14-Sep-2020

Lincoln National Corp. (LNC)

Barclays Global Financials Conference

CORPORATE PARTICIPANTS

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

OTHER PARTICIPANTS

Tracy Benguigui
Analyst, Barclays Capital

MANAGEMENT DISCUSSION SECTION

Tracy Benguigui
Analyst, Barclays Capital

Well, I'm Tracy Benguigui. I'm the Insurance Analyst at Barclays. And I'm pleased today to conduct a fireside session with Dennis Glass, President and CEO of Lincoln. Before we get into the Q&A portion just the housekeeping items, a quick reminder on the left side of your screen, you could either submit questions or be a part of our audience response system which is our polling questions.

QUESTION AND ANSWER SECTION

Tracy Benguigui Q
Analyst, Barclays Capital

And with that, Dennis, to start off, can you describe some big picture thoughts on the current macro environment from Lincoln?

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

I'll be glad to do that. And thank you for having us. It's always a high-class conference and we're glad to be a part of it. So, big picture issues around right now are that we are – let's starts with COVID and its effect on operations. Because of COVID, and we all know how terrible it is from a health perspective, but just setting – moving on to the consequences to Lincoln, first thing is the operating model. And we moved 11,000 people from working in the office to working at home and I'm very pleased to say that that's been a very good experience for us.

In terms of productivity, it has actually in some instances been better during this period of time than working in the office. We don't know if that'll continue. So that's been good. From a distribution standpoint, moving from in-person to virtual has been very powerful as well, and we've seen quite a bit of actual improvement in reaching our customers. So, on an operating perspective it's been quite good for us.

Now, when you move to COVID specifically, of course, you have the excess claims both in our Group business and our Life business, and we've spoken to that and given some guidance on what the effect on our earnings is, approximately $12 million for every 10,000 deaths in the United States. So we're working with that.

The consequences of COVID economically had us focusing on a couple of things. The first one is credit. And obviously credit would be a big issue in a continued recessionary environment. I will say that our actual experience so far with credit, credit defined as investment losses and downgrades, has been much better than our expectations. Part of that is related to the support that's coming out of both the Treasury and fiscal support. And so, as long as that continues and gives the economy time to recover, I think we'll see that same improvement in expectations with respect to losses and downgrades.

Equity markets, they hurt a little bit in the first quarter and the consequence is to particularly alternative investments in the second quarter. We expect that to come back. Equity markets have come back and we expect that to have a positive impact on our alternative investment earnings in the third quarter as we talked about.

The other thing that's happening big picture is interest rates have been declining for some time. I think the economic consequences of COVID has accelerated that, and earnings have dropped quite a bit 10-year now in the plus or minus 70 basis point rate.

That affects us in three ways. Importantly, it affects the pricing of our products. And so we have been in a continuous state of repricing our products and maintaining the return on capital. That's been helpful. Spread compression is an issue in lower interest rates. I think we're getting about a third of our earnings from spread in our overall earnings mix. And so that's moved up a little bit. We're able to offset some of that by some of the very strong cost programs that we are underway and we can get into that.

We've talked about, from a statutory perspective, lower interest rates possibly presenting a challenge on our statutory asset adequacy, but our guidance on that right now is even at these rates it'll be little bit lower. We're in the $100 million to $200 million range of having to strengthen our reserves, which is not a very significant issue. So that's the big picture from my perspective.

Tracy Benguigui
Analyst, Barclays Capital

Q

Excellent. Let's just talk a little bit about the economic shutdown. The shelter-in-place has made it tougher to sell life insurance, couple that with the ultra-low interest rate environment, what are the new normal growth prospects for Lincoln? In a way just today's environment can provide an accelerating of initiatives that you've already done, but are doing more so now with greater urgency?

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

A

Well, I already touched on them. We have a couple of programs. Let's talk about the interest rate effect on our products. We, a long time ago or four, five months before COVID started, we had a program of reprice, because interest rates were already falling, reprice, add, and expand our product portfolio. So, the repricing has been underway for some time to – again, to assure that we have the appropriate returns on the capital we put behind our products, the shift of products that support our capital management goals, for example, the indexed variable annuity, which is then meeting its pricing targets, has grown to a very significant part of our overall annuity sales. So that's offset some of the problem that's related to having to significantly reduce the – increase the prices on our variable annuities with living benefits. So that's an example of this shift, they can very well.

And then we're going to have new products, well-priced products that should give appropriate returns. I think one opportunity in that area is to add inside of our retirement plan, because of this Care Act, the ability to sell guaranteed lifetime income products. So reprice, shift, and add.

In terms of the long-term effect on growth rate, I think we can go back in our history and see that because of the strength of our product development and the strength of our distribution, we've already been able to make significant changes in the portfolio. One that stands out is guaranteed universal life, used to be 64% of our sales about five years ago, maybe six or seven years ago, and today it's only 4%. So, it's a combination of providing good products in the marketplace and the very strong distribution model that we have, tremendous shelf space and a very large, productive wholesale distribution organization. So the combination of those two things, product development, and the ability to put products into the market through our distribution will help us over time keep the top line growing.

Tracy Benguigui
Analyst, Barclays Capital

Q

Great. And I do want to talk a little bit more about product development and distribution, but maybe I could just play up your comments on the indexed variable annuities. And that has a lot of names in the industry, structured annuities, buffer annuities, RILA, whatever you call it. It seems to be a bright spot, because Lincoln actually climbed to the number one rankings in the second quarter, basically leapfrogging to established players. So do you expect to keep your indexed variable annuity market share up in a segment that's gaining in popularity?

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

A

So, let me come back to, so, the foundation, which is very good product development. And what's happening in the indexed annuity space is, as you pointed out, there is the buffer and the other type of value propositions, customer value propositions. The product also is structured such that it provides the opportunity for other consumer value propositions, and to some extent, provides the same type of value proposition for customers that fixed indexed annuities do. And so we're going to continue to improve that product, provide additional consumer value propositions and that will help Lincoln continue to grow in this space.

Now, you're absolutely correct, because the product meets so many different consumer needs, others are coming into the marketplace, but it'll take some time for those new entrants to get shelf space. We already have it. We've been adding it significantly over the last six months. Sometimes when people come into a new market, they might on a temporary basis underprice the market to get market share. So we could see some of that.

But I'll come back to the basic foundation, we have the best distribution platform in our industry to get newly developed products into the hands of our customers and we'll continue to rely on those strengths.

Tracy Benguigui
Analyst, Barclays Capital

Q

Okay. Great. And just staying on the macro themes, how significant of an impact are you anticipating, higher unemployment will be on your Group Protection business, false employee paid and employer paid claims?

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

A

So, COVID is having an impact right now, direct COVID claims. And again, we've talked about that and I've shared the guidance we've been providing. If you go back in time and you'll see that there is some connection between recession and increasing LTD claims. And so, depending on where we go economically, you could see some effect on our risk ratios LTD, short-term disability from a recession if it has the same relationship that we've seen in past years.

So, the effect is at the margin. It's happened before. And we expect to some extent it will happen again. It's very hard to quantify what that means, but there will be some effect. And of course the fundamental question is when does the economy get back to where it was? That is in part predicated on the path of COVID. Hopefully, mostly from a health perspective we can get that under control, and then the consequence of that would be a stronger economy. So, yes, there's a connection most important what is the direction of the economy.

Tracy Benguigui
Analyst, Barclays Capital

Q

Great. And maybe just walking around the product world, right, we talked about a few of your products, but maybe one that sticks out is your fixed annuity sales, which decreased by 77%. It did seem purposeful for this product, new sales get priced – repriced seems like every other week, and I'm hearing that credit rates are approaching 0%. So what are your long-term prospects for FAs? And if I could also sneak in FIAs which also have guaranteed credit rates?

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

A

Yeah. Fixed annuities have – we look at it from two perspectives. One is return on capital deployed and the second issue would be fixed annuities have a higher first-year strain and requires more capital than some of our other products. And then the third thing I would add is that we have a business model that doesn't rely on excess credit spread to be successful, but it's the interaction of product development, our strong distribution model of taking – obviously, we take some credit risk. And so, when we add all those things together, we do not see fixed annuities as coming back to the level that we have been selling that before, and again, protecting the capital on our balance sheet, getting the appropriate returns being the two key issues.

And again, some business models, I'm not trying to make pluses or minuses about other business models, but our business model doesn't rely on taking a lot of credit risk. And so, we're competing against models where they take more credit risk than we'd be prepared to do. So, bottom line, I don't think fixed annuities are going to come back in our mix in the short-term to medium-term to the extent that they were a year ago.

Now I mentioned a moment ago that the indexed variable annuity can capture on much more capital efficient basis some of the consumer value propositions, and so, more traditional fixed indexed annuity. And so, we'll get some of that business, but that business will come through our indexed variable annuity rather than the fixed-annuity chassis.

Tracy Benguigui
Analyst, Barclays Capital

Q

Got it. And maybe just shifting gears to life insurance, it does have a little different pricing dynamic, but UL and MoneyGuard sales were also meaningfully down. How are you going to build a new mousetrap both for product design and pricing in order to solve customer needs on balance with near zero interest rates?

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

A

Yeah, that's really a very good question. And that goes back to just what you're saying is at 2% investment grade credit spread, plus 10-year treasury, it's very hard for products like guaranteed universal life and MoneyGuard to provide the same level of guaranteed outcome as you could when you were investing at 3% and 4%.

So, using MoneyGuard as the example, we've got a lot of interesting work underway where we will be shifting the investment engine more to the equity markets and then providing much more upside, the benefit payments for the consumer than what you could get out of a product where the investment engine is the general account and bonds. So, we'll be moving to a product design that gives bigger opportunity. Guaranteed returns might be a little bit lower – will be a little bit lower, but we think the combination of upside potential will offset the lower guaranteed part of the program. So we're redesigning the product.

And this idea of where products have been – the investment engine of the product has been the general account, bonds and mortgages and stuff, investments like that, it is very much more difficult. And let's say you have to be more creative, and we'll come back once again to the strong foundations that we have, best distribution, great shelf space, great product development, and we've done this before. As I mentioned already, guaranteed universal life used to be in the life business, 64% of sales, went to 4% while we were increasing our overall sales volumes. So that's what we're thinking about.

And you have to react to the interest rate markets, there is no question about that. We've done it before. And if I could repeat myself one more time, we've been able to do it because of the strength of our distribution and product development capabilities.

Tracy Benguigui Q
Analyst, Barclays Capital

Got it. So it seems like because you have such a broad product suite, you're able to move levers up and down where you find appropriate risk. We did see...

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

Yeah.

Tracy Benguigui Q
Analyst, Barclays Capital

...per sales per VA with GLB decline to less than $1 billion in the second quarter. And I'm wondering going forward, should we expect that to be the new watermark?

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

That's very difficult. And by the way, all my comments – I mentioned it a little bit, but all my comments about our opportunities will be governed by macroeconomic conditions as you're pointing out, interest rates, strength of the equity markets. I haven't mentioned it specifically, but some of the regulatory changes where the capital behind products was increased for all considerations. And the last one, which is, what is the competition going to do? And so, all that comes into play.

Competition in the short run, as I mentioned, could be more difficult if people decided to try to take market share by underpricing the product for a temporary basis, not a bad idea on a temporary basis. But long run, again, the basic foundational strengths of product development and great distribution will permit us to make the shifts as we have demonstrated the ability to do in the past.

I'll say one more thing, just to add another statistics on distribution strength. In every 24 month period, about 100,000 independent advisers, independent marketing organizations sell a Lincoln product. And behind those 100,000 independent distributors who choose Lincoln is their entire customer bases which could be tens and multiples of 100,000, because each of these advisers have significant customer bases themselves. And within that customer base, you have a lot of different needs. And so back to the strength of distribution, product development, over the long-term, this will keep us on a growth mode. Short-run, because of the significant changes in consumer value proposition, some of the point – again, coming back to the point you made that others entering markets where we're the leader already, again, probably some headwinds. But again, we've demonstrated time and time again that our business model permits us to reprice shift and add successfully over time.

Tracy Benguigui
Analyst, Barclays Capital

Q

Got it. Maybe shifting gears to capital management and Lincoln had announced in the first quarter a suspension of share repurchases as you embarked on a number of internal stress scenarios including a 40% drop in equity markets and a CTE-99 credit stress test. While we're not in the clear, this doom's day scenario is not playing out either. And you also, in your opening remarks you seemed to be pretty optimistic about credit risk for your portfolio given your appetite. So what are some of your guideposts in resuming share buybacks?

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

A

Great question. Let me talk about our primary goals in periods of stress. Number one is to maintain our financial strength, ratings and business franchise. Number two is maintain our shareholder dividend, and number three is not to need to raise equity capital. So we're quite comfortable at this point that all of those objectives can be met as we work our way through this current economic environment.

And so what are some of the key actions that we've taken to preserve our financial strength? The first one is the one that I've talked about, which is that, because of repricing and because of the focus on the balance sheet, preserving statutory capital, our sales levels are down from what they are. We've been talking about this and some of the reasons. But one of the consequences of low interest rates and all the things that we've been talking about with respect to sales is we're putting less capital behind sales, maintaining our statutory capital position.

The second thing that you've mentioned is that we've halted share buybacks in the second quarter and we're going to revisit that in the third quarter, and let me come back to that in a minute. The other capital actions that we've taken to preserve statutory capital is expense management. We did a couple of transactions, swap transactions, that increased our capital base. And then we issued some debt for $150 million to strengthen the – again, the statutory capital.

Now, of course, offsetting that is the morbidity and credit losses and downgrades. But as I mentioned, we're in a much better position today than we thought we would be. So, that would point to us taking a very – coming back specifically to buybacks, we'll take a very hard look at the environment when we get into the third quarter and to the fourth quarter. And some of the positives are, because of the actions that I've just described, we are in a stronger position than we thought we would be.

And so we're going to take a very hard look at whether or not it makes sense to restart a share buyback program. Now, we're going to take a hard look. As we've discussed throughout the morning, we're in a very unpredictable environment. And I think that from my perspective, we know what the environment is and we've seen rough economic circumstances in the past. But what we haven't seen is just the unpredictable nature of the kind of environment that we're in. So, we're in a better position than we thought we'd be. We're going to take a very hard look, and we'll give some more specific guidance on that when we get to our third quarter earnings release.

Tracy Benguigui
Analyst, Barclays Capital

Q

Got it. Yeah, I do recognize at least for statutory capital cutting back on sales does give that boost to capital adequacy. Will you spend – you mentioned a little bit earlier today about your expense savings that could potentially diffuse some of the spread compression that we're seeing along with some of your strategic repricing and product designs. You could just touch a little bit more on the expense controls and how you're feeling about that and your plans into 2021 in accelerating those plans?

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

A

Yeah. We're pretty proud of our expense programs. And let me sort of go back a little bit in time. We've had two programs that came from earlier decisions. The first one is our decision to spend significantly more capital on improving our digital capabilities. And I might say that decision which we made three years ago is why, coming back to when I started the meeting – comments of the meeting, that's why we are so well-positioned to work from the office, so well-positioned to be able to continue to improve productivity on the distribution side. It was that intentional decision three years ago to spend several hundred million dollars in improving our digital capabilities.

So, that was one reason – customer service productivity is one reason we did the digital program. The other one was that we thought we'd be able to save in the neighborhood of $90 million to $150 million. We're on track for about $120 million, some of it's already shown up, I think another $40 million this quarter or this year, and then another $40 million next years. So we've got that in place. We know we're going to get that, and that's positive and comes back to your question.

The other savings that we've been talking about is about $125 million from our Group acquisition. Most of that's been our run rate. I think $100 million of the $125 million is in the run rate, we'll get another $25 million in 2021, exiting 2020.

But another program which is another $100 million that we've been talking about, and let me put that into two years, 2020 and 2021, when we saw COVID and we knew that we're going to have earnings pressure because of it, we went very hard at this year's budget and took $100 million out of this year's budget. We're on track to get that $100 million.

We've just finished an exercise that demonstrates that we can preserve that $100 million cost savings, not an increase in the run rate, but preserve it in 2021. So I'm excited about that. And we're about to embark on a program that's sort of similar to the first one I've talked about, the digitization to make that $100 million that we've got in 2020 and 2021, and actually increase it by some significant amount over the period of 2021, 2022 and 2023. And the way we're going to do that is improved distribution, improved process reengineering and things like that.

So, we've got the $150 million or $120 million at least from our digitization program.

We've got the $125 million from our Group acquisition integration savings. We've already got another $100 million on top of that. And I repeat those numbers, because it just demonstrates that Lincoln has an ability to aggressively go after cost and get those cost savings.

Now that's not indefinite. But I think we have more opportunity in the 2021, 2022, 2023 period to reduce expenses and offset some of the pressures you've been talking about, somewhat lower sales for a little bit – somewhat higher spread compression. So all that works together, that will keep coming back to foundational capabilities, product development, distribution strength, clear ability to get expense savings as opportunities for us to improve on earnings growth over the next several years.

Tracy Benguigui
Analyst, Barclays Capital

Q

Great. And with one minute left, we talked a lot about the current environment, but if I could put you on the spot for a bold prediction into 2021 and then we'll conclude.

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

A

Yeah, my prediction is that sometime in the first half of 2021, all the work being done around the world will provide some vaccine opportunities for COVID-19 and it will take a while to work its way into the world economies. Then when it does, that will be a positive outcome, most importantly, from a health perspective and saving people's lives, but then also help us get back to in the United States over a period of time. I don't think it's going to happen in 2021. But once we get the vaccine, we can start rebuilding the economy. The vaccine is not going to, in and of itself, change some of people's behaviors. Airline industries I think will take a longer time to get back. But if I come back to our industry, I think what's happened over the six months is people see the benefits of the type of the financial protection that's provided by insurance companies in general, but back to Lincoln, Group and disability, short-term and long-term disability, I expect people to buy more of that product. The new products on the life insurance side could get a boost because of increased concerns about financial security.

So hopefully, we will solve the COVID issue with vaccine and a lot of positive things, most importantly, people's health and then drive back to a better economic situation.

Tracy Benguigui
Analyst, Barclays Capital

All right. Let's cross our fingers that happens. So I really enjoyed talking to you today, and I think that concludes our session. So thank you so much.

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

Thank you very much.

Tracy Benguigui
Analyst, Barclays Capital

Okay. Bye.

Dennis R. Glass

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

Bye.

Operator: Okay. That does conclude our session. We are no longer live. Thank you very much. You may continue with the rest of your day.