04-Nov-2021

# Lincoln National Corp. (LNC)

Q3 2021 Earnings Call

# CORPORATE PARTICIPANTS

**Albert S. Copersino**
*Vice President & Head-Investor Relations, Lincoln National Corp.*

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

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

# OTHER PARTICIPANTS

**Jimmy S. Bhullar**
*Analyst, JPMorgan Securities LLC*

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

**Thomas Gallagher**
*Analyst, Evercore ISI*

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

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

**Joshua Shanker**
*Analyst, BofA Securities, Inc.*

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

# MANAGEMENT DISCUSSION SECTION

**Operator**: Good morning, and thank you for joining Lincoln Financial Group's Third Quarter 2021 Earnings Conference Call. At this time, all lines are in listen-only mode. Later, we'll 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 Vice President of Investor Relations, Al Copersino. Please go ahead, sir.

## Albert S. Copersino
*Vice President & Head-Investor Relations, 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, 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 2020 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 of 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 Randy Freitag, Chief Financial Officer and Head of Individual Life. After their prepared comments, we will move to the question-and-answer portion of the call.

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

## Dennis R. Glass

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

Thank you, Al. Good morning, everyone. Third quarter operating earnings were reduced by pandemic claims and other charges and helped by strong alternative investment results. Adjusting out these various items, our underlying earnings and earnings growth potential remain strong. Our expectation remains to be at the high end or above our 8% to 10% EPS growth target in the intermediate and longer term.

Intermediate term expectations are primarily based on recovering sales momentum, strong fees on assets under management, incremental expense management initiatives and the combination of $900 million of buybacks related to our recent block sale and ongoing share repurchases.

Taking each of these in turn. Sales year-to-date are consistent with our expectations of building off the levels achieved as we exited 2020. We are also achieving returns in the low to mid teens on capital backing sales across all business lines. Overall, sales growth is reemerging due to our distribution strength, added shelf space, digital capabilities and product innovation. After introducing 10 new products since the beginning of the year, including the industry's first combined life plus long-term care policy built on a variable chassis, we have more updates planned and additional products in development.

Expense efficiency has long been a key focus for Lincoln. This quarter, we once again reported a lower expense ratio across most of our businesses. We also have a track record of delivering on past cost savings initiatives. We expect Spark, our new cost savings initiative, to drive savings well in excess of the impact of spread compression through 2024 and to improve both our operational effectiveness and the customer experience.

Finally, our buyback strategy, as just mentioned, is comprised of two components: first, our ongoing repurchases, which returned to pre-COVID levels this year, driven by the capital efficiency of our products, including the impact of the recently announced VA living benefit flow reinsurance deal, low levels of credit losses and net ratings upgrades in our high-quality investment portfolio and our well-managed hedge strategy; second, the buybacks funded by the block deal.

Before turning to the business segments, I want to congratulate Ellen Cooper. In August, the board announced that Ellen will succeed me as CEO after our Annual Shareholders Meeting next May. Since joining Lincoln in 2012, Ellen has worked with me and the rest of our executive team to shape and execute on Lincoln's strategy. She joined us as Chief Investment Officer, and her responsibilities have grown to include leading our enterprise risk efforts and our Annuities business.

Ellen is a gifted leader with a proven track record of empowering high-performing teams and executing effectively in challenging environments. I know that Lincoln will be in great hands with Ellen at the helm as she moves forward in fully capitalizing on the exciting opportunities ahead for Lincoln. Ellen will be joining Randy and me on the first quarter's earnings call.

Now, turning to the business segments. In Annuities, we reported sales growth of 7% over the prior year quarter, driven by our industry-leading product breadth and distribution force plus shelf space added over the last two years. Sales were down sequentially as we led the industry with rate reductions on index variable annuities in response to market conditions as well as typical third quarter seasonality. We remain pleased with our sales mix of guaranteed and non-guaranteed products, providing us diversification and attractive new business returns.

Looking forward, we are expanding customer choice by adding new investment options and index strategies and have improved the attractiveness of our index variable annuity product, setting us up for sales growth in the fourth quarter. Finally, we expect our earnings to continue to benefit from the high quality and diversified in-force book we have built over the years.

In Retirement Plan Services, we reported another quarter of excellent results and remain well-positioned with award-winning digital technology, a competitive cost structure, an expanding set of product solutions and scale in our target markets. Total deposits were up 2% despite being negatively impacted by some sales shifting into the fourth quarter. While we reported slightly negative flows this quarter, trailing 12-month net flows remained strong at positive $1.2 billion, and we expect full-year 2021 net flows to be positive.

Sales of YourPath, our alternative to target-date funds, remain strong. We have continued to innovate, enhancing our in-plan income solution called PathBuilder Income and integrating the solution inside our YourPath investment option. As a result of the SECURE Act, we also see significant long-term opportunities around in-plan guarantees, pooled employer plan solutions and adviser managed accounts.

Finally, the macro environment continues to provide a tailwind to Retirement Plan Services. In addition to healthy equity markets, the economic recovery is contributing to better wage growth, higher employee contribution rates and a greater employer deposits. Retirement business is having an outstanding year as we continue to execute on our strategy.

In Life Insurance, our focus on expanding both consumer value propositions and distribution shelf space resulted in sequential sales growth of 32% this quarter, with sales totaling $166 million and all product categories reporting double-digit increases. The focus on expanded customer choice aligns with our ongoing efforts to diversify our product risk profile. As examples, in the Life business, our variable MoneyGuard and our principal VUL products offer the customer the choice of lower guarantees and higher upside potential. Sale of these types of products have been growing faster than segment-wide sales. The products have less potential tail risk and better capital efficiency.

In addition to the property and casualty distribution partnership we added in the second quarter, we recently launched our variable MoneyGuard product at two of our largest strategic partners, providing 25,000 more advisers with access to this first-of-its-kind solution. Complementing our distribution and product expansion efforts, our digital-first focus continues to drive a lower cost per policy and an improved customer experience.

Looking ahead, we are enthusiastic about the future of the Life business. We are introducing new solutions that will further expand our customer and distribution reach, with more introductions planned for the first half of 2022.

Lastly, our Group Protection business continues to be impacted by the pandemic, particularly as the Delta variant affected more individuals under age 65, driving increased claims. While the pandemic continues to be a headwind, the underlying fundamentals of the business are strong, and we're pleased with the progress we are making. We achieved 5% premium growth over the prior year, which is a result of a stronger persistency rate of nearly 90% and renewal rate increases implemented earlier this year.

Year-over-year sales are flat as we stick to our pricing discipline. We're seeing more sales from our higher-margin employee-paid products year-to-date. 59% of Group Protection sales have come from these products, as more individuals see the value of them. Within this category, we have begun to quote our new hospital indemnity product, rounding out our suite of supplemental health products.

Underlying margins, after adjusting primarily for pandemic-related claims, were again in the middle of our target range this quarter. We will continue to build on our progress and expect margins to grow towards the top end of our 5% to 7% target range, as we remain disciplined on pricing, new business, reducing costs, and managing claims.

Briefly on investment results. Credit quality remains excellent. Our general account portfolio is predominantly comprised of fixed income investments, of which 97% are investment-grade equivalent. We continue to expect a benign credit outlook and have seen favorable credit trends within our portfolio, with minimal credit losses and positive net credit migrations.

During the quarter, we invested new money at an average yield of 2.6%, with one-half in shorter-duration assets versus one-third for the full year 2020, reflecting the increase in shorter-duration product sales and our disciplined asset/liability matching. Approximately 60% of our purchases were in investments other than public corporates, providing diversification and good relative value, and yielding approximately 100 basis points over comparably-rated public corporates.

Lastly, our alternative investment performance was once again strong, with an 8% return in the quarter, exceeding our long-term targeted quarterly return of 2.5%.

In summary, reported results this quarter continue to reflect ongoing impacts from the pandemic in Life Insurance and Group Protection. Our product strategy, distribution strength, and ongoing innovation are helping to build sales momentum at attractive returns.

Our new expense savings initiative is expected to more than offset spread compression, improve overall operational effectiveness, and drive earnings growth. And ongoing share buybacks, driven by our strong balance sheet and free cash flow generation, combined with the incremental buybacks enabled by our recent block deal, will further boost EPS.

In sum, our underlying earnings power is improving and we remain confident in our ability to grow EPS at or above our 8% to 10% target range.

I will now turn the call over to Randy.

## Randal J. Freitag

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

Thank you, Dennis. Last night, we reported third quarter adjusted operating income of $307 million, or $1.62 per share. As noted in the earnings release, adjusted operating income included net unfavorable notable items of $108 million, or $0.57 per share, including $93 million from legal-related expenses and a $15 million net charge from this year's annual review of DAC and reserve assumptions.

Also, this quarter's results were impacted by pandemic-related claims, which reduced earnings by $180 million, or $0.95 per share, while results benefited from strong performance in the alternative investment portfolio, boosting earnings by $89 million, or $0.47 per share above target. Additionally, we experienced some unfavorable non-pandemic mortality in the Life Insurance segment that I will discuss further in the Life commentary.

From a reported adjusted operating income standpoint, it was a bit of a noisy quarter, but we have strong underlying earnings power as we exit the quarter. Net income totaled $318 million, or $1.68 per share, boosted by gains in the investment portfolio and strong performance from the variable annuity hedge program.

Moving to the performance of key financial metrics. Consolidated adjusted operating revenue grew 9% from the prior year, which included growth in each of the four businesses. Average account values increased 17%, and book value per share, excluding AOCI, grew 8% and stands at $76.96, an all-time high.

Now turning to segment results, starting with Annuities. Operating income for the quarter was $338 million, which included a $5 million net unfavorable impact from our annual review compared to $196 million in the prior-year quarter, which included a $101 million net unfavorable impact from the annual review. Adjusting for notable items in both periods, operating income increased 15% from the prior-year quarter, driven by record average account values of $170 billion, up 17% over the past year.

The current quarter included $10 million of favorable alternative investment income. The expense ratio improved 80 basis points compared to the prior-year period as our focus on expenses continues to benefit the bottom line. Return metrics remained solid with return on assets coming in at 80 basis points and return on equity at 26%.

Risk metrics on our VA book once again demonstrate the quality of our in-force with the net amount of risk at 63 basis points of account values for living benefits and at 43 basis points for death benefits. So a great result for the Annuities business with another quarter of high-quality earnings, strong returns and solid risk metrics, leaving us well-positioned to finish the year with another excellent quarter.

Retirement Plan Services reported operating income of $60 million compared to $50 million in the prior-year quarter, with the increase driven by higher fees and account values, continued expense efficiency and higher alternative investment income, which was $6 million favorable to our expectation in the current quarter.

Our annual review had no impact in the current quarter, but did have a net unfavorable impact of $3 million in the prior-year quarter. Favorable equity markets drove average account value up 21% to $97 billion. Expense ratio improved 80 basis points over the prior-year quarter as revenue growth combined with continued diligent expense management contributed to improved results.

Base spreads, excluding variable investment income, compressed 10 basis points versus the prior-year quarter, in line with our stated 10-basis-point to 15-basis-point range as crediting rate actions continue to take hold. Overall, the Retirement business had an excellent quarter, and continues to be well-positioned to drive strong results.

Turning to Life Insurance. Operating income for the quarter was $93 million, which included a $26 million net unfavorable impact from our annual review compared to an operating loss of $311 million in the prior-year quarter, which included a $440 million net unfavorable impact from the annual review. Additionally, the current quarter included an unfavorable notable item of $19 million related to a legal expense associated with the reinsurance arbitration award.

Adjusting for notable items in both periods, operating income increased 7% from the prior-year quarter, driven by higher alternative investment income, as the current quarter included $65 million compared to $37 million in the prior-year quarter. Elevated mortality related to the pandemic was $60 million in the quarter compared to $70 million in the prior-year quarter.

This quarter's impact for 10,000 COVID deaths of $6 million was down year-over-year as expected, but was up sequentially as the severity of our average COVID claim was elevated. We believe this elevation is normal volatility as we had a few larger COVID claims in the quarter. In addition to the impacts of the pandemic, underlying mortality was negatively impacted by $34 million. We believe this was driven by two factors.

First, over the course of the pandemic, when COVID cases have been increasing, which they did in the third quarter, we have seen elevated non-COVID mortality as well. And second, normal quarterly volatility. I'd point out that we experienced favorable underlying mortality in the prior two quarters, and when viewed on a year-to-date basis, our actual to expected mortality ratio remains under 100%, better than expected.

Earnings drivers continue to grow, with average account values up 9% and average life insurance in-force up 7% over the prior year. Base spreads, excluding variable investment income, declined 13 basis points compared to the prior-year quarter, above our 5-basis-point to 10-basis-point expectation.

Our expense ratio improved 30 basis points over the prior-year quarter as our efficiency efforts continue to benefit margins. This was a noisy quarter for life earnings, but growth in earnings drivers, long-term mortality results in line with expectations and continued expense discipline keep us confident in our underlying business.

Group Protection reported an operating loss of $32 million, which included a $16 million net favorable impact from our annual review of reserve assumptions compared to operating income of $6 million in the prior-year quarter, which included a $3 million net unfavorable impact from the annual review.

Adjusting for notable items in both periods, operating income decreased from $9 million to an operating loss of $48 million, driven by higher mortality impact from the pandemic. The current quarter also included $6 million of favorable alternative investment income.

On a sequential basis, pandemic-related claims in the quarter negatively impacted earnings by $120 million compared to $28 million in the second quarter, and included $107 million in life claims and $13 million in disability claims.

In the quarter, US COVID deaths significantly shifted to the working age population, and in our Group business, the average claim size for active employees across all ages is consistently three to four times the size of those for retirees. This significant increase in working age deaths, coupled with the higher average claim size, drove the sequential increase in mortality.

While I've been humbled by trying to predict the impacts of the pandemic, I do believe that this quarter's increased impact reflects the current state of the pandemic, with a higher percentage of deaths occurring in the working-age population. Excluding the annual review of reserve assumptions, pandemic claims and favorable alternative investment income, the group margin of 5.9% was consistent with the prior quarter and in the middle of our 5% to 7% targeted range.

The loss ratio was 87.8% in the quarter, an 8.5-percentage-point sequential increase. Excluding pandemic-related claims and the impact of the assumption review, the loss ratio improved 20 basis points to 75.9%. Group's expense ratio remained flat despite ongoing investments in our claims organization to address elevated claim volumes from the pandemic.

Despite the tough quarter for Group, we are confident that the underlying business fundamentals are solid, and the strength of this business will reemerge as the pandemic subsides.

Turning to capital and capital management. We ended the quarter with $10.9 billion of statutory capital and estimate our RBC ratio at 463%. As a reminder, our RBC ratio includes 25 percentage points from non-economic goodwill associated with the Liberty acquisition that we expect will go away by year-end.

Cash at the holding company stands at $754 million, above our $450 million target as we have pre-funded our $300 million 2022 debt maturity. We deployed $200 million towards buybacks in the third quarter in line with our goal communicated last quarter to have full year buybacks in line with pre-pandemic levels of approximately $600 million, excluding any incremental buybacks from transactions.

Our block sale with Resolution Life, which we announced in September and closed on October 1, generated approximately $1.2 billion of capital, $900 million of which we plan to use for incremental share repurchases. We expect these repurchases to be completed by the end of the first quarter of 2022 and began the incremental buybacks in October, via a $500 million accelerated share repurchase program.

Outside of the deployment of proceeds from the block sale, we expect to continue our ongoing buyback program. Although I'd point out that the timing of ongoing buybacks may be influenced by the accelerated share repurchase program. We were pleased to have executed both a life block deal and a VA flow deal last quarter, and we continue to be open to additional block and flow reinsurance deals. Additionally, we announced a 7% increase in our quarterly dividend this quarter.

Now, to provide some details on the Spark Initiative. As we have been communicating for the past few quarters, we are excited to be embarking on another meaningful expense savings program. Teams from across the organization have been hard at work identifying and prioritizing opportunities for us to invest and improve efficiencies through this initiative. And they have been working with them and across departments to identify the best project to maximize effectiveness as part of Spark. Because the strategic digital program is nearing its end, we have decided to integrate the balance of that program into this new cost savings initiative for ease of tracking and communication.

As of the end of 2020, the total net recurring benefit from our strategic digital program is $80 million, on track with our target. In addition to these savings, we expect to achieve $260 million to $300 million in run rate savings through Spark as we exit 2024, with benefits growing steadily starting this year, and ramping up in the out years. The total expected one-time investment to achieve this savings is $350 million to $410 million, including the $57 million in investments we've made already this year.

We expect investment spend to peak in 2022 and decline in subsequent years. All numbers that I've just discussed are pre-tax and pre-DAC. Spark will be focused on driving efficiencies throughout all aspects of our business, from leveraging automation to simplifying and improving process efficiency. And we will continue to focus on enhancing the customer and employee experiences, while modernizing our technology footprint. We are also targeting benefits beyond cost savings, including improving the way we work, by focusing on re-skilling and up-skilling our valuable employee base.

A detailed breakdown of the benefits, investments, and net impact for 2021 through 2025 from Spark, combined with the remainder of the strategic digital initiative, can be found in this quarter's press release. We will update you on our progress going forward tying back to this disclosure.

To conclude, the pandemic environment continues to challenge our Life Insurance and Group Protection segments. However, underlying earnings in these businesses remain strong. Our Annuities and Retirement businesses both delivered excellent results. In sum, our underlying results and earnings power are both strong and growing.

With that, let me join Dennis in congratulating Ellen, and turn the call back over to Al.

**Albert S. Copersino**

*Vice President & Head-Investor Relations, 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 one follow-up, and then re-queue if you have additional questions. With that, let me turn the call over to Catherine to begin the Q&A.

# QUESTION AND ANSWER SECTION

**Operator**: Thank you. [Operator Instructions] Our first question comes from Jimmy Bhullar with JPMorgan. Your line is open.

**Jimmy S. Bhullar**

*Analyst, JPMorgan Securities LLC*

Q

Hey, good morning. So first, just had a question on your elevated COVID claims that you saw and, I guess, you had higher claims in the group life business, which is partly related to the pandemic affecting more younger individuals, then you had the elevated COVID life claims in the individual life side, and then also, I think, non-COVID mortality. So out of these, what do you think is sort of something that might continue in the near term versus maybe being more of an aberration and just the result of normal volatility and mortality.

**Randal J. Freitag**

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

A

Hey Jimmy, it's Randy. I think, as I said in my script, when it comes to the Group business, we think that the results we saw in this quarter reflect the state of the current pandemic, which is that deaths are occurring more frequently in the working age population. If you look at the numbers, it's pretty pronounced this quarter, and we use CDC data here, 40% of the 100,000 or so COVID deaths were in the working age population. And in previous quarters, pretty consistently, that had been between 15% to 20%. So you've seen a pretty dramatic shift.

I don't know of any reasons why that shift should not continue into the fourth quarter. So, I think what you saw in the Group business reflects the state of the pandemic today, even though we do believe that the impact of the pandemic, right, the number of people dying should continue to trend down over time as immunizations, both natural and the vaccination, continue to increase over time.

On the Life side, we think of the impact, which was largely driven by severity this time, as more random. Pretty consistently over the first five quarters or so of the pandemic the average COVID claim we saw was right in the $130,000, $140,000 range.

And this quarter was simply an outlier. The average COVID claim we saw this quarter was about $260,000, and there's really no example of that sort of impact in any preceding quarter. So, I think of it as more random this quarter in the Life business, really driven by a few large claims that we sell. Hope that helps, Jimmy.

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**Jimmy S. Bhullar**
*Analyst, JPMorgan Securities LLC*

Q

Yeah. And then on the Retirement business, I think you mentioned some – your flows were obviously negative. You mentioned some of the sales shifted into 4Q. Can you talk about what you're seeing in terms of employer behavior and – on matching employee behavior on deferrals and stuff and how the underlying trends are in that market?

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

A

All right. Jimmy, just in general – this is Dennis. As I mentioned in my script, as recovery in the economy is occurring, people are contributing a little bit more to their plans. Employers are increasing or returning to making contributions. So in general, it's a positive story.

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**Jimmy S. Bhullar**
*Analyst, JPMorgan Securities LLC*

Q

Thanks. And just lastly, on the accounting changes, I was wondering where you are internally on sort of figuring out what the impact is on Lincoln. And when do you think you'll actually end up sharing that with the Street? Or quantifying at least some of the impact?

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

A

Yeah, Jimmy, I think we have been pretty consistent in saying, we see a discussion with investors in the middle of next year as the most likely timing in terms of when we discuss. I know I've listened to some of the calls, I've read some of the questions. And I do know that there were some questions around impacts that some companies in the group business were talking about this quarter. We don't see that as the biggest driver of any potential impact for us.

In fact, I would say that impact we would expect to be rather small in terms of if you wanted to spike out specifically the impact on group claims reserves.

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**Jimmy S. Bhullar**
*Analyst, JPMorgan Securities LLC*

Q

Okay. Thank you.

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

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

Q

Hi. Thank you. Can you provide some more details on how you expect the upfront investment related to the Spark Initiative to flow through the P&L from a timing perspective? Then also, where should we expect the savings to show up across the different businesses?

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

A

Erik, thank you for the question. We're going to follow the methodology that we did with the strategic digital program in that you're going to see the investments flow through other operations. And we'll probably just continue that methodology going forward for this program.

And the benefits themselves, you'll see appear throughout the company through the four businesses. Now in terms of what you should expect from a dollar standpoint, we had a disclosure in the press release. If you compare to 2021, where we had net incremental benefits of $50 million, and we're anticipating we'll have roughly $75 million of investments this year for a negative $25 million impact, we'd expect that net impact to roughly grow by – if I use the midpoint, roughly $20 million next year. So a relatively modest incremental negative.

When you think about the outer years, we ultimately expect the net benefit to grow to the $260 million to $300 million range. So a pretty substantial impact across the organization and something that will be very supportive and why Dennis and us, we're very confident when we talk about our ability to grow at or above the top end of our 8% to 10% EPS range. I hope that helps, Erik.

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

Q

Yes. I was thinking more specifically where some of the savings would end up, maybe sort of – if you can give any more details on what your – kind of where the savings are coming from? And are they going to be more allocated to specific businesses? Or should we think of it sort of proportional to their contribution to earnings?

[indiscernible] (00:40:40)

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

A

Let me just jump in just for a second. This is not specifically the question that you asked, but it might be helpful to the answer. Just generally speaking, first of all, we're very excited about this project, and we're investing in technology, automation, processes and capabilities across Lincoln to help our businesses operate more efficiently. And part of this is investing in ongoing development growth for our employees. So these enhancements across the company, they will improve the customer experience, and as Randy has just mentioned, will have a positive impact on our bottom line over time.

And I want to mention on this, and I mentioned in my remarks that we have a good track record when we get to the point where we share this information with the investor groups that we've pretty much nailed down the framework here and all of the investments that we need. There's a name behind it. There's an outcome tied to it. We put it into our financial plans. So we're pretty excited.

And so you can see it's across the businesses, and some of it, for example, is coming of our IT department, cost reductions inside the IT department, take on new ways of doing business and those cost reductions will flow into all of the businesses.

In the Group area, as Randy had mentioned, where we haven't made as much investment in the digital space and in automation the last couple of years because we're focusing on integration, we'll see some pretty big benefits in that area. So I hope that's more helpful. And Randy, you may want to add to that.

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

A

Yeah, I think you nailed it, Dennis. The benefits are going to be spread across the organization with Group having maybe a little bit of an incremental boost just because for the last few years, their focus has been less on digital and more on integration. So I think you nailed it.

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

Q

Great. Thank you.

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

A

Yes.

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

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**Thomas Gallagher**
*Analyst, Evercore ISI*

Q

Good morning. Hey, Randy, I just wanted to follow up on your answer to Jimmy's question about the severity within individual life COVID claims, which I think puts your sensitivity at $6 million per $100,000 this quarter. So am I right with your response that you would expect that to go down going forward, closer to like the 2Q level of, I think, which was around $3 million per $10,000? Or can you just provide a little bit of color what sensitivity you expect on individual going forward?

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

A

Tom, I think that as you look forward and you think about the impact of COVID on the Life business, the driver of any movements in the impact is going to be severity. So incidents has come down very nicely as we've talked about, pretty heavy vaccination among the population that we insure in the individual life business. So incidents come down substantially. And what you're going to see now is the impact is driven by severity.

We do see this particular quarter the average COVID claim of $250,000 as an outlier. It's way out of whack with any of the preceding five quarters. So we do expect severity to come back down. But once again, you could get some volatility if you get a couple of big claims. But yeah, we do expect that to come down and revert more to what we've experienced over the first five quarters or so of this pandemic, Tom.

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**Thomas Gallagher**
*Analyst, Evercore ISI*

Q

Got you, thanks. And then my follow-up is, Randy, I think there have been some concerns that your GAAP earnings are going to be disproportionately negatively affected by the LDTI changes mainly because of your universal life business. I'm not asking you to give any hard core quantitative answer, but anything to say at a high level, whether you think that will be directionally true or not, or any comments on that topic.

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

A

Tom, I can't talk about proportionality because I don't spend time at the other companies. But I don't think the ongoing earnings impacts in the Life Insurance business, I would describe as large. I mean really, to the best of my recollection, the big thing that's changing in the Life Insurance business is the pattern of how you amortize DAC and unearned revenue, right? We're going from a pattern that is driven by the emergence of profitability to a pattern that is more locked and loaded in terms of being more fixed.

So Tom, that's not an area where I spend a lot of time thinking about very large impacts on earnings. There could be some impact, of course, but I don't see it as very large.

**Thomas Gallagher**
*Analyst, Evercore ISI*

Q

That's helpful. Thanks.

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

A

You bet.

**Operator**: Thank you. Our next question comes from Ryan Krueger with KBW. Your line is open.

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

Q

Hey, good morning. One more somewhat on LDTI. But I guess in – as of now, the – I believe you used a GAAP accounting framework in LNBar to calculate your VA reserves. Do you have any sense of if you can continue to use the current GAAP accounting framework post LDTI given that this actually has more of an impact on how you think about actual regulatory reserve requirements?

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

A

Ryan, thanks for the question. Yeah, I don't want to prejudge, I think it's all part of the analysis of the impact of LDTI, how that impacts the hedge program and how that impacts the underlying accounting that we have in LNBar, I think those are all part of the overall analysis. And I think at the end of the day, they're all very manageable in our opinion. So it's not something that I'm losing sleep over. But it is something that we have to deal with as we go about implementing this new approach, new accounting.

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

Q

Thanks. And then where would you characterize spread compression, kind of where it's running at this point? Is it still in that 2% to 3% type range right now?

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

A

Yeah. At this red hot moment, I think we're sort of in the middle of that 2% to 3%, but we continue to trend down over time. So if you go out a few years, I think we'll be more in the 1% to 2%, if not the low end of that 1% to 2%.

So yeah, it continues to trend down as the portfolio gets closer to the new money rates, but at this red hot moment, I believe in the middle of the 2% to 3% range.

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

Q

Thank you.

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

A

Yes.

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

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

Q

Good morning and thank you for taking my question. Just to kind of drill down on the kind of the severity impacts on Life Insurance a little bit more. Can you maybe size kind of how much more, kind of large claims or maybe percentage-wise this quarter that you saw versus kind of previous quarters?

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

A

Humphrey, thank you for the question. So I think in a normal typical quarter, if you just want to – there's a number of different ways to slice large claims. I'll talk about very large claims. Claims, for instance, that exceed $15 million to $20 million. Typical quarter, we see a couple of those. In this quarter, we happened to see about three – I think we're at about seven. So I hope that helped you, but we're talking about the largest of large claims when I spike this out.

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

Q

Okay. Yeah, that's helpful. And then, shifting to Group Protection, the disability result seems to be pretty consistent over the past several quarters. But some of your peers have talked about there is a shift in terms of STD versus a LTD. Can you just generally talk about what you saw in the quarter in terms of your disability results?

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

A

Humphrey, if you look at the loss ratios that we reported, we were – just the reported numbers, right? The disability loss ratio was 79% last quarter, 77.7% this quarter.

And if you go in there and you adjust for the pandemic claims that we've talked about and the benefit we got from the review of assumptions this quarter, what you would see is the underlying disability ratio increased just a little bit.

It would have went from 77.5% to 78.3%. What drove that was a little bit of an uptick in incidents offset by continued ongoing good performance from a claims resolution standpoint. But there was a little bit of an uptick in disability incidents.

And I would say that occurred in both the LTD and STD space. But as I talked about, we're talking about 77.5% to 78.3%, so I don't see it as a huge item in the broad context of all the items that can impact disability results.

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**Humphrey Lee**

*Analyst, Dowling & Partners Securities LLC*

Q

Got it. Thank you.

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**Operator**: Thank you. Our next question comes from Josh Shanker with Bank of America. Your line is open.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Yeah. I just want to talk about the benefits business a little bit. It looks like sales were somewhat weak, especially I thought there might be a rebound post-pandemic conditions a little bit. I know third quarter is not the biggest quarter for renewals or whatnot, but fourth quarter is pretty chunky. Can you talk about your positioning and how you see the growth in that business performing?

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**Dennis R. Glass**

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

A

Yeah, Josh, let me take that. The decline this quarter was driven primarily by lower sales from new customers. They're down, I think, in the mid-30s. That is the most competitive and price-sensitive segment for sales at the moment, in part because of the pandemic, customers have been reluctant to move carriers. And so, that's where the majority of the sales decline occurred.

On the other hand, we're pleased with the amount of sales coming from existing customers as we deepen our relationships and while improving our margins. And in this category, the percentage of sales coming from existing customers made up 64%, up from 56%. So, we're getting prices increases with our existing customers, developing strong relationships. And as the pandemic, hopefully, fades over time, I think the opportunity for new business from new customers will increase.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Does this condition seem to bode for a continuation into 4Q?

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**Dennis R. Glass**

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

A

We're seeing more opportunity for bids, but I don't think we're going to see a dramatic uptick in the fourth quarter in new business from new customers. But maybe; it's hard to predict right now. And just, again, overall, we're pretty confident in maintaining our sales, increasing our premiums, increasing our margins in this business, and sort of temporary sales issues related to pandemic, again, are going to fade over time.

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**Joshua Shanker**

*Analyst, BofA Securities, Inc.*

Q

Thank you for the answers.

**Operator**: Thank you. Our next question comes from Andrew Kligerman with Credit Suisse. Your line is open.

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Thank you for taking my questions. I'm kind of – I'm interested in the demographics of the claims in Life Insurance that you had in individual life, both the COVID claims and the non-COVID. Could you give a little color on the vintages of when those policies were written, the ages of the individuals, and if those were books of business from recaptured reinsurance?

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

A

Andrew, thanks for the question. One of the interesting things we've noticed, and I think it's consistent with the higher vaccination rates with increasing age, is that we've actually seen the average age of a COVID claim in our Life business come down over the course of the pandemic. At the beginning, we were averaging 80 – in the low 80s was sort of your average COVID claim, and in most recent quarter, it's come down to 72. I think this factoid speaks to the power, by the way, of the vaccinations in having a very favorable impact on mortality.

So, outside of that, Andrew, and we haven't seen anything atypical other than the fact that the average age of COVID claim has come down over the course of this pandemic as the vaccinations – as I mentioned, as vaccinations have increased the most among the older.

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Got it. So, really no particular policy vintages, not necessarily recaptured reinsurance policies, none of that, right?

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

A

Yeah. Nothing that I've noticed. I mean, if you think about the average age coming down, that would actually be potentially even younger policies than we've seen in the past, but I haven't directly looked at that.

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Got it, Randy. And then just I was curious on the COLI block divestiture. You certainly got a nice multiple for that. And then, you're doing flow business, which is new business.

But how about your – like a lot of other – a lot of your peer group competitors, they've been divesting variable annuity blocks, individual life, fixed annuities. Do you think – why not divest of those blocks? Are the multiples not where you want them to be? Are the economics not that good? What might be the reason for not doing some of those type blocks?

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

A

Well, I think I said in my script that we remain open to...

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

No, totally...

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

A

...both...

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

No, totally. I just [indiscernible] (00:56:55) do those stuff.

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

A

Andrew, this is not a factory where you just churn out things day after day after day, right? So, we're constantly analyzing what makes sense. I think it probably helps to think about what drives block sales and flow deals at Lincoln.

So when we think about this, we don't go, we want to reduce our risk and that's going to drive us to do something. I'll remind everybody, we're in the life insurance business, it's the insurance business, that's what's driven strong earnings growth, great performance, strong returns over the years. And at the end of the day, the insurance business nothing more than the ability to price, distribute and manage risk.

So it isn't risk that drives us to think about block sales. What drives us to think about block sales is, is there somebody out there who will pay you more than the value that shareholders are giving you in your share price? And thus, do you have a chance to do something that can be accretive to shareholder value. I think we definitively did that with the life block sale we just did. And we continue to analyze whether things like that make sense.

I would remind you that we did it, what, three or four years ago, when we did the fixed annuity deal, and we'll continue to analyze whether these make sense. That's no guarantee, but that's not a prohibition. We will continue to be very active in looking at whether or not there are things that we believe make sense from a shareholder value standpoint.

**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Yeah, and...

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

A

Yeah, Erik, I think – I mean, Andrew, I guess, I really don't even understand the question. Our business model is something that we're very comfortable with. The source of earnings, the different kind of liabilities that we sell; take a look at the VA business, for a decade, we've had excellent experience. We have lower amounts of risk in the Life Insurance business. We have good liabilities, and we're not running away from anything.

Some of the companies that are spinning off their businesses want to focus on something else. So they're choosing to do – focus on this business and not on the businesses that they're spinning off. And some of that's because that's what management thinks is the right answer. So we are very comfortable with our business mix. We are very comfortable with our strategy. And we're doing the right things at the right time to improve shareholder value. So that's the way I think about it.

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**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Thank you, Dennis. If I could sneak one quick one in on LDTI. I collected the answer to Tom's question on the non-traditional UL. But when Jimmy asked my line went off. Would there potentially be a material traditional product move in reserves due to LDTI, maybe term or – in those products?

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

A

Once again, we're working on the impacts, but no, that's not an item that I'm losing a lot of sleep on. The biggest single bucket of traditional liabilities is our group claims reserves. They're a little over $5 billion, and a couple of points, Andrew. One, we have a pretty low discount rate to begin with on that business. We're – I think our current year rate is going on at 2.5%. So I think we have a discount rate that by the time we get around to implementing this thing is not going to be too far above the index. So not something we're losing a lot of sleep on, Andrew.

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**Andrew Kligerman**
*Analyst, Credit Suisse Securities (USA) LLC*

Q

Thank you so much. Have a great day.

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

A

Yes.

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**Operator**: Thank you. And that's all the time we have for questions. I'd like to turn it back to Al Copersino for any closing remarks.

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**Albert S. Copersino**
*Vice President & Head-Investor Relations, Lincoln National Corp.*

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

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**Operator**: This concludes today's conference call. Thank you for participating. You may now disconnect. Speakers, standby.