

LINCOLN NATIONAL CORP
Form 10-Q
October 30, 2014

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

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

For the transition period from to

Commission File Number: 1-6028

LINCOLN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(484) 583-1400

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

Smaller reporting company

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

As of October 27, 2014, there were 259,789,727 shares of the registrant’s common stock outstanding.

Lincoln National Corporation

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	As of September 30, 2014 (Unaudited)	As of December 31, 2013
ASSETS		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2014 – \$78,484; 2013 – \$76,353)	\$ 85,348	\$ 80,078
Variable interest entities' fixed maturity securities (amortized cost: 2014 – \$586; 2013 – \$682)	598	697
Equity securities (cost: 2014 – \$217; 2013 – \$182)	234	201
Trading securities	2,134	2,282
Mortgage loans on real estate	7,466	7,210
Real estate	20	47
Policy loans	2,677	2,677
Derivative investments	1,439	881
Other investments	1,469	1,218
Total investments	101,385	95,291
Cash and invested cash	1,821	2,364
Deferred acquisition costs and value of business acquired	8,372	8,886
Premiums and fees receivable	448	420
Accrued investment income	1,129	1,029
Reinsurance recoverables	5,906	6,041
Funds withheld reinsurance assets	761	776
Goodwill	2,273	2,273
Other assets	3,414	2,730
Separate account assets	122,937	117,135
Total assets	\$ 248,446	\$ 236,945
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Future contract benefits	\$ 19,553	\$ 17,251
Other contract holder funds	74,893	74,548
Short-term debt	250	501
Long-term debt	5,186	5,320
Reinsurance related embedded derivatives	141	108
Funds withheld reinsurance liabilities	806	867

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Deferred gain on business sold through reinsurance	190	245
Payables for collateral on investments	3,853	3,238
Variable interest entities' liabilities	17	27
Other liabilities	5,168	4,253
Separate account liabilities	122,937	117,135
Total liabilities	232,994	223,493

Contingencies and Commitments (See Note 8)

Stockholders' Equity

Preferred stock – 10,000,000 shares authorized	-	-
Common stock – 800,000,000 shares authorized; 259,786,446 and 262,896,701 shares issued and outstanding as of September 30, 2014, and December 31, 2013, respectively	6,696	6,876
Retained earnings	5,834	5,013
Accumulated other comprehensive income (loss)	2,922	1,563
Total stockholders' equity	15,452	13,452
Total liabilities and stockholders' equity	\$ 248,446	\$ 236,945

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in millions, except per share data)

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
Revenues				
Insurance premiums	\$ 741	\$ 672	\$ 2,236	\$ 2,000
Fee income	1,216	1,032	3,448	2,973
Net investment income	1,212	1,180	3,627	3,543
Realized gain (loss):				
Total other-than-temporary impairment losses on securities	(6)	(22)	(21)	(61)
Portion of loss recognized in other comprehensive income	2	3	10	9
Net other-than-temporary impairment losses on securities recognized in earnings	(4)	(19)	(11)	(52)
Realized gain (loss), excluding other-than-temporary impairment losses on securities	93	(9)	117	(53)
Total realized gain (loss)	89	(28)	106	(105)
Amortization of deferred gain on business sold through reinsurance	18	19	55	56
Other revenues	135	134	397	380
Total revenues	3,411	3,009	9,869	8,847
Expenses				
Interest credited	631	627	1,900	1,871
Benefits	1,117	945	3,275	2,894
Commissions and other expenses	995	928	2,929	2,721
Interest and debt expense	67	67	201	196
Total expenses	2,810	2,567	8,305	7,682
Income (loss) before taxes	601	442	1,564	1,165
Federal income tax expense (benefit)	162	105	398	272
Net income (loss)	439	337	1,166	893
Other comprehensive income (loss), net of tax	(277)	(143)	1,359	(2,058)
Comprehensive income (loss)	\$ 162	\$ 194	\$ 2,525	\$ (1,165)
Net Income (Loss) Per Common Share				
Basic	\$ 1.69	\$ 1.28	\$ 4.45	\$ 3.35
Diluted	1.65	1.23	4.34	3.24

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited, in millions, except per share data)

	For the Nine Months Ended September 30,	
	2014	2013
Common Stock		
Balance as of beginning-of-year	\$ 6,876	\$ 7,121
Stock compensation/issued for benefit plans	51	27
Retirement of common stock/cancellation of shares	(231)	(262)
Balance as of end-of-period	6,696	6,886
Retained Earnings		
Balance as of beginning-of-year	5,013	4,044
Net income (loss)	1,166	893
Retirement of common stock	(219)	(88)
Common stock dividends declared (2014 – \$0.48; 2013 – \$0.36)	(126)	(96)
Balance as of end-of-period	5,834	4,753
Accumulated Other Comprehensive Income (Loss)		
Balance as of beginning-of-year	1,563	3,808
Other comprehensive income (loss), net of tax	1,359	(2,058)
Balance as of end-of-period	2,922	1,750
Total stockholders' equity as of end-of-period	\$ 15,452	\$ 13,389

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in millions)

	For the Nine Months Ended September 30,	
	2014	2013
Cash Flows from Operating Activities		
Net income (loss)	\$ 1,166	\$ 893
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads deferrals and interest, net of amortization	(346)	(355)
Trading securities purchases, sales and maturities, net	223	90
Change in premiums and fees receivable	(28)	(47)
Change in accrued investment income	(100)	(96)
Change in future contract benefits and other contract holder funds	224	18
Change in reinsurance related assets and liabilities	10	(207)
Change in federal income tax accruals	198	262
Realized (gain) loss	(106)	105
Amortization of deferred gain on business sold through reinsurance	(55)	(56)
Other	(91)	(103)
Net cash provided by (used in) operating activities	1,095	504
Cash Flows from Investing Activities		
Purchases of available-for-sale securities	(6,127)	(8,719)
Sales of available-for-sale securities	498	800
Maturities of available-for-sale securities	3,607	4,772
Purchases of other investments	(2,843)	(1,867)
Sales or maturities of other investments	2,597	1,901
Increase (decrease) in payables for collateral on investments	615	(628)
Other	(69)	(73)
Net cash provided by (used in) investing activities	(1,722)	(3,814)
Cash Flows from Financing Activities		
Payment of long-term debt, including current maturities	(500)	-
Issuance of long-term debt, net of issuance costs	-	397
Deposits of fixed account values, including the fixed portion of variable	7,213	7,847
Withdrawals of fixed account values, including the fixed portion of variable	(4,162)	(3,910)
Transfers to and from separate accounts, net	(1,914)	(2,158)
Common stock issued for benefit plans and excess tax benefits	23	1
Repurchase of common stock	(450)	(350)
Dividends paid to common and preferred stockholders	(126)	(97)
Net cash provided by (used in) financing activities	84	1,730

Net increase (decrease) in cash and invested cash	(543)	(1,580)
Cash and invested cash as of beginning-of-year	2,364	4,230
Cash and invested cash as of end-of-period	\$ 1,821	\$ 2,650

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Operations and Basis of Presentation

Nature of Operations

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

Basis of Presentation

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission (“SEC”) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. Therefore, the information contained in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013 (“2013 Form 10-K”), should be read in connection with the reading of these interim unaudited consolidated financial statements.

Certain GAAP policies, which significantly affect the determination of financial position, results of operations and cash flows, are summarized in our 2013 Form 10-K.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company’s results. Operating results for the nine month period ended September 30, 2014, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2014. All material inter-company accounts and transactions have been eliminated in consolidation.

2. New Accounting Standards

Adoption of New Accounting Standards

Financial Services – Investment Companies Topic

In June 2013, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2013-08, “Amendments to the Scope, Measurement, and Disclosure Requirements” (“ASU 2013-08”), which provides comprehensive accounting guidance for assessing whether an entity is an investment company. For a more detailed description of ASU 2013-08, see “Future Adoption of New Accounting Standards – Financial Services – Investment Companies Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements in ASU 2013-08 effective January 1, 2014, and evaluated all of our entities under the investment company criteria defined in ASU 2013-08. The adoption of ASU 2013-08 did not have an effect on our consolidated financial condition and results of operations.

Income Taxes Topic

In July 2013, the FASB issued ASU No. 2013-11, “Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists” (“ASU 2013-11”) in order to explicitly define the financial statement presentation requirements in GAAP. For a more detailed description of ASU 2013-11, see “Future Adoption of New Accounting Standards – Income Taxes Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements of ASU 2013-11 effective January 1, 2014. The adoption of ASU 2013-11 did not have an effect on the deferred tax asset or liability classification on our balance sheet and did not result in any additional disclosures to our financial statements.

Other Expenses Topic

In July 2011, the FASB issued ASU No. 2011-06, “Fees Paid to the Federal Government by Health Insurers” (“ASU 2011-06”) in order to address the question of how health insurers should recognize and classify fees mandated by the Patient Protection and Affordable Care Act as amended by the Health Care and Education Reconciliation Act. For a more detailed description of ASU 2011-06, see “Future Adoption of New Accounting Standards – Other Expenses Topic” in Note 2 of our 2013 Form 10-K. We adopted the requirements of ASU 2011-06 effective January 1, 2014. The adoption of ASU 2011-06 did not have a material effect on our consolidated financial condition and results of operations.

Future Adoption of New Accounting Standards

Investments – Equity Method and Joint Ventures Topic

In January 2014, the FASB issued ASU No. 2014-01, “Accounting for Investments in Qualified Affordable Housing Projects” (“ASU 2014-01”) in response to stakeholders’ feedback that the presence of certain conditions in order to apply the effective yield method to investments in qualified affordable housing projects may be overly restrictive and could result in certain investments being accounted for under a method of accounting that may not fairly represent the economics of the investments. For a more detailed description of ASU 2014-01, see “Future Adoption of New Accounting Standards – Investments – Equity Method and Joint Ventures” in Note 2 of our 2013 Form 10-K. We will adopt the requirements of ASU 2014-01 effective January 1, 2015, and do not expect the adoption will have a material effect on our consolidated financial condition and results of operations.

Revenue from Contracts with Customers Topic

In May 2014, the FASB issued ASU No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”) in order to clarify the principles of recognizing revenue. ASU 2014-09 establishes the core principle of recognizing revenue to depict the transfer of promised goods or services in an amount that reflects the consideration the entity expects to be entitled in exchange for those goods or services. The FASB defines a five-step process that systematically identifies the various components of the revenue recognition process, culminating with the recognition of revenue upon satisfaction of an entity’s performance obligation. By completing all five steps of the process, the core principles of revenue recognition will be achieved. The amendments in ASU 2014-09 are effective for annual and interim reporting periods beginning after December 15, 2016, with early adoption prohibited. We will adopt the requirements of ASU 2014-09 effective January 1, 2017, and are currently evaluating the impact of the adoption on our consolidated financial condition and results of operations.

Transfers and Servicing Topic

In June 2014, the FASB issued ASU No. 2014-11, “Repurchase-to-Maturity Transactions, Repurchase Financings and Disclosures” (“ASU 2014-11”) in order to eliminate a distinction in current accounting guidance related to certain repurchase agreements. The FASB noted that the distinction in the accounting guidance was not warranted because in all types of repurchase transactions the transferor retains exposure to the transferred financial assets and obtains important benefits from those assets through the term of the transaction. ASU 2014-11 amends current accounting guidance to require repurchase-to-maturity transactions and linked repurchase financings to be accounted for as secured borrowings, which is consistent with the accounting for other repurchase agreements. In addition, ASU 2014-11 includes new disclosure requirements related to transfers accounted for as sales that are economically similar to repurchase agreements, and information about the types of collateral pledged in repurchase agreements and similar

transactions accounted for as secured borrowings. The amendments in ASU 2014-11 are effective for annual and interim reporting periods beginning after December 15, 2014, with early adoption prohibited. Changes in accounting for transactions outstanding on the effective date are reported as a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The disclosures are not required to be presented for comparative periods before the effective date. We will adopt the requirements of ASU 2014-11 effective January 1, 2015, and are currently evaluating the impact of the adoption on our consolidated financial condition and results of operations.

3. Variable Interest Entities (“VIEs”)

Consolidated VIEs

See Note 4 in our 2013 Form 10-K for a detailed discussion of our consolidated VIEs, which information is incorporated herein by reference.

The following summarizes information regarding the credit-linked note (“CLN”) structures (dollars in millions) as of September 30, 2014:

	Amount and Date of Issuance	
	\$400 December 2006	\$200 April 2007
Original attachment point (subordination)	5.50%	2.05%
Current attachment point (subordination)	4.21%	1.48%
Maturity	12/20/2016	3/20/2017
Current rating of tranche	BBB-	Ba2
Current rating of underlying reference obligations	AA - BB	AAA - CCC
Number of defaults in	3	2

underlying
reference
obligations

Number of
entities

123

99

Number of
countries

20

21

6

The following summarizes the exposure of the CLN structures' underlying reference obligations by industry and rating as of September 30, 2014:

	AAA	AA	A	BBB	BB	B	CCC	Total
Industry								
Financial intermediaries	0.0%	2.1%	6.7%	1.7%	0.0%	0.0%	0.0%	10.5%
Telecommunications	0.0%	0.0%	4.0%	5.5%	1.4%	0.0%	0.0%	10.9%
Oil and gas	0.3%	2.1%	1.0%	4.6%	0.0%	0.0%	0.0%	8.0%
Utilities	0.0%	0.0%	2.6%	1.9%	0.0%	0.0%	0.0%	4.5%
Chemicals and plastics	0.0%	0.0%	2.3%	1.2%	0.3%	0.0%	0.0%	3.8%
Drugs	0.3%	2.2%	1.2%	0.0%	0.0%	0.0%	0.0%	3.7%
Retailers (except food and drug)	0.0%	0.0%	2.1%	0.9%	0.5%	0.0%	0.0%	3.5%
Industrial equipment	0.0%	0.0%	2.6%	0.7%	0.0%	0.0%	0.0%	3.3%
Sovereign	0.0%	0.7%	1.2%	1.4%	0.0%	0.0%	0.0%	3.3%
Conglomerates	0.0%	2.3%	0.9%	0.0%	0.0%	0.0%	0.0%	3.2%
Forest products	0.0%	0.0%	0.0%	1.6%	1.4%	0.0%	0.0%	3.0%
Other	0.0%	4.1%	15.5%	17.1%	4.6%	0.7%	0.3%	42.3%
Total	0.6%	13.5%	40.1%	36.6%	8.2%	0.7%	0.3%	100.0%

Asset and liability information (dollars in millions) for the consolidated VIEs included on our Consolidated Balance Sheets was as follows:

	As of September 30, 2014			As of December 31, 2013		
	Number of Instruments	Notional Amounts	Carrying Value	Number of Instruments	Notional Amounts	Carrying Value
Assets						
Fixed maturity securities:						
Asset-backed credit card loans	N/A	\$ -	\$ 598	N/A	\$ -	\$ 595
U.S. government bonds	N/A	-	-	N/A	-	102
Total return swap	1	402	-	1	361	-
Total assets (1)	1	\$ 402	\$ 598	1	\$ 361	\$ 697
Liabilities						
Non-qualifying hedges:						
Credit default swaps	2	\$ 600	\$ 17	2	\$ 600	\$ 27
Contingent forwards	2	-	-	2	-	-
Total liabilities (2)	4	\$ 600	\$ 17	4	\$ 600	\$ 27

- (1) Reported in variable interest entities' fixed maturity securities on our Consolidated Balance Sheets.
- (2) Reported in variable interest entities' liabilities on our Consolidated Balance Sheets.

For details related to the fixed maturity available-for-sale ("AFS") securities for these VIEs, see Note 4.

As described more fully in Note 1 of our 2013 Form 10-K, we regularly review our investment holdings for other-than-temporary impairment ("OTTI"). Based upon this review, we believe that the AFS fixed maturity securities were not other-than-temporarily impaired as of September 30, 2014.

The gains (losses) for the consolidated VIEs (in millions) recorded on our Consolidated Statements of Comprehensive Income (Loss) were as follows:

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
Non-Qualifying Hedges				
Credit default swaps	\$ (7)	\$ 35	\$ 10	\$ 61
Contingent forwards	-	-	-	-
Total non-qualifying hedges (1)	\$ (7)	\$ 35	\$ 10	\$ 61

(1) Reported in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).

Unconsolidated VIEs

See Note 4 in our 2013 Form 10-K for a detailed discussion of our unconsolidated VIEs, which information is incorporated herein by reference.

Effective December 31, 2010, we issued a \$500 million long-term senior note in exchange for a corporate bond AFS security of like principal and duration from a non-affiliated VIE. For a more detailed description of this transaction, see “Unconsolidated VIEs” in Note 4 of our 2013 Form 10-K. Effective September 30, 2014, we terminated our \$500 million long-term senior note financing arrangement and entered into a new transaction with the same non-affiliated VIE whose primary activities are to acquire, hold and issue notes and loans, pay and collect interest on the notes and loans, and enter into derivative instruments. Under this new transaction, we issued a \$697 million long-term senior note to the non-affiliated VIE in exchange for a corporate bond AFS security of like principal and duration that was assigned to one of our subsidiaries. The outstanding principal balance of this new long-term senior note is variable in nature, moving concurrently with any variability in the face amount of the corporate bond AFS security up to a maximum amount of \$1.1 billion. We have concluded that we are not the primary beneficiary of the non-affiliated VIE because we do not have power over the activities that most significantly affect its economic performance. In addition, the terms of the senior note provide us with a set-off right with the corporate bond AFS security we purchased from the VIE; therefore, neither appears on our Consolidated Balance Sheets. The VIE has entered into a total return swap with an unaffiliated third party that supports any necessary principal funding of the corporate bond AFS security required by our subsidiaries while the security is outstanding.

We invest in certain limited partnerships (“LPs”) that operate qualified affordable housing projects that we have concluded are VIEs. We receive returns from the LPs in the form of income tax credits that are guaranteed by creditworthy third parties, and our exposure to loss is limited to the capital we invest in the LPs. We are not the primary beneficiary of these VIEs as we do not have the power to direct the most significant activities of the LPs. Our maximum exposure to loss was \$70 million and \$77 million as of September 30, 2014, and December 31, 2013, respectively.

4. Investments

AFS Securities

See Note 1 in our 2013 Form 10-K for information regarding our accounting policy relating to AFS securities, which also includes additional disclosures regarding our fair value measurements.

The amortized cost, gross unrealized gains, losses and OTTI and fair value of AFS securities (in millions) were as follows:

	As of September 30, 2014				
	Amortized Cost	Gross Gains	Unrealized Losses	OTTI	Fair Value
Fixed maturity securities:					
Corporate bonds	\$ 68,077	\$ 6,175	\$ 369	\$ 85	\$ 73,798
U.S. government bonds	365	38	1	-	402
Foreign government bonds	489	62	-	-	551
Residential mortgage-backed securities ("RMBS")	4,063	267	-	21	4,309
Commercial mortgage-backed securities ("CMBS")	607	29	-	14	622
Collateralized loan obligations ("CLOs")	287	-	1	-	286
State and municipal bonds	3,709	716	5	-	4,420
Hybrid and redeemable preferred securities	887	110	37	-	960
VIEs' fixed maturity securities	586	12	-	-	598
Total fixed maturity securities	79,070	7,409	413	120	85,946
Equity securities	217	17	-	-	234
Total AFS securities	\$ 79,287	\$ 7,426	\$ 413	\$ 120	\$ 86,180

	As of December 31, 2013				
	Amortized Cost	Gross Gains	Unrealized Losses	OTTI	Fair Value

Fixed maturity securities:					
Corporate bonds	\$ 65,808	\$ 4,374	\$ 1,157	\$ 90	\$ 68,935
U.S. government bonds	355	26	14	-	367
Foreign government bonds	505	45	1	-	549
RMBS	4,135	256	10	31	4,350
CMBS	713	36	4	17	728
CLOs	232	-	1	6	225
State and municipal bonds	3,638	308	27	-	3,919
Hybrid and redeemable preferred securities	967	89	51	-	1,005
VIEs' fixed maturity securities	682	15	-	-	697
Total fixed maturity securities	77,035	5,149	1,265	144	80,775
Equity securities	182	19	-	-	201
Total AFS securities	\$ 77,217	\$ 5,168	\$ 1,265	\$ 144	\$ 80,976

The amortized cost and fair value of fixed maturity AFS securities by contractual maturities (in millions) as of September 30, 2014, were as follows:

	Amortized Cost	Fair Value
Due in one year or less	\$ 2,338	\$ 2,388
Due after one year through five years	17,352	18,852
Due after five years through ten years	22,426	23,467
Due after ten years	31,997	36,022
Subtotal	74,113	80,729
Mortgage-backed securities ("MBS")	4,670	4,931
CLOs	287	286
Total fixed maturity AFS securities	\$ 79,070	\$ 85,946

Actual maturities may differ from contractual maturities because issuers may have the right to call or pre-pay obligations.

The fair value and gross unrealized losses, including the portion of OTTI recognized in other comprehensive income (loss) (“OCI”), of AFS securities (dollars in millions), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, were as follows:

	As of September 30, 2014					
	Less Than or Equal to Twelve Months		Greater Than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI
Fixed maturity securities:						
Corporate bonds	\$ 5,133	\$ 90	\$ 5,810	\$ 364	\$ 10,943	\$ 454
U.S. government bonds	156	1	-	-	156	1
RMBS	403	3	293	18	696	21
CMBS	6	-	116	14	122	14
CLOs	34	-	81	1	115	1
State and municipal bonds	44	1	24	4	68	5
Hybrid and redeemable preferred securities	13	-	194	37	207	37
Total AFS securities	\$ 5,789	\$ 95	\$ 6,518	\$ 438	\$ 12,307	\$ 533

Total number of AFS securities in an unrealized loss position 1,057

	As of December 31, 2013					
	Less Than or Equal to Twelve Months		Greater Than Twelve Months		Total	
	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI
Fixed maturity securities:						
Corporate bonds	\$ 16,918	\$ 1,018	\$ 1,258	\$ 229	\$ 18,176	\$ 1,247
U.S. government bonds	163	14	-	-	163	14
Foreign government bonds	69	1	-	-	69	1
RMBS	488	17	267	24	755	41
CMBS	109	7	43	14	152	21
CLOs	136	2	50	5	186	7

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State and municipal bonds	377	20	24	7	401	27
Hybrid and redeemable preferred securities	62	6	197	45	259	51
Total AFS securities	\$ 18,322	\$ 1,085	\$ 1,839	\$ 324	\$ 20,161	\$ 1,409

Total number of AFS securities in an unrealized loss position 1,484

For information regarding our investments in VIEs, see Note 3.

We perform detailed analysis on the AFS securities backed by pools of residential and commercial mortgages that are most at risk of impairment based on factors discussed in Note 1 in our 2013 Form 10-K. Selected information for these securities in a gross unrealized loss position (in millions) was as follows:

	As of September 30, 2014		
	Amortized Cost	Fair Value	Unrealized Loss
Total			
AFS securities backed by pools of residential mortgages	\$ 1,088	\$ 1,024	\$ 64
AFS securities backed by pools of commercial mortgages	148	134	14
Total	\$ 1,236	\$ 1,158	\$ 78
Subject to Detailed Analysis			
AFS securities backed by pools of residential mortgages	\$ 790	\$ 731	\$ 59
AFS securities backed by pools of commercial mortgages	26	25	1
Total	\$ 816	\$ 756	\$ 60

	As of December 31, 2013		
	Amortized Cost	Fair Value	Unrealized Loss
Total			
AFS securities backed by pools of residential mortgages	\$ 1,261	\$ 1,146	\$ 115
AFS securities backed by pools of commercial mortgages	193	169	24
Total	\$ 1,454	\$ 1,315	\$ 139
Subject to Detailed Analysis			
AFS securities backed by pools of residential mortgages	\$ 933	\$ 833	\$ 100
AFS securities backed by pools of commercial mortgages	29	24	5
Total	\$ 962	\$ 857	\$ 105

The fair value, gross unrealized losses, the portion of OTTI recognized in OCI (in millions) and number of AFS securities where the fair value had declined and remained below amortized cost by greater than 20% were as follows:

	As of September 30, 2014			
	Fair Value	Gross Unrealized Losses		Number of Securities (1)
		OTTI		
Less than six months	\$ 14	\$ -	\$ 7	3
Nine months or greater, but less than twelve months	1	-	-	3
Twelve months or greater	242	58	51	77
Total	\$ 257	\$ 58	\$ 58	83

	As of December 31, 2013			
	Fair Value	Gross Unrealized Losses		Number of Securities (1)
		OTTI		
Less than six months	\$ 1	\$ 1	\$ -	4
Six months or greater, but less than nine months	7	3	-	1
Nine months or greater, but less than twelve months	59	19	-	4
Twelve months or greater	349	92	81	92
Total	\$ 416	\$ 115	\$ 81	101

(1) We may reflect a security in more than one aging category based on various purchase dates.

We regularly review our investment holdings for OTTI. Our gross unrealized losses, including the portion of OTTI recognized in OCI, on AFS securities decreased by \$876 million for the nine months ended September 30, 2014. As discussed further below, we believe the unrealized loss position as of September 30, 2014, did not represent OTTI as (i) we did not intend to sell the fixed maturity AFS securities; (ii) it is not more likely than not that we will be required to sell the fixed maturity AFS securities before recovery of their amortized cost basis; (iii) the estimated future cash flows were equal to or greater than the amortized cost basis of the debt securities; and (iv) we had the ability and intent to hold the equity AFS securities for a period of time sufficient for recovery.

Based upon this evaluation as of September 30, 2014, management believes we have the ability to generate adequate amounts of cash from our normal operations (e.g., insurance premiums and fees and investment income) to meet cash requirements with a prudent margin of safety without requiring the sale of our temporarily-impaired securities.

As of September 30, 2014, the unrealized losses associated with our corporate bond securities were attributable primarily to securities that were backed by individual issuer companies. For individual issuers, we performed detailed analysis of the financial performance of the issuer and determined that we expected to recover the entire amortized cost for each security.

As of September 30, 2014, the unrealized losses associated with our MBS and commercial real estate (“CRE”) collateralized debt obligations (“CDOs”) were attributable primarily to collateral losses and credit spreads. We assessed our MBS and CRE CDOs for credit impairment using a cash flow model that incorporates key assumptions including default rates, severities and prepayment rates. We estimated losses for a security by forecasting the underlying loans in each transaction. The forecasted loan performance was used to project cash flows to the various tranches in the structure, as applicable. Our forecasted cash flows also considered, as applicable, independent industry analyst reports and forecasts, sector credit ratings and other independent market data. Based upon our assessment of the expected credit losses of the security given the performance of the underlying collateral compared to our subordination or other credit enhancement, we expected to recover the entire amortized cost basis of each temporarily-impaired security.

As of September 30, 2014, the unrealized losses associated with our hybrid and redeemable preferred securities were attributable primarily to wider credit spreads caused by illiquidity in the market and subordination within the capital structure, as well as credit risk of specific issuers. For our hybrid and redeemable preferred securities, we evaluated the financial performance of the issuer based upon credit performance and investment ratings and determined that we expected to recover the entire amortized cost of each security.

Changes in the amount of credit loss of OTTI recognized in net income (loss) where the portion related to other factors was recognized in OCI (in millions) on fixed maturity AFS securities were as follows:

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
Balance as of beginning-of-period	\$ 389	\$ 413	\$ 404	\$ 424
Increases attributable to:				

Credit losses on securities for which an OTTI was not previously recognized	1	6	2	26
Credit losses on securities for which an OTTI was previously recognized	4	16	12	37
Decreases attributable to:				
Securities sold	(17)	(16)	(41)	(68)
Balance as of end-of-period	\$ 377	\$ 419	\$ 377	\$ 419

During the nine months ended September 30, 2014 and 2013, we recorded credit losses on securities for which an OTTI was not previously recognized as we determined the cash flows expected to be collected would not be sufficient to recover the entire amortized cost basis of the debt security. The credit losses we recorded on securities for which an OTTI was not previously recognized were attributable primarily to one or a combination of the following reasons:

- Failure of the issuer of the security to make scheduled payments;
- Deterioration of creditworthiness of the issuer;
- Deterioration of conditions specifically related to the security;
- Deterioration of fundamentals of the industry in which the issuer operates; and
- Deterioration of the rating of the security by a rating agency.

We recognize the OTTI attributed to the noncredit portion as a separate component in OCI referred to as unrealized OTTI on AFS securities.

Details of the amount of credit loss of OTTI recognized in net income (loss) for which a portion related to other factors was recognized in OCI (in millions), were as follows:

	As of September 30, 2014				
	Gross Unrealized Losses			Fair	OTTI in Credit
	Amortized Cost	Gains	OTTI	Value	Losses
Corporate bonds	\$ 280	\$ 34	\$ 35	\$ 279	\$ 125
RMBS	472	27	10	489	187
CMBS	48	4	12	40	65
Total	\$ 800	\$ 65	\$ 57	\$ 808	\$ 377

	As of December 31, 2013				
	Gross Unrealized Losses			Fair	OTTI in Credit
	Amortized Cost	Gains	OTTI	Value	Losses
Corporate bonds	\$ 265	\$ 18	\$ 49	\$ 234	\$ 133
RMBS	550	18	18	550	184
CMBS	35	4	12	27	87
Total	\$ 850	\$ 40	\$ 79	\$ 811	\$ 404

Mortgage Loans on Real Estate

See Note 1 in our 2013 Form 10-K for information regarding our accounting policy relating to mortgage loans on real estate.

Mortgage loans on real estate principally involve commercial real estate. The commercial loans are geographically diversified throughout the U.S. with the largest concentrations in California and Texas, which accounted for 23% and 9%, respectively, of mortgage loans on real estate as of September 30, 2014, and December 31, 2013.

The following provides the current and past due composition of our mortgage loans on real estate (in millions):

	As of September 30, 2014	As of December 31, 2013
Current	\$ 7,457	\$ 7,200
60 to 90 days past due	-	4
Greater than 90 days past due	8	3
Valuation allowance associated with impaired mortgage loans on real estate	(3)	(3)
Unamortized premium (discount)	4	6
Total carrying value	\$ 7,466	\$ 7,210

The number of impaired mortgage loans on real estate, each of which had an associated specific valuation allowance, and the carrying value of impaired mortgage loans on real estate (dollars in millions) were as follows:

	As of September 30, 2014	As of December 31, 2013
Number of impaired mortgage loans on real estate	3	3
Principal balance of impaired mortgage loans on real estate	\$ 27	\$ 27
Valuation allowance associated with impaired mortgage loans on real estate	(3)	(3)
Carrying value of impaired mortgage loans on real estate	\$ 24	\$ 24

The changes in the valuation allowance associated with impaired mortgage loans on real estate (in millions) were as follows:

	As of September 30, 2014	As of December 31, 2013
Balance as of beginning-of-year	\$ 3	\$ 21
Additions	-	3
Charge-offs, net of recoveries	-	(21)
Balance as of end-of-period	\$ 3	\$ 3

The average carrying value on the impaired mortgage loans on real estate (in millions) was as follows:

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
	2014	2013	2014	2013
Average carrying value for impaired mortgage loans on real estate	\$ 24	\$ 31	\$ 24	\$ 37
Interest income recognized on impaired mortgage loans on real estate	-	-	1	1
Interest income collected on impaired mortgage loans on real estate	-	-	1	1

As described in Note 1 in our 2013 Form 10-K, we use the loan-to-value and debt-service coverage ratios as credit quality indicators for our mortgage loans, which were as follows (dollars in millions):

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	As of September 30, 2014			As of December 31, 2013		
	Carrying Value	% of Total	Debt-Service Coverage Ratio	Carrying Value	% of Total	Debt-Service Coverage Ratio
Less than 65%	\$ 6,480	86.8%	1.86	\$ 6,026	83.6%	1.78
65% to 74%	663	8.9%	1.54	744	10.3%	1.42
75% to 100%	292	3.9%	0.81	402	5.6%	0.83
Greater than 100%	31	0.4%	0.76	35	0.5%	0.78
Total mortgage loans on real estate	\$ 7,466	100.0%		\$ 7,207	100.0%	

Alternative Investments

As of September 30, 2014, and December 31, 2013, alternative investments included investments in 152 and 121 different partnerships, respectively, and the portfolio represented approximately 1% of our overall invested assets.

Realized Gain (Loss) Related to Certain Investments

The detail of the realized gain (loss) related to certain investments (in millions) was as follows:

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
Fixed maturity AFS securities:				
Gross gains	\$ 4	\$ 5	\$ 23	\$ 17
Gross losses	(6)	(28)	(18)	(73)
Equity AFS securities:				
Gross gains	2	1	5	7
Gross losses	-	(1)	-	(2)
Gain (loss) on other investments	-	(2)	3	(3)
Associated amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds	(7)	(8)	(24)	(19)
Total realized gain (loss) related to certain investments, pre-tax	\$ (7)	\$ (33)	\$ (11)	\$ (73)

Details underlying write-downs taken as a result of OTTI (in millions) that were recognized in net income (loss) and included in realized gain (loss) on AFS securities above, and the portion of OTTI recognized in OCI (in millions) were as follows:

	For the Three Months Ended September 30, 2014		For the Nine Months Ended September 30, 2013	
OTTI Recognized in Net Income (Loss)				
Fixed maturity securities:				
Corporate bonds	\$ (2)	\$ (11)	\$ (7)	\$ (21)

RMBS	(1)	(10)	(4)	(25)
CMBS	-	(1)	(1)	(15)
CRE CDOs	(2)	-	(2)	(1)
Total fixed maturity securities	(5)	(22)	(14)	(62)
Equity securities	-	(1)	-	(1)
Gross OTTI recognized in net income (loss)	(5)	(23)	(14)	(63)
Associated amortization of DAC, VOBA, DSI and DFEL	1	4	3	11
Net OTTI recognized in net income (loss), pre-tax	\$ (4)	\$ (19)	\$ (11)	\$ (52)

Portion of OTTI Recognized in OCI

Gross OTTI recognized in OCI	\$ 2	\$ 4	\$ 11	\$ 10
Change in DAC, VOBA, DSI and DFEL	-	(1)	(1)	(1)
Net portion of OTTI recognized in OCI, pre-tax	\$ 2	\$ 3	\$ 10	\$ 9

Determination of Credit Losses on Corporate Bonds and CDOs

As of September 30, 2014, and December 31, 2013, we reviewed our corporate bond and CDO portfolios for potential shortfall in contractual principal and interest based on numerous subjective and objective inputs. The factors used to determine the amount of credit loss for each individual security, include, but are not limited to, near term risk, substantial discrepancy between book and market value, sector or company-specific volatility, negative operating trends and trading levels wider than peers.

Credit ratings express opinions about the credit quality of a security. Securities rated investment grade, that is those rated BBB- or higher by Standard & Poor's ("S&P") Rating Services or Baa3 or higher by Moody's Investors Service ("Moody's"), are generally considered by the rating agencies and market participants to be low credit risk. As of September 30, 2014, and December 31, 2013, 95% and 96%, respectively, of the fair value of our corporate bond portfolio was rated investment grade. As of September 30, 2014, and December 31, 2013, the portion of our corporate bond portfolio rated below investment grade had an amortized cost of \$3.5 billion and \$3.0 billion,

respectively, and a fair value of \$3.5 billion and \$2.9 billion, respectively. As of September 30, 2014, and December 31, 2013, 96% and 94%, respectively, of the fair value of our CDO portfolio was rated investment grade. As of September 30, 2014, and December 31, 2013, the portion of our CDO portfolio rated below investment grade had an amortized cost of \$12 million and \$16 million, respectively, and fair value of \$12 million and \$13 million, respectively. Based upon the analysis discussed above, we believe as of September 30, 2014, and December 31, 2013, that we would recover the amortized cost of each fixed maturity security.

Determination of Credit Losses on MBS

As of September 30, 2014, and December 31, 2013, default rates were projected by considering underlying MBS loan performance and collateral type. Projected default rates on existing delinquencies vary between approximately 10% to 100% depending on loan type and severity of delinquency status. In addition, we estimate the potential contributions of currently performing loans that may become delinquent in the future based on the change in delinquencies and loan liquidations experienced in the recent history. Finally, we develop a default rate timing curve by aggregating the defaults for all loans in the pool (delinquent loans, foreclosure and real estate owned and new delinquencies from currently performing loans) and the associated loan-level loss severities.

We use certain available loan characteristics such as lien status, loan sizes and occupancy to estimate the loss severity of loans. Second lien loans are assigned 100% severity, if defaulted. For first lien loans, we assume a minimum of 30% severity with higher severity assumed for investor properties and further adjusted by housing price assumptions. With the default rate timing curve and loan-level severity, we derive the future expected credit losses.

Payables for Collateral on Investments

The carrying value of the payables for collateral on investments (in millions) included on our Consolidated Balance Sheets and the fair value of the related investments or collateral consisted of the following:

	As of September 30, 2014		As of December 31, 2013	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Collateral payable for derivative investments (1)	\$ 1,276	\$ 1,276	\$ 638	\$ 638
Securities pledged under securities lending agreements (2)	197	191	184	178
Securities pledged under repurchase agreements (3)	205	215	530	553
Securities pledged for Term Asset-Backed Securities				

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Loan Facility (“TALF”) (4)	-	-	36	49
Investments pledged for Federal Home Loan Bank of Indianapolis (“FHLBI”) (5)	2,175	3,535	1,850	3,127
Total payables for collateral on investments	\$ 3,853	\$ 5,217	\$ 3,238	\$ 4,545

(1)