $100 million.

On top of that $100 million is what we're talking about. Well, let me say two things. One, preserving that $100 million and increasing it as we go forward. That will take incremental investment. We're in the process right now, Suneet, of sizing that. And when we get comfortable with the magnitude of that increase, we'll share it with you and others.

**Suneet Kamath**
*Analyst, Citigroup Global Markets, Inc.*

Q

Okay. Thanks, Dennis.

**Operator**: Thank you. And our next question comes from Elyse Greenspan with Wells Fargo. Your line is open.

**Elyse Greenspan**
*Analyst, Wells Fargo Securities LLC*

Q

Hi. Thanks. Good morning. I wanted...

**Operator**: It looks like Elyse hung up.

**Christopher A. Giovanni**
*Senior Vice President-Investor Relations & Treasurer, Lincoln National Corp.*

A

Okay. Are there any further questions in queue?

**Operator**: There are no other questions in the queue.

## Christopher A. Giovanni

*Senior Vice President-Investor Relations & Treasurer, Lincoln National Corp.*

Okay. So with that, thank you all for joining us this morning. As always, we are happy to take any follow-up questions that you have. You can email us at investorrelations@lfg.com. Thank you all and have a great day.

**Operator**: Ladies and gentlemen, this concludes today's conference call. Thank you for participating. You may now disconnect. Everyone have a great day. Speakers, please standby.