

LINCOLN NATIONAL CORP
Form 10-K
February 29, 2008
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

FORM 10-K

(Mark One)

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 31, 2007

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)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

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)

Registrant's telephone number, including area code: **(484) 583-1400**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock	New York and Chicago
\$3.00 Cumulative Convertible Preferred Stock, Series A	New York and Chicago
6.75% Capital Securities	New York
6.75% Trust Preferred Securities, Series F ⁽¹⁾	New York

⁽¹⁾ Issued by Lincoln National Capital VI. Payments of distributions and payments on liquidation or redemption are guaranteed by Lincoln National Corporation.

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 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 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

The aggregate market value of the shares of the registrant's common stock held by non-affiliates (based upon the closing price of these shares on the New York Stock Exchange) as of the last business day of the registrant's most recently completed second fiscal quarter was \$19.2 billion.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

As of February 19, 2008, 264,567,819 shares of common stock of the registrant were outstanding.

Documents Incorporated by Reference:

Selected portions of the Proxy Statement for the Annual Meeting of Shareholders, scheduled for May 8, 2008 have been incorporated by reference into Part III of this Form 10-K.

Table of Contents**Lincoln National Corporation****Table of Contents**

Item	Page
<u>PART I</u>	
1. <u>Business</u>	1
<u>Overview</u>	1
<u>Business Segments and Other Operations</u>	3
<u>Individual Markets</u>	3
<u>Individual Markets - Annuities</u>	3
<u>Individual Markets - Life Insurance</u>	7
<u>Employer Markets</u>	10
<u>Employer Markets - Retirement Products</u>	11
<u>Employer Markets - Group Protection</u>	12
<u>Investment Management</u>	14
<u>Lincoln UK</u>	17
<u>Other Operations</u>	17
<u>Reinsurance</u>	18
<u>Reserves</u>	18
<u>Investments</u>	19
<u>Ratings</u>	19
<u>Regulatory</u>	21
<u>Employees</u>	24
<u>Available Information</u>	24
1A. <u>Risk Factors</u>	24
1B. <u>Unresolved Staff Comments</u>	31
2. <u>Properties</u>	31
3. <u>Legal Proceedings</u>	31
4. <u>Submission of Matters to a Vote of Security Holders</u>	31
<u>Executive Officers of the Registrant</u>	32
<u>PART II</u>	
5. <u>Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	34
6. <u>Selected Financial Data</u>	35
7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	36
<u>Forward-Looking Statements - Cautionary Language</u>	36
<u>Introduction</u>	37
<u>Executive Summary</u>	37
<u>Industry Trends</u>	39
<u>Recent Developments</u>	40
<u>Critical Accounting Policies and Estimates</u>	40
<u>Impact of Equity Market Sensitivity</u>	49
<u>Acquisition and Dispositions</u>	50
<u>Results of Consolidated Operations</u>	52
<u>Results of Individual Markets</u>	55
<u>Individual Markets - Annuities</u>	55
<u>Individual Markets - Life Insurance</u>	62

Table of Contents

Item	Page
<u>Results of Employer Markets</u>	69
<u>Employer Markets - Retirement Products</u>	69
<u>Employer Markets - Group Protection</u>	79
<u>Results of Investment Management</u>	82
<u>Results of Lincoln UK</u>	86
<u>Results of Other Operations</u>	91
<u>Consolidated Investments</u>	94
<u>Reinsurance</u>	114
<u>Review of Consolidated Financial Condition</u>	115
<u>Liquidity and Capital Resources</u>	115
<u>Other Matters</u>	122
<u>Other Factors Affecting Our Business</u>	122
<u>Recent Accounting Pronouncements</u>	122
<u>Acquisitions and Divestitures</u>	122
<u>Restructuring Activities</u>	122
7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	122
8. <u>Financial Statements and Supplementary Data</u>	130
9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	203
9A. <u>Controls and Procedures</u>	203
9B. <u>Other Information</u>	204
<u>PART III</u>	
10. <u>Directors, Executive Officers and Corporate Governance</u>	205
11. <u>Executive Compensation</u>	205
12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	205
13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	206
14. <u>Principal Accountant Fees and Services</u>	206
<u>PART IV</u>	
15. <u>Exhibits and Financial Statement Schedules</u>	207
<u>Signatures</u>	208
<u>Index to Financial Statement Schedules</u>	FS-1
<u>Index to Exhibits</u>	E-1

Table of Contents**PART I**

The Business section and other parts of this Form 10-K contain forward-looking statements that involve inherent risks and uncertainties. Statements that are not historical facts, including statements about our beliefs and expectations, and containing words such as believes, estimates, anticipates, expects or similar words are forward-looking statements. Our actual results may differ materially from the projected results discussed in the forward-looking statements. Factors that could cause such differences include, but are not limited to, those discussed in Item 1A. Risk Factors and in the Forward-Looking Statements Cautionary Language in Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A). Our consolidated financial statements and the accompanying notes to the consolidated financial statements (Notes) are presented in Item 8. Financial Statements and Supplementary Data.

Item 1. Business**OVERVIEW**

Lincoln National Corporation (LNC which also may be referred to as Lincoln, we, our or us) is a holding company, which operates multiple insurance and investment management businesses through subsidiary companies. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance, variable universal life insurance, term life insurance, mutual funds and managed accounts. LNC was organized under the laws of the state of Indiana in 1968. We currently maintain our principal executive offices in Radnor, Pennsylvania, which were previously located in Philadelphia, Pennsylvania. Lincoln Financial Group is the marketing name for LNC and its subsidiary companies. As of December 31, 2007, LNC had consolidated assets of \$191.4 billion and consolidated stockholders' equity of \$11.7 billion.

We provide products and services in four operating businesses and report results through six business segments, as follows:

- (1) Individual Markets, which includes the Annuities and Life Insurance segments,
- (2) Employer Markets, which includes the Retirement Products and Group Protection segments,
- (3) Investment Management, which is an operating business and segment, and
- (4) Lincoln UK, which is an operating business and segment.

We also have Other Operations, which includes the financial data for operations that are not directly related to the business segments, unallocated corporate items (such as investment income on investments related to the amount of statutory surplus in our insurance subsidiaries that is not allocated to our business units and other corporate investments, interest expense on short-term and long-term borrowings, and certain expenses, including restructuring and merger-related expenses) and the ongoing amortization of deferred gain on the indemnity reinsurance portion of the sale of our former reinsurance segment to Swiss Re Life & Health America Inc. (Swiss Re) in the fourth quarter of 2001.

In addition, as a result of our agreements dated as of November 12, 2007 to divest the television stations, sports programming and certain radio properties of our former Lincoln Financial Media segment, beginning in the fourth quarter of 2007, we are reporting the results of those businesses as discontinued operations in all periods presented, and the results of the remaining radio properties are included in Other Operations. These remaining businesses do not qualify as discontinued operations. For further information, see Acquisition and Dispositions below.

The results of Lincoln Financial Network (LFN) and Lincoln Financial Distributors (LFD), our retail and wholesale distributors, are included in the segments for which they distribute products. LFD distributes our individual products and services primarily through brokers, planners, agents and other intermediaries. As of December 31, 2007, LFD had approximately 650 internal and external wholesalers (including sales managers). The Employer Markets group distributes the employer products and services primarily through financial advisors, employee benefit brokers, third party administrators, and other employee benefit firms. As of December 31, 2007, LFN offered LNC and non-proprietary products and advisory services through a national network of approximately 7,300 active producers who placed business with us within the last twelve

months.

Financial information in the tables that follow is presented in conformity with accounting principles generally accepted in the United States of America (GAAP), unless otherwise indicated. As a result of our agreements to divest a portion of our media businesses in 2007, we changed the composition of our segments and restated the prior periods segment financial information to conform to the 2007 presentation. We provide revenues, income (loss) from operations and assets attributable to each of our business segments and Other Operations as well as revenues derived inside and outside the U.S. for the last three fiscal years in Note 20.

Table of Contents

Revenues by segment (in millions) were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Operating revenues:			
Individual Markets:			
Annuities	\$ 2,600	\$ 2,161	\$ 1,422
Life Insurance	3,921	3,256	1,911
Total Individual Markets	6,521	5,417	3,333
Employer Markets:			
Retirement Products	1,441	1,360	1,175
Group Protection	1,500	1,032	
Total Employer Markets	2,941	2,392	1,175
Investment Management	590	564	475
Lincoln UK	370	308	318
Other Operations	281	283	175
Realized loss	(118)	(3)	(3)
Amortization of deferred gain on indemnity reinsurance related to reserve developments	9	1	2
Total revenues	\$ 10,594	\$ 8,962	\$ 5,475

Acquisition and Dispositions

On November 12, 2007, Lincoln Financial Media Company (LFMC), our wholly owned subsidiary, entered into two stock purchase agreements with Raycom Holdings, LLC (Raycom). Pursuant to one of the agreements, LFMC has agreed to sell to Raycom all of the outstanding capital stock of three of LFMC 's wholly owned subsidiaries: (i) WBTV, Inc., the owner and operator of television station WBTV, Charlotte, North Carolina; (ii) WCSC, Inc., the owner and operator of television station WCSC, Charleston, South Carolina; and (iii) WWBT, Inc., the owner and operator of television station WWBT, Richmond, Virginia. Upon the closing of the transaction, LFMC expects to receive proceeds of \$548 million, subject to certain adjustments. We expect to close during the first quarter of 2008. Pursuant to the other agreement, LFMC agreed to sell to Raycom all of the outstanding capital stock of Lincoln Financial Sports, Inc., a wholly owned subsidiary of LFMC. This transaction closed on November 30, 2007 and LFMC received \$42 million of proceeds.

On November 12, 2007, LFMC also entered into a stock purchase agreement with Greater Media, Inc., to sell all of the outstanding capital stock of Lincoln Financial Media Company of North Carolina, the owner and operator of radio stations WBT(AM), Charlotte, North Carolina, WBT-FM, Chester, South Carolina and WLNK(FM), Charlotte, North Carolina. This transaction closed on January 31, 2008, and LFMC received proceeds of \$100 million. More information on these LFMC transactions can be found in our Form 8-K filed on November 14, 2007 and in Acquisition and Dispositions in the MD&A.

During the fourth quarter of 2007, we sold certain institutional taxable fixed income business to an unaffiliated investment management company. Investment Management transferred \$12.3 billion of assets under management as part of this transaction. Based upon the assets transferred as of October 31, 2007, the purchase price is expected to be no more than \$49 million. We expect this transaction to decrease income from operations, relative to 2007, by approximately \$3 million, after-tax, per quarter in 2008. During the fourth quarter we received \$25 million of the purchase price, with additional scheduled payments over the next three years. We recorded an after-tax realized loss of \$2 million on our Consolidated Statements of Income as a result of this transaction. There were certain other pipeline accounts in process at the time of the transaction closing, and any adjustment to the purchase price, if necessary, will be determined at October 31, 2008. Investment Management manages approximately \$94.0 billion of fixed income assets with a team of 100 fixed income investment professionals. The transaction did not impact the fixed income team that manages our fixed income mutual funds or general account assets.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

On April 3, 2006, we completed our merger with Jefferson-Pilot Corporation (Jefferson-Pilot), pursuant to which Jefferson-Pilot merged into one of our wholly owned subsidiaries. Jefferson-Pilot, through its subsidiaries, offered full lines of individual life, annuity and investment products, and group life insurance products, disability income and dental contracts, and it operated television and radio stations.

In September 2004, we completed the sale of our London-based international investment unit, Delaware International Advisors Ltd. (DIAL), to a newly-formed company associated with DIAL s management and a private-equity firm. At closing, we

Table of Contents

received \$181 million in cash and relief of certain obligations of approximately \$19 million. We had an after-tax gain from the transaction of \$46 million. DIAL, which has since been renamed Mondrian Investment Partners (Mondrian), continues to provide sub-advisory services with respect to certain international asset classes for our Investment Management segment and LNC.

For further information about acquisitions and divestitures, see Acquisition and Dispositions in the MD&A and Note 3.

Branding

Branding is a key element of our strategy. Our branding efforts are focused on three primary target audiences: financial intermediaries; affluent consumers (top 11% of the population); and plan sponsors. Through our branding efforts, we work to build name awareness and brand familiarity.

In 2007, we continued to build our brand on a national basis through an integrated package of consumer print and television, trade print and online advertising, sponsorships, marketing, public relations and promotional events. As a result, we believe that our awareness among our core target audiences continues to be strong.

We recognize that our brand embodies the experience our customers have with us. Steps were taken in 2007 to identify and closely link the various channels of brand including customer touchpoint areas, Marketing, Advertising, Public Affairs, Investor Relations, Government Relations, Community Relations, Corporate Communications and affiliated media companies. Major brand initiatives across these channels include a customer touchpoint audit, an internal brand campaign that targets customer-facing employees, and a media campaign. In addition, we launched a new brand advertising campaign and consumer facing website. All of these efforts are focused on the Retirement Income Security strategy.

BUSINESS SEGMENTS AND OTHER OPERATIONS

INDIVIDUAL MARKETS

Overview

The Individual Markets business provides its products through two segments: Annuities and Life Insurance. The Annuities segment provides tax-deferred growth and lifetime income opportunities for its clients by offering individual fixed annuities, including indexed annuities, and variable annuities. Its variable annuities are distributed by affiliated and unaffiliated broker-dealers. The Life Insurance segment offers wealth protection and transfer opportunities through both individual and survivorship versions of universal life and variable universal life, as well as term insurance and a linked-benefit product (which is a universal life insurance policy linked with riders that provide for long-term care costs).

During 2007, the Individual Markets business launched its Unified Product Portfolio (UPP), a wide array of life insurance and annuity products. The UPP combines and improves upon the product suites, system platforms and product development of LNC and Jefferson-Pilot into a more streamlined and rationalized range of products.

Individual Markets Annuities

Overview

The Annuities segment, with principal operations in Fort Wayne, Indiana, Hartford, Connecticut, and Greensboro, North Carolina, and additional operations in Concord, New Hampshire, provides tax-deferred growth and lifetime income opportunities for its clients by offering fixed and variable annuities. As a result of a broad product portfolio and a strong and diverse distribution network, we ranked 7th in assets and 5th in individual and group contract variable annuity flows for the year ended December 31, 2007 in the U.S., according to Morningstar Annuity Research Center.

The Annuities segment offers non-qualified and qualified fixed and variable annuities to individuals. The fixed and variable classification describes whether we or the contract holders bear the investment risk of the assets supporting the contract. This also determines the manner in which we earn investment margin profits from these products, either as investment spreads for fixed products or as asset-based fees charged to variable products.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Annuities are attractive because they provide tax-deferred growth in the underlying principal, thereby deferring the tax consequences of the growth in value until withdrawals are made from the accumulation values, often at lower tax rates occurring during retirement. In addition to favorable tax treatment, annuities are unique in that contract holders can select a variety of payout alternatives to help provide an income flow for life. The individual annuities market has seen an increase in competition along with new product types and promotion. The guarantee features (living and death benefits) offered within an annuity are not found in any other investment vehicle, and, we believe, make annuities attractive especially in times of economic uncertainty.

Table of Contents**Products**

In general, an annuity is a contract between an insurance company and an individual or group in which the insurance company, after receipt of one or more premium payments, agrees to pay an amount of money either in one lump sum or on a periodic basis (i.e., annually, semi-annually, quarterly or monthly), beginning on a certain date and continuing for a period of time as specified in the contract. Periodic payments can begin within twelve months after the premium is received (referred to as an immediate annuity) or at a future date in time (referred to as a deferred annuity). This retirement vehicle helps protect an individual from outliving his or her money and can be either a fixed annuity or a variable annuity.

The Annuities segment's deposits (in millions) were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Variable portion of variable annuity	\$ 9,135	\$ 7,251	\$ 5,539
Fixed portion of variable annuity	2,795	2,090	1,871
Total variable annuity	11,930	9,341	7,410
Fixed indexed annuity	755	717	
Other fixed annuity	772	698	118
Total deposits	\$ 13,457	\$ 10,756	\$ 7,528

Variable Annuities

A variable annuity provides the contract holder the ability to direct the investment of premium deposits into one or more sub-accounts offered through the product (variable portion) or into a fixed account with a guaranteed return (fixed portion). The value of the variable portion of the contract holder's account varies with the performance of the underlying sub-accounts chosen by the contract holder. The underlying assets of the sub-accounts are managed within a special insurance series of mutual funds. The contract holder's return is tied to the performance of the segregated assets underlying the variable annuity, (i.e. the contract holder bears the investment risk associated with these investments), except for the impact of guaranteed benefit features. The value of the fixed portion is guaranteed by us and recorded in our general account liabilities. Variable annuity account values were \$62.1 billion, \$51.8 billion and \$41.6 billion for the years ended December 31, 2007, 2006 and 2005, respectively, including the fixed portions of variable accounts of \$3.5 billion, \$3.6 billion and \$3.9 billion, for the years ended December 31, 2007, 2006 and 2005, respectively.

We charge mortality and expense assessments and administrative fees on variable annuity accounts to cover insurance and administrative expenses. These assessments are built into accumulation unit values, which when multiplied by the number of units owned for any sub-account equals the contract holder's account value for that sub-account. The fees that we earn from these contracts are reported as insurance fees on the income statement. In addition, for some contracts, we collect surrender charges that range from 0% to 10% of withdrawals when contract holders surrender their contracts during the surrender charge period, which is generally higher during the early years of a contract. Our individual variable annuity products have a maximum surrender charge period of ten years.

We offer A-share, B-share, C-share, L-share and bonus variable annuities, although not with every annuity product. The differences in these relate to the sales charge and fee structure associated with the contract.

An A-share has a front-end sales charge and no back-end contingent deferred sales charge, also known as a surrender charge. The net premium (premium less front-end charge) is invested in the contract, resulting in full liquidity and lower mortality and expense assessments over the long term than those in other share classes.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

A B-share has a seven-year surrender charge that is only paid if the account is surrendered or withdrawals are in excess of contractual free withdrawals within the contract's specified surrender charge period. The entire premium is invested in the contract, but it offers limited liquidity during the surrender charge period.

A C-share has no front-end sales charge or back-end surrender charge. Accordingly, it offers maximum liquidity but mortality and expense assessments are higher than those for A-share or B-share. It offers a persistency credit in year eight to revert pricing to B-share levels.

An L-share has a four to five year surrender charge that is only paid if the account is surrendered or withdrawals are in excess of contractual free withdrawals within the contract's specified surrender charge period. The differences between the L-share and the B-share are the length of the surrender charge period and the fee structure. L-shares have a shorter surrender charge period, so for the added liquidity, mortality and expense assessments are higher. We offer L-share annuity products with persistency credits beginning in years five or eight to revert pricing back to B-share levels.

Table of Contents

A bonus annuity is a variable annuity contract that offers a bonus credit to a contract based on a specified percentage (typically ranging from 2% to 5%) of each deposit. The entire premium plus the bonus are invested in the sub-accounts supporting the contract. It has a seven to nine-year surrender charge. The expenses are slightly more than those for a B-share. We also offer bonus annuity products with persistency credits beginning in years eight or fifteen to revert bonus pricing back to B-share pricing levels.

Certain of our variable annuity products offer guaranteed benefit features, such as a guaranteed minimum death benefit (GMDB), a guaranteed minimum withdrawal benefit (GMWB), a guaranteed income benefit (GIB) and a combination of such benefits. Most of our variable annuity products also offer the choice of a fixed option that provides for guaranteed interest credited to the account value.

Approximately 91%, 91% and 90% of variable annuity separate account values had a GMDB feature as of December 31, 2007, 2006 and 2005, respectively. The GMDB features include those where we contractually guarantee to the contract holder that upon death, we will return no less than: (a) the total deposits made to the contract adjusted to reflect any partial withdrawals; (b) the highest contract value on a specified anniversary date adjusted to reflect any partial withdrawals following the contract anniversary; or (c) the current contract value plus an additional amount, either 40% or 25% of contract gains, to help offset the impact of taxes.

The *Lincoln SmartSecurity*[®] Advantage benefit is a GMWB feature that offers the contract holder a guarantee equal to the initial deposit (or contract value, if elected after issue), adjusted for any subsequent purchase payments or withdrawals. There are two elective step-up options: a one-year option and a five-year option. In general, the one-year option allows an owner to step up the guarantee amount automatically on the benefit anniversary to the current contract value, and the five-year option allows the owner to step up the guarantee amount to the current contract value on or after the fifth anniversary of the election or of the most recent step up. In each case, the contract value must be greater than the guarantee amount at the time of step up. To receive the full amount of the guarantee, annual withdrawals are limited to either 5% of the guaranteed amount for the one-year option or 7% of the guaranteed amount for the five-year option. Under the one-year option, withdrawals will continue for the rest of the owner's life (single life version) or the life of the owner or owner's spouse (joint life version) as long as withdrawals begin after attained age 65 and are limited to 5% of the guaranteed amount. Withdrawals in excess of the applicable maximum in any contract year are assessed any applicable surrender charges, and the guaranteed amount is recalculated. Approximately 31%, 26% and 21% of variable annuity account values as of December 31, 2007, 2006 and 2005, respectively, had a GMWB feature.

We offer other product riders including *i4LIFE*[®] Advantage and 4LATER[®]. The *i4LIFE*[®] feature, on which we have received a U.S. patent, allows variable annuity contract holders access and control during the income distribution phase of their contract. This added flexibility allows the contract holder to access the account value for transfers, additional withdrawals, and other service features like portfolio rebalancing. In general, GIB is an optional feature available with *i4LIFE*[®] Advantage that guarantees regular income payments will not fall below 75% of the highest income payment on a specified anniversary date (reduced for any subsequent withdrawals). Approximately 88%, 83% and 72% of *i4LIFE*[®] Advantage account values elected the GIB feature as of December 31, 2007, 2006 and 2005, respectively. Approximately 9%, 6% and 4% of variable annuity account values as of December 31, 2007, 2006 and 2005, respectively, have elected an *i4LIFE*[®] feature. 4LATER[®] provides a minimum income base used to determine the GIB floor when a client begins income payments under *i4LIFE*[®]. The income base is equal to the initial deposit (or contract value, if elected after issue) and increases by 15% every three years (subject to a 200% cap). The owner may step up the income base on or after the third anniversary of rider election or of the most recent step-up (which also resets the 200% cap).

To mitigate the increased risks associated with guaranteed benefits, we developed a dynamic hedging program. The customized dynamic hedging program uses equity and interest rate futures positions, interest rate and variance swaps, as well as equity-based options depending upon the risks underlying the guarantees. Our program is designed to offset both positive and negative changes in the carrying value of the guarantees. However, while we actively manage these hedge positions, the hedge positions may not be effective to exactly offset the changes in the carrying value of the guarantees due to, among other things, the time lag between changes in their values and corresponding changes in the hedge positions, high levels of volatility in the equity markets, contract holder behavior, and divergence between the performance of the underlying funds and hedging indices. For more information on our hedging program, see *Critical Accounting Policies and Estimates Derivatives* of the MD&A. For information regarding risks related to guaranteed benefits, see *Item 1A. Risk Factors*.

Fixed Annuities

A fixed annuity preserves the principal value of the contract while guaranteeing a minimum interest rate to be credited to the accumulation value. We offer single and flexible premium fixed deferred annuities to the individual annuities market. Single premium fixed deferred annuities are contracts that allow only a single premium to be paid. Flexible premium fixed deferred annuities are contracts that allow multiple premium payments on either a scheduled or non-scheduled basis. Our fixed annuities include both traditional fixed-rate and fixed indexed annuities. With fixed deferred annuities, the contract holder has the right to surrender the contract and receive the current accumulation value less any applicable surrender charge and, if applicable, a market value adjustment (MVA).

Table of Contents

Fixed indexed annuities allow the contract holder to elect an interest rate linked to the performance of the S&P 500 Index[®]. The indexed interest rate is guaranteed never to be less than zero. Our fixed indexed annuities provide contract holders a choice of a traditional fixed-rate account and one or more different indexed accounts. A contract holder may elect to change allocations at renewal dates, either annually or biannually. At each renewal date, we have the opportunity to re-price the indexed component (i.e. reset the caps, spreads or participation rates), subject to guarantees.

Fixed annuity contracts are general account obligations. We bear the investment risk for fixed annuity contracts. To protect from premature withdrawals, we impose surrender charges. Surrender charges are typically applicable during the early years of the annuity contract, with a declining level of surrender charges over time. We expect to earn a spread between what we earn on the underlying general account investments supporting the fixed annuity product line and what we credit to our fixed annuity contract holders' accounts. In addition, with respect to fixed indexed annuities, we purchase options that are highly correlated to the indexed account allocation decisions of our contract holders, such that we are closely hedged with respect to indexed interest for the current reset period. For more information on our hedging program for fixed indexed annuities, see "Critical Accounting Policies" of the MD&A.

Individual fixed annuity account values were \$14.4 billion, \$14.9 billion and \$6.9 billion as of December 31, 2007, 2006 and 2005, respectively. Approximately \$10.5 billion of individual fixed annuity account values as of December 31, 2007 were still within the surrender charge period. However, certain fixed annuities allow window periods during which contract holders can withdraw their funds without incurring a surrender charge. For example, our *StepFive*[®] Fixed Annuity has a sixty-day window period following each five-year fixed guarantee period. Crediting rates for each subsequent five-year fixed guarantee period are set at the beginning of the window period. During the window period, account holders can withdraw their funds without incurring a surrender charge. Account values for this type of product were \$4.2 billion, \$3.6 billion and \$2.8 billion as of December 31, 2007, 2006 and 2005, respectively, with approximately \$736 million of account values entering the window period during 2008.

Our fixed annuity product offerings as of December 31, 2007 consisted of traditional fixed-rate and fixed indexed deferred annuities. We also offer fixed-rate immediate annuities with various payment options, including lifetime incomes. In addition to traditional fixed-rate immediate annuities, we introduced in 2007 *Lincoln SmartIncome*SM Inflation Annuity. This product provides lifetime income with annual adjustments to keep pace with inflation. It uses a patent-pending design to preserve access to remaining principal, also adjusted annually for inflation, for premature death or unexpected needs. The traditional fixed-rate deferred annuity products include the *Lincoln Classic*SM (Single and Flexible Premium), *Lincoln Select*SM and *Lincoln ChoicePlus*SM Fixed annuities. The fixed indexed deferred annuity products include the *Lincoln OptiPoint*[®], *Lincoln OptiChoice*[®], *Lincoln New Directions*[®], and *Lincoln Future Point*[®] annuities. The fixed indexed annuities offer one or more of the following indexed accounts:

The Performance Triggered Indexed Account pays a specified rate, declared at the beginning of the indexed term, if the S&P 500 Index[®] value at the end of the indexed term is the same or greater than the S&P 500 Index[®] value at the beginning of the indexed term.

The Point to Point Indexed Account compares the value of the S&P 500 Index[®] at the end of the indexed term to the S&P 500 Index[®] value at the beginning of the term. If the S&P 500 Index[®] at the end of the indexed term is higher than the S&P 500 Index[®] value at the beginning of the term, then the percentage change, up to the declared indexed interest cap, is credited to the indexed account.

The Monthly Cap Indexed Account reflects the monthly changes in the S&P 500 Index[®] value over the course of the indexed term. Each month, the percentage change in the S&P 500 Index[®] value is calculated, subject to a monthly indexed cap that is declared at the beginning of the indexed term. At the end of the indexed term, all of the monthly change percentages are summed to determine the rate of indexed interest that will be credited to the account.

The Monthly Average Indexed Account compares the average monthly value of the S&P 500 Index[®] to the S&P 500 Index[®] value at the beginning of the term. The average of the S&P 500 Index[®] values at the end of each of the twelve months in the indexed term is calculated. The percentage change of the average S&P 500 Index[®] value to the starting S&P 500 Index[®] value is calculated. From that amount, the indexed interest spread, which is declared at the beginning of the indexed term, is subtracted. The resulting rate is used to calculate the indexed interest that will be credited to the account.

If the S&P 500 Index[®] values produce a negative indexed interest rate, no indexed interest is credited to the indexed account.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

We introduced the *Lincoln Living Income*SM Advantage in 2007. Available with certain of our fixed indexed annuities, it provides the contract holder a guaranteed minimum lifetime withdrawal benefit. Withdrawals in excess of the guaranteed amount are assessed any applicable surrender charges, and the guaranteed withdrawal amount is recalculated.

Many of our fixed annuities have an MVA. If a contract with an MVA is surrendered during the surrender charge period, both a surrender charge and an MVA may be applied. The MVA feature increases or decreases the contract value of the annuity based on a decrease or increase in interest rates. Individual fixed annuities with an MVA feature constituted 29%, 24% and 11% of total fixed annuity account values as of December 31, 2007, 2006 and 2005, respectively.

Table of Contents

Distribution

The Annuities segment distributes all its individual fixed and variable annuity products through LFD, our wholesaling distribution organization. LFD's distribution channels give the Annuities segment access to its target markets. LFD distributes the segment's products to a large number of financial intermediaries, including LFN. The financial intermediaries include wire/regional firms, independent financial planners, financial institutions and managing general agents.

Competition

The annuities market is very competitive and consists of many companies, with no one company dominating the market for all products. The Annuities segment competes with numerous other financial services companies. The main factors upon which entities in this market compete are distribution channel access and the quality of wholesalers, investment performance, cost, product features, speed to market, brand recognition, financial strength ratings, crediting rates and client service.

We believe that the Annuities segment's high service levels help it to compete in the annuities market. We track the time to answer calls to the center as well as the average response time to customer queries. Further, the segment tracks the turnaround time for various customer services such as processing of applications.

The Annuities segment attempts to design products that meet the needs of clients in its markets. The speed in which the segment's products reach the market is, from concept of the product to launch, six to nine months. Over the last five years, the segment has announced several new products and product features to the market in response to the evolving nature of the annuities market.

Individual Markets – Life Insurance

Overview

The Life Insurance segment, with principal operations in Greensboro, North Carolina, and Hartford, Connecticut and additional operations in Concord, New Hampshire and Fort Wayne, Indiana, focuses on the creation and protection of wealth for its clients through the manufacturing of life insurance products. The Life Insurance segment offers wealth protection and transfer opportunities through term insurance, a linked-benefit product (which is a universal life insurance policy linked with riders that provide for long-term care costs) and both single and survivorship versions of universal life (UL) and variable universal life (VUL).

The Life Insurance segment primarily targets the affluent to high net worth markets, defined as households with at least \$250,000 of financial assets. For those individual policies we sold in 2007, the average face amount (excluding term and *MoneyGuard*[®]) was \$1 million and average first year premiums paid were approximately \$58,000.

Products

The Life Insurance segment sells primarily interest/market-sensitive products (UL and VUL) and term products. The segment's sales (in millions) were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Universal Life:			
Excluding <i>MoneyGuard</i> [®]	\$ 597	\$ 436	\$ 192
<i>MoneyGuard</i> [®]	40	31	34
Total Universal Life	637	467	226
Variable Universal Life	77	61	42
Term/Whole Life	32	43	36
Total sales	\$ 746	\$ 571	\$ 304

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

UL and VUL sales represent target premium plus 5% of excess premium (including adjustments for internal replacements at 50%); whole life and term sales throughout the presentation represent 100% of first year paid premium; and linked-benefit sales represent 15% of premium deposits.

Table of Contents

Due to some seasonality, we generally have higher sales in the second half of the year than in the first half of the year. Approximately 41% and 46% of total sales were in the first half of 2006 and 2005, with the remainder occurring in the second half of the year for the same periods. However in 2007, approximately 51% of total sales were in the first half of 2007 due to the transition of our product portfolio to the new UPP.

In addition, the following table shows life policies' face amount in force (in millions):

	As of December 31,		
	2007	2006	2005
Universal Life and other	\$ 284,305	\$ 267,228	\$ 128,792
Term Insurance	235,919	234,148	187,849
Total in-force face amount	\$ 520,224	\$ 501,376	\$ 316,641

Mortality margins, morbidity margins (for linked-benefit products), investment margins (through spreads or fees), net expense charges (expense charges assessed to the contract holder less expenses incurred to manage the business) and surrender fees drive life insurance profits. Mortality margins represent the difference between amounts charged to the customer to cover the mortality risk and the actual cost of reinsurance and death benefits paid. Mortality charges are either specifically deducted from the contract holder's policy account value (i.e. cost of insurance assessments or COI's) or are embedded in the premiums charged to the customer. In either case, these amounts are a function of the rates priced into the product and level of insurance in-force (less reserves previously set aside to fund benefits). Insurance in-force, in turn, is driven by sales, persistency, and mortality experience.

Similar to the annuity product classifications described above, life products can be classified as fixed or variable contracts. This classification describes whether we or the policy holders bear the investment risk of the assets supporting the policy. This also determines the manner in which we earn investment margin profits from these products, either as investment spreads for fixed products or as asset-based fees charged to variable products.

We offer four categories of life insurance products consisting of:

Interest-sensitive Life Insurance (primarily UL)

Interest-sensitive life insurance products provide life insurance with account (cash) values that earn rates of return based on company-declared interest rates. Contract holder account values are invested in our general account investment portfolio, so we bear the risk of investment performance. Some of our UL contracts include secondary guarantees, which are explained more fully later in the document.

In a UL contract, contract holders have flexibility in the timing and amount of premium payments and the amount of death benefit, provided there is sufficient account value to cover all policy charges for mortality and expenses for the coming period. Under certain contract holder options and market conditions, the death benefit amount may increase or decrease. Premiums received on a UL product, net of expense loads and charges, are added to the contract holder's account value. The client has access to their account value (or a portion thereof) through contractual liquidity features such as loans, partial withdrawals, and full surrenders. Loans and withdrawals reduce the death benefit amount payable and are limited to certain contractual maximums (some of which are required under state law), and interest is charged on all loans. Our UL contracts assess surrender charges against the policies' account values for full or partial face amount surrenders that occur during the contractual surrender charge period. Depending on the product selected, surrender charge periods can range from 0 to 20 years.

During 2007, we enhanced our fixed UL product offerings by introducing a fixed indexed universal life product. A fixed indexed UL product functions similarly to a traditional UL policy, with the added flexibility of allowing contract holders to have portions of their account value earn interest credits linked to the performance of the S&P 500 Index[®]. The indexed interest rate is guaranteed never to be less than 1%. Our fixed indexed UL policy provides contract holders a choice of a traditional fixed rate account and several different indexed accounts. A contract holder may elect to change allocations annually for amounts in the indexed accounts and quarterly for new premiums into the policy. Prior to each new allocation we have the opportunity to re-price the indexed components, subject to minimum guarantees.

We manage investment margins (i.e. the difference between the amount the portfolio earns compared to the amount that is credited to the customer) by seeking to maximize current yields, in line with asset/liability and risk management targets, while crediting a competitive rate to the customer. Crediting rates are typically subject to guaranteed minimums specified in the underlying life insurance contract. Interest-sensitive life account values (including *MoneyGuard*[®] and the fixed portion of VUL) were \$23.2 billion, \$21.9 billion and \$11.8 billion as of

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

December 31, 2007, 2006 and 2005, respectively.

Table of Contents

Linked-Benefit Life Products

Linked-benefit products combine universal life insurance with long-term care insurance through the use of riders. The first rider allows the contract holder to accelerate death benefits on a tax-free basis in the event of a qualified long-term care need. The second rider extends the long-term care insurance benefits for an additional period of time if the death benefit is fully depleted for the purposes of long-term care. If the long-term care benefits are never used, the policy provides a tax-free death benefit to the contract holder's heirs. Linked-benefit products generate earnings through investment, mortality and morbidity margins. Our linked-benefit product is called *MoneyGuard*[®].

VUL

VUL products are UL products that provide a return on account values linked to an underlying investment portfolio of sub-accounts offered through the product. The value of the contract holder's account varies with the performance of the sub-accounts chosen by the contract holder. The underlying assets of the sub-accounts are managed within a special insurance series of mutual funds. Premiums, net of expense loads and charges for mortality and expenses, received on VUL products are invested according to the contract holder's investment option selection. As the return on the investment portfolio increases or decreases, the account value of the variable universal life policy will increase or decrease. As with fixed UL products, contract holders have access, within contractual maximums, to account values through loans, withdrawals and surrenders. Surrender charges are assessed during the surrender charge period, ranging from 0 to 20 years depending on the product. The investment choices we offer in VUL products are the same, in most cases, as the investment choices offered in our individual variable annuity contracts.

In addition, VUL products offer a fixed account option that is managed by us. Investment risk is borne by the customer on all but the fixed account option. We charge fees for mortality costs and administrative expenses as well as asset-based investment management fees. VUL account values (excluding the fixed portion of VUL) were \$5.0 billion, \$4.6 billion and \$2.2 billion as of December 31, 2007, 2006 and 2005, respectively.

As mentioned previously, we offer survivorship versions of our individual UL and VUL products. These products insure two lives with a single policy and pay death benefits upon the second death.

Sales results continue to be heavily influenced by the series of universal life products with secondary guarantees. A UL policy with a secondary guarantee can stay in force, even if the base policy account value is zero, as long as secondary guarantee requirements have been met. The secondary guarantee requirement is based on the evaluation of a reference value within the policy, calculated in a manner similar to the base policy account value, but using different assumptions as to expense charges, COI charges and credited interest. The assumptions for the secondary guarantee requirement are listed in the contract. As long as the contract holder funds the policy to a level that keeps this calculated reference value positive, the death benefit will be guaranteed. The reference value has no actual monetary value to the contract holder; it is only a calculated value used to determine whether or not the policy will lapse should the base policy account value be less than zero.

Unlike other guaranteed death benefit designs, our secondary guarantee benefits maintain the flexibility of a traditional UL policy, which allows a contract holder to take loans or withdrawals. Although loans and withdrawals are likely to shorten the time period of the guaranteed death benefit, the guarantee is not automatically or completely forfeited, as is sometimes the case with other death benefit guarantee designs. The length of the guarantee may be increased at any time through additional excess premium deposits. Secondary guarantee UL face amount in-force was \$83.9 billion, \$65.5 billion and \$30.9 billion as of December 31, 2007, 2006 and 2005, respectively. For information on the reserving requirements for this business, see *Regulatory* below and *Review of Consolidated Financial Condition* in the MD&A.

During 2007, we expanded and enhanced our variable products by introducing a survivorship version of and enhancing our single life version of our secondary guarantee VUL products. These products combine the lapse protection elements of universal life with the upside potential of a traditional variable universal life product, giving clients the flexibility to choose the appropriate balance between protection and market risk that meets their individual needs. The combined single life and survivorship face amount in-force of these products was \$4.0 billion, \$2.9 billion and \$1.8 billion as of December 31, 2007, 2006 and 2005, respectively.

Term Life Insurance

Term life insurance provides a fixed death benefit for a scheduled period of time. It usually does not offer cash values. Scheduled policy premiums are required to be paid at least annually. Products offering a Return of Premium benefit payable at the end of a specified period are also available.

Table of Contents

Distribution

The Life Insurance segment's products are sold through LFD. LFD provides the Life Insurance segment with access to financial intermediaries in the following primary distribution channels: wire/regional firms, independent planner firms (including LFN), financial institutions and managing general agents/independent marketing organizations.

Competition

The life insurance industry is very competitive and consists of many companies with no one company dominating the market for all products. As of the end of 2006, the latest year for which data is available, there were 1,072 life insurance companies in the U.S., according to the American Council of Life Insurers.

The Life Insurance segment designs products specifically for the high-net-worth and affluent markets. In addition to the growth opportunity offered by its target market, our product breadth, design innovation, competitiveness, speed to market, customer service, underwriting and risk management and extensive distribution network all contribute to the strength of the Life Insurance segment. On average, the development of products takes approximately six months. The Life Insurance segment implemented several major product upgrades and/or new features, including important UL, VUL, linked-benefit and term product enhancements in 2007. With respect to customer service, management tracks the speed, accuracy and responsiveness of service to customers' calls and transaction requests. Further, the Life Insurance segment tracks the turnaround time and quality for various client services such as processing of applications.

Underwriting

In the context of life insurance, underwriting is the process of evaluating medical and non-medical information about an individual and determining the effect these factors statistically have on life expectancy or mortality. This process of evaluation is often referred to as risk classification. Of course, no one can accurately predict how long any individual will live, but certain risk factors can affect life expectancy and are evaluated during the underwriting process.

Claims Administration

Claims services are delivered to customers from the Greensboro, North Carolina and Concord, New Hampshire home offices. Claims examiners are assigned to each claim notification based on coverage amount, type of claim and the experience of the examiner. Claims meeting certain criteria are referred to senior claim examiners. A formal quality assurance program is carried out to ensure the consistency and effectiveness of claims examining activities. A network of in-house legal counsel, compliance officers, medical personnel and an anti-fraud investigative unit also support claim examiners. A special team of claims examiners, in conjunction with claims management, focus on more complex claims matters such as long-term care claims, claims incurred during the contestable period, beneficiary disputes, litigated claims and the few invalid claims that are encountered.

The Life Insurance segment maintains a centralized claim service center in order to minimize the volume of clerical and repetitive administrative demands on its claims examiners while providing convenient service to policy owners and beneficiaries.

EMPLOYER MARKETS

Overview

Lincoln Employer Markets offers and distributes a broad breadth of products focused on retirement income security through its Defined Contribution, Executive Benefits and Group Protection businesses. Lincoln Employer Markets was formed in 2006 to deliver retirement income security products and services that are focused on the needs of employers and their employees.

Although formed in 2006, Lincoln Employer Markets is well-established in the employer marketplace. As of December 31, 2007, Lincoln Employer Markets served approximately 60,000 plan sponsors and approximately 6 million plan participants.

The Employer Markets business provides its products through two key segments: Retirement Products and Group Protection. The Retirement Products segment includes two major lines of business:

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The Defined Contribution business provides employer-sponsored fixed and variable annuities, mutual fund-based programs in the 401(k), 403(b) and 457 plan marketplaces through a wide range of intermediaries including advisors, consultants, brokers, banks, wirehouses, third-party administrators (TPAs) and individual planners.

Table of Contents

The Executive Benefits business offers corporate-owned universal and variable universal life insurance (COLI) and bank-owned universal and variable universal life insurance (BOLI) to small to mid-sized banks and mid to large-sized corporations, mostly through executive benefit brokers.

The Group Protection segment focuses on offering group term life, disability income and dental insurance primarily in the small to mid-sized employer marketplace for their eligible employees.

Employer Markets Retirement Products

The Defined Contribution business is the largest business in this segment and focuses on 403(b) plans and 401(k) plans. Lincoln has a strong historical presence in the 403(b) space where assets account for about 61% of total assets under management in this segment as of December 31, 2007. The 401(k) business accounts for 51% of our new deposits as of December 31, 2007. The Retirement Products segment's deposits (in millions) were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Variable portion of variable annuity	\$ 2,355	\$ 2,525	\$ 2,254
Fixed portion of variable annuity	351	441	520
Total variable annuity	2,706	2,966	2,774
Fixed annuity	754	506	563
Alliance Mutual Fund	2,090	1,113	1,066
Total annuity and Alliance	5,550	4,585	4,403
COLI and BOLI	303	267	210
Total deposits	\$ 5,853	\$ 4,852	\$ 4,613

Retirement Products Defined Contribution**Products**

Employer Markets currently offers four primary products to the employer-sponsored market: *Lincoln American Legacy Retirement*SM, LINCOLN DIRECTORSM, LINCOLN ALLIANCE[®] and Multi-Fund[®]. *Lincoln American Legacy Retirement*SM, LINCOLN DIRECTORSM and Multi-Fund[®] products are group variable annuities. LINCOLN ALLIANCE[®] is a mutual fund-based product. These products cover both the 403(b) and 401(k) marketplace. Both 403(b) and 401(k) plans are tax-deferred, defined contribution plans offered to employees of an entity to enable them to save for retirement. The 403(b) plans are available to employees of educational institutions and certain non-profit entities, while 401(k) plans are generally available to employees of for-profit entities. The investment options for our annuities encompass the spectrum of asset classes with varying levels of risk and include both equity and fixed income. As of December 31, 2007, healthcare clients accounted for 43% of account values for these products.

The *Lincoln American Legacy Retirement*SM variable annuity, launched in the third quarter of 2006, offers 51 investment options with 10 fund families, 20 of which are American Funds[®] options. This product is focused on the micro to small corporate 401(k) market. LALR account values were \$49 million as of December 31, 2007.

LINCOLN DIRECTORSM is a defined contribution retirement plan solution available to businesses of all sizes, but focused on micro- to small-sized corporations, generally with five to 200 lives. Funded through a Lincoln National Life Insurance Company (LNL) group variable annuity contract, LINCOLN DIRECTORSM offers participants 60 investment options from 15 fund families. In New York, Lincoln Life & Annuity Company of New York (LLANY) underwrites the annuity contracts, and these contracts offer 57 investment options from 16 fund families. LINCOLN DIRECTORSM has the option of being serviced through a third-party administrator or fully serviced by Lincoln. The Employer Markets Defined Contribution segment earns advisory fees, investment income, surrender charges and recordkeeping fees from this product. Account values for LINCOLN DIRECTORSM were \$7.7 billion, \$7.5 billion and \$6.5 billion as of December 31, 2007, 2006 and 2005, respectively. Deposits for LINCOLN DIRECTORSM were \$1.5 billion, \$1.7 billion and \$1.6 billion as of December 31, 2007, 2006 and 2005, respectively.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The *LINCOLN ALLIANCE*[®] program, with an open architecture platform, bundles our traditional fixed annuity products with the employer's choice of retail mutual funds, along with recordkeeping and customized employee education components. We earn fees for the services we provide to mutual fund accounts and investment margins on fixed annuities of *LINCOLN ALLIANCE*[®] program accounts. The retail mutual funds associated with this program are not included in the separate accounts reported on our Consolidated Balance Sheets. This program is customized for each employer. The target market is primarily education and

Table of Contents

healthcare. *LINCOLN ALLIANCE*[®] program account values were \$9.5 billion, \$7.0 billion and \$5.3 billion as of December 31, 2007, 2006 and 2005, respectively. *Multi-Fund*[®] Variable Annuity is a defined contribution retirement plan solution with full-bundled administrative services, experienced retirement consultants and high quality investment choices marketed to small- to mid-sized healthcare, education, governmental and not-for-profit plans. The product can be sold either to the employer through the *Multi-Fund*[®] Group Variable Annuity contract, or directly to the individual through the *Multi-Fund*[®] Select Variable Annuity contract. Funded through an LNL variable annuity contract, *Multi-Fund*[®] Variable Annuity offers participants 42 investment options from 9 fund families across a variety of asset classes. Included in the product offering is Lincoln Financial's LIFESPAN[®] learning program, which provides participants with educational materials and one-on-one guidance for retirement planning assistance. We earn advisory fees, investment income, surrender charges and recordkeeping and administrative fees from this product. The *Multi-Fund*[®] Variable Annuity is currently not available in New York. Account values for the *Multi-Fund*[®] Variable Annuity were \$13.3 billion, \$13.5 billion and \$12.9 billion as of December 31, 2007, 2006 and 2005, respectively. *Multi-Fund*[®] program deposits represented 17%, 20% and 22% of the segment's deposits in 2007, 2006 and 2005, respectively.

Retirement Products - Executive Benefits

Products

Through the Executive Benefits business, we offer COLI and BOLI products. COLI and BOLI are typically purchased by corporations and banks on the lives of their employees, with the corporation or bank or a trust sponsored by the corporation or bank named as a beneficiary under the policy, for the purpose of funding various employee benefit plans, including non-qualified deferred compensation plans.

We offer a portfolio of both fixed UL and VUL COLI products sold primarily through specialty brokers. COLI and BOLI account values were \$4.4 billion, \$4.3 billion and \$1.3 billion as of December 31, 2007, 2006 and 2005, respectively.

This segment also includes a closed-block of pension business in the form of group annuity and insured funding-type of contracts with assets under management of approximately \$2.1 billion as of December 31, 2007. This block is currently in run-off.

Distribution

Defined Contribution has its own distribution force consisting of 80 internal and external wholesalers (including sales managers). The wholesalers distribute the Defined Contribution products through advisors, consultants, banks, wirehouses, TPAs and individual planners. *Multi-Fund*[®] is sold primarily through advisors to 403(b) plans in the healthcare and education markets. The *LINCOLN ALLIANCE*[®] program is sold primarily through consultants and advisors to 403(b) and 401(k) plans in the mid to large healthcare and corporate markets. *Lincoln American Legacy Retirement*SM and *LINCOLN DIRECTOR*SM are sold primarily through banks, wirehouses, TPAs and individual planners to 401(k) plans in the micro to small corporate market. In October 2006, Employer Markets terminated its contract with the primary third-party wholesaler of the *LINCOLN DIRECTOR*SM product. Although this termination did not have a material adverse effect on the Retirement Products segment's results of operations, we have experienced a disruption in deposits and outflows of business as a result. However, we expect that in the long-term the benefits associated with our investment in a new wholesaling force will outweigh the consequences of terminating our third-party wholesaling relationship.

The distribution of Executive Benefit products are dominated by 15 intermediaries who specialize in the executive benefits market. We serve this group through a network of internal and external sales professionals.

Competition

The Retirement Products marketplace is very competitive and is comprised of many providers, with no one company dominating the market for all products. The Retirement Products area competes with numerous other financial services companies. The main factors upon which entities in this market compete are wholesaling, investment performance, cost, product features, speed to market, brand recognition, financial strength ratings, distribution channel access, crediting rates and client service.

Employer Markets Group Protection

Overview

The Group Protection segment offers group non-medical insurance products, principally term life, disability and dental, to the employer marketplace through various forms of contributory and noncontributory plans. Most of the segment's group contracts are sold to employers with fewer than 500 employees.

Table of Contents

The Group Protection segment was added as a result of the merger with Jefferson-Pilot and was previously known as Benefit Partners. Accordingly, the insurance premium product line data (in millions) for this segment, provided in the following table, only include nine months during 2006:

	For the Years Ended December 31,	
	2007	2006
Life	\$ 494	\$ 334
Disability	601	407
Dental	136	95
Total non-medical	1,231	836
Medical	149	113
Total insurance premiums	\$ 1,380	\$ 949

Products*Group Life Insurance*

We offer employer-sponsored group term life insurance products including basic, optional and voluntary term life insurance to employees and their dependents. Additional benefits may be provided in the event of a covered individual's accidental death or dismemberment.

Group Disability Insurance

We offer short- and long-term employer-sponsored group disability insurance, which protects an employee against loss of wages due to illness or injury. Short-term disability generally provides benefits for up to 26 weeks following a short waiting period, ranging from one to 30 days. Long-term disability provides benefits following a longer waiting period, usually between 30 and 180 days and provides benefits for a longer period, at least two years and typically extending to normal (Social Security) retirement age.

Group Dental

We offer employer-sponsored group dental insurance, which covers a portion of the cost of eligible dental procedures for employees and their dependents. Products offered include indemnity coverage, which does not distinguish benefits based on a dental provider's participation in a network arrangement, and a Preferred Provider Organization (PPO) product that does reflect the dental provider's participation in the PPO network arrangement, including agreement with network fee schedules.

Distribution

The segment's products are marketed primarily through a national distribution system of 27 regional group offices. These offices develop business through employee benefit brokers, third-party administrators and other employee benefit firms.

Competition

The Group Protection marketplace is very competitive. Principal competitive factors include particular product features, price, quality of customer service and claims management, technological capabilities, financial strength and claims-paying ratings. In the group insurance market, the Group Protection segment competes with a limited number of major companies and selected other companies that focus on these products.

Underwriting

The Group Protection segment's underwriters evaluate the risk characteristics of each employee group. Generally, the relevant characteristics evaluated include employee census information (such as age, gender, income and occupation), employer industry classification, geographic

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

location, benefit design elements and other factors. The segment employs detailed underwriting policies, guidelines and procedures designed to assist the underwriter to properly assess and quantify risks. The segment uses technology to efficiently review, price and issue smaller cases, utilizing its underwriting staff on larger, more complex cases. Individual underwriting techniques (including evaluation of individual medical history information) may be used on certain covered individuals selecting larger benefit amounts. For voluntary and other forms of employee paid coverages, minimum participation requirements are used to obtain a better spread of risk and minimize the risk of anti-selection.

Table of Contents**Claims Administration**

Claims for the Group Protection segment are managed by a staff of experienced claim specialists. Disability claims management is especially important to segment results, as results depend on both the incidence and the length of approved disability claims. The segment employs nurses and rehabilitation specialists to help evaluate medical conditions and develop return to work plans. Independent medical reviews are routinely performed by external medical professionals to further evaluate conditions as part of the claim management process.

INVESTMENT MANAGEMENT**Overview**

The Investment Management segment, with principal operations in Philadelphia, Pennsylvania, provides investment products and services to both individual and institutional investors through Delaware Management Holdings, Inc. and its affiliates, (Delaware Investments). Delaware Investments offers a broad line of mutual funds and other investment products to retail investors (including managed accounts).

Delaware Investments also offers investment advisory services and products to institutional clients, such as corporate and public retirement plans, endowments and foundations, nuclear decommissioning trusts, sub-advisory clients and Taft-Hartley plans, and includes mutual funds offered by non-Delaware Investments entities for which Delaware Investments acts as a sub-advisor. As of December 31, 2007, Delaware Investments served as investment advisor to approximately 200 institutional accounts, acted as investment manager and performed additional services for approximately 95 open-end funds and for 7 closed-end funds. The Investment Management segment also provides investment advisory services for our corporate and general insurance portfolios, including separate accounts and mutual funds, and acts as investment advisor to collateralized debt obligations.

Products

Investment Management products include U.S. and international equity and fixed-income retail mutual funds, institutional separate accounts, institutional mutual funds, managed accounts, as well as administration services for some of these products.

The Investment Management segment's assets under management (including assets under administration) (in millions) were as follows:

	As of December 31,		
	2007	2006	2005
Retail equity	\$ 31,598	\$ 31,705	\$ 25,202
Retail fixed	10,801	8,790	7,766
Total retail	42,399	40,495	32,968
Institutional equity	21,732	21,957	18,755
Institutional fixed ⁽¹⁾	11,526	21,105	13,079
Total institutional	33,258	43,062	31,834
Inter-segment assets	77,117	81,186	55,917
Total assets under management	\$ 152,774	\$ 164,743	\$ 120,719
Total sub-advised assets, included above⁽²⁾	\$ 20,789	\$ 22,671	\$ 20,503

(1)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

In the fourth quarter of 2007, the Investment Management segment sold a portion of our institutional fixed-income business to an unaffiliated investment management company.

- (2) Effective May 1, 2007, the investment advisory role for the Lincoln Variable Insurance Trust, a product within our Employer Markets business, transitioned from Investment Management to another internal advisor. In the role of investment advisor, Investment Management provided investment performance and compliance oversight on third-party investment managers in exchange for a fee. Investment Management will continue to manage certain of the assets as a sub-advisor. As a result of this change, the Investment Management assets under management decreased by \$3.2 billion, with a corresponding reduction in investment advisory fees inter-segment and associated expenses.

Table of Contents*Retail Products and Services*

The Investment Management segment offers various retail products including mutual funds to individual investors, as well as investment services to high net worth and small institutional investors through managed accounts. The retail assets under management were \$42.4 billion, \$40.5 billion and \$33.0 billion as of December 31, 2007, 2006 and 2005, respectively. These assets include \$16.2 billion, \$18.0 billion and \$15.4 billion of sub-advised assets as of December 31, 2007, 2006 and 2005, respectively. We pay fees to the third party sub-advisors to manage the assets.

As of December 31, 2007, the Investment Management segment, through Delaware Investments, offered 42 open-end retail mutual funds to suit an array of investment needs. Delaware Investments' mutual funds are grouped by asset class, with each investment management team focused on a specific investment discipline. This structure of distinct investment teams allows for a style-specific research effort tailored for each asset class. The mutual funds are owned by the shareholders of those funds and not by Delaware Investments. Delaware Investments manages the funds pursuant to an agreement with the separate funds boards. Accordingly, the mutual fund assets and liabilities, as well as related investment returns, are not reflected in our consolidated financial statements. Instead, Delaware Investments earns fees for providing the management and other services to the funds.

Delaware Investments manages both open-end and closed-end funds. An open-end mutual fund does not have a fixed number of shares and will normally offer as many shares as investors are willing to buy. Investors sell their shares by requesting the fund to redeem the shares. The open-end funds are available with various pricing structures, such as A-class with a front end sales charge, B-class and C-class with a contingent deferred sales charge as well as R-class and Institutional class, which are sold without a front end or contingent deferred sales charge and are designed for certain retirement plans and/or institutional investors. A-, B-, C- and R-classes are generally subject to Rule 12b-1 fees. A closed-end fund offers a fixed number of shares and is usually sold through a brokerage firm. After the initial offering, shares normally trade on a major stock exchange. During 2007, Investment Management closed three funds: the VIP Global Bond fund, which was liquidated in February 2007; the Tax Free Minnesota Insured fund, which merged into the Tax Free Minnesota fund in April 2007; and the Tax Free Florida Insured fund, which merged into the Tax Free USA fund in July 2007. In addition, Investment Management launched a new closed-end fund, the Delaware Enhanced Global Dividend and Income Fund, which combines domestic and international stocks, real estate investment trusts and debt securities for investors seeking diversification and high current income.

The Investment Management segment also provides investment advisory services to clients through separately managed accounts, commonly referred to as wrap accounts. These products are offered by a sponsor, typically a broker-dealer, to higher net worth individuals with a minimum investment of approximately \$250,000. During 2006, the Investment Management segment closed the International American Depository Receipt (ADR) separately managed account product, which is sub-advised by Mondrian, and the Delaware Large Cap Growth Equity separately managed account to new investors. An ADR is a security that trades in the U.S. but represents a specified number of shares in a foreign corporation. ADRs are bought and sold on U.S. markets just like traditional stocks and are issued or sponsored in the U.S. by a bank or brokerage firm.

Institutional Products and Services

For institutional clients, the Investment Management segment offers Delaware Pooled Trust and institutional separate accounts and manages collateralized debt obligations (CDOs). Institutional assets under management were \$33.3 billion, \$43.1 billion and \$31.8 billion as of December 31, 2007, 2006 and 2005, respectively.

Delaware Pooled Trust is a registered investment company which offers a series of mutual funds managed in styles that are similar to institutional separate account offerings and are best suited for smaller to medium-sized institutional investment mandates. Delaware Pooled Trusts' minimum initial investment is typically \$1 million. The funds included in Delaware Pooled Trust are offered without a sales charge directly through Delaware Investments' institutional marketing and client services group.

The Investment Management segment provides investment advisory services through individually managed accounts to a broad range of institutional clients, such as corporate and public retirement plans, endowments and foundations, nuclear decommissioning trusts, sub-advisory clients and Taft-Hartley plans, among others. Included among sub-advisory clients are mutual funds and other commingled vehicles offered by institutional parties. Most clients utilize individually managed separate accounts, which means clients have the opportunity to customize the management of their portfolio by including or excluding certain types of securities, sectors or segments within a given asset class. Because of their individually managed nature, these separate accounts are best suited for larger investment mandates. Currently, the minimum account size is typically \$25 million for U.S. investments.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The Investment Management segment also provides investment advisory services for CDOs. CDOs are pools of debt instruments that are securitized and sold to investors through a sponsor, typically an investment bank. The Investment Management segment does not invest in these securities but provides investment advisory services at a fee. As of December 31, 2007, the Investment Management segment provided advisory services for \$6.1 billion of CDO s.

Table of Contents

As stated in **Acquisition and Dispositions** above, on October 31, 2007, we completed the sale with an unaffiliated investment management company involving certain members of our fixed income team and related institutional taxable fixed income business.

The Investment Management segment also provides investment management services for LNC's general account assets for which it earns advisory revenue.

Distribution

The businesses in the Investment Management segment deliver their broad range of products through multiple distribution channels, enabling them to reach an expanding community of retail and institutional investors. Investment Management distributes retail mutual funds and managed accounts through intermediaries, including LFN, which are serviced by the LFD wholesaling distribution network. Delaware Distributors, L.P. is the principal underwriter for the Delaware Investments mutual funds and serves as a liaison between the funds and LFD.

Delaware Investments' institutional marketing group, working closely with manager selection consultants, markets substantially all of the institutional products.

Competition

The Investment Management segment primarily competes with mutual fund complexes that are broker sold, and other asset managers offering managed accounts, institutional accounts and sub-advisory services. Competitive factors impacting the Investment Management segment include investment performance, breadth of investment styles offered, distribution capabilities and customer service.

Investment performance is a key driver of the Investment Management segment's ability to attract new sales, retain existing assets and improve net flows. The following table summarizes the performance of institutional and managed accounts composites relative to their respective benchmarks for the one-, three- and five-year periods ended December 31, 2007.

	One Year	Three Year	Five Year
Number of institutional composites outperforming their respective benchmarks ⁽¹⁾	4 of 8	4 of 8	3 of 7
Number of managed account styles outperforming their respective benchmarks ⁽²⁾	4 of 7	4 of 5	2 of 5

⁽¹⁾ Represents the largest composites based on assets under management. The returns for these composites are Global Investment Performance Standards compliant and the benchmarks are industry standards.

⁽²⁾ Represents Delaware Investments' managed account styles that have associated benchmarks for the respective length of time. Delaware Investments closely monitors the relative performance of individual funds. Fund performance is compared to a benchmark group of peer funds that have similar investment characteristics and objectives. Performance in various key categories, as reported to Lipper, one of the leading providers of mutual fund research, is used by Delaware Investments in measuring its funds' performance. The following table summarizes the performance for the 25 largest mutual funds and for all of the mutual funds in the Delaware Investments' family of funds for the one-, three- and five-year periods ended December 31, 2007.

	One Year	Three Year	Five Year
Number of Funds out of Delaware's top 25 retail mutual funds in top half of their Lipper category ⁽¹⁾	9 of 25	13 of 25	14 of 25
Number of all retail mutual funds in top half of their Lipper category ⁽¹⁾	13 of 42	24 of 42	25 of 41

⁽¹⁾ For these purposes, Delaware Investments' family of funds does not include variable insurance product funds or mutual funds managed by Delaware Investments for certain of our affiliates or other third parties.

Table of Contents**LINCOLN UK****Overview**

Lincoln UK is headquartered in Barnwood, Gloucester, England, and is licensed to do business throughout the United Kingdom (U.K.). Lincoln UK is primarily focused on protecting and enhancing the value of its existing customer base. The segment accepts new deposits on the existing block of business and markets a limited range of new products.

Beginning in 2006 and continuing into 2007, Lincoln UK began participating in our overall Retirement Income Security Venture initiative and we have now introduced retirement income product solutions into the U.K. marketplace. Lincoln UK's product portfolio principally consists of unit-linked life and pension products, which are similar to U.S. produced variable life and annuity products, where the risk associated with the underlying investments is borne by the contract holders. These products have largely been issued to individuals, and benefits, premium levels and charges can often be varied within limits. Certain contract holders have chosen to contract out of the State Second Pension through a Lincoln personal pension arrangement. Lincoln UK receives rebate premiums from the government for those contract holders. These rebates are reported as deposits and as such only the fees earned by Lincoln UK are reported as revenue.

The Lincoln UK segment's product revenues (in millions) were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Life products	\$ 121	\$ 95	\$ 142
Pension products	160	131	88
Other products	8	11	10
Total product revenues	\$ 289	\$ 237	\$ 240

Product revenues include premiums, fees and assessments for Lincoln UK's products.

Our subsidiary in the U.K. has its balance sheets and income statements translated at the current spot exchange rate as of the year-end and average spot exchange rate for the year, respectively.

Lincoln UK has an evergreen agreement to outsource its customer service and policy administration functions to Capita Life & Pensions Services Limited, a subsidiary of Capita Group Plc (Capita). The purpose of the outsourcing is to reduce the operational risk and variability of future costs associated with administering the business by taking advantage of Capita's proven expertise in providing outsourcing solutions to a variety of industries including insurance companies. To date, the relationship has provided the segment with results in line with expectations.

OTHER OPERATIONS**Overview**

Other Operations includes the financial data for operations that are not directly related to the business segments, unallocated corporate items (such as investment income on investments related to the amount of statutory surplus in our insurance subsidiaries that is not allocated to our business units and other corporate investments, interest expense on short-term and long-term borrowings and certain expenses, including restructuring and merger-related expenses), along with the ongoing amortization of deferred gain on the indemnity reinsurance portion of the transaction with Swiss Re. Other Operations also includes the eliminations of intercompany transactions and the inter-segment elimination of the investment advisory fees for asset management services the Investment Management segment provides to Individual Markets and Employer Markets. In addition, as a result of our agreements dated as of November 12, 2007, we executed plans to divest our television broadcasting, sports programming and Charlotte radio stations, and accordingly, we have reported the results of these businesses as discontinued operations. Consequently, we no longer have the Lincoln Financial Media segment and now report our remaining media operations within Other Operations.

Table of Contents

Revenues (in millions) from Other Operations were as follows:

	For the Years Ended December 31,		
	2007	2006	2005
Insurance premiums	\$ 2	\$ 5	\$ 1
Net investment income	192	225	203
Amortization of deferred gain on indemnity reinsurance	74	75	76
Communications revenue (net)	107	85	
Other revenues and fees	(7)	(10)	(6)
Inter-segment elimination of investment advisory fees	(87)	(97)	(99)
Total operating revenues	\$ 281	\$ 283	\$ 175

REINSURANCE

We follow the industry practice of reinsuring a portion of our life insurance and annuity risks with unaffiliated reinsurers. In a reinsurance transaction, a reinsurer agrees to indemnify another insurer for part or all of its liability under a policy or policies it has issued for an agreed upon premium. We use reinsurance to protect our insurance subsidiaries against the severity of losses on individual claims and unusually serious occurrences in which a number of claims produce an aggregate extraordinary loss. We also use reinsurance to improve our results by leveraging favorable reinsurance pricing. Although reinsurance does not discharge the insurance subsidiaries from their primary liabilities to their contract holders for losses insured under the insurance policies, it does make the assuming reinsurer liable to the insurance subsidiaries for the reinsured portion of the risk.

We reinsure approximately 45% to 50% of the mortality risk on newly issued non-term life insurance contracts and approximately 40% to 45% of total mortality risk including term insurance contracts. Our policy for this program is to retain no more than \$10 million on a single insured life issued on fixed and variable universal life insurance contracts. Additionally, the retention per single insured life for term life insurance and for COLI is \$2 million for each type of insurance.

On July 31, 2007, we entered into a reinsurance arrangement with Swiss Re covering *Lincoln SmartSecurity*[®] Advantage, our rider related to our Individual Market's variable annuity products. This is the first time we have entered into a third-party reinsurance agreement related to our variable annuity business. Swiss Re is providing 50% quota share coinsurance of our lifetime guaranteed minimum withdrawal benefit, *Lincoln SmartSecurity*[®] Advantage, for business written in 2007 and 2008, up to a total of \$3.8 billion in deposits. As of December 31, 2007, we had remaining capacity of \$2.2 billion. We will retain 100% of the base variable annuity contracts. This reinsurance agreement strengthens and diversifies our enterprise risk management platform and expands our capacity with regard to retirement income security products.

Portions of our deferred annuity business have been reinsured on a modified coinsurance (Modco) basis with other companies to limit our exposure to interest rate risks. In a Modco program, the reinsurer shares proportionally in all financial terms of the reinsured policies (i.e. premiums, expenses, claims, etc.) based on their respective quota share of the risk.

In addition, we acquire other reinsurance to cover products other than as discussed above with retentions and limits that management believes are appropriate for the circumstances.

For more information regarding reinsurance, see Reinsurance in the MD&A and Note 8. For risks involving reinsurance, see Item 1A. Risk Factors.

RESERVES

The applicable insurance laws under which insurance companies operate require that they report, as liabilities, policy reserves to meet future obligations on their outstanding policies. These reserves are the amounts that, with the additional premiums to be received and interest thereon compounded annually at certain assumed rates, are calculated to be sufficient to meet the various policy and contract obligations as they mature. These laws specify that the reserves shall not be less than reserves calculated using certain specified mortality and morbidity tables, interest rates and methods of valuation.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The reserves reported in our financial statements contained herein are calculated based on GAAP and differ from those specified by the laws of the various states and carried in the statutory financial statements of the life insurance subsidiaries. These differences arise from the use of mortality and morbidity tables, interest, persistency and other assumptions which are believed to be more representative of the expected experience for these policies than those required for statutory accounting purposes and

Table of Contents

from differences in actuarial reserving methods. See **Regulatory** below for information on proposed regulations that may impact the amount of statutory reserves necessary to support our current insurance liabilities.

The assumptions on which reserves are based are intended to represent an estimation of experience for the period that policy benefits are payable. If actual experience is not less favorable than the reserve assumptions, then reserves should be adequate to provide for future benefits and expenses. If experience is less favorable than the reserve assumptions, additional reserves may be required. The key experience assumptions include mortality rates, policy persistency and interest rates. We periodically review our experience and update our policy reserves for new issues and reserve for all claims incurred as we believe appropriate.

For risks related to reserves, see **Item 1A. Risk Factors**.

INVESTMENTS

An important component of our financial results is the return on invested assets. Our investment strategy is to balance the need for current income with prudent risk management, with an emphasis on generating sufficient current income to meet our obligations. This approach requires the evaluation of risk and expected return of each asset class utilized, while still meeting our income objectives. This approach also permits us to be more effective in our asset-liability management, since decisions can be made based upon both the economic and current investment income considerations affecting assets and liabilities. Investments by our insurance subsidiaries must comply with the insurance laws and regulations of the states of domicile.

We do not use derivatives for speculative purposes. Derivatives are used for hedging purposes and income generation. Hedging strategies are employed for a number of reasons including, but not limited to, hedging certain portions of our exposure to changes in our GMDB, GMWB and GIB liabilities, interest rate fluctuations, the widening of bond yield spreads over comparable maturity U.S. Government obligations, and credit, foreign exchange and equity risks. Income generation strategies include credit default swaps through replication synthetic asset transactions. These derivatives synthetically create exposure in the general account to corporate debt, similar to investing in the credit markets. Our investment portfolio does not contain any significant concentrations in single issuers. In addition, we do not have a significant concentration of investments in any single industry segment; no single segment comprised more than 10% of invested assets as of December 31, 2007.

For additional information on our investments, including carrying values by category, quality ratings and net investment income, see **Consolidated Investments** in the MD&A, as well as Notes 1 and 4.

RATINGS

The Nationally Recognized Statistical Ratings Organizations rate the financial strength of our principal insurance subsidiaries and the debt of LNC. Ratings are not recommendations to buy our securities.

Rating agencies rate insurance companies based on financial strength and the ability to pay claims, factors more relevant to contract holders than investors. We believe that the ratings assigned by nationally recognized, independent rating agencies are material to our operations. There may be other rating agencies that also rate our securities, which we do not disclose in our reports.

Insurer Financial Strength Ratings

The insurer financial strength rating scales of A.M. Best, Fitch Ratings (**Fitch**), Moody's Investors Service (**Moody's**) and Standard & Poor's (**S&P**) are characterized as follows:

A.M. Best A++ to S

Fitch AAA to D

Moody's Aaa to C

S&P AAA to R

Table of Contents

As of January 31, 2008, the financial strength ratings of our principal insurance subsidiaries, as published by the principal rating agencies that rate our securities, or us, were as follows:

	A.M. Best A+	Fitch AA	Moody's Aa3	S&P AA
LNL	(2 nd of 16) A+	(3 rd of 24) AA	(4 th of 21) Aa3	(3 rd of 21) AA
LLANY	(2 nd of 16) A+	(3 rd of 24) AA	(4 th of 21) A1	(3 rd of 21) AA-
First Penn-Pacific Life Insurance Company (FPP)	(2 nd of 16)	(3 rd of 24)	(5 th of 21)	(4 th of 21)

The A.M. Best, Fitch and Moody's ratings above have a stable outlook. The S&P ratings have a positive outlook for LNL and LLANY.

A downgrade of the financial strength rating of one of our principal insurance subsidiaries could affect our competitive position in the insurance industry and make it more difficult for us to market our products as potential customers may select companies with higher financial strength ratings.

Debt Ratings

The long-term credit rating scales of A.M. Best, Fitch, Moody's and S&P are characterized as follows:

A.M. Best aaa to d

Fitch AAA to D

Moody's Aaa to C

S&P AAA to D

As of January 31, 2008, our long-term credit ratings, as published by the principal rating agencies that rate our long-term credit, were as follows:

A. M. Best	a	(6th of 22)
Fitch	A	(6th of 24)
Moody's	A3	(7th of 21)
S&P	A+	(5th of 22)

The short-term credit rating scales of A.M. Best, Fitch Ratings, Moody's and S&P are characterized as follows:

A.M. Best AMB-1+ to d

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Fitch F1 to D

Moody's P-1 to NP

S&P- A-1 to D

As of January 31, 2008, our short-term credit ratings, as published by the principal rating agencies that rate our short-term credit, were as follows:

A. M. Best	AMB-1	(2nd of 6)
Fitch	F1	(1st of 6)
Moody's	P-2	(2nd of 4)
S&P	A-1	(2nd of 6)

A downgrade of our debt ratings could affect our ability to raise additional debt with terms and conditions similar to our current debt, and accordingly, likely increase our cost of capital. In addition, a downgrade of these ratings could make it more difficult to raise capital to refinance any maturing debt obligations, to support business growth at our insurance subsidiaries and to maintain or improve the current financial strength ratings of our principal insurance subsidiaries described above.

All of our ratings are subject to revision or withdrawal at any time by the rating agencies, and therefore, no assurance can be given that our principal insurance subsidiaries or that LNC can maintain these ratings. Each rating should be evaluated independently of any other rating.

Table of Contents**REGULATORY****General**

Our insurance subsidiaries, like other insurance companies, are subject to regulation and supervision by the states, territories and countries in which they are licensed to do business. The extent of such regulation varies, but generally has its source in statutes that delegate regulatory, supervisory and administrative authority to supervisory agencies. In the U.S., this power is vested in state insurance departments.

In supervising and regulating insurance companies, state insurance departments, charged primarily with protecting contract holders and the public rather than investors, enjoy broad authority and discretion in applying applicable insurance laws and regulation for that purpose. Our principal insurance subsidiaries are domiciled in the following states:

Insurance Subsidiary	State of Domicile
LNL	Indiana
LLANY	New York
FPP	Indiana

During 2007, we merged our Jefferson-Pilot Life Insurance Company subsidiary, domiciled in North Carolina, and our Jefferson-Pilot Financial Insurance Company subsidiary, domiciled in Nebraska, with and into LNL. Also, in 2007, we redomiciled our Jefferson-Pilot LifeAmerica Insurance Company subsidiary from New Jersey to New York, and merged our New York domiciled company subsidiary, LLANY, with and into it. We renamed the merged entity LLANY. LLANY is a wholly owned subsidiary of LNL. Finally, as of October 1, 2007, LNL voluntarily withdrew as an accredited reinsurer from the state of New York.

The insurance departments of the domiciliary states exercise principal regulatory jurisdiction over our insurance subsidiaries. The extent of regulation by the states varies, but in general, most jurisdictions have laws and regulations governing standards of solvency, adequacy of reserves, reinsurance, capital adequacy, licensing of companies and agents to transact business, prescribing and approving policy forms, regulating premium rates for some lines of business, prescribing the form and content of financial statements and reports, regulating the type and amount of investments permitted and standards of business conduct. Insurance company regulation is discussed further under Insurance Holding Company Regulation and Restrictions on Subsidiaries Dividends and Other Payments.

A new statutory reserving standard (commonly called VACARVM) is being developed by the National Association of Insurance Commissioners (NAIC) replacing current statutory reserve practices for variable annuities with guaranteed benefits, such as GMWBs. The timing for adoption of VACARVM is anticipated to occur sometime in 2008, with an effective date of December 31, 2008. Because the NAIC has not determined the final version of VACARVM, we cannot estimate the ultimate impact that VACARVM will have on our liquidity and capital resources. However, in its current draft form, VACARVM has the potential to require statutory reserves well in excess of current levels for certain variable annuity riders sold by us. We plan to utilize existing captive reinsurance structures, as well as pursue additional third-party reinsurance arrangements, to lessen any negative impact on statutory capital and dividend capacity in our life insurance subsidiaries. However, additional statutory reserves could lead to lower risk-based capital ratios and potentially reduce future dividend capacity from our insurance subsidiaries. For more information on VACARVM and our use of captive reinsurance structures, see Review of Consolidated Financial Condition Liquidity and Capital Resources in the MD&A.

The U.S. federal government does not directly regulate the insurance industry; however, federal initiatives from time to time can impact the insurance industry. In June 2001, the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) was enacted. EGTRRA contains provisions that have and will continue, near term, to significantly lower individual tax rates. These may have the effect of reducing the benefits of tax deferral on the inside build-up of annuities and life insurance products. EGTRRA also includes provisions that will eliminate, over time, the estate, gift and generation-skipping taxes and partially eliminates the step-up in basis rule applicable to property held in a decedent's estate. Some of these changes might hinder our sales and result in the increased surrender of insurance and annuity products. These provisions expire after 2010, unless extended.

In May 2003, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) was enacted. Individual taxpayers are the principal beneficiaries of JGTRRA, which includes an acceleration of certain of the income tax rate reductions enacted originally under EGTRRA, as well as capital gains and dividend tax rate reductions. On May 17, 2006, the Tax Increase Prevention and Reconciliation Act of 2006 (TIPRA) was signed into law. TIPRA extends the lower capital gains and dividends rates through the end of 2010. Although most of these rate reductions expire after 2010, these reductions have the effect of reducing the benefits of tax deferral on the build-up of value of annuities and life insurance products. Like the EGTRRA changes, the JGTRRA changes may hinder our sales and result in increased surrender of insurance and annuity

products.

On October 22, 2004, President Bush signed into law the American Jobs Creation Act of 2004 (AJCA), which includes provisions affecting non-qualified deferred compensation plans that may make such plans more complicated for employers

Table of Contents

depending on final tax rules and regulations. Because our COLI products are often used to support such deferred compensation liabilities, the AJCA may constrain sales of our COLI products.

In February 2007, bills were introduced in Congress to provide tax incentives designed to encourage individuals to invest their after-tax income in retirement vehicles, such as annuities, that provide guaranteed lifetime income. Under the proposal, individuals would not pay federal taxes on one-half of the income generated by annuities that make lifetime payments up to an annual limit of \$20,000. If this bill is enacted into law, we believe that it would have a favorable impact on our annuity business.

In February 2008, the Bush Administration proposed that many of the temporary rate reductions from EGTRRA and the JGTRRA be made permanent. The Administration also continues to propose tax-favored savings initiatives that, if enacted by Congress, could also adversely affect the sale of our annuity, life and tax-qualified retirement products and increase the surrender of such products. However, we expect that the income for life guarantee provided within an annuity and features like our GMWB will continue to be viewed as significant benefits and may offset the adverse effect of these proposals.

On August 17, 2006, the Pension Protection Act of 2006 (PPA) was signed into law. PPA makes numerous changes to pension and other tax laws including: permanence for the EGTRRA enacted pension provisions including higher annual contribution limits for defined contribution plans and IRAs as well as catch-up contributions for persons over age 50; clarification of the safest available annuity standard for the selection of an annuity as a distribution option for defined contribution plans; expansion of investment advice options for defined contribution plan participants and IRA owners; more stringent funding requirements for defined benefit pension plans and clarification of the legal status of hybrid (cash balance) pension plans; and non-pension related tax changes such as the codification of COLI best practices bringing more certainty to this market segment; permanence for EGTRRA enacted tax benefits for section 529 college savings plans; and favorable tax treatment for long-term care insurance included as a rider to or on annuity products.

We expect many of these changes to have a beneficial effect upon various segments of our business lines.

Some of our separate accounts as well as mutual funds that we sponsor, in addition to being registered under the Securities Act of 1933, are registered as investment companies under the Investment Company Act of 1940, and the shares of certain of these entities are qualified for sale in some or all states and the District of Columbia. We also have several subsidiaries that are registered as broker-dealers under the Securities Exchange Act of 1934 (Exchange Act) and are subject to federal and state regulation, including but not limited to the Financial Industry Regulation Authority (FINRA) net capital rules. In addition, we have several subsidiaries that are investment advisors registered under the Investment Advisers Act of 1940. LFN s agents and our employees, insofar as they are involved in the sale or marketing of products that are securities, are subject to the Exchange Act and to examination requirements and regulation by the U.S. Securities and Exchange Commission (SEC), the FINRA and state securities commissioners. Regulation also extends to various LNC entities that employ or control those individuals. The SEC and other governmental agencies and self-regulatory organizations, as well as state securities commissions in the U.S., have the power to conduct administrative proceedings that can result in censure, fines, the issuance of cease-and-desist orders or suspension, termination or limitation of the activities of the regulated entity or its employees.

Federal and state regulators are devoting substantial attention to the mutual fund, indexed annuity and variable annuity businesses. As a result of publicity relating to widespread perceptions of industry abuses, there have been numerous regulatory reform initiatives addressing issues which include, but are not limited to, mutual fund governance and compliance practices, late trading, suitability of indexed and variable annuity products, directed brokerage and soft dollars, and new disclosure requirements concerning commission breakpoints, revenue sharing, shelf space, advisory fees, market timing, portfolio pricing, information about portfolio managers and other issues. While we have made certain changes to our businesses in response to new regulations, they have not had a significant impact on our businesses. However, it is difficult to predict whether additional changes resulting from new regulations will materially affect our businesses, and, if so, to what degree.

Insurance Holding Company Regulation

LNC and its primary insurance subsidiaries are subject to regulation pursuant to the insurance holding company laws of the states of Indiana and New York. These insurance holding company laws generally require an insurance holding company and insurers that are members of such insurance holding company s system to register with the insurance department authorities, to file with it certain reports disclosing information including their capital structure, ownership, management, financial condition, certain intercompany transactions, including material transfers of assets and intercompany business agreements, and to report material changes in that information. These laws also require that intercompany transactions be fair and reasonable and, under certain circumstances, prior approval of the insurance departments must be received before entering into an intercompany transaction. Further, these laws require that an insurer s contract holders surplus following any dividends or distributions to shareholder affiliates is reasonable in relation to the insurer s outstanding liabilities and adequate for its financial needs.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

In general, under state holding company regulations, no person may acquire, directly or indirectly, a controlling interest in our capital stock unless such person, corporation or other entity has obtained prior approval from the applicable insurance

Table of Contents

commissioner for such acquisition of control. Pursuant to such laws, in general, any person acquiring, controlling or holding the power to vote, directly or indirectly, ten percent or more of the voting securities of an insurance company, is presumed to have control of such company. This presumption may be rebutted by a showing that control does not exist in fact. The insurance commissioner, however, may find that control exists in circumstances in which a person owns or controls a smaller amount of voting securities. To obtain approval from the insurance commissioner of any acquisition of control of an insurance company, the proposed acquirer must file with the applicable commissioner an application containing information regarding: the identity and background of the acquirer and its affiliates; the nature, source and amount of funds to be used to carry out the acquisition; the financial statements of the acquirer and its affiliates; any potential plans for disposition of the securities or business of the insurer; the number and type of securities to be acquired; any contracts with respect to the securities to be acquired; any agreements with broker-dealers; and other matters.

Other jurisdictions in which our insurance subsidiaries are licensed to transact business may have similar or additional requirements for prior approval of any acquisition of control of an insurance or reinsurance company licensed or authorized to transact business in those jurisdictions. Additional requirements in those jurisdictions may include re-licensing or subsequent approval for renewal of existing licenses upon an acquisition of control. As further described below, laws that govern the holding company structure also govern payment of dividends to us by our insurance subsidiaries.

Restrictions on Subsidiaries Dividends and Other Payments

We are a holding company that transacts substantially all of our business directly and indirectly through subsidiaries. Our primary assets are the stock of our operating subsidiaries. Our ability to meet our obligations on our outstanding debt and to pay dividends and our general and administrative expenses depends on the surplus and earnings of our subsidiaries and the ability of our subsidiaries to pay dividends or to advance or repay funds to us.

In addition, our insurance subsidiaries are subject to certain insurance department regulatory restrictions as to the transfer of funds and payment of dividends to the holding company. Under Indiana laws and regulations, our Indiana insurance subsidiaries, including our primary insurance subsidiary, LNL, may pay dividends to LNC only from unassigned surplus, without prior approval of the Indiana Insurance Commissioner (the Commissioner), or must receive prior approval of the Commissioner to pay a dividend if such dividend, along with all other dividends paid within the preceding twelve consecutive months, would exceed the statutory limitation. The current statutory limitation is the greater of (i) 10% of the insurer's contract holders' surplus, as shown on its last annual statement on file with the Commissioner or (ii) the insurer's statutory net gain from operations for the previous twelve months, but in no event to exceed statutory unassigned surplus. Indiana law gives the Commissioner broad discretion to disapprove requests for dividends in excess of these limits. New York, the state of domicile of our other major insurance subsidiary, LLANY, has similar restrictions, except that in New York it is the lesser of (i) 10% of surplus to contract holders as of the immediately preceding calendar year or (ii) net gain from operations for the immediately preceding calendar year, not including realized capital gains.

Indiana law also provides that following the payment of any dividend, the insurer's contract holders' surplus must be reasonable in relation to its outstanding liabilities and adequate for its financial needs, and permits the Indiana Insurance Commissioner to bring an action to rescind a dividend which violates these standards. In the event that the Indiana Insurance Commissioner determines that the contract holders' surplus of one subsidiary is inadequate, the Commissioner could use his or her broad discretionary authority to seek to require us to apply payments received from another subsidiary for the benefit of that insurance subsidiary. For information regarding dividends paid to us during 2007 from our insurance subsidiaries, see Review of Consolidated Financial Condition Liquidity and Capital Resources-Sources of Liquidity and Cash Flow in the MD&A.

Lincoln UK's insurance subsidiaries are regulated by the U.K. Financial Services Authority (FSA) and are subject to capital requirements as defined by the U.K. Capital Resources Requirement. Lincoln UK targets maintaining approximately 1.5 to 2.0 times the required capital as prescribed by the regulatory resource requirement. Effective January 1, 2005, all insurance companies operating in the U.K. also have to complete a risk-based capital (RBC) assessment to demonstrate to the FSA that they hold sufficient capital to cover their risks. RBC requirements in the U.K. are different than the NAIC requirements. In addition, the FSA imposes certain minimum capital requirements for the combined U.K. subsidiaries. As is the case with regulated insurance companies in the U.S., future changes to regulatory capital requirements could impact the dividend capacity of our U.K. insurance subsidiaries and cash flow to the holding company.

Risk-Based Capital

The NAIC has adopted risk-based capital requirements for life insurance companies to evaluate the adequacy of statutory capital and surplus in relation to investment and insurance risks. The requirements provide a means of measuring the minimum amount of statutory surplus appropriate for an insurance company to support its overall business operations based on its size and risk profile. There are five major risks involved in determining the requirements.

Table of Contents

Category	Name	Description
Asset risk affiliates	C-0	Risk of assets default for certain affiliated investments
Asset risk other	C-1	Risk of assets default of principal and interest or fluctuation in fair value
Insurance risk	C-2	Risk of underestimating liabilities from business already written or inadequately pricing business to be written in the future
Interest rate risk, health credit risk and market risk	C-3	Risk of losses due to changes in interest rate levels, risk that health benefits prepaid to providers become the obligation of the health insurer once again and risk of loss due to changes in market levels associated with variable products with guarantees
Business risk	C-4	Risk of general business

A company's risk-based statutory surplus is calculated by applying factors and performing calculations relating to various asset, premium, claim, expense and reserve items. Regulators can then measure adequacy of a company's statutory surplus by comparing it to the risk-based capital determined by the formula. Under RBC requirements, regulatory compliance is determined by the ratio of a company's total adjusted capital, as defined by the NAIC, to its company action level of RBC (known as the RBC ratio), also as defined by the NAIC.

Four levels of regulatory attention may be triggered if the RBC ratio is insufficient:

Company action level If the RBC ratio is between 75% and 100%, then the insurer must submit a plan to the regulator detailing corrective action it proposes to undertake.

Regulatory action level If the RBC ratio is between 50% and 75%, then the insurer must submit a plan, but a regulator may also issue a corrective order requiring the insurer to comply within a specified period.

Authorized control level If the RBC ratio is between 35% and 50%, then the regulatory response is the same as at the Regulatory action level, but in addition, the regulator may take action to rehabilitate or liquidate the insurer.

Mandatory control level If the RBC ratio is less than 35%, then the regulator must rehabilitate or liquidate the insurer. As of December 31, 2007, the RBC ratios of LNL, LLANY and FPP reported to their respective states of domicile and the NAIC all exceeded the Company action level. We believe that we will be able to maintain the RBC ratios of our insurance subsidiaries in excess of Company action level through prudent underwriting, claims handling, investing and capital management. However, no assurances can be given that developments affecting the insurance subsidiaries, many of which could be outside of our control, including but not limited to changes in the regulatory environment, including changes to the manner in which the RBC ratio is calculated, economic conditions and competitive conditions in the jurisdictions in which we write business, will not cause the RBC ratios to fall below required levels resulting in a corresponding regulatory response.

EMPLOYEES

As of December 31, 2007, we had a total of 10,870 employees. None of our employees are represented by a labor union, and we are not a party to any collective bargaining agreements. We consider our employee relations to be good.

AVAILABLE INFORMATION

We file annual, quarterly and current reports, proxy statements and other documents with the SEC under the Exchange Act. The public may read and copy any materials that we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, DC 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. Also, the SEC maintains an Internet website that contains reports, proxy and information statements, and other information regarding issuers, including LNC, that file electronically with the SEC. The public can obtain any documents that we file with the SEC at <http://www.sec.gov>.

We also make available, free of charge, on or through our Internet website <http://www.lfg.com>, our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC.

Item 1A. Risk Factors

You should carefully consider the risks described below before investing in our securities. The risks and uncertainties described below are not the only ones facing our company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial may also impair our business operations. If any of these risks actually occur, our business, financial condition and results of operations could be materially affected. In that case, the value of our securities could decline substantially.

Table of Contents**Our reserves for future policy benefits and claims related to our current and future business as well as businesses we may acquire in the future may prove to be inadequate.**

Our reserves for future policy benefits and claims may prove to be inadequate. We establish and carry, as a liability, reserves based on estimates of how much we will need to pay for future benefits and claims. For our life insurance and annuity products, we calculate these reserves based on many assumptions and estimates, including estimated premiums we will receive over the assumed life of the policy, the timing of the event covered by the insurance policy, the lapse rate of the policies, the amount of benefits or claims to be paid and the investment returns on the assets we purchase with the premiums we receive. The assumptions and estimates we use in connection with establishing and carrying our reserves are inherently uncertain. Accordingly, we cannot determine with precision the ultimate amounts that we will pay, or the timing of payment of, actual benefits and claims or whether the assets supporting the policy liabilities will grow to the level we assume prior to payment of benefits or claims. If our actual experience is different from our assumptions or estimates, our reserves may prove to be inadequate in relation to our estimated future benefits and claims. As a result, we would incur a charge to our earnings in the quarter in which we increase our reserves.

Because the equity markets and other factors impact the profitability and expected profitability of many of our products, changes in equity markets and other factors may significantly affect our business and profitability.

The fee revenue that we earn on equity-based variable annuities, unit-linked accounts, VUL insurance policies and investment advisory business is based upon account values. Because strong equity markets result in higher account values, strong equity markets positively affect our net income through increased fee revenue. Conversely, a weakening of the equity markets results in lower fee income and may have a material adverse effect on our results of operations and capital resources.

The increased fee revenue resulting from strong equity markets increases the expected gross profits (EGPs) from variable insurance products as do better than expected lapses, mortality rates and expenses. As a result, the higher EGPs may result in lower net amortized costs related to deferred acquisition costs (DAC), deferred sales inducements (DSI), value of business acquired (VOBA), and deferred front-end sales loads (DFEL). However, a decrease in the equity markets as well as worse than expected increases in lapses, mortality rates and expenses depending upon their significance, may result in higher net amortized costs associated with DAC, DSI, VOBA and DFEL and may have a material adverse effect on our results of operations and capital resources. For more information on DAC, DSI, VOBA and DFEL amortization, see Critical Accounting Policies and Estimates in the MD&A.

Changes in the equity markets, interest rates and/or volatility affects the profitability of our products with guaranteed benefits; therefore, such changes may have a material adverse effect on our business and profitability.

The amount of reserves related to GMDB for variable annuities is tied to the difference between the value of the underlying accounts and the guaranteed death benefit, calculated using a benefit ratio approach. The GMDB reserves take into account the present value of total expected GMDB payments and the present value of total expected assessments over the life of the contract and claims and assessments to date. The amount of reserves related to GMWB and GIB for variable annuities is based on the fair value of the underlying benefit. Both the level of expected GMDB payments and expected total assessments used in calculating the benefit ratio are affected by the equity markets. The liabilities related to GMWB and GIB benefits valued at fair value are impacted by changes in equity markets, interest rates and volatility. Accordingly, strong equity markets will decrease the amount of GMDB reserves that we must carry, and strong equity markets, increases in interest rates and decreases in volatility will generally decrease the fair value of the liabilities underlying the GMWB and GIB benefits.

Conversely, a decrease in the equity markets will increase the net amount at risk under the GMDB benefits we offer as part of our variable annuity products, which has the effect of increasing the amount of GMDB reserves that we must carry. Also, a decrease in the equity market along with a decrease in interest rates and an increase in volatility will generally result in an increase in the fair value of the liabilities underlying GMWB and GIB benefits, which has the effect of increasing the amount of GMWB and GIB reserves that we must carry. Such an increase in reserves would result in a charge to our earnings in the quarter in which we increase our reserves. We maintain a customized dynamic hedge program that is designed to mitigate the risks associated with income volatility around the change in reserves on guaranteed benefits. However, the hedge positions may not be effective to exactly offset the changes in the carrying value of the guarantees due to, among other things, the time lag between changes in their values and corresponding changes in the hedge positions, high levels of volatility in the equity markets and derivatives markets, extreme swings in interest rates, contract holder behavior different than expected, and divergence between the performance of the underlying funds and hedging indices. For more information on our hedging program, see Critical Accounting Policies and Estimates Future Contract Benefits and Other Contract Holder Funds in the MD&A.

Table of Contents

Changes in interest rates may cause interest rate spreads to decrease and may result in increased contract withdrawals.

Because the profitability of our fixed annuity and interest-sensitive whole life, UL and fixed portion of VUL insurance business depends in part on interest rate spreads, interest rate fluctuations could negatively affect our profitability. Changes in interest rates may reduce both our profitability from spread businesses and our return on invested capital. Some of our products, principally fixed annuities and interest-sensitive whole life, universal life and the fixed portion of variable universal life insurance, have interest rate guarantees that expose us to the risk that changes in interest rates will reduce our spread, or the difference between the amounts that we are required to pay under the contracts and the amounts we are able to earn on our general account investments intended to support our obligations under the contracts. Declines in our spread or instances where the returns on our general account investments are not enough to support the interest rate guarantees on these products could have a material adverse effect on our businesses or results of operations.

In periods of increasing interest rates, we may not be able to replace the assets in our general account with higher yielding assets needed to fund the higher crediting rates necessary to keep our interest sensitive products competitive. We therefore may have to accept a lower spread and thus lower profitability or face a decline in sales and greater loss of existing contracts and related assets. In periods of declining interest rates, we have to reinvest the cash we receive as interest or return of principal on our investments in lower yielding instruments than available. Moreover, borrowers may prepay fixed-income securities, commercial mortgages and mortgage-backed securities in our general account in order to borrow at lower market rates, which exacerbates this risk. Because we are entitled to reset the interest rates on our fixed rate annuities only at limited, pre-established intervals, and since many of our contracts have guaranteed minimum interest or crediting rates, our spreads could decrease and potentially become negative.

Increases in interest rates may cause increased surrenders and withdrawals of insurance products. In periods of increasing interest rates, policy loans and surrenders and withdrawals of life insurance policies and annuity contracts may increase as contract holders seek to buy products with perceived higher returns. This process may lead to a flow of cash out of our businesses. These outflows may require investment assets to be sold at a time when the prices of those assets are lower because of the increase in market interest rates, which may result in realized investment losses. A sudden demand among consumers to change product types or withdraw funds could lead us to sell assets at a loss to meet the demand for funds.

A downgrade in our financial strength or credit ratings could limit our ability to market products, increase the number or value of policies being surrendered and/or hurt our relationships with creditors.

Nationally recognized rating agencies rate the financial strength of our principal insurance subsidiaries and rate our debt. Ratings are not recommendations to buy our securities. Each of the rating agencies reviews its ratings periodically, and our current ratings may not be maintained in the future. Please see Item 1. Business Ratings for a complete description of our ratings.

Our financial strength ratings, which are intended to measure our ability to meet contract holder obligations, are an important factor affecting public confidence in most of our products and, as a result, our competitiveness. A downgrade of the financial strength rating of one of our principal insurance subsidiaries could affect our competitive position in the insurance industry and make it more difficult for us to market our products as potential customers may select companies with higher financial strength ratings. This could lead to a decrease in fees as outflows of assets increase, and therefore, result in lower fee income. Furthermore, sales of assets to meet customer withdrawal demands could also result in losses, depending on market conditions. The interest rates we pay on our borrowings are largely dependent on our credit ratings. A downgrade of our debt ratings could affect our ability to raise additional debt with terms and conditions similar to our current debt, and accordingly, likely increase our cost of capital. In addition, a downgrade of these ratings could make it more difficult to raise capital to refinance any maturing debt obligations, to support business growth at our insurance subsidiaries and to maintain or improve the current financial strength ratings of our principal insurance subsidiaries described above.

A drop in the rankings of the mutual funds that we manage as well as a loss of key portfolio managers could result in lower advisory fees.

While mutual funds are not rated, per se, many industry periodicals and services, such as Lipper, provide rankings of mutual fund performance. These rankings often have an impact on the decisions of customers regarding which mutual funds to invest in. If the rankings of the mutual funds for which we provide advisory services decrease materially, the funds' assets may decrease as customers leave for funds with higher performance rankings. Similarly, a loss of our key portfolio managers who manage mutual fund investments could result in poorer fund performance, as well as customers leaving these mutual funds for new mutual funds managed by the portfolio managers. Any loss of fund assets would decrease the advisory fees that we earn from such mutual funds, which are generally tied to the amount of fund assets and performance. This would have an adverse effect on our results of operations.

Table of Contents

Our businesses are heavily regulated and changes in regulation may reduce our profitability.

Our insurance subsidiaries are subject to extensive supervision and regulation in the states in which we do business. The supervision and regulation relate to numerous aspects of our business and financial condition. The primary purpose of the supervision and regulation is the protection of our insurance contract holders, and not our investors. The extent of regulation varies, but generally is governed by state statutes. These statutes delegate regulatory, supervisory and administrative authority to state insurance departments. This system of supervision and regulation covers, among other things:

Standards of minimum capital requirements and solvency, including risk-based capital measurements;

Restrictions of certain transactions between our insurance subsidiaries and their affiliates;

Restrictions on the nature, quality and concentration of investments;

Restrictions on the types of terms and conditions that we can include in the insurance policies offered by our primary insurance operations;

Limitations on the amount of dividends that insurance subsidiaries can pay;

The existence and licensing status of the company under circumstances where it is not writing new or renewal business;

Certain required methods of accounting;

Reserves for unearned premiums, losses and other purposes; and

Assignment of residual market business and potential assessments for the provision of funds necessary for the settlement of covered claims under certain policies provided by impaired, insolvent or failed insurance companies.

We may be unable to maintain all required licenses and approvals and our business may not fully comply with the wide variety of applicable laws and regulations or the relevant authority's interpretation of the laws and regulations, which may change from time to time. Also, regulatory authorities have relatively broad discretion to grant, renew or revoke licenses and approvals. If we do not have the requisite licenses and approvals or do not comply with applicable regulatory requirements, the insurance regulatory authorities could preclude or temporarily suspend us from carrying on some or all of our activities or impose substantial fines. Further, insurance regulatory authorities have relatively broad discretion to issue orders of supervision, which permit such authorities to supervise the business and operations of an insurance company. As of December 31, 2007, no state insurance regulatory authority had imposed on us any substantial fines or revoked or suspended any of our licenses to conduct insurance business in any state or issued an order of supervision with respect to our insurance subsidiaries, which would have a material adverse effect on our results of operations or financial condition.

In addition, LFN and LFD, as well as our variable annuities and variable life insurance products, are subject to regulation and supervision by the SEC and FINRA. Our Investment Management segment, like other investment management companies, is subject to regulation and supervision by the SEC, FINRA, the Municipal Securities Rulemaking Board, the Pennsylvania Department of Banking and jurisdictions of the states, territories and foreign countries in which they are licensed to do business. Lincoln UK is subject to regulation by the FSA in the U.K. These laws and regulations generally grant supervisory agencies and self-regulatory organizations broad administrative powers, including the power to limit or restrict the subsidiaries from carrying on their businesses in the event that they fail to comply with such laws and regulations. Finally, our radio operations require a license, subject to periodic renewal, from the Federal Communications Commission to operate. While management considers the likelihood of a failure to renew remote, any station that fails to receive renewal would be forced to cease operations.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Many of the foregoing regulatory or governmental bodies have the authority to review our products and business practices and those of our agents and employees. In recent years, there has been increased scrutiny of our businesses by these bodies, which has included more extensive examinations, regular sweep inquiries and more detailed review of disclosure documents. These regulatory or governmental bodies may bring regulatory or other legal actions against us if, in their view, our practices, or those of our agents or employees, are improper. These actions can result in substantial fines, penalties or prohibitions or restrictions on our business activities and could have a material adverse effect on our business, results of operations or financial condition.

For further information on regulatory matters relating to us, see Item 1. Business Regulatory.

Changes in accounting standards issued by the Financial Accounting Standards Board or other standard-setting bodies may adversely affect our financial statements.

Our financial statements are subject to the application of GAAP, which is periodically revised and/or expanded. Accordingly, from time to time we are required to adopt new or revised accounting standards or guidance issued by recognized authoritative bodies, including the Financial Accounting Standards Board. It is possible that future accounting standards we are required to adopt could change the current accounting treatment that we apply to our consolidated financial statements and that such changes could have a material adverse effect on our financial condition and results of operations. For example, effective January 1, 2008, we adopted Statements of Financial Accounting Standards (SFAS) No. 157 Fair Value Measurements (SFAS 157) which resulted in an increase to our embedded derivative liability for variable annuity living benefits of \$25 million \$75 million after

Table of Contents

DAC and after-tax, recorded through net income. For more information on SFAS 157 and other accounting pronouncements, see Note 2.

Legal and regulatory actions are inherent in our businesses and could result in financial losses or harm our businesses.

Federal and state regulators continue to focus on issues relating to variable insurance products, including suitability and replacements and sales to seniors. Like others in the industry, we have received inquiries including requests for information regarding sales to seniors from FINRA. We are in the process of responding to these inquiries. We continue to cooperate fully with such authority. In addition, we are, and in the future may be, subject to legal actions in the ordinary course of our insurance and investment management operations, both domestically and internationally. Pending legal actions include proceedings relating to aspects of our businesses and operations that are specific to us and proceedings that are typical of the businesses in which we operate. Some of these proceedings have been brought on behalf of various alleged classes of complainants. In certain of these matters, the plaintiffs are seeking large and/or indeterminate amounts, including punitive or exemplary damages. Substantial legal liability in these or future legal or regulatory actions could have a material financial effect or cause significant harm to our reputation, which in turn could materially harm our business prospects. For more information on pending material legal proceedings, see Item 3. Legal Proceedings.

Changes in U.S. federal income tax law could make some of our products less attractive to consumers and increase our tax costs.

EGTRRA and JGTRRA contain provisions that have and will (in the absence of any further legislation) continue, near term, to significantly lower individual tax rates. These may have the effect of reducing the benefits of deferral on the build-up of value of annuities and life insurance products. EGTRRA also includes provisions that will eliminate, over time, the estate, gift and generation-skipping taxes and partially eliminate the step-up in basis rule applicable to property held in a decedent's estate. Many of these provisions expire in 2010, unless extended. The Bush Administration continues to propose that many of the foregoing rate reductions, as well as elimination of the estate tax, be made permanent, and continues to propose several tax-favored savings initiatives, that, if enacted by Congress, could also adversely affect the sale of our annuity, life and tax-qualified retirement products and increase the surrender of such products. Although we cannot predict the overall effect on the sales of our products of the tax law changes included in these Acts, some of these changes might hinder our sales and result in the increased surrender of insurance products.

In addition, changes to the Internal Revenue Code, administrative rulings or court decisions could increase our effective tax rate. In this regard, on August 16, 2007, the Internal Revenue Service (IRS) issued a revenue ruling which purports, among other things, to modify the calculation of separate account deduction for dividends received by life insurance companies. Subsequently, the IRS issued another revenue ruling that suspended the August 16, 2007 ruling and announced a new regulation project on the issue. The current separate account deduction for dividends calculation lowered the effective tax rate by approximately 4% for the year ended December 31, 2007.

Our risk management policies and procedures may leave us exposed to unidentified or unanticipated risk, which could negatively affect our businesses or result in losses.

We have devoted significant resources to develop our risk management policies and procedures and expect to continue to do so in the future. Nonetheless, our policies and procedures to identify, monitor and manage risks may not be fully effective. Many of our methods of managing risk and exposures are based upon our use of observed historical market behavior or statistics based on historical models. As a result, these methods may not predict future exposures, which could be significantly greater than the historical measures indicate, such as the risk of pandemics causing a large number of deaths. Other risk management methods depend upon the evaluation of information regarding markets, clients, catastrophe occurrence or other matters that is publicly available or otherwise accessible to us, which may not always be accurate, complete, up-to-date or properly evaluated. Management of operational, legal and regulatory risks requires, among other things, policies and procedures to record properly and verify a large number of transactions and events, and these policies and procedures may not be fully effective.

Because we are a holding company with no direct operations, the inability of our subsidiaries to pay dividends to us in sufficient amounts would harm our ability to meet our obligations.

We are a holding company and we have no direct operations. Our principal asset is the capital stock of our insurance and investment management subsidiaries.

Our ability to meet our obligations for payment of interest and principal on outstanding debt obligations and to pay dividends to shareholders and corporate expenses depends upon the surplus and earnings of our subsidiaries and the ability of our subsidiaries to pay dividends or to advance or repay funds to us. Payments of dividends and advances or repayment of funds to us by our insurance subsidiaries are restricted by the applicable laws of their respective jurisdictions, including laws establishing minimum

Table of Contents

solvency and liquidity thresholds. Changes in these laws can constrain the ability of our subsidiaries to pay dividends or to advance or repay funds to us in sufficient amounts and at times necessary to meet our debt obligations and corporate expenses.

We face a risk of non-collectibility of reinsurance, which could materially affect our results of operations.

We follow the insurance practice of reinsuring with other insurance and reinsurance companies a portion of the risks under the policies written by our insurance subsidiaries (known as ceding). As of December 31, 2007, we have ceded approximately \$351 billion of life insurance in-force to reinsurers for reinsurance protection. Although reinsurance does not discharge our subsidiaries from their primary obligation to pay contract holders for losses insured under the policies we issue, reinsurance does make the assuming reinsurer liable to the insurance subsidiaries for the reinsured portion of the risk. As of December 31, 2007, we had \$8.2 billion of reinsurance receivables from reinsurers for paid and unpaid losses, for which they are obligated to reimburse us under our reinsurance contracts. Of this amount, \$4.3 billion relates to the sale of our reinsurance business to Swiss Re in 2001 through an indemnity reinsurance agreement. Swiss Re has funded a trust to support this business. The balance in the trust changes as a result of ongoing reinsurance activity and was \$1.8 billion as of December 31, 2007. In addition, should Swiss Re's financial strength ratings drop below either S&P AA- or A.M. Best A or their NAIC risk based capital ratio fall below 250%, assets equal to the reserves supporting business reinsured must be placed into a trust according to pre-established asset quality guidelines. Furthermore, approximately \$2.1 billion of the Swiss Re treaties are funds-withheld structures where we have a right of offset on assets backing the reinsurance receivables.

Included in the business sold to Swiss Re through indemnity reinsurance in 2001 was disability income business. Swiss Re is disputing its obligation to pay approximately \$73 million of reinsurance recoverables on certain of this income disability business. We have agreed to arbitrate this dispute with Swiss Re. Although the outcome of the arbitration is uncertain, we currently believe that it is probable that we will ultimately collect the full amount of the reinsurance recoverable from Swiss Re and that Swiss Re will ultimately remain at risk on all of its obligations on the disability income business that it acquired from us in 2001.

During the third quarter of 2006, one of LNL's reinsurers, Scottish Re Group Ltd (Scottish Re), received rating downgrades from various rating agencies. As of December 31, 2007, of the \$800 million of fixed annuity business that LNL reinsures with Scottish Re, approximately 71% is reinsured through the use of Modco treaties, in which LNL possesses the investments that support the reserves ceded to Scottish Re. For its annuity business ceded on a coinsurance basis, Scottish Re had previously established an irrevocable investment trust for the benefit of LNL that supports the reserves. In addition to fixed annuities, LNL has approximately \$108 million of policy liabilities on the life insurance business it reinsures with Scottish Re. Scottish Re continues to perform under its contractual responsibilities to LNL.

The balance of the reinsurance is due from a diverse group of reinsurers. The collectibility of reinsurance is largely a function of the solvency of the individual reinsurers. We perform annual credit reviews on our reinsurers, focusing on, among other things, financial capacity, stability, trends and commitment to the reinsurance business. We also require assets in trust, letters of credit or other acceptable collateral to support balances due from reinsurers not authorized to transact business in the applicable jurisdictions. Despite these measures, a reinsurer's insolvency, inability or unwillingness to make payments under the terms of a reinsurance contract, especially Swiss Re, could have a material adverse effect on our results of operations and financial condition.

Significant adverse mortality experience may result in the loss of, or higher prices for, reinsurance.

We reinsure a significant amount of the mortality risk on fully underwritten newly issued, individual life insurance contracts. We regularly review retention limits for continued appropriateness and they may be changed in the future. If we were to experience adverse mortality or morbidity experience, a significant portion of that would be reimbursed by our reinsurers. Prolonged or severe adverse mortality or morbidity experience could result in increased reinsurance costs, and ultimately, reinsurers not willing to offer coverage. If we are unable to maintain our current level of reinsurance or purchase new reinsurance protection in amounts that we consider sufficient, we would either have to be willing to accept an increase in our net exposures or revise our pricing to reflect higher reinsurance premiums. If this were to occur, we may be exposed to reduced profitability and cash flow strain or we may not be able to price new business at competitive rates.

Catastrophes may adversely impact liabilities for contract holder claims and the availability of reinsurance.

Our insurance operations are exposed to the risk of catastrophic mortality, such as a pandemic, an act of terrorism or other event that causes a large number of deaths or injuries. Significant influenza pandemics have occurred three times in the last century, but the likelihood, timing, or the severity of a future pandemic cannot be predicted. In our group insurance operations, a localized event that affects the workplace of one or more of our group insurance customers could cause a significant loss due to mortality or morbidity claims. These events could cause a material adverse effect on our results of operations in any period and, depending on their severity, could also materially and adversely affect our financial condition.

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The extent of losses from a catastrophe is a function of both the total amount of insured exposure in the area affected by the event and the severity of the event. Pandemics, hurricanes, earthquakes and man-made catastrophes, including terrorism, may produce

Table of Contents

significant damage in larger areas, especially those that are heavily populated. Claims resulting from natural or man-made catastrophic events could cause substantial volatility in our financial results for any fiscal quarter or year and could materially reduce our profitability or harm our financial condition. Also, catastrophic events could harm the financial condition of our reinsurers and thereby increase the probability of default on reinsurance recoveries. Accordingly, our ability to write new business could also be affected.

Consistent with industry practice and accounting standards, we establish liabilities for claims arising from a catastrophe only after assessing the probable losses arising from the event. We cannot be certain that the liabilities we have established will be adequate to cover actual claim liabilities, and a catastrophic event or multiple catastrophic events could have a material adverse effect on our business, results of operations and financial condition.

We may be unable to attract and retain sales representatives and other employees, particularly financial advisors.

We compete to attract and retain financial advisors, wholesalers, portfolio managers and other employees, as well as independent distributors of our products. Intense competition exists for persons and independent distributors with demonstrated ability. We compete with other financial institutions primarily on the basis of our products, compensation, support services and financial position. Sales in our businesses and our results of operations and financial condition could be materially adversely affected if we are unsuccessful in attracting and retaining financial advisors, wholesalers, portfolio managers and other employees, as well as independent distributors of our products.

Our sales representatives are not captive and may sell products of our competitors.

We sell our annuity and life insurance products through independent sales representatives. These representatives are not captive, which means they may also sell our competitors' products. If our competitors offer products that are more attractive than ours, or pay higher commission rates to the sales representatives than we do, these representatives may concentrate their efforts in selling our competitors' products instead of ours.

Intense competition could negatively affect our ability to maintain or increase our profitability.

Our businesses are intensely competitive. We compete based on a number of factors including name recognition, service, the quality of investment advice, investment performance, product features, price, perceived financial strength, claims-paying and credit ratings. Our competitors include insurers, broker-dealers, financial advisors, asset managers and other financial institutions. A number of our business units face competitors that have greater market share, offer a broader range of products or have higher financial strength or credit ratings than we do.

In recent years, there has been substantial consolidation and convergence among companies in the financial services industry resulting in increased competition from large, well-capitalized financial services firms. Many of these firms also have been able to increase their distribution systems through mergers or contractual arrangements. Furthermore, larger competitors may have lower operating costs and an ability to absorb greater risk while maintaining their financial strength ratings, thereby allowing them to price their products more competitively. We expect consolidation to continue and perhaps accelerate in the future, thereby increasing competitive pressure on us.

Losses due to defaults by others could reduce our profitability or negatively affect the value of our investments.

Third parties that owe us money, securities or other assets may not pay or perform their obligations. These parties include the issuers whose securities we hold, borrowers under the mortgage loans we make, customers, trading counterparties, counterparties under swaps and other derivative contracts, reinsurers and other financial intermediaries. These parties may default on their obligations to us due to bankruptcy, lack of liquidity, downturns in the economy or real estate values, operational failure, corporate governance issues or other reasons. A downturn in the U.S. and other economies could result in increased impairments.

Anti-takeover provisions could delay, deter or prevent our change in control even if the change in control would be beneficial to LNC shareholders.

We are an Indiana corporation subject to Indiana state law. Certain provisions of Indiana law could interfere with or restrict takeover bids or other change in control events affecting us. Also, provisions in our articles of incorporation, bylaws and other agreements to which we are a party could delay, deter or prevent our change in control, even if a change in control would be beneficial to shareholders. In addition, under Indiana law, directors may, in considering the best interests of a corporation, consider the effects of any action on stockholders, employees, suppliers and customers of the corporation and the communities in which offices and other facilities are located, and other factors the directors consider pertinent. One statutory provision prohibits, except under specified circumstances, LNC from engaging in any business combination with any shareholder who owns 10% or more of our common stock (which shareholder, under the statute, would be considered an interested shareholder) for a period of five years following the time that such shareholder became an interested shareholder, unless such business

combination is

Table of Contents

approved by the board of directors prior to such person becoming an interested shareholder. In addition, our articles of incorporation contain a provision requiring holders of at least three-fourths of our voting shares then outstanding and entitled to vote at an election of directors, voting together, to approve a transaction with an interested shareholder rather than the simple majority required under Indiana law.

In addition to the anti-takeover provisions of Indiana law, there are other factors that may delay, deter or prevent our change in control. As an insurance holding company, we are regulated as an insurance holding company and are subject to the insurance holding company acts of the states in which our insurance company subsidiaries are domiciled. The insurance holding company acts and regulations restrict the ability of any person to obtain control of an insurance company without prior regulatory approval. Under those statutes and regulations, without such approval (or an exemption), no person may acquire any voting security of a domestic insurance company, or an insurance holding company which controls an insurance company, or merge with such a holding company, if as a result of such transaction such person would control the insurance holding company or insurance company. Control is generally defined as the direct or indirect power to direct or cause the direction of the management and policies of a person and is presumed to exist if a person directly or indirectly owns or controls 10% or more of the voting securities of another person.

Our business, results of operations and financial condition may be adversely affected by general domestic economic and business conditions that are less favorable than anticipated.

Recent events, including fallout from problems in the U.S. credit markets, indicate a potential near-term recession in the U.S. economy. A steady economy is important as it provides for continuing demand for our insurance and investment-type products. Insurance premium growth, with respect to life and disability products, for example, is closely tied to employers' total payroll growth. A recession resulting in higher unemployment, lower family income, lower corporate earnings, lower business investment and lower consumer spending, could cause the demand for our financial and insurance products to be adversely affected, and therefore, have an adverse effect on our results of operations. In addition, continued problems in the U.S. capital markets could have an adverse effect on our financial condition and liquidity.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

LNC and the various operating businesses own or lease approximately 4.1 million square feet of office space. We lease 0.4 million square feet of office space in Philadelphia, Pennsylvania. In 2007, our corporate center, the Investment Management segment, LFD and LFN occupied the space in Philadelphia. In 2007, we leased 0.2 million square feet of office space in Radnor, Pennsylvania, which will contain our corporate center and LFD beginning in the second quarter of 2008. The operating units in the Fort Wayne, Indiana and Greensboro, North Carolina areas own or lease 1.6 million square feet. Also, businesses operating in the Chicago, Illinois metro area, Atlanta, Georgia, Omaha, Nebraska, Concord, New Hampshire, Hartford, Connecticut and the U.K. own or lease another 0.9 million square feet of office space. An additional 1.0 million square feet of office space is owned or leased in other U.S. cities for branch offices and other operations. As provided in Note 13, the rental expense on operating leases for office space and equipment totaled \$65 million for 2007. This discussion regarding properties does not include information on investment properties.

Item 3. Legal Proceedings

For information regarding legal proceedings, see Regulatory and Litigation Matters in Note 13 which is incorporated herein by reference.

Item 4. Submission of Matters to a Vote of Security Holders

During the fourth quarter of 2007, no matters were submitted to security holders for a vote.

Table of Contents**Executive Officers of the Registrant**

Executive Officers of the Registrant as of February 29, 2008 were as follows:

Name	Age**	Position with LNC and Business Experience During the Past Five Years
Dennis R. Glass	58	President, Chief Executive Officer and Director (since July 2007). President, Chief Operating Officer and Director (April 2006 - July 2007). President and Chief Executive Officer, Jefferson-Pilot (2004 - April 2006). President and Chief Operating Officer, Jefferson-Pilot (2001 - April 2006).
Charles C. Cornelio	48	Senior Vice President, Shared Services and Chief Information Officer (since April 2006). Executive Vice President, Technology and Insurance Services, Jefferson-Pilot (2004 - April 2006). Senior Vice President, Jefferson-Pilot (1997 - 2004).
Patrick P. Coyne	44	President of Lincoln National Investment Companies, Inc.* and Delaware Management Holdings, Inc.* (since July 2006). Executive Vice President and Chief Investment Officer, Lincoln National Investment Company, Inc. and Delaware Management Holdings, Inc. (2003 - July 2006). Senior Vice President and Deputy Chief Investment Officer, Lincoln National Investment Company, Inc. and Delaware Management Holdings, Inc. (2002 -2003).
Frederick J. Crawford	44	Senior Vice President and Chief Financial Officer (since 2005). Vice President and Treasurer (2001 - 2004).
Robert W. Dineen	58	President, Lincoln Financial Advisors* (since 2002). Senior Vice President, Managed Asset Group, Merrill Lynch, a diversified financial services company (2001 - 2002).
Heather C. Dzielak	39	Senior Vice President, Retirement Income Security Ventures* (since September 2006). Vice President, Lincoln National Life Insurance Company* (December 2003 - September 2006). Vice President of Sales - Chief Administrative Officer, ING USA Annuity and Life Insurance Co. (May - November 2003). Vice President of Sales - Income Annuity Product Line Leader, ING USA Annuity and Life Insurance Co. (2001 - 2003).
Mark E. Konen	48	President, Individual Markets* (since April 2006). Executive Vice President, Life and Annuity Manufacturing, Jefferson-Pilot (2004 - April 2006). Executive Vice President, Product/Financial Management (2002 - 2004). Executive Vice President, Product Development, M&A (2000 - 2002).
Terrence J. Mullen	43	President, Lincoln Financial Distributors (since 2006). Senior Vice President, Head of Sales, Lincoln Financial Distributors (2004 - 2006). Senior Vice President and Managing Director, American Legacy (2003 - 2004). Senior Vice President, National Sales Manager and Managing Director, Seasons Select at AIG SunAmerica, a retirement savings and investment products company (1996 - 2003).
Elizabeth L. Reeves	54	Senior Vice President, Chief Human Resources Officer (since 2005). Senior Vice President, Human Resources, The ServiceMaster Company, a home services company (2002 - 2004). Executive Vice President, Human Resources, BCOM 3 Group (now Publicis), a communications company (2000 - 2002).

Table of Contents

Name	Age**	Position with LNC and Business Experience During the Past Five Years
Dennis L. Schoff	48	Senior Vice President, LNC and General Counsel (since 2002). Vice President and Deputy General Counsel (2001 - 2002).
Michael Tallett-Williams	54	President and Managing Director, Lincoln National (UK)* (since 2000).
Westley V. Thompson	53	President, Employer Markets* (since April 2006). Chief Executive Officer and President, Lincoln Financial Distributors (2000 - April 2006). Senior Vice President, Lincoln Life and Annuity Distributors (1998 - 2002).

* Denotes an affiliate of LNC.

** Age shown is based on the officer's age as of February 29, 2008.

Table of Contents**PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities****(a) Stock Market and Dividend Information**

Our common stock is traded on the New York and Chicago stock exchanges under the symbol LNC. At December 31, 2007, the number of shareholders of record of our common stock was 11,742. The dividend on our common stock is declared each quarter by our Board of Directors. In determining dividends, the Board takes into consideration items such as our financial condition, including current and expected earnings, projected cash flows and anticipated financing needs. For potential restrictions on our ability to pay dividends, see "Review of Consolidated Financial Condition" in the MD&A and Note 18. The following table presents the high and low closing prices for our common stock on the New York Stock Exchange during the periods indicated and the dividends declared per share during such periods:

	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
2007				
High	\$ 71.18	\$ 74.72	\$ 72.28	\$ 70.66
Low	64.29	66.90	54.40	55.84
Dividend declared	0.395	0.395	0.395	0.415
2006				
High	\$ 57.97	\$ 60.52	\$ 63.47	\$ 66.72
Low	52.00	54.30	53.94	61.74
Dividend declared	0.380	0.380	0.380	0.395

(b) Not Applicable**(c) Issuer Purchases of Equity Securities**

The following table summarizes our stock repurchases during the quarter ended December 31, 2007 (dollars in millions, except per share data):

Period	(a) Total Number of Shares (or Units) Purchased ⁽¹⁾	(b) Average Price Paid per Share (or Unit)	(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs ⁽²⁾	(d) Approximate Dollar Value of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs ⁽³⁾
10/1/07 - 10/31/07	4,362	\$ 68.47		\$ 1,963.4
11/1/07 - 11/30/07	4,182,013	59.76	4,181,100	1,713.5
12/1/07 - 12/31/07	846,056	59.49	842,281	1,663.4

(1)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Of the total number of shares purchased, 7,236 shares were received in connection with the exercise of stock options and related taxes and 1,814 shares were withheld for taxes on the vesting of restricted stock. For the quarter ended December 31, 2007, there were 5,023,381 shares purchased as part of publicly announced plans or programs.

- (2) On February 23, 2007, our Board approved a \$2 billion increase to our existing securities repurchase authorization, bringing the total authorization at that time to \$2.6 billion. At December 31, 2007, our security repurchase authorization was \$1.7 billion. The security repurchase authorization does not have an expiration date. The amount and timing of share repurchase depends on key capital ratios, rating agency expectations, the generation of free cash flow and an evaluation of the costs and benefits associated with alternative uses of capital. The shares repurchased in connection with the awards described in footnote (1) are not included in our security repurchase.
- (3) As of the last day of the applicable month.

Table of Contents**(d) Securities Authorized for Issuance Under Equity Compensation Plans**

For information on securities authorized for issuance under equity compensation plans, see Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters, which is hereby incorporated by reference.

Item 6. Selected Financial Data

The following selected financial data (in millions, except per share data) should be read in conjunction with the MD&A and the Notes of this report. Some previously reported amounts have been reclassified to conform to the presentation at and for the year ended December 31, 2007.

	For the Years Ended December 31,				
	2007	2006	2005	2004	2003
Total revenues	\$ 10,594	\$ 8,962	\$ 5,475	\$ 5,351	\$ 5,284
Income from continuing operations	1,321	1,295	831	732	767
Net income	1,215	1,316	831	707	512
Per share data ⁽¹⁾ :					
Net income basic	\$ 4.50	\$ 5.21	\$ 4.80	\$ 4.01	\$ 2.89
Net income diluted	4.43	5.13	4.72	3.95	2.85
Common stock dividends	1.600	1.535	1.475	1.415	1.355
	As of December 31,				
	2007	2006	2005	2004	2003
Assets	\$ 191,435	\$ 178,495	\$ 124,860	\$ 116,219	\$ 106,745
Long-term debt	4,618	3,458	1,333	1,389	1,459
Stockholders' equity	11,718	12,201	6,384	6,176	5,812
Per share data ⁽¹⁾ :					
Stockholders' equity including accumulated other comprehensive income ⁽²⁾	\$ 44.32	\$ 44.21	\$ 36.69	\$ 35.53	\$ 32.56
Stockholders' equity excluding accumulated other comprehensive income ⁽²⁾	43.46	41.99	33.66	30.17	27.69
Market value of common stock	58.22	66.40	53.03	46.68	40.37

⁽¹⁾ Per share amounts were affected by the issuance of 112.3 million shares for the acquisition of Jefferson-Pilot in 2006 and the retirement of 15.4 million, 16.9 million, 2.3 million and 7.6 million shares of common stock during the years ended December 31, 2007, 2006, 2005 and 2004, respectively.

⁽²⁾ Per share amounts are calculated under the assumption that preferred stock has been converted to common stock.

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following Management's Discussion and Analysis (MD&A) is intended to help the reader understand the results of operations and financial condition of Lincoln National Corporation and its consolidated subsidiaries (LNC, Lincoln or the Company which also may be referred to as we, our or us) as of December 31, 2007, compared with December 31, 2006, and the results of operations of LNC in 2007 and 2006, compared with the immediately preceding year. On April 3, 2006, LNC completed its merger with Jefferson-Pilot Corporation (Jefferson-Pilot). Beginning on April 3, 2006, the results of operations and financial condition of Jefferson-Pilot, after being adjusted for the effects of purchase accounting, were consolidated with LNC. The financial information presented herein for the year ended December 31, 2006 reflects the accounts of LNC for the three months ended March 31, 2006, and the consolidated accounts of LNC and Jefferson-Pilot for the remainder of 2006. The data presented herein for the 2005 period reflects the accounts of LNC. The MD&A is provided as a supplement to, and should be read in conjunction with, our consolidated financial statements and the accompanying notes to the consolidated financial statements (Notes) presented in Item 8. Financial Statements and Supplementary Data.

In this report, in addition to providing consolidated revenues and net income (loss), we also provide segment operating revenues and income (loss) from operations because we believe they are meaningful measures of revenues and the profitability of our operating segments.

Operating revenues are revenues recorded in accordance with accounting principles generally accepted in the United States of America (GAAP) excluding realized gains and losses and the amortization of deferred gains arising from reserve development on business sold through reinsurance.

Income (loss) from operations is GAAP net income excluding net realized gains and losses, losses on early retirement of debt, reserve development (net of related amortization) on business sold through reinsurance, discontinued operations and the initial impact of the adoption of changes in accounting principles.

Operating revenues and income (loss) from operations are the financial performance measures we use to evaluate and assess the results of our segments. Accordingly, we report operating revenues and income (loss) from operations by segment in Note 20. Our management and Board of Directors believe that operating revenues and income (loss) from operations explain the results of our ongoing businesses in a manner that allows for a better understanding of the underlying trends in our current businesses because the excluded items are unpredictable and not necessarily indicative of current operating fundamentals or future performance of the business segments, and, in many instances, decisions regarding these items do not necessarily relate to the operations of the individual segments. Operating revenues and income (loss) from operations do not replace revenues and net income as the GAAP measures of our consolidated results of operations.

Certain reclassifications have been made to prior periods' financial information to conform to the 2007 presentation.

FORWARD-LOOKING STATEMENTS - CAUTIONARY LANGUAGE

Certain statements made in this report and in other written or oral statements made by LNC or on LNC's behalf are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (PSLRA). A forward-looking statement is a statement that is not a historical fact and, without limitation, includes any statement that may predict, forecast, indicate or imply future results, performance or achievements, and may contain words like: believe, anticipate, expect, estimate, project, will, shall and other words or phrases with similar meaning in connection with a discussion of future operating or financial performance. In particular, these include statements relating to future actions, trends in our business, prospective services or products, future performance or financial results and the outcome of contingencies, such as legal proceedings. LNC claims the protection afforded by the safe harbor for forward-looking statements provided by the PSLRA.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from the results contained in the forward-looking statements. Risks and uncertainties that may cause actual results to vary materially, some of which are described within the forward-looking statements, include, among others:

Legislative, regulatory or tax changes, both domestic and foreign, that affect the cost of, or demand for, LNC's products, the required amount of reserves and/or surplus, or otherwise affect our ability to conduct business, including changes to statutory reserves and/or risk-based capital requirements related to secondary guarantees under universal life and variable annuity products such as Actuarial Guideline VACARVM (VACARVM); restrictions on revenue sharing and 12b-1 payments; and the potential for U.S. Federal tax reform;

The initiation of legal or regulatory proceedings against LNC or its subsidiaries, and the outcome of any legal or regulatory proceedings, such as: (a) adverse actions related to present or past business practices common in businesses in which LNC and its subsidiaries compete; (b) adverse decisions in significant actions including, but not limited to, actions brought by federal and state authorities and extra-contractual and class action damage cases; (c) new decisions that result in changes in law; and (d) unexpected trial court rulings;

Table of Contents

Changes in interest rates causing a reduction of investment income, the margins of LNC's fixed annuity and life insurance businesses and demand for LNC's products;

A decline in the equity markets causing a reduction in the sales of LNC's products, a reduction of asset-based fees that LNC charges on various investment and insurance products, an acceleration of amortization of deferred acquisition costs (DAC), value of business acquired (VOBA), deferred sales inducements (DSI) and deferred front-end loads (DFEL) and an increase in liabilities related to guaranteed benefit features of LNC's variable annuity products;

Ineffectiveness of LNC's various hedging strategies used to offset the impact of changes in the value of liabilities due to changes in the level and volatility of the equity markets and interest rates;

A deviation in actual experience regarding future persistency, mortality, morbidity, interest rates or equity market returns from LNC's assumptions used in pricing its products, in establishing related insurance reserves and in the amortization of intangibles that may result in an increase in reserves and a decrease in net income, including as a result of investor-owned life insurance business;

Changes in GAAP that may result in unanticipated changes to LNC's net income, including the impact of Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements (SFAS 157), and SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities;

Lowering of one or more of LNC's debt ratings issued by nationally recognized statistical rating organizations and the adverse impact such action may have on LNC's ability to raise capital and on its liquidity and financial condition;

Lowering of one or more of the insurer financial strength ratings of LNC's insurance subsidiaries and the adverse impact such action may have on the premium writings, policy retention and profitability of its insurance subsidiaries;

Significant credit, accounting, fraud or corporate governance issues that may adversely affect the value of certain investments in the portfolios of LNC's companies requiring that LNC realize losses on such investments;

The impact of acquisitions and divestitures, restructurings, product withdrawals and other unusual items, including LNC's ability to integrate acquisitions and to obtain the anticipated results and synergies from acquisitions, including LNC's ability to successfully integrate Jefferson-Pilot's businesses, to achieve the expected synergies from the merger or to achieve such synergies within our expected timeframe;

The adequacy and collectibility of reinsurance that LNC has purchased;

Acts of terrorism, war or other man-made and natural catastrophes that may adversely affect LNC's businesses and the cost and availability of reinsurance;

Competitive conditions, including pricing pressures, new product offerings and the emergence of new competitors, that may affect the level of premiums and fees that LNC can charge for its products;

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

The unknown impact on LNC's business resulting from changes in the demographics of LNC's client base, as aging baby-boomers move from the asset-accumulation stage to the asset-distribution stage of life;

Loss of key management, portfolio managers in the Investment Management segment, financial planners or wholesalers; and

Changes in general economic or business conditions, both domestic and foreign, that may be less favorable than expected and may affect foreign exchange rates, premium levels, claims experience, the level of pension benefit costs and funding and investment results. The risks included here are not exhaustive. Other sections of this report, LNC's quarterly reports on Form 10-Q, current reports on Form 8-K and other documents filed with the Securities and Exchange Commission (SEC) include additional factors that could impact LNC's business and financial performance, including Item 1A. Risk Factors, Item 7A. Quantitative and Qualitative Disclosures About Market Risk and the risk discussions included in this section under Critical Accounting Policies and Estimates, Consolidated Investments and Reinsurance, which are incorporated herein by reference. Moreover, LNC operates in a rapidly changing and competitive environment. New risk factors emerge from time to time, and it is not possible for management to predict all such risk factors.

Further, it is not possible to assess the impact of all risk factors on LNC's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results. In addition, LNC disclaims any obligation to update any forward-looking statements to reflect events or circumstances that occur after the date of this report.

INTRODUCTION

Executive Summary

We are a holding company that operates multiple insurance and investment management businesses as well as a radio broadcasting business through subsidiary companies. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products include institutional and/or retail fixed and indexed annuities, variable annuities, universal life insurance (UL), variable universal life insurance (VUL), linked-benefit UL, term life insurance, mutual funds and managed accounts.

Table of Contents

We provide products and services in four operating businesses: (1) Individual Markets; (2) Employer Markets; (3) Investment Management; and (4) Lincoln UK, and report results through six business segments. These operating businesses and their segments are described in Item 1. Business.

In 2007, we launched a broader life insurance and annuity unified product suite available to our distribution force. We have plans to launch the final unified variable life insurance product in the second quarter of 2008 after receiving appropriate regulatory approvals. In February 2008, we launched a new guaranteed minimum withdrawal benefit (GMWB), *Lincoln Lifetime Income*SM Advantage, which includes such features as a reduced minimum age for lifetime income eligibility; a 5% benefit enhancement in each year an owner does not take a withdrawal; a health care benefit; and a guaranteed minimum accumulation benefit.

Our individual products and services are distributed primarily through brokers, planners, agents and other intermediaries with sales and marketing support provided by approximately 650 wholesalers within Lincoln Financial Distributors (LFD), our wholesaling distributor. Our group products and services are distributed primarily through financial advisors, employee benefit brokers, third party administrators and other employee benefit firms with sales support provided by Lincoln s Employer Markets group and retirement sales specialists. Our retail distributor, Lincoln Financial Network, offers LNC and non-proprietary products and advisory services through a national network of approximately 7,300 active producers who placed business with us within the last twelve months.

We offer creative product solutions that focus on how each part of a person s portfolio can provide income, accumulation, protection or leverage appropriately during the different phases of the retirement wealth cycle. We believe that our Retirement Income Security Venture (RISV), a group of individuals from within our organization, is focused on anticipating future needs and developing solutions to meet those opportunities during the different phases. We believe that the baby-boomer generation reaching retirement age will present an emerging opportunity for companies like ours that offer products allowing baby-boomers to better manage their wealth accumulation, retirement income and wealth transfer needs and to protect their assets through risk transfer product features. Retirement income security represents all of the risks at various stages of the wealth management cycle, not just the risk of outliving income during retirement. According to industry studies, by 2012, it is estimated that there will be over \$1 trillion of money in motion each and every year as retirees begin to withdraw funds from their retirement vehicles and the retirees will need a strategy to manage those funds. We expect that these retirees will also be looking for the ability to transfer risk of their financial retirement decisions from themselves to someone else, and we believe the insurance industry is uniquely positioned to transfer those risks.

Within the Individual Markets variable annuity business, our *Lincoln SmartSecurity*[®] Advantage, with its one-year reset feature, including the Lifetime withdrawal benefit introduced in 2006, and five-year reset feature, contributed to our growth with elections of these riders totaling 41% of deposits in 2007. We also offer a patented annuity product feature, *i4LIFE*[®], which we introduced a few years ago to meet the needs of baby-boomers for retirement income as they enter the retirement phase of their life cycle. The *i4LIFE*[®] Advantage product offers a guaranteed minimum income benefit (GIB) rider, which can be elected to provide a floor to the amount of income available from the annuity during retirement. In 2007, elections of *i4LIFE*[®] were \$2.4 billion, an increase of \$786 million over 2006. Additionally, in 2006, we introduced 4LATER[®] to meet the needs of baby-boomers who are not ready for retirement but are ready to plan for it. In 2007, deposits of 4LATER[®] were approximately \$2.0 billion. We also offer a fixed indexed annuity, which offers upside growth from equity markets with fixed return protection.

In our Individual Markets - Life Insurance segment, we are in a competitive marketplace, especially related to life insurance products with secondary guarantees. This product requires us to maintain risk management and pricing discipline, which is especially important in the competitive environment. Sales of insurance products with such guarantees comprised 70% of our life insurance sales in 2007. The statutory reserving requirements for these products are such that it is necessary for us to utilize capital market solutions to manage the level of reserves held in our domestic life insurance companies. As a result, as discussed in Recent Developments below, we completed a transaction that enabled us to release approximately \$300 million of capital in 2007 from one of our insurance subsidiaries under Actuarial Guideline 38 (AXXX).

Our Employer Markets business has more than \$42.6 billion in account values, including \$36.1 billion for Defined Contribution. This business unit provides us the platform to benefit from the movement in the marketplace by employees away from the traditional defined benefit pension plans towards voluntary defined contribution plans, such as 401(k)s and 403(b)s, and the increase in voluntary group life and disability has also provided for a convergence of distribution strategies. We also believe that there are opportunities to capitalize on revenue synergies by leveraging our Group Protection s group business with Retirement Products defined contribution platform for a single employer solution. We also believe that the Pension Protection Act of 2006 (PPA) will benefit the Employer Markets business. Our oldest block of business in our Retirement Products segment is in run-off mode, and a substantial increase in new deposit production will be necessary to maintain earnings at current levels.

As our businesses and products are complex, so is the manner in which we derive income. For a discussion on how we derive our revenues, see our discussion in results of operations by segment below.

Table of Contents

Going into 2008, we expect our major challenges to include:

Continuation of volatility in the capital markets;

Continuation of decline in the economy or a recession;

Success of our unified product portfolio and marketplace acceptance of new variable annuity features that will help maintain our competitive position;

Continuation of the low interest rate environment, which creates a challenge for our products that generate investment margin profits, such as fixed annuities and UL;

Continuation of competitive pressures in the life insurance and annuity marketplace and regulatory scrutiny of the life and annuity industry, which may lead to higher product costs and negative perceptions about the industry;

Continuation of the successful expansion of our wholesale distribution businesses;

Ability to improve financial and sales results and increase scale in our Employer Markets business;

Ability to generate tangible results from RISV; and

Continuation of focus by the government on tax reform, which may impact our products.

In the face of these challenges, we expect to focus on the following throughout 2008:

Continue to significantly invest in expanding our distribution in each of our core Individual Markets, Investment Management and Employer Markets businesses;

Continue near term product development in our manufacturing units and future product development initiatives in our RISV unit related to the evolving retirement income security marketplace;

Explore strategies to increase scale in our Employer Markets - Defined Contribution and Investment Management segments;

Further embed financial and execution discipline throughout our operations by using technology and making other investments to improve operating effectiveness and lower unit costs; and

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Substantially complete the remaining platform and system consolidations necessary to achieve the final portion of integration cost saves as well as prepare us for more effective customer interaction in the future.

Industry Trends

We continue to be influenced by a variety of trends that affect the industry.

Financial Environment

The level of long-term interest rates and the shape of the yield curve can have a negative impact on the demand for and the profitability of spread-based products such as fixed annuities and UL. A flat or inverted yield curve and low long-term interest rates will be a concern if new money rates on corporate bonds are lower than overall life insurer investment portfolio yields. Equity market performance can also impact the profitability of life insurers, as product demand and fee revenue from variable annuities and fee revenue from pension products tied to separate account balances often reflect equity market performance. Since mid-2007, the capital markets have experienced uncertainty in consumer credit related to sub-prime loans, which has contributed to increased credit losses and illiquidity. This uncertainty has also contributed to significant volatility in the equity markets and has raised fears of recession. A steady economy is important as it provides for continuing demand for insurance and investment-type products. Insurance premium growth, with respect to life and disability products, for example, is closely tied to employers' total payroll growth. Additionally, the potential market for these products is expanded by new business creation.

Demographics

In the coming decade, a key driver shaping the actions of the insurance industry will be the rising income protection, wealth accumulation and needs of the retiring baby-boomers. As a result of increasing longevity, retirees will need to accumulate sufficient savings to finance retirements that may span 30 or more years. Helping the baby-boomers to accumulate assets for retirement and subsequently to convert these assets into retirement income represents an opportunity for the insurance industry.

Insurers are well positioned to address the baby-boomers' rapidly increasing need for savings tools and for income protection. We believe that, among insurers, those with strong brands, high financial strength ratings and broad distribution, are best positioned to capitalize on the opportunity to offer income protection products to baby-boomers.

Moreover, the insurance industry's products and the needs they are designed to address are complex. We believe that individuals approaching retirement age will need to seek information to plan for and manage their retirements and that, in the workplace, as employees take greater responsibility for their benefit options and retirement planning, they will need information about their possible individual needs. One of the challenges for the insurance industry will be the delivery of this information in a cost effective manner.

Table of Contents

Competitive Pressures

The insurance industry remains highly competitive. The product development and product life cycles have shortened in many product segments, leading to more intense competition with respect to product features. Larger companies have the ability to invest in brand equity, product development, technology and risk management, which are among the fundamentals for sustained profitable growth in the life insurance industry. In addition, several of the industry's products can be quite homogeneous and subject to intense price competition. Sufficient scale, financial strength and financial flexibility are becoming prerequisites for sustainable growth in the life insurance industry. Larger market participants tend to have the capacity to invest in additional distribution capability and the information technology needed to offer the superior customer service demanded by an increasingly sophisticated industry client base.

Regulatory Changes

The insurance industry is regulated at the state level, with some products and services also subject to federal regulation. As life insurers introduce new and often more complex products, regulators refine capital requirements and introduce new reserving standards for the life insurance industry. Regulations recently adopted or currently under review can potentially impact the reserve and capital requirements of the industry. In addition, regulators have undertaken market and sales practice reviews of several markets or products, including indexed annuities, variable annuities and group products.

Pension Plans

On August 17, 2006, President Bush signed the PPA into law. This act is considered to be the most sweeping pension legislation since the adoption of the Employee Retirement Income Security Act of 1974 on September 2, 1974. The provisions of the PPA may have a significant impact on demand for pension, retirement savings and lifestyle protection products in both the institutional and retail markets. This legislation, while not immediate, may have a positive impact on the life insurance and financial services industries in the future.

Recent Developments

On October 9, 2007, we issued \$375 million aggregate principal amount of our 6.30% Senior Notes due October 9, 2037. We contributed the net proceeds of approximately \$370 million from the offering to a new wholly-owned insurance subsidiary. This new subsidiary was created for the purpose of reinsuring the policy liabilities of our existing insurance affiliates, primarily related to statutory reserves on UL products with secondary guarantees. These reserves are calculated under prevailing statutory reserving requirements as promulgated under AXXX. The transaction released approximately \$300 million of capital previously supporting our UL products with secondary guarantees. We intend to use the released capital for general corporate purposes, including for share repurchase and supporting future business growth.

For details surrounding the 2007 transactions pertaining to our media and fixed income investment management businesses, see [Acquisition and Dispositions](#) below.

Critical Accounting Policies and Estimates

We have identified the accounting policies below as critical to the understanding of our results of operations and our financial position. In applying these critical accounting policies in preparing our financial statements, management must use significant assumptions, estimates, and judgments and estimates concerning future results or other developments, including the likelihood, timing or amount of one or more future events. Actual results may differ from these estimates under different assumptions or conditions. On an ongoing basis, we evaluate our assumptions, estimates and judgments based upon historical experience and various other information that we believe to be reasonable under the circumstances. For a detailed discussion of other significant accounting policies, see Note 1.

DAC, VOBA, DSI and DFEL

Accounting for intangible assets requires numerous assumptions, such as estimates of expected future profitability for our operations and our ability to retain existing blocks of life and annuity business in force. Our accounting policies for DAC, VOBA, DSI and DFEL impact the Individual Markets - Annuities, Individual Markets - Life Insurance, Employer Markets - Retirement Products, Employer Markets - Group Protection and Lincoln UK segments.

Acquisition costs for variable annuity and deferred fixed annuity contracts and UL and VUL policies, which are accounted for under SFAS No. 97, [Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts](#) and for Realized Gains and Losses from the Sale of Investments ([SFAS 97](#)), are amortized over the lives of the contracts in relation to the incidence of estimated gross profits ([EGPs](#))

derived from the contracts. Acquisition costs are those costs that vary with and are

Table of Contents

primarily related to new or renewal business. These costs include commissions and other expenses that vary with new business volume. The costs that we defer are recorded as an asset on our Consolidated Balance Sheets as DAC for products we sold or VOBA for books of business we acquired. In addition, we defer costs associated with DSI and revenues associated with DFEL. DFEL is a liability included within other contract holder funds on our Consolidated Balance Sheets, and when amortized, increases product expense charge revenues and income. DSI is included within other assets on our Consolidated Balance Sheets and, when amortized, increases interest credited and reduces income.

EGPs vary based on a number of sources including policy persistency, mortality, fee income, investment margins, expense margins and realized gains and losses on investments, including assumptions about the expected level of credit-related losses. Each of these sources of profit is, in turn, driven by other factors. For example, assets under management and the spread between earned and credited rates drive investment margins; net amount at risk (NAR) drives the level of cost of insurance (COI) charges and reinsurance premiums. The level of separate account assets under management is driven by changes in the financial markets (equity and bond markets, hereafter referred to collectively as equity markets) and net flows. Realized gains and losses on investments include amounts resulting from differences in the actual level of impairments and the levels assumed in calculating EGPs.

Our DAC, VOBA, DSI and DFEL balances (in millions) by business segment as of December 31, 2007, were as follows:

	Individual Markets		Employer Markets		Lincoln UK	Other Operations	Total
	Annuities	Life Insurance	Retirement Products	Group Protection			
DAC and VOBA	\$ 2,477	\$ 5,409	\$ 797	\$ 123	\$ 772	\$ 2	\$ 9,580
DSI	279						279
Total	2,756	5,409	797	123	772	2	9,859
DFEL	131	649	24		379		1,183
Net total	\$ 2,625	\$ 4,760	\$ 773	\$ 123	\$ 393	\$ 2	\$ 8,676

Note: The above table includes DAC and VOBA amortized in accordance with SFAS No. 60, Accounting and Reporting by Insurance Enterprises (SFAS 60). Under SFAS 60, acquisition costs for traditional life insurance and Group Protection's products, which include whole life and term life insurance policies and group life, dental and disability policies, are amortized over periods of 10 to 30 years for life products and up to 15 years for group products on either a straight-line basis or as a level percent of premium of the related policies depending on the block of business. No DAC is being amortized under SFAS 60 for fixed and variable payout annuities.

The adoption of Statement of Position (SOP) 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts (SOP 05-1) on January 1, 2007, increased DAC and VOBA amortization, net of deferrals by approximately \$11 million. The adoption of this new guidance primarily impacts our Individual Markets - Annuities and Employer Markets - Group Protection businesses, and our accounting policies regarding the assumptions for lapsation used in the amortization of DAC and VOBA. For a detailed discussion of SOP 05-1, see Note 2.

On a quarterly basis, we may record an adjustment to the amounts included within our Consolidated Balance Sheets for DAC, VOBA, DSI and DFEL with an offsetting benefit or charge to revenue or expense for the impact of the difference between the estimates of future gross profits used in the prior quarter and the emergence of actual and updated estimates of future gross profits in the current quarter (retrospective unlocking). In addition, in the third quarter of each year, we conduct our annual comprehensive review of the assumptions and the projection models used for our estimates of future gross profits underlying the amortization of DAC, VOBA, DSI and DFEL and the calculations of the embedded derivatives and reserves for annuity and life insurance products with certain guarantees. These assumptions include investment margins, mortality, retention and rider utilization. Based on our review, the cumulative balances of DAC, VOBA, DSI and DFEL, included on our Consolidated Balance Sheets, are adjusted with an offsetting benefit or charge to revenue or amortization expense to reflect such change (prospective unlocking). The distinction between these two types of unlocking is that retrospective unlocking is driven by the emerging experience period-over-period, while prospective unlocking is driven by changes in assumptions or projection models related to estimated future gross profits.

Table of Contents

The increase (decrease) to income from operations by business segment from our prospective unlocking (in millions) was as follows:

	DFEL ⁽¹⁾	DAC and VOBA ⁽²⁾	DSI ⁽³⁾	GMDB and Life Reserves ⁽⁴⁾	Guarantee Embedded Derivative ⁽⁴⁾	Total
For the Years Ended December 31,						
2007						
Individual Markets:						
Annuities	\$ (1)	\$ 8	\$ 1	\$ (1)	\$ 1	\$ 8
Life Insurance	18	(13)				5
Employer Markets:						
Defined Contribution		(2)				(2)
COLI and BOLI		(1)				(1)
Lincoln UK	3	(1)				2
Total	\$ 20	\$ (9)	\$ 1	\$ (1)	\$ 1	\$ 12
2006						
Individual Markets:						
Annuities	\$ (2)	\$ 1	\$ 1	\$ 2		\$ 2
Life Insurance	(1)	(9)		(10)		(20)
Employer Markets:						
Defined Contribution		5				5
COLI and BOLI		(1)				(1)
Lincoln UK	(8)	2				(6)
Total	\$ (11)	\$ (2)	\$ 1	\$ (8)		\$ (20)
2005						
Individual Markets:						
Annuities	\$ 1	\$ 22	\$ 1	\$ 5	\$ (7)	\$ 22
Life Insurance	(13)	16				3
Employer Markets:						
Defined Contribution		14				14
COLI and BOLI	(1)	1				
Lincoln UK	6	6				12
Total	\$ (7)	\$ 59	\$ 1	\$ 5	\$ (7)	\$ 51

(1) Reported in insurance fees on our Consolidated Statements of Income.

(2) Reported in underwriting, acquisition, insurance and other expenses on our Consolidated Statements of Income.

(3) Reported in interest credited on our Consolidated Statements of Income.

(4) Reported in benefits on our Consolidated Statements of Income.

The impact of prospective unlocking on income from operations included a \$28 million increase from assumption changes net of a \$16 million decrease from model refinements for 2007, an \$18 million decrease from assumption changes and a \$2 million decrease from model refinements for 2006 and a \$50 million increase from assumption changes and a \$1 million increase from model refinements for 2005. The 2006 amounts also reflect our harmonization of several assumptions and related processes as a result of our merger with Jefferson-Pilot. The effects varied by segment and are discussed further in the respective segment discussions below.

Because equity market movements have a significant impact on the value of variable annuity and unit-linked accounts (contracts written in the U.K. similar to U.S. produced variable life and annuity products) and the fees earned on these accounts, EGPs could increase or decrease with movements in the equity markets. Significant and sustained changes in equity markets could therefore have an impact on DAC, VOBA, DSI and

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

DFEL amortization for our variable annuity, annuity-based 401(k) business and unit-linked business, but have significantly less impact on DAC, VOBA and DFEL amortization for our life insurance business because approximately 82% of their account values pertain to interest sensitive products, such as UL and interest-sensitive whole life. Our assumption for the long-term annual gross growth rate of the equity markets used in the determination of DAC amortization is 9%, which is reduced by mortality and expense charges and asset management charges.

Table of Contents

As equity markets do not move in a systematic manner, we use a reversion to the mean (RTM) process to compute our best estimate long-term gross growth rate assumption. Under our current RTM process, on each valuation date, future EGPs are projected using stochastic modeling of a large number of future equity market scenarios in conjunction with best estimates of lapse rates, interest rate spreads and mortality to develop a statistical distribution of the present value of future EGPs for our variable annuity, annuity-based 401(k) and unit-linked product blocks of business. This process is not applied to our life insurance and fixed annuity businesses, as equity market performance does not have as significant of an impact on these products. Because future equity market returns are unpredictable, the underlying premise of this process is that best estimate projections of future EGPs, as required by SFAS 97, need not be affected by random short-term and insignificant deviations from expectations in equity market returns. However, long-term or significant deviations from expected equity market returns require a change to best estimate projections of EGPs and prospective unlocking of DAC, VOBA, DSI and DFEL. The statistical distribution is designed to identify when the equity market return deviations from expected returns have become significant enough to warrant a change of the future equity return EGP assumption. As an illustration of the potential impact, given where our best estimate of EGPs for the Individual Markets - Annuities and Employer Markets - Defined Contribution segments were positioned in the range as of December 31, 2007, if we were to reset the RTM to a gross variable account growth assumption representing the midpoint between the first of the two statistical ranges and the mean of the projections from December 31, 2007, forward in determining revised EGPs, we estimate it would result in a cumulative favorable prospective unlocking of approximately \$124 million, pre-tax (\$81 million, after-tax).

The stochastic modeling performed for our variable annuity blocks of business as described above is used to develop a range of reasonably possible future EGPs. We compare the range of the present value of the future EGPs from the stochastic modeling to that used in our amortization model. A set of intervals around the mean of these scenarios is utilized to calculate two separate statistical ranges of reasonably possible EGPs. These intervals are compared to the present value of the EGPs used in the amortization model. If the present value of EGP assumptions utilized for amortization were to exceed the margin of the reasonable range of statistically calculated EGPs, a revision of the EGPs used to calculate amortization would occur. If a revision is deemed necessary, future EGPs would be re-projected using the current account values at the end of the period during which the revision occurred along with a revised long-term annual equity market gross return assumption such that the re-projected EGPs would be our best estimate of EGPs.

Notwithstanding these intervals, if a severe decline or advance in equity markets were to occur or should other circumstances, including contract holder activity, suggest that the present value of future EGPs no longer represents our best estimate, we could determine that a revision of the EGPs is necessary. A severe decline or advance in equity markets would involve a sustained change from December 31, 2007 levels.

Our practice is not necessarily to unlock immediately after exceeding the first of the two statistical ranges, but, rather, if we stay between the first and second statistical range for several quarters, we would likely unlock. Additionally, if we exceed the ranges as a result of a short-term market reaction, such as we saw after the events of September 11, 2001, we would not necessarily unlock. However, if the second statistical range is exceeded for more than one quarter, it is likely that we would unlock. While this approach reduces adjustments to DAC, VOBA, DSI and DFEL due to short-term equity market fluctuations, significant changes in the equity markets that extend beyond one or two quarters could result in a significant favorable or unfavorable unlocking.

Our long-term equity market growth assumption rate is 9%, which is used in the determination of DAC, VOBA, DSI and DFEL amortization for the variable component of our variable annuity products, as this component is primarily related to underlying investments in equity funds within the separate accounts. This variable appreciation rate is before the deduction of our contract fees. For business issued in years prior to 2005 for the Individual Markets - Annuities segment and a portion of the Employer Markets - Defined Contribution segment, the assumed annual variable appreciation rate is 5.11% as of December 31, 2007. It remains 5.11% for the subsequent 9-month period and is then 9% thereafter. The actual variable appreciation rate in recent years has been higher than the assumed rate. As a result, we are more likely to unlock from positive variable performance rather than from negative returns from December 31, 2007. Given our position within the range around our best estimate of EGPs for the Individual Markets - Annuities and the Employer Markets - Defined Contribution segments as of December 31, 2007, a one-quarter equity market movement of positive 10% would bring us to the first of the two statistical ranges while a one-quarter equity market movement of positive 30% would bring us to the second of the two ranges for these segments. Subsequent equity market performance that would keep us at or move us beyond the first statistical range would likely result in favorable unlocking. Negative equity market performance would have to be significantly greater than the above percentages for us to exceed the lower end of the two statistical ranges.

Goodwill and Other Intangible Assets

Under SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and intangible assets with indefinite lives are not amortized, but are subject to impairment tests conducted at least annually. Intangibles that do not have indefinite lives are amortized over their estimated useful lives.

Table of Contents

The valuation techniques we use to estimate the fair value of the group of assets comprising the different reporting units varies based on the characteristics of each reporting unit's business and operations. A market-based valuation technique that focuses on price-to-earnings multiplier and the segment-level operating income is used for the Individual Markets and Employer Markets segments and the remaining media business that is now reported in Other Operations. For the Lincoln UK segment, a discounted cash flow model is utilized to determine the fair value. A valuation technique combining multiples of revenues, earnings before interest, taxes, depreciation and amortization and assets under management is used to assess the goodwill in our Investment Management segment. We use October 1 as the annual review date for impairment. The results of the tests performed as of October 1, 2007, 2006 and 2005, indicated that we did not have impaired goodwill or other intangibles. The tests performed on our media properties as of October 1, 2007, only included our San Diego, Denver, Atlanta and Miami radio stations (station clusters) within Other Operations as the other media properties are identified as held for sale. For details surrounding the 2007 dispositions of our media properties, see Acquisition and Dispositions below.

Investments

Our primary investments are in fixed maturity securities, including corporate and government bonds, asset and mortgage-backed securities and redeemable preferred stock, and equity securities, mortgage loans and policy loans. All our fixed maturity and equity securities are classified as available-for-sale as defined in SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, except for those securities supporting certain reinsurance transactions which are classified as trading securities. Available-for-sale securities are carried at fair value with the difference from amortized cost included in stockholders' equity as a component of accumulated other comprehensive income. The difference is net of related DAC, VOBA, DSI and DFEL and amounts that would be credited to contract holders, if realized, and taxes.

Investment Valuation

Fair values for fixed maturity securities are based on quoted market prices, where available. For fixed maturity securities that are not actively traded, fair values are estimated using values obtained from independent pricing services. The fair values for equity securities are based on quoted market prices. Fair values for private securities are estimated by: (1) a matrix process that employs discounting expected future cash flows using a current market rate applicable to the coupon rate, credit quality, industry sector and maturity of the investments; (2) third party-supplied prices or secondary market transactions; and (3) applying professional judgment to arrive at the fair value based upon prices of public or non-public securities of similarly situated issuers.

Write-Downs for Other-Than-Temporary Impairments and Allowance for Losses

The criteria for determining whether or not a security is impaired is not based upon a permanent impairment standard, but rather an other-than-temporary impairment standard. Under the other-than-temporary criteria, we could have a security that we believe is likely to recover its value over time, but we would still be required to record an impairment write-down under GAAP. Determining whether or not a decline in current fair values for securities classified as available-for-sale is other-than-temporary can frequently involve a variety of assumptions and estimates, particularly for investments that are not actively traded on established markets. For instance, assessing the value of some investments requires an analysis of expected future cash flows. Some investment structures, such as collateralized debt obligations, often represent selected tranches collateralized by underlying investments in a wide variety of issuers and security types.

Factors we consider in determining whether declines in the fair value of fixed maturity securities are other-than-temporary include: 1) the significance of the decline; 2) our ability and intent to retain the investment for a sufficient period of time for it to recover to an amount at least equal to its carrying value; 3) the time period during which there has been a significant decline in value; and 4) fundamental analysis of the liquidity, business prospects and overall financial condition of the issuer. Based upon these factors, securities that have indications of potential impairment are subject to intensive review. Where such analysis results in a conclusion that declines in fair values are other-than-temporary, the security is written down to fair value. The fixed maturity securities to which these write-downs apply were generally of investment grade at the time of purchase, but were subsequently downgraded by rating agencies to below-investment grade. Another key factor in whether a write-down for impairment is necessary is our intent or ability to hold to recovery or maturity. In the event that we determine that we do not have the intent or ability to hold to recovery or maturity, we are required to write down the security. A write-down is necessary even in situations where the unrealized loss is not due to an underlying credit issue, but may be solely related to the impact of changes in interest rates on the fair value of the security. See Note 19 for a general discussion of the methodologies and assumptions used to determine estimated fair values.

For certain securitized fixed maturity securities with contractual cash flows, including asset-backed securities, we use our best estimate of cash flows for the life of the security to determine whether there is an other-than-temporary impairment of the security as required under Emerging Issues Task Force Issue No. 99-20, Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets, and we review for other indicators of impairment as required by FASB Staff Position 115-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.

Table of Contents

Based on our evaluation of securities with an unrealized loss as of December 31, 2007, we do not believe that any additional other-than-temporary impairment losses, other than those already reflected in the financial statements, are necessary. As of December 31, 2007, there were available-for-sale securities with unrealized losses totaling \$1.2 billion, pre-tax, and prior to the impact on DAC, VOBA, DSI and other contract holder funds.

As the discussion above indicates, there are risks and uncertainties associated with determining whether declines in the fair value of investments are other-than-temporary. These include subsequent significant changes in general overall economic conditions, as well as specific business conditions affecting particular issuers, future financial market effects such as interest rate spreads, stability of foreign governments and economies, future rating agency actions and significant accounting, fraud or corporate governance issues that may adversely affect certain investments. In addition, there are often significant estimates and assumptions that we use to estimate the fair values of securities, including projections of expected future cash flows and pricing of private securities. We continually monitor developments and update underlying assumptions and financial models based upon new information.

Write-downs and allowances for losses on select mortgage loans on real estate, real estate and other investments are established when the underlying value of the property is deemed to be less than the carrying value. All mortgage loans that are impaired have an established allowance for credit loss. Changing economic conditions impact our valuation of mortgage loans. Increasing vacancies, declining rents and the like are incorporated into the discounted cash flow analysis that we perform for monitored loans and may contribute to the establishment of (or an increase in) an allowance for credit losses. In addition, we continue to monitor the entire commercial mortgage loan portfolio to identify risk. Areas of current emphasis are the hotel mortgage loan portfolio and retail, office and industrial properties that have deteriorating credits or have experienced debt coverage reduction. Where warranted, we have established or increased loss reserves based upon this analysis.

Derivatives

To protect us from a variety of equity market and interest rate risks that are inherent in many of our life insurance and annuity products, we use various derivative instruments. Assessing the effectiveness of these hedging programs and evaluating the carrying values of the related derivatives often involve a variety of assumptions and estimates. We use derivatives to hedge equity market risks, interest rate risk and foreign currency exposures that are embedded in our annuity and life insurance product liabilities or investment portfolios. Derivatives held as of December 31, 2007, contain industry standard terms and are entered into with financial institutions with long-standing, superior performance records. Our accounting policies for derivatives and the potential impact on interest spreads in a falling rate environment are discussed in Item 7A. Quantitative and Qualitative Disclosures About Market Risk. See Note 5 for additional information on our accounting for derivatives.

Guaranteed Living Benefits

The Individual Markets - Annuities segment has a hedging strategy designed to mitigate the risk and statement of income volatility caused by changes in the equity markets, interest rates, and market implied volatilities associated with the *Lincoln SmartSecurity*[®] Advantage GMWB feature and, beginning in the fourth quarter of 2006, our *i4LIFE*[®] Advantage GIB feature that is available in our variable annuity products. In the second quarter of 2007, we also began hedging our 4LATER[®] Advantage GIB feature available in our variable annuity products. These living benefit features are collectively referred to as guaranteed living benefits (GLBs). During 2007, we made adjustments to our hedging program to purchase longer dated volatility protection and increased our hedges related to volatility to better match liability sensitivities under SFAS 157. In addition, in early January 2008, we added our New York variable annuity business, with total account values of approximately \$1.2 billion, to our hedge program. The hedging strategy is designed such that changes in the value of the hedge contracts move in the opposite direction of changes in the value of the embedded derivative of the GMWB and GIB features. This dynamic hedging strategy utilizes options on U.S.-based equity indices, futures on U.S.-based and international equity indices, variance swaps on U.S.-based equity indices, as well as interest rate futures and swaps. The notional amounts of the underlying hedge instruments are such that the magnitude of the change in the value of the hedge instruments due to changes in equity markets, interest rates, and implied volatilities is designed to offset the magnitude of the change in the fair value of the GMWB and GIB guarantees caused by those same factors. As of December 31, 2007, the embedded derivatives for GMWB, 4LATER[®] Advantage GIB and the *i4LIFE*[®] Advantage GIB were liabilities valued at \$175 million, \$48 million, and \$29 million, respectively.

As part of our current hedging program, contract holder behavior and equity, interest rate and market implied volatility conditions are monitored on a daily basis. We rebalance our hedge positions based upon changes in these factors as needed. While we actively manage our hedge positions, our hedge positions may not be totally effective to offset changes in the embedded derivative caused by movements in these factors due to, among other things, differences in timing between when a market exposure changes and corresponding changes to the hedge positions, extreme swings in the equity markets, interest rates and market implied volatilities, realized market volatility, contract holder behavior, divergence between the performance of the underlying funds and the hedging indices, divergence between the actual and expected performance of the hedge instruments or our ability to purchase hedging instruments at prices consistent with our desired risk and return trade-off.

Table of Contents

The following table presents our estimates of the potential instantaneous impact to income from operations, which could result from sudden changes that may occur in equity markets, interest rates and implied market volatilities (in millions) at the levels indicated in the table and excludes the net cost of operating the hedging program. The amounts represent the estimated difference between the change in GMWB and GIB reserves and the change in the value of the underlying hedge instruments after the amortization of DAC, VOBA, DSI and DFEL and taxes. These impacts do not include any estimate of retrospective or prospective unlocking that could occur. These estimates are based upon the recorded reserves for GMWB as of January 4, 2008, which includes the effects of changes related to the implementation of SFAS 157 and the related hedge instruments in place as of that date, along with additional vega (implied volatility) hedges that have been implemented to further close the vega shortfall that existed as of January 4, 2008. The impacts presented below are not representative of the aggregate impacts that could result if a combination of such changes to equity market returns, interest rates and implied volatilities occurred.

	In-Force Sensitivities			
	-20%	-10%	-5%	5%
Equity market return	\$ (34)	\$ (8)	\$ (2)	\$ (2)
	-50 bps	-25 bps	+25 bps	+50 bps
Interest rates	\$ (4)	\$ (1)	\$ (1)	\$ (1)
	-4%	-2%	2%	4%
Implied volatilities	\$ (2)	\$ (1)	\$ (1)	\$ (2)

The analysis is only valid as of this particular business day, due to changing market conditions, contract holder activity, hedge positions and other factors;

The analysis assumes instantaneous shifts in the capital market factors and no ability to rebalance hedge positions prior to the market changes;

Assumptions regarding shifts in the market factors, such as assuming parallel shifts in interest rate and implied volatility term structures, may be overly simplistic and not indicative of actual market behavior in stress scenarios;

It is very unlikely that one capital market sector (e.g. equity markets) will sustain such a large instantaneous movement without affecting other capital market sectors; and

The analysis assumes that there is no tracking or basis risk between the funds and/or indices affecting the GLBs and the instruments utilized to hedge these exposures.

The following table shows the effect (dollars in millions) of indicated changes in instantaneous shifts in equity market returns, interest rate scenarios and market implied volatilities:

	Assumptions of Changes In			Hypothetical
	Equity Market Return	Interest Rate Yields	Market Implied Volatilities	Impact to Net Income
Scenario 1	-5%	-12.5 bps	+1%	\$ (4)
Scenario 2	-10%	-25.0 bps	+2%	(13)
Scenario 3	-20%	-50.0 bps	+4%	(49)

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Annuity Hedge Performance by Benefit Feature

A comparison of the costs of our guaranteed benefit features of our variable annuity products, net of the impacts of our hedge performance, related amortization of DAC, VOBA, DSI and DFEL and income taxes (i.e., earnings impact) by benefit feature (in millions) was as follows:

	For the Years Ended December 31,			Change Over Prior Year	
	2007	2006	2005	2007	2006
GLB	\$ (36)	\$ (4)	\$ (2)	NM	-100%
GMDB ⁽¹⁾	1	1	2	0%	-50%
Total	\$ (35)	\$ (3)	\$	NM	NM

⁽¹⁾ Our reserves related to our guaranteed minimum death benefits (GMDB) are not accounted for as derivatives, and because of this, the quarterly changes in values for our GMDB reserves and the hedging contracts may not offset each other.

NM - Not Meaningful

Table of Contents

For additional information on our hedging results, see our discussion in Individual Markets - Annuities - Benefits below.

S&P 500 Index[®] Benefits

We also have in place a hedging program for our indexed annuities and indexed UL. These contracts permit the holder to elect a fixed interest rate return or a return where interest credited to the contracts is linked to the performance of the S&P 500 Index[®]. Contract holders may elect to rebalance among the various accounts within the product at renewal dates, either annually or biannually. At the end of each 1-year or 2-year indexed term we have the opportunity to re-price the indexed component by establishing different caps, spreads or specified rates, subject to contractual guarantees. We purchase options that are highly correlated to the portfolio allocation decisions of our contract holders, such that we are economically hedged with respect to equity returns for the current reset period. The mark-to-market of the options held impacts net investment income and generally offsets the change in value of the embedded derivative within the indexed annuity, which is recorded as a component of interest credited to contract holders. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133), requires that we calculate fair values of index options we may purchase in the future to hedge contract holder index allocations in future reset periods. These fair values represent an estimate of the cost of the options we will purchase in the future, discounted back to the date of the balance sheet, using current market indicators of volatility and interest rates. Changes in the fair values of these liabilities are included as a component of interest credited to contract holders.

Future Contract Benefits and Other Contract Holder Obligations

Reserves

Reserves are the amounts that, with the additional premiums to be received and interest thereon compounded annually at certain assumed rates, are calculated to be sufficient to meet the various policy and contract obligations as they mature. Establishing adequate reserves for our obligations to contract holders requires assumptions to be made regarding mortality and morbidity. The applicable insurance laws under which insurance companies operate require that they report, as liabilities, policy reserves to meet future obligations on their outstanding contracts. These laws specify that the reserves shall not be less than reserves calculated using certain specified mortality and morbidity tables, interest rates, and methods of valuation.

The reserves reported in our financial statements contained herein are calculated in accordance with GAAP and differ from those specified by the laws of the various states and carried in the statutory financial statements of the life insurance subsidiaries. These differences arise from the use of mortality and morbidity tables, interest, persistency and other assumptions that we believe to be more representative of the expected experience for these contracts than those required for statutory accounting purposes and from differences in actuarial reserving methods. For example, in September 2006, the National Association of Insurance Commissioners (NAIC) adopted a revision, often referred to as the interim solution, to AXXX, the statutory reserve requirements for UL products with secondary guarantees, which impacts such business written after the effective date of January 1, 2007. There was no impact to GAAP reserves or results of operations as a result of AXXX.

The assumptions on which reserves are based are intended to represent an estimation of experience for the period that policy benefits are payable. If actual experience is better than or equal to the assumptions, then reserves should be adequate to provide for future benefits and expenses. If experience is worse than the assumptions, additional reserves may be required. This would result in a charge to our net income during the period the increase in reserves occurred. The key experience assumptions include mortality rates, policy persistency and interest rates. We periodically review our experience and update our policy reserves for new issues and reserve for all claims incurred, as we believe appropriate.

GMDB

The reserves related to the GMDB features available in our variable annuity products are based on the application of a benefit ratio to total assessments related to the variable annuities. The level and direction of the change in reserves will vary over time based on the emergence of the benefit ratio (which is based on both historical and projected future level of benefits) and the level of assessments (both historical and projected) associated with the variable annuity.

We utilize a delta hedging strategy for variable annuity products with a GMDB feature, which uses futures on U.S.-based equity market indices to hedge against movements in equity markets. The hedging strategy is designed such that changes in the value of the hedge contracts move in the opposite direction of equity market driven changes in the reserve for GMDB contracts subject to the hedging strategy. Because the GMDB reserves are based upon projected long-term equity market return assumptions, and since the value of the hedging contracts will reflect current capital market conditions, the quarterly changes in values for the GMDB reserves and the hedging contracts may not offset each other on an exact basis. Despite these short-term fluctuations in values, we intend to continue to hedge our long-term GMDB exposure in order to mitigate

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

the risk associated with falling equity markets. Account balances covered in this hedging program, which excludes the Alliance mutual fund business, combined with account balances for which there is no death benefit represent approximately 94% of total variable annuity account balances.

Table of Contents**Deferred Gain on Sale of the Reinsurance Segment**

In 2001, we sold our reinsurance operation to Swiss Re Life & Health America Inc. (Swiss Re). The transaction involved a series of indemnity reinsurance transactions combined with the sale of certain stock companies that comprised our reinsurance operation. The gain related to the indemnity reinsurance transactions was recorded as deferred gain in the liability section of our Consolidated Balance Sheets in accordance with the requirements of SFAS No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts (SFAS 113). The deferred gain is being amortized into income at the rate that earnings on the reinsured business are expected to emerge, over a period of 15 years. In addition, because we have not been relieved of our legal liabilities to the underlying ceding companies with respect to the portion of the business indemnity reinsured by Swiss Re, under SFAS 113, the reserves for the underlying reinsurance contracts as well as a corresponding reinsurance recoverable from Swiss Re will continue to be carried on our Consolidated Balance Sheets during the run-off period of the underlying reinsurance business. This is particularly relevant in the case of the exited personal accident reinsurance lines of business where the underlying reserves are based upon various estimates that are subject to considerable uncertainty.

Because of ongoing uncertainty related to personal accident business, the reserves related to these exited business lines carried on our Consolidated Balance Sheets as of December 31, 2007, may ultimately prove to be either excessive or deficient. For instance, in the event that future developments indicate that these reserves should be increased, we would record a current period non-cash charge to record the increase in reserves. Because Swiss Re is responsible for paying the underlying claims to the ceding companies, we would record a corresponding increase in reinsurance recoverable from Swiss Re. However, SFAS 113 does not permit us to take the full benefit in earnings for the recording of the increase in the reinsurance recoverable in the period of the change. Rather, we would increase the deferred gain recognized upon the closing of the indemnity reinsurance transaction with Swiss Re and would report a cumulative amortization catch-up adjustment to the deferred gain balance as increased earnings recognized in the period of change. Any amount of additional increase to the deferred gain above the cumulative amortization catch-up adjustment must continue to be deferred and will be amortized into income in future periods over the remaining period of expected run-off of the underlying business. No cash would be transferred between Swiss Re and us as a result of these developments.

Pension and Other Postretirement Benefit Plans

Pursuant to the accounting rules for our obligations to employees under our various pension and other postretirement benefit plans, we are required to make a number of assumptions to estimate related liabilities and expenses. We use assumptions for the weighted-average discount rate, expected return on plan assets and a salary increase assumption to estimate pension expense. The discount rate assumptions are determined using an analysis of current market information and the projected benefit flows associated with these plans. The expected long-term rate of return on plan assets is initially established at the beginning of the plan year based on historical and projected future rates of return and is the average rate of earnings expected on the funds invested or to be invested in the plan. The calculation of our accumulated postretirement benefit obligation also uses an assumption of weighted-average annual rate of increase in the per capita cost of covered benefits, which reflects a health care cost trend rate. See Note 16 for more information on our accounting for employee benefit plans.

Contingencies

Management establishes separate reserves for each contingent matter when it is deemed probable and can be reasonably estimated. The outcomes of contingencies, which relate to corporate litigation and regulatory matters, are inherently difficult to predict, and the reserves that have been established for the estimated settlement are subject to significant changes. It is possible that the ultimate cost to LNC including the tax-deductibility of payments could exceed the reserve by an amount that would have a material adverse effect on our consolidated results of operations or cash flows in a particular quarterly or annual period. See Note 13 for more information on our contingencies.

Stock-Based Incentive Compensation

Determining the fair value of stock options at the grant date requires judgment including estimates for the average risk-free interest rate, expected volatility, expected exercise behavior, expected dividend yield, and expected forfeitures. If any of those assumptions differ significantly from actual, stock-based compensation expense could be impacted, which could have a material effect on our consolidated results of operations in a particular quarterly or annual period. See Note 17 for more information on our stock-based incentive compensation plans.

Income Taxes

Management uses certain assumptions and estimates in determining the income taxes payable or refundable for the current year, the deferred income tax liabilities and assets for items recognized differently in its financial statements from amounts shown on its income tax returns, and the federal income tax expense. Determining these amounts requires analysis and interpretation of current tax laws and regulations. Management exercises considerable judgment in evaluating the amount and timing of recognition of the

Table of Contents

resulting income tax liabilities and assets. These judgments and estimates are re-evaluated on a continual basis as regulatory and business factors change.

Changes to the Internal Revenue Code, administrative rulings or court decisions could increase our effective tax rate. In this regard, on August 16, 2007, the Internal Revenue Service (IRS) issued a revenue ruling which purports, among other things, to modify the calculation of separate account deduction for dividends received by life insurance companies. Subsequently, the IRS issued another revenue ruling that suspended the August 16 ruling and announced a new regulation project on the issue. The current separate account deduction for dividends calculation lowered the effective tax rate by approximately 4% for the year ended December 31, 2007.

We adopted FASB Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement 109 (FIN 48) effective January 1, 2007, and recorded an increase in the liability for unrecognized tax benefits of \$15 million in our Consolidated Balance Sheets, offset by a reduction to the beginning balance of retained earnings with no impact on net income. FIN 48 established criteria for recognizing or continuing to recognize only more-likely-than-not tax positions, which may result in federal income tax expense volatility in future periods. While we believe we have adequately provided for all tax positions, amounts asserted by taxing authorities could be greater than our accrued position. Accordingly, additional provisions on federal and foreign tax-related matters could be recorded in the future as revised estimates are made or the underlying matters are settled or otherwise resolved. For a detailed discussion of FIN 48, see Notes 2 and 6.

Impact of Equity Market Sensitivity

Due to the use of our RTM process and our hedging strategies as described in Critical Accounting Policies and Estimates above, we expect that in general, short-term fluctuations in the equity markets should not have a significant impact on our quarterly earnings from unlocking of assumptions for DAC, VOBA, DSI and DFEL, as we do not unlock our long-term equity market assumptions based upon short-term fluctuations in the equity markets. However, there is an impact to earnings from the effects of equity market movements on account values and assets under management and the related asset-based fees we earn on those assets net of related expenses we incur based upon the level of assets. The table below presents our estimate of the annual, after-tax, after-DAC, impact on income from operations, from a 1% change in the equity markets (in millions), excluding any impact related to sales, prospective and retrospective unlocking, persistency, hedge program performance or customer behavior caused by the equity market change.

Segment	Relevant Measure	Impact per 1% Change
Investment Management	Composite of Equity Assets ⁽¹⁾	\$ 2
Individual Markets - Annuities	Average daily change in the S&P 500	4
Employer Markets - Defined Contribution	Average daily change in the S&P 500	1
Lincoln UK	Average daily change in the FTSE 100	

⁽¹⁾ The estimated annual after-tax effect on advisory fees noted above is based on a 1% increase in overall Investment Management equity-based assets. The Investment Management segment manages equity-based assets of varying styles (growth, value, blend and international) and underlying products (mutual funds, institutional accounts, insurance separate accounts, etc.). No single equity benchmark is an accurate predictor of the change in fee revenue for this segment.

The earnings impact summarized above is an expected annual effect. The result of the above factor should be multiplied by 25% to arrive at an estimated quarterly effect. The effect of quarterly equity market changes upon fee revenues and asset-based expenses will not be fully recognized in the current quarter due to the fact that fee revenues are earned and related expenses are incurred based upon daily variable account values. The difference between the current period average daily variable account values compared to the end of period variable account values impacts fee revenues in subsequent periods. This discussion concerning the estimated effects of ongoing equity market volatility on the fees we earn from account values and assets under management is intended to be illustrative. Actual effects may vary depending on a variety of factors, many of which are outside of our control, such as changing customer behaviors that might result in changes in the mix of our business between variable and fixed annuity contracts, switching between investment alternatives available within variable products, changes in sales production levels or changes in policy persistency. For purposes of this guidance, the change in account values is assumed to correlate with the change in the relevant index. See Item 7A. Quantitative and Qualitative Disclosures About Market Risk - Fee Revenues for additional information of the effect of equity markets on fee revenues.

Table of Contents*Acquisition and Dispositions***Acquisition**

On April 3, 2006, Jefferson-Pilot, a financial services and broadcasting holding company, merged with and into one of our wholly owned subsidiaries. Through its subsidiaries, Jefferson-Pilot provided products and services in four major businesses: (1) life insurance; (2) annuities and investment products; (3) group life, disability and dental insurance; and (4) broadcasting and sports programming production and distribution. This merger increased our distribution breadth through retail distribution channels and increased our capital position to support growth. This acquisition was accounted for using the purchase method of accounting, and, beginning on April 3, 2006, our consolidated financial statements include the results of operations and financial condition of Jefferson-Pilot, after being adjusted for the effects of purchase accounting.

The following summarizes the fair value of certain assets acquired and liabilities assumed (in millions) as of the acquisition date:

	Fair Value Acquired as of the Acquisition Date				
	Investments	VOBA	Goodwill	Identifiable Intangible Assets	Contract Liabilities
Business Segments					
Individual Markets:					
Life Insurance	\$ 11,896	\$ 1,767	\$ 1,346	\$ 100	\$ 11,636
Annuities	9,767	460	1,002		9,399
Total Individual Markets	21,663	2,227	2,348	100	21,035
Employer Markets:					
Retirement Products - Executive Benefits	2,964	143			2,804
Group Protection	1,790	116	274		1,179
Total Employer Markets	4,754	259	274		3,983
Lincoln Financial Media (former segment)			702	670	
Other Operations	1,493				1,623
	\$ 27,910	\$ 2,486	\$ 3,324	\$ 770	\$ 26,641

For additional information, see Note 3.

Dispositions*Media Business*

On June 7, 2007, we announced plans to explore strategic options for our former business segment, Lincoln Financial Media. During the fourth quarter 2007, we decided to divest our television and Charlotte radio broadcasting and sports programming businesses, and, on November 12, 2007, we signed agreements to sell them. Accordingly, we have reported the results of these businesses as discontinued operations on our Consolidated Statements of Income and the assets and liabilities as held for sale on our Consolidated Balance Sheets for all periods presented. We continue to actively manage our investment in our remaining radio clusters to maximize station performance and future valuation, which are now being reported within Other Operations. For additional information, see Item 1. Business and Note 3.

The proceeds from the sale of the above media properties are expected to be used for repurchase of shares, repayment of debt and other strategic initiatives. In addition to the cash proceeds, this sale will affect the ongoing dividends from Lincoln Financial Media Company to the holding company, which totaled \$44 million in 2007. The annual operating dividends are expected to be approximately \$18 million, though 2008 may be slightly higher due to cash flow from discontinued operations prior to the closings on the sales of those properties. In addition, net income will

be lower by approximately \$7 million per quarter.

Table of Contents

The results of operations of these businesses have been reclassified into income from discontinued operations for all periods presented on the Consolidated Statements of Income. The amounts (in millions) related to operations of these businesses, included in income from discontinued operations, were as follows:

	For the Years Ended December 31,			Change Over Prior Year	
	2007	2006	2005	2007	2006
Discontinued Operations Before Disposal					
Communications revenues, net of agency commissions	\$ 144	\$ 101	\$	43%	NM
Income from discontinued operations before disposal, before federal income taxes	\$ 46	\$ 33	\$	39%	NM
Federal income taxes	16	12		33%	NM
Income from discontinued operations before disposal	30	21		43%	NM
Disposal					
Gain on disposal	57			NM	NM
Federal income taxes	193			NM	NM
Loss on disposal	(136)			NM	NM
Income (loss) from discontinued operations	\$ (106)	\$ 21	\$	NM	NM

The tax rate associated with the gain on disposal differs significantly from the amount computed by applying our U.S. federal income tax rate of 35% due primarily to the increase in taxable gain associated with the recognition of \$363 million in basis difference attributable to goodwill.

Fixed Income Investment Management Business

During the fourth quarter of 2007, we sold certain institutional taxable fixed income business to an unaffiliated investment management company. Investment Management transferred \$12.3 billion of assets under management as part of this transaction. Based upon the assets transferred as of October 31, 2007, the purchase price is expected to be no more than \$49 million. We expect this transaction to decrease income from operations, relative to 2007, by approximately \$3 million, after-tax, per quarter in 2008.

During the fourth quarter, we received \$25 million of the purchase price, with additional scheduled payments over the next three years. We recorded an after-tax realized loss of \$2 million on our Consolidated Statements of Income as a result of goodwill we attributed to this business. There were certain other pipeline accounts in process at the time of the transaction closing, and any adjustment to the purchase price, if necessary, will be determined at October 31, 2008.

Investment Management manages approximately \$94.0 billion of fixed income assets with a team of 100 fixed income investment professionals. The transaction did not impact the fixed income team that manages our fixed income mutual funds or general account assets.

Table of Contents**RESULTS OF CONSOLIDATED OPERATIONS****Net Income**

Details underlying the consolidated results and assets under management (in millions) were as follows:

	For the Years Ended December 31,			Change Over Prior Year	
	2007	2006	2005	2007	2006
Insurance premiums	\$ 1,945	\$ 1,406	\$ 308	38%	NM
Insurance fees	3,254	2,604	1,752	25%	49%
Investment advisory fees	360	328	256	10%	28%
Net investment income	4,384	3,981	2,702	10%	47%
Realized loss	(118)	(3)	(3)	NM	0%
Amortization of deferred gain on indemnity reinsurance	83	76	77	9%	-1%
Other revenues and fees	686	570	383	20%	49%
Total revenues	10,594	8,962	5,475	18%	64%
Interest credited	2,454	2,259	1,526	9%	48%
Benefits	2,698	1,911	806	41%	137%
Underwriting, acquisition, insurance and other expenses	3,284	2,790	1,981	18%	41%
Interest and debt expenses	284	224	87	27%	157%
Total benefits and expenses	8,720	7,184	4,400	21%	63%
Income from continuing operations before taxes	1,874	1,778	1,075	5%	65%
Federal income taxes	553	483	244	14%	98%
Income from continuing operations	1,321	1,295	831	2%	56%
Income (loss) from discontinued operations, net of federal income taxes	(106)	21		NM	NM
Net income	\$ 1,215	\$ 1,316	\$ 831	-8%	58%

	For the Years Ended December 31,			Change Over Prior Year	
	2007	2006	2005	2007	2006
Revenues					
Operating revenues:					
Individual Markets:					
Annuities	\$ 2,600	\$ 2,161	\$ 1,422	20%	52%
Life Insurance	3,921	3,256	1,911	20%	70%
Total Individual Markets	6,521	5,417	3,333	20%	63%
Employer Markets:					
Retirement Products	1,441	1,360	1,175	6%	16%
Group Protection	1,500	1,032		45%	NM
Total Employer Markets	2,941	2,392	1,175	23%	104%

Edgar Filing: LINCOLN NATIONAL CORP - Form 10-K

Investment Management	590	564	475	5%	19%
Lincoln UK	370	308	318	20%	-3%
Other Operations	281	283	175	-1%	62%
Realized loss	(118)	(3)	(3)	NM	0%
Amortization of deferred gain on indemnity reinsurance related to reserve developments	9	1	2	NM	-50%
Total revenues	\$ 10,594	\$ 8,962	\$ 5,475	18%	64%

Table of Contents

	For the Years Ended December 31,			Change Over Prior Year	
	2007	2006	2005	2007	2006
Net Income					
Operating income:					
Individual Markets:					
Annuities	\$ 448	\$ 409	\$ 252	10%	62%
Life Insurance	675	496	260	36%	91%
Total Individual Markets	1,123	905	512	24%	77%
Employer Markets:					
Retirement Products	235	253	207	-7%	22%
Group Protection	114	99		15%	NM
Total Employer Markets	349	352	207	-1%	70%
Investment Management	76	55	17	38%	224%
Lincoln UK	46	39	43	18%	-9%
Other Operations	(184)	(53)	54	NM	NM
Realized loss	(82)	(1)	(2)	NM	50%
Early extinguishment of debt		(3)		100%	NM
Reserve development, net of related amortization on business sold through indemnity reinsurance	(7)	1		NM	NM