

LINCOLN NATIONAL CORP
Form 10-Q
August 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2018

OR

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

For the transition period from to

Commission File Number: 1-6028

LINCOLN NATIONAL CORPORATION

(Exact name of registrant as specified in its charter)

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

(484) 583-1400

(Registrant's telephone number, including area code)

Not Applicable

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

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

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

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

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

Smaller reporting company Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 30, 2018, there were 216,680,606 shares of the registrant's common stock outstanding.

Lincoln National Corporation

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(in millions, except share data)

	As of June 30, 2018 (Unaudited)	As of December 31, 2017
ASSETS		
Investments:		
Available-for-sale securities, at fair value:		
Fixed maturity securities (amortized cost: 2018 – \$90,083; 2017 – \$86,993)	\$ 93,060	\$ 94,840
Equity securities (cost: 2017 – \$247)	-	246
Trading securities	1,450	1,620
Equity securities	112	-
Mortgage loans on real estate	12,217	10,762
Real estate	11	11
Policy loans	2,508	2,399
Derivative investments	584	915
Other investments	2,065	2,296
Total investments	112,007	113,089
Cash and invested cash	1,775	1,628
Deferred acquisition costs and value of business acquired	9,904	8,403
Premiums and fees receivable	574	396
Accrued investment income	1,119	1,078
Reinsurance recoverables	17,979	4,907
Funds withheld reinsurance assets	572	593
Goodwill	1,750	1,368
Other assets	8,921	6,082
Separate account assets	144,231	144,219
Total assets	\$ 298,832	\$ 281,763
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities		
Future contract benefits	\$ 33,718	\$ 22,887
Other contract holder funds	88,698	80,209
Short-term debt	-	450
Long-term debt	5,826	4,894
Reinsurance related embedded derivatives	25	57
Funds withheld reinsurance liabilities	1,711	1,761
Deferred gain on business sold through reinsurance	1	1
Payables for collateral on investments	4,699	4,417

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Other liabilities	4,746	5,546
Separate account liabilities	144,231	144,219
Total liabilities	283,655	264,441

Contingencies and Commitments (See Note 10)

Stockholders' Equity		
Preferred stock – 10,000,000 shares authorized	-	-
Common stock – 800,000,000 shares authorized; 217,294,051 and 218,090,114 shares issued and outstanding as of June 30, 2018, and December 31, 2017, respectively	5,674	5,693
Retained earnings	8,302	8,399
Accumulated other comprehensive income (loss)	1,201	3,230
Total stockholders' equity	15,177	17,322
Total liabilities and stockholders' equity	\$ 298,832	\$ 281,763

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited, in millions, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues				
Insurance premiums	\$ 1,165	\$ 801	\$ 1,943	\$ 1,608
Fee income	1,470	1,393	2,926	2,747
Net investment income	1,232	1,262	2,465	2,499
Realized gain (loss):				
Total other-than-temporary impairment losses on securities	(1)	(4)	(3)	(8)
Portion of loss recognized in other comprehensive income	-	-	-	-
Net other-than-temporary impairment losses on securities recognized in earnings	(1)	(4)	(3)	(8)
Realized gain (loss), excluding other-than-temporary impairment losses on securities	(6)	(6)	8	(41)
Total realized gain (loss)	(7)	(10)	5	(49)
Amortization of deferred gain on business sold through reinsurance	-	4	-	22
Other revenues	160	127	290	250
Total revenues	4,020	3,577	7,629	7,077
Expenses				
Interest credited	647	646	1,300	1,293
Benefits	1,661	1,287	3,019	2,578
Commissions and other expenses	1,177	1,034	2,234	2,048
Interest and debt expense	68	63	159	127
Strategic digitization expense	16	14	31	23
Total expenses	3,569	3,044	6,743	6,069
Income (loss) before taxes	451	533	886	1,008
Federal income tax expense (benefit)	66	122	134	162
Net income (loss)	385	411	752	846
Other comprehensive income (loss), net of tax	(1,032)	864	(2,671)	1,145
Comprehensive income (loss)	\$ (647)	\$ 1,275	\$ (1,919)	\$ 1,991
Net Income (Loss) Per Common Share				
Basic	\$ 1.76	\$ 1.84	\$ 3.45	\$ 3.77
Diluted	1.70	1.81	3.34	3.70
Cash Dividends Declared Per Common Share	\$ 0.33	\$ 0.29	\$ 0.66	\$ 0.58

See accompanying Notes to Consolidated Financial Statements

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LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited, in millions, except per share data)

	For the Six Months Ended June 30,	
	2018	2017
Common Stock		
Balance as of beginning-of-year	\$ 5,693	\$ 5,869
Stock compensation/issued for benefit plans	19	58
Retirement of common stock/cancellation of shares	(38)	(153)
Balance as of end-of-period	5,674	5,774
Retained Earnings		
Balance as of beginning-of-year	8,399	7,043
Cumulative effect from adoption of new accounting standards	(642)	-
Net income (loss)	752	846
Retirement of common stock	(62)	(247)
Common stock dividends declared	(145)	(131)
Balance as of end-of-period	8,302	7,511
Accumulated Other Comprehensive Income (Loss)		
Balance as of beginning-of-year	3,230	1,566
Cumulative effect from adoption of new accounting standards	642	-
Other comprehensive income (loss), net of tax	(2,671)	1,145
Balance as of end-of-period	1,201	2,711
Total stockholders' equity as of end-of-period	\$ 15,177	\$ 15,996

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in millions)

	For the Six Months Ended June 30,	
	2018	2017
Cash Flows from Operating Activities		
Net income (loss)	\$ 752	\$ 846
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Deferred acquisition costs, value of business acquired, deferred sales inducements and deferred front-end loads deferrals and interest, net of amortization	(3)	30
Trading securities purchases, sales and maturities, net	133	60
Change in premiums and fees receivable	(91)	65
Change in accrued investment income	(17)	(20)
Change in future contract benefits and other contract holder funds	(848)	(864)
Change in reinsurance related assets and liabilities	664	(92)
Change in accrued expenses	(90)	(96)
Change in federal income tax accruals	44	162
Realized (gain) loss	(5)	49
Amortization of deferred gain on business sold through reinsurance	-	(22)
Other	93	84
Net cash provided by (used in) operating activities	632	202
Cash Flows from Investing Activities		
Purchases of available-for-sale securities and equity securities	(4,836)	(5,513)
Sales of available-for-sale securities and equity securities	870	842
Maturities of available-for-sale securities	3,351	2,840
Purchase of common stock in acquisition, net of cash acquired	(1,404)	-
Sale of business, net	(12)	-
Purchases of alternative investments	(146)	(124)
Sales and repayments of alternative investments	69	100
Issuance of mortgage loans on real estate	(1,310)	(705)
Repayment and maturities of mortgage loans on real estate	513	571
Issuance and repayment of policy loans, net	23	34
Net change in collateral on investments, derivatives and related settlements	588	(12)
Other	(79)	(37)
Net cash provided by (used in) investing activities	(2,373)	(2,004)
Cash Flows from Financing Activities		
Payment of long-term debt, including current maturities	(537)	-
Issuance of long-term debt, net of issuance costs	1,094	-
Payment related to early extinguishment of debt	(23)	-

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Proceeds from sales leaseback transaction	51	45
Deposits of fixed account values, including the fixed portion of variable	5,916	5,216
Withdrawals of fixed account values, including the fixed portion of variable	(3,007)	(2,934)
Transfers to and from separate accounts, net	(1,353)	(770)
Common stock issued for benefit plans	(8)	33
Repurchase of common stock	(100)	(400)
Dividends paid to common stockholders	(145)	(132)
Net cash provided by (used in) financing activities	1,888	1,058
Net increase (decrease) in cash, invested cash and restricted cash	147	(744)
Cash, invested cash and restricted cash as of beginning-of-year	1,628	2,722
Cash, invested cash and restricted cash as of end-of-period	\$ 1,775	\$ 1,978

See accompanying Notes to Consolidated Financial Statements

LINCOLN NATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of Operations and Basis of Presentation

Nature of Operations

Lincoln National Corporation and its majority-owned subsidiaries (“LNC” or the “Company,” which also may be referred to as “we,” “our” or “us”) operate multiple insurance businesses through four business segments. See Note 15 for additional details. The collective group of businesses uses “Lincoln Financial Group” as its marketing identity. Through our business segments, we sell a wide range of wealth protection, accumulation and retirement income products and solutions. These products primarily include fixed and indexed annuities, variable annuities, universal life insurance (“UL”), variable universal life insurance (“VUL”), linked-benefit UL, indexed universal life insurance (“IUL”), term life insurance, employer-sponsored retirement plans and services, and group life, disability and dental.

Basis of Presentation

The accompanying unaudited consolidated financial statements are prepared in accordance with United States of America generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions for the Securities and Exchange Commission (“SEC”) Quarterly Report on Form 10-Q, including Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. As discussed in Note 3, on May 1, 2018, LNC and The Lincoln National Life Insurance Company (“LNL”) completed the acquisition of Liberty Life Assurance Company of Boston (“Liberty Life”). The information contained in the Notes to Consolidated Financial Statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2017 (“2017 Form 10-K”), should be read in connection with the reading of these interim unaudited consolidated financial statements.

Certain GAAP policies, which significantly affect the determination of financial condition, results of operations and cash flows, are summarized in our 2017 Form 10-K.

In the opinion of management, these statements include all normal recurring adjustments necessary for a fair presentation of the Company’s results. Operating results for the six months ended June 30, 2018, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2018. All material inter-company accounts and transactions have been eliminated in consolidation.

2. New Accounting Standards

Adoption of New Accounting Standards

The following table provides a description of our adoption of new Accounting Standards Updates (“ASUs”) issued by the Financial Accounting Standards Board and the impact of the adoption on our financial statements. ASUs not listed below were assessed and determined to be either not applicable or not material in presentation or amount.

Standard	Description	Date of Adoption	Effect on Financial Statements or Other Significant Matters
ASU 2014-09, Revenue from Contracts with Customers and all related amendments	This standard establishes the core principle of recognizing revenue to depict the transfer of promised goods and services and defines a five-step process that systematically identifies the various components of the revenue recognition process, culminating with the recognition of revenue upon satisfaction of an entity’s performance obligation. Although the standard and all related amendments supersede nearly all existing revenue recognition guidance under GAAP, the guidance does not amend the accounting for insurance and investment contracts recognized in accordance with Accounting Standards Codification™ (“ASC”) Topic 944, Financial Services – Insurance, leases, financial instruments and guarantees.	January 1, 2018	We adopted the standard and all related amendments using the modified retrospective method. Our primary sources of revenue are recognized in accordance with ASC Topic 944, Financial Services – Insurance; as such, revenue within the scope of the new standard primarily includes commissions and advisory fees earned by our broker dealer operation. The adoption did not have a material impact on our consolidated financial condition, results of operations, stockholders’ equity or cash flows. There were no material changes in the timing or measurement of revenues based upon the guidance. As a result, there is no cumulative effect on retained earnings. For more information, see Note 15.

Standard	Description	Date of Adoption	Effect on Financial Statements or Other Significant Matters
ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities	These amendments require, among other things, the fair value measurement of investments in equity securities and certain other ownership interests that do not result in consolidation and are not accounted for under the equity method of accounting. The change in fair value of the impacted investments in equity securities must be recognized in net income in the period of the change in fair value. In addition, the amendments include certain enhancements to the presentation and disclosure requirements for financial assets and financial liabilities. The guidance does not apply to Federal Home Loan Bank (“FHLB”) stock. Early adoption of the ASU is generally not permitted, except as defined in the ASU. The amendments were adopted in the financial statements through a cumulative-effect adjustment to the beginning balance of retained earnings in the period of adoption.	January 1, 2018	At the time of adoption, we had equity securities classified as available-for-sale (“AFS”) with a total carrying value of \$246 million. We classified, prospectively, \$110 million of equity securities within the scope of this ASU in a separate line on our Consolidated Balance Sheets. The remaining securities, consisting of \$136 million of FHLB stock, are classified in other investments on our Consolidated Balance Sheets and carried at cost. The cumulative-effect adjustment of adopting this ASU was \$1 million.
ASU 2018-02, Reclassification of Certain Tax Effects From Accumulated Other Comprehensive Income	These amendments require a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects associated with the change in the federal corporate income tax rate in the Tax Cuts and Jobs Act (“Tax Act”) of 2017. The amount of the reclassification is equal to the impact of the change in deferred taxes related to amounts recorded in accumulated other comprehensive income (loss) (“AOCI”) resulting from the change in the statutory corporate tax rate from 35% to 21%. Early adoption is permitted and retrospective application is required.	January 1, 2018	We retrospectively reclassified \$641 million of stranded tax effects from AOCI to retained earnings in the period of adoption.

Future Adoption of New Accounting Standards

The following table provides a description of future adoptions of new accounting standards that may have an impact on our financial statements when adopted:

Standard	Description	Projected Date of Adoption	Effect on Financial Statements or Other Significant Matters
ASU 2016-02, Leases	This standard establishes a new accounting model for leases. Lessees will recognize most leases on the balance sheet as a right-of-use asset and a related lease liability. The lease liability is measured as the present value of the lease payments over the lease term with the right-of-use asset measured at the lease liability amount and including adjustments for certain lease incentives and initial direct costs. Lease expense recognition will continue to differentiate between finance leases and operating leases resulting in a similar pattern of lease expense recognition as under current GAAP. This ASU permits a modified retrospective adoption approach that includes a number of optional practical expedients that entities may elect upon adoption. Early adoption is permitted.	January 1, 2019	We continue to gather information to determine our leases that are within the scope of this standard. We do not expect there to be a significant difference in our pattern of lease expense recognition under this ASU.
ASU 2016-13, Measurement of Credit Losses on Financial Instruments	These amendments adopt a new model to measure and recognize credit losses for most financial assets. The method used to measure estimated credit losses for AFS debt securities will be unchanged from current GAAP; however, the amendments require credit losses to be recognized through an allowance rather than as a reduction to the amortized cost of those debt securities. The amendments will permit entities to recognize improvements in credit loss estimates on AFS debt securities by reducing the allowance account immediately through earnings. The amendments will be adopted through a cumulative effect adjustment to the beginning balance of retained earnings as of the first reporting period in which the amendments are effective. Early adoption is permitted for annual periods beginning after December 15, 2018, and interim periods therein.	January 1, 2020	We are currently evaluating the impact of adopting this ASU on our consolidated financial condition and results of operations, with a primary focus on our fixed maturity securities, mortgage loans and reinsurance recoverables.
ASU 2017-08, Premium Amortization on Purchased Callable Debt Securities	These amendments require an entity to shorten the amortization period for certain callable debt securities held at a premium so that the premium is amortized to the earliest call date. Early adoption is permitted, and the ASU requires adoption under a modified retrospective basis through a cumulative-effect adjustment to the beginning balance of retained earnings.	January 1, 2019	We are currently evaluating the impact of adopting this ASU on our consolidated financial condition and results of operations.

ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities	These amendments change both the designation and measurement guidance for qualifying hedging relationships and the presentation of hedge results. These amendments retain the threshold of highly effective for hedging relationships, remove the requirement to bifurcate between the portions of the hedging relationship that are effective and ineffective, record hedge item and hedging instrument results in the same financial statement line item, require quantitative assessment initially for all hedging relationships unless the hedging relationship meets the definition of either the shortcut method or critical terms match method and allow the contractual specified index rate to be designated as the hedged risk in a cash flow hedge of interest rate risk of a variable rate financial instrument. These amendments also eliminate the benchmark interest rate concept for variable rate instruments. Early adoption is permitted.	January 1, 2019	We are currently evaluating the impact of adopting this ASU on our consolidated financial condition and results of operations.
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3. Acquisition

As previously announced, on May 1, 2018, we completed the acquisition of 100% of the capital stock of Liberty Life, which operates a group benefits business (“Liberty Group Business”) and individual life and individual and group annuity business (the “Liberty Life Business”), from Liberty Mutual Insurance Company in a transaction accounted for under the acquisition method of accounting pursuant to Business Combinations Topic 805 (“Topic 805”). The acquisition enables us to increase our market share within the group protection marketplace.

In connection with the acquisition and pursuant to the Master Transaction Agreement (“MTA”), dated January 18, 2018, which was attached as Exhibit 2.1 to the Company’s Current Report on Form 8-K filed on January 22, 2018, Liberty Life sold the Liberty Life Business on May 1, 2018, by entering into reinsurance agreements and related ancillary documents (including administrative services agreements and transition services agreements) with Protective Life Insurance Company and its wholly-owned subsidiary, Protective Life and Annuity Insurance Company (together with Protective Life Insurance Company, “Protective”), providing for the reinsurance and administration of the Liberty Life Business.

Liberty Life’s excess capital of \$1.8 billion was paid to Liberty Mutual Insurance Company through an extraordinary dividend at the acquisition date. We paid \$1.5 billion of cash to Liberty Mutual Insurance Company to acquire the Liberty Group Business.

We recognized \$44 million and \$50 million of acquisition-related costs, pre-tax, for the three and six months ended June 30, 2018, respectively. These costs are included in commissions and other expenses on our Consolidated Statements of Comprehensive Income (Loss).

The acquisition date fair values of certain assets and liabilities, including future contract benefits, intangible assets and related weighted average expected lives, commercial mortgage loans, reinsurance recoverables and deferred income taxes, are provisional and subject to revision within one year of the acquisition date. Under the terms of the MTA, a final balance sheet will be agreed upon during the third quarter of 2018. As such, our estimates of fair values are pending finalization, which may result in adjustments to goodwill. The following table presents the preliminary fair values (in millions) of the net assets acquired related to the Liberty Group Business as of the acquisition date:

Preliminary
Fair Value

Assets	
Investments	\$ 2,493
Mortgage loans on real estate	658
Cash and invested cash	113
Reinsurance recoverables	76
Premiums and fees receivable	83
Accrued investment income	24
Other intangible assets acquired	640
Other assets acquired	141
Separate account assets	99
Total assets acquired	\$ 4,327
Liabilities	
Future contract benefits	\$ 2,930
Other contract holder funds	43
Other liabilities acquired	120
Separate account liabilities	99
Total liabilities assumed	\$ 3,192
Net identifiable assets acquired	\$ 1,135
Goodwill	382
Net assets acquired	\$ 1,517

Identifiable Intangible Assets

The following table presents the fair value of identifiable intangible assets acquired (dollars in millions):

	Fair Value	Weighted- Average Amortization Period
Value of customer relationships acquired	\$ 576	20
Value of distribution agreements	31	13
Value of business acquired	30	3
Insurance licenses	3	N/A
Total identifiable intangible assets	\$ 640	

The value of customer relationships acquired (“VOCRA”) and value of distribution agreements (“VODA”), included in other assets on our Consolidated Balance Sheets, reflects the estimated fair value of the customer relationships acquired and distribution agreements of the Liberty Group Business as of May 1, 2018. The value of the identifiable intangible assets was estimated using a discounted cash flow method. Significant inputs to the valuation models include estimates of expected premiums, persistency rates, investment returns, claim costs, expenses and discount rates based on a weighted average cost of capital. Similar to other specifically identifiable intangible assets, the carrying values of VOCRA and VODA will be amortized using a straight-line method and reviewed at least annually for indicators of impairment in value that are other-than-temporary.

For information on value of business acquired (“VOBA”), see Notes 1 and 8 in our 2017 Form 10-K.

The value of insurance licenses was estimated using the comparable transaction method under the market approach based on arms-length transactions in which certificate authority companies with life and health insurance licenses were purchased. The value of insurance licenses has an indefinite useful life.

Goodwill

Goodwill is calculated as the excess of the consideration transferred over the net assets recognized and represents the future economic benefits arising from assets acquired and liabilities assumed that could not be individually

identified. The goodwill recorded as part of the acquisition includes the expected synergies and other benefits that management believes will result from the acquisition, including an increase in distribution strength. The goodwill resulting from the acquisition was allocated to the Group Protection segment. The goodwill is not expected to be deductible for income tax purposes. For more information on goodwill, see Notes 1 and 10 in our 2017 Form 10-K.

Future Contract Benefits

Unpaid claims acquired reflected within future contract benefits were recorded at estimated fair value. The reserve discount rate was based on the investment yield of the assets acquired with adjustments for risk margin. The actuarial classifications and methodologies were adjusted to be consistent with our accounting policies and reserve methodologies.

Financial Information

Since the acquisition date of May 1, 2018, the revenues and net income of the business acquired have been included in our Consolidated Statements of Comprehensive Income (Loss) in the Group Protection segment and were \$373 million and \$12 million, respectively.

The following unaudited pro forma condensed consolidated results of operations of the Company assume that the acquisition of Liberty Life was completed on January 1, 2017 (in millions):

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Revenue	\$ 4,217	\$ 4,058	\$ 8,382	\$ 8,041
Net income	422	379	800	806

Pro forma adjustments include the revenue and net income of the acquired business for each period as well as amortization of identifiable intangible assets acquired and the fair value adjustment to acquired insurance reserves and investments. Other pro forma adjustments include the incremental increase to interest expense attributable to financing the acquisition; and the impact of reflecting acquisition and integration costs and investment expenses directly attributable to the business combination in 2017 instead of in 2018. Pro forma

adjustments do not include retrospective adjustments to defer and amortize acquisition costs as would be recorded under our accounting policy.

Reinsurance

Pursuant to the reinsurance agreements, we sold the Liberty Life Business to Protective for a ceding commission of \$423 million. Our amounts recoverable from reinsurers increased significantly to \$18.0 billion as of June 30, 2018, from \$4.9 billion as of December 31, 2017, primarily as a result of this reinsurance transaction. As such, Protective now represents our largest reinsurance exposure. As we are not relieved of our liability, the liabilities and obligations associated with the reinsured policies remain on our Consolidated Balance Sheets with a corresponding reinsurance recoverable from Protective. To support its obligations under the reinsurance agreements, Protective has established trust accounts for our benefit that fully collateralize the related reinsurance recoverable. We recorded a deferred tax asset attributed to a tax loss carryforward arising from the reinsurance transaction with Protective.

4. Variable Interest Entities

Consolidated VIEs

See Note 4 in our 2017 Form 10-K for a detailed discussion of our consolidated variable interest entities (“VIEs”), which information is incorporated herein by reference.

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

	As of June 30, 2018			As of December 31, 2017		
	Number of Instruments	Notional Amounts	Carrying Value	Number of Instruments	Notional Amounts	Carrying Value
Assets						
Total return swap	1	574	-	1	573	-
Total assets	1	\$ 574	\$ -	1	\$ 573	\$ -

As of June 30, 2018 and December 31, 2017, there were no gains or losses for consolidated VIEs recognized on our Consolidated Statements of Comprehensive Income (Loss).

Unconsolidated VIEs

See Note 4 in our 2017 Form 10-K for a detailed discussion of our unconsolidated VIEs, which information is incorporated herein by reference.

Limited Partnerships and Limited Liability Companies

We invest in certain limited partnerships (“LPs”) and limited liability companies (“LLCs”), including qualified affordable housing projects, that we have concluded are VIEs. We do not hold any substantive kick-out or participation rights in the LPs and LLCs, and we do not receive any performance fees or decision maker fees from the LPs and LLCs. Based on our analysis of the LPs and LLCs, we are not the primary beneficiary of the VIEs as we do not have the power to direct the most significant activities of the LPs and LLCs.

The carrying amounts of our investments in the LPs and LLCs are recognized in other investments on our Consolidated Balance Sheets and were \$1.6 billion and \$1.5 billion as of June 30, 2018 and December 31, 2017, respectively. Included in these carrying amounts are our investments in qualified affordable housing projects, which were \$26 million and \$31 million as of June 30, 2018, and December 31, 2017, respectively. We do not have any contingent commitments to provide additional capital funding to these qualified affordable housing projects. We received returns from these qualified affordable housing projects in the form of income tax credits and other tax benefits that were \$1 million and \$2 million for the six months ended June 30, 2018 and 2017, respectively, which were recognized in federal income tax expense (benefit) on our Consolidated Statements of Comprehensive Income (Loss).

Our exposure to loss is limited to the capital we invest in the LPs and LLCs, and there have been no indicators of impairment that would require us to recognize an impairment loss related to the LPs and LLCs as of June 30, 2018.

5. Investments

AFS Securities

See Note 1 in our 2017 Form 10-K for information regarding our accounting policy relating to AFS securities, which also includes additional disclosures regarding our fair value measurements. In addition, we adopted ASU 2016-01, Recognition and Measurement of Financial Assets and Financial Liabilities, in 2018 that resulted in a new classification and measurement of our equity securities. See Note 2 for additional information.

The amortized cost, gross unrealized gains, losses and other-than-temporary impairment (“OTTI”) and fair value of AFS securities (in millions) were as follows:

	As of June 30, 2018				
	Amortized	Gross	Unrealized		Fair
	Cost	Gains	Losses	OTTI (1)	Value
Fixed maturity AFS securities:					
Corporate bonds	\$ 78,009	\$ 3,605	\$ 1,582	\$ (9)	\$ 80,041
Asset-backed securities ("ABS")	964	44	7	(17)	1,018
U.S. government bonds	396	29	3	-	422
Foreign government bonds	430	41	-	-	471
Residential mortgage-backed securities ("RMBS")	3,317	119	84	(22)	3,374
Commercial mortgage-backed securities ("CMBS")	759	5	20	(3)	747
Collateralized loan obligations ("CLOs")	1,121	-	7	(5)	1,119
State and municipal bonds	4,509	753	14	-	5,248
Hybrid and redeemable preferred securities	578	65	23	-	620
Total AFS securities	\$ 90,083	\$ 4,661	\$ 1,740	\$ (56)	\$ 93,060

	As of December 31, 2017				
	Amortized	Gross	Unrealized		Fair
	Cost	Gains	Losses	OTTI (1)	Value
Fixed maturity AFS securities:					
Corporate bonds	\$ 75,701	\$ 6,862	\$ 354	\$ (7)	\$ 82,216
ABS	903	51	7	(27)	974
U.S. government bonds	527	41	1	-	567

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Foreign government bonds	395	56	-	-	451
RMBS	3,327	155	39	(22)	3,465
CMBS	590	10	2	(2)	600
CLOs	803	2	2	(5)	808
State and municipal bonds	4,172	953	6	-	5,119
Hybrid and redeemable preferred securities	575	87	22	-	640
Total fixed maturity securities	86,993	8,217	433	(63)	94,840
Equity AFS securities	247	16	17	-	246
Total AFS securities	\$ 87,240	\$ 8,233	\$ 450	\$ (63)	\$ 95,086

(1) Includes unrealized (gains) and losses on impaired securities related to changes in the fair value of such securities subsequent to the impairment measurement date.

The amortized cost and fair value of fixed maturity AFS securities by contractual maturities (in millions) as of June 30, 2018, were as follows:

	Amortized Cost	Fair Value
Due in one year or less	\$ 3,607	\$ 3,649
Due after one year through five years	18,525	18,658
Due after five years through ten years	17,025	17,013
Due after ten years	44,765	47,482
Subtotal	83,922	86,802
Structured securities (ABS, MBS, CLOs)	6,161	6,258
Total fixed maturity AFS securities	\$ 90,083	\$ 93,060

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

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

	As of June 30, 2018					
	Less Than or Equal to Twelve Months		Greater Than Twelve Months		Total	Gross Unrealized Losses and OTTI
	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI
Fixed maturity AFS securities:						
Corporate bonds	\$ 29,697	\$ 1,070	\$ 4,512	\$ 513	\$ 34,209	\$ 1,583
ABS	171	2	135	13	306	15
U.S. government bonds	113	1	18	2	131	3
RMBS	760	27	607	58	1,367	85
CMBS	525	16	58	4	583	20
CLOs	639	7	57	-	696	7
State and municipal bonds	215	5	85	9	300	14
Hybrid and redeemable preferred securities	47	2	118	21	165	23
Total AFS securities	\$ 32,167	\$ 1,130	\$ 5,590	\$ 620	\$ 37,757	\$ 1,750

Total number of AFS securities in an unrealized loss position

3,092

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	As of December 31, 2017					
	Less Than or Equal to Twelve Months		Greater Than Twelve Months		Total	Gross Unrealized Losses and OTTI
	Fair Value	Gross Unrealized Losses and OTTI	Fair Value	Gross Unrealized Losses and OTTI		
Fixed maturity AFS securities:						
Corporate bonds	\$ 4,854	\$ 68	\$ 4,893	\$ 288	\$ 9,747	\$ 356
ABS	62	1	151	15	213	16
U.S. government bonds	156	-	19	1	175	1
RMBS	302	4	641	36	943	40
CMBS	113	-	60	3	173	3
CLOs	281	2	72	-	353	2
State and municipal bonds	34	-	93	6	127	6
Hybrid and redeemable preferred securities	20	-	126	22	146	22
Total fixed maturity securities	5,822	75	6,055	371	11,877	446
Equity AFS securities	22	14	8	3	30	17
Total AFS securities	\$ 5,844	\$ 89	\$ 6,063	\$ 374	\$ 11,907	\$ 463
Total number of AFS securities in an unrealized loss position						1,128

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

	As of June 30, 2018			
	Fair Value	Gross Unrealized		Number of Securities (1)
		Losses	OTTI	
Less than six months	\$ 173	\$ 59	\$ -	23
Six months or greater, but less than nine months	39	16	-	6
Nine months or greater, but less than twelve months	7	4	-	1
Twelve months or greater	117	47	8	28

Total	\$ 336	\$ 126	\$ 8	58
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As of December 31, 2017

	Fair Value	Gross Unrealized Losses	OTTI	Number of Securities (1)
Less than six months	\$ 156	\$ 57	\$ 1	26
Six months or greater, but less than nine months	2	1	-	4
Nine months or greater, but less than twelve months	15	8	-	7
Twelve months or greater	215	78	10	49
Total	\$ 388	\$ 144	\$ 11	86

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

We regularly review our investment holdings for OTTI. Our gross unrealized losses, including the portion of OTTI recognized in OCI, on fixed maturity AFS securities increased by \$1.2 billion for the six months ended June 30, 2018. As discussed further below, we believe the unrealized loss position as of June 30, 2018, did not represent OTTI as (i) we did not intend to sell these fixed maturity AFS securities; (ii) it is not more likely than not that we will be required to sell these fixed maturity AFS securities before recovery of their amortized cost basis; and (iii) the estimated future cash flows were equal to or greater than the amortized cost basis of the debt securities.

Based upon this evaluation as of June 30, 2018, management believes we have the ability to generate adequate amounts of cash from our normal operations (e.g., insurance premiums and fees and investment income) to meet cash requirements with a prudent margin of safety without requiring the sale of our temporarily-impaired securities.

As of June 30, 2018, the unrealized losses associated with our corporate bond securities were attributable primarily to widening credit spreads and rising interest rates since purchase. We performed a detailed analysis of the financial performance of the underlying issuers and determined that we expected to recover the entire amortized cost for each temporarily-impaired security.

As of June 30, 2018, the unrealized losses associated with our mortgage-backed securities (“MBS”) and ABS were attributable primarily to widening credit spreads and rising interest rates since purchase. We assessed for credit impairment using a cash flow model that incorporates key assumptions including default rates, severities and prepayment rates. We estimated losses for a security by forecasting the underlying loans in each transaction. The forecasted loan performance was used to project cash flows to the various tranches in the structure, as applicable. Our forecasted cash flows also considered, as applicable, independent industry analyst reports and forecasts and other independent market data. Based upon our assessment of the expected credit losses of the security given the performance of the underlying collateral compared to our subordination or other credit enhancement, we expected to recover the entire amortized cost of each temporarily-impaired security.

As of June 30, 2018, the unrealized losses associated with our hybrid and redeemable preferred securities were attributable primarily to wider credit spreads caused by illiquidity in the market and subordination within the capital structure, as well as credit risk of underlying issuers. For our hybrid and redeemable preferred securities, we evaluated the financial performance of the underlying issuers based upon credit performance and investment ratings and determined that we expected to recover the entire amortized cost of each temporarily-impaired security.

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

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Balance as of beginning-of-period	\$ 378	\$ 393	\$ 378	\$ 430
Increases attributable to:				
Credit losses on securities for which an OTTI was not previously recognized	1	4	2	5
Credit losses on securities for which an OTTI was previously recognized	-	-	1	3
Decreases attributable to:				
Securities sold, paid down or matured	(4)	(7)	(6)	(48)

Balance as of end-of-period \$ 375 \$ 390 \$ 375 \$ 390

During the six months ended June 30, 2018 and 2017, we recorded credit losses on securities for which an OTTI was not previously recognized as we determined the cash flows expected to be collected would not be sufficient to recover the entire amortized cost basis of the debt security. The credit losses we recorded on securities for which an OTTI was not previously recognized were attributable primarily to one or a combination of the following reasons:

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

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

Mortgage Loans on Real Estate

See Note 1 in our 2017 Form 10-K for information regarding our accounting policy relating to mortgage loans on real estate.

Mortgage loans on real estate principally involve commercial real estate. The commercial loans are geographically diversified throughout the U.S. with the largest concentrations in California, which accounted for 22% and 21% of mortgage loans on real estate as of June 30, 2018, and December 31, 2017, respectively, and Texas which accounted for 12% of mortgage loans on real estate as of June 30, 2018, and December 31, 2017.

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

	As of June 30, 2018	As of December 31, 2017
Current	\$ 12,231	\$ 10,762
60 to 90 days past due	2	-
Greater than 90 days past due	3	3
Valuation allowance associated with impaired mortgage loans on real estate	(2)	(3)
Unamortized premium (discount)	(17)	-
Total carrying value	\$ 12,217	\$ 10,762

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

	As of June 30, 2018	As of December 31, 2017
Number of impaired mortgage loans on real estate	2	3
Principal balance of impaired mortgage loans on real estate	\$ 8	\$ 11
Valuation allowance associated with impaired mortgage loans on real estate	(2)	(3)
Carrying value of impaired mortgage loans on real estate	\$ 6	\$ 8

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

For the Three Months Ended	For the Six Months Ended
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	June 30,		June 30,	
	2018	2017	2018	2017
Balance as of beginning-of-period	\$ 3	\$ 2	\$ 3	\$ 2
Additions	-	-	-	-
Charge-offs, net of recoveries	(1)	-	(1)	-
Balance as of end-of-period	\$ 2	\$ 2	\$ 2	\$ 2

Additional information related to impaired mortgage loans on real estate (in millions) was as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Average carrying value for impaired mortgage loans on real estate	\$ 7	\$ 5	\$ 7	\$ 5
Interest income recognized on impaired mortgage loans on real estate	-	-	-	-
Interest income collected on impaired mortgage loans on real estate	-	-	-	-

As described in Note 1 in our 2017 Form 10-K, we use the loan-to-value and debt-service coverage ratios as credit quality indicators for our mortgage loans on real estate, which were as follows (dollars in millions):

	As of June 30, 2018			As of December 31, 2017		
	Carrying Value	% of Total	Debt- Service Coverage Ratio	Carrying Value	% of Total	Debt- Service Coverage Ratio
Loan-to-Value Ratio						
Less than 65%	\$ 11,043	90.4%	2.31	\$ 9,642	89.6%	2.26
65% to 74%	1,081	8.8%	1.84	1,000	9.3%	1.94
75% to 100%	87	0.7%	1.03	112	1.0%	0.97
Greater than 100%	6	0.1%	0.77	8	0.1%	0.82
Total mortgage loans on real estate	\$ 12,217	100.0%		\$ 10,762	100.0%	

Alternative Investments

As of June 30, 2018, and December 31, 2017, alternative investments included investments in 238 and 224 different partnerships, respectively, and the portfolios represented approximately 1% of our overall invested assets.

Realized Gain (Loss) Related to Certain Investments

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

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Fixed maturity AFS securities: (1)				
Gross gains	\$ 1	\$ 3	\$ 16	\$ 11
Gross losses	(12)	(13)	(45)	(25)
Equity AFS securities:				
Gross gains	-	-	-	1
Gain (loss) on other investments (2)	4	(2)	6	(5)
Associated amortization of DAC, VOBA, DSI and DFEL and changes in other contract holder funds	(6)	(6)	(11)	(13)
Total realized gain (loss) related to certain investments, pre-tax	\$ (13)	\$ (18)	\$ (34)	\$ (31)

(1) These amounts are represented net of related fair value hedging activity. See Note 6 for more information.

(2) Includes market adjustments on equity securities still held of \$2 million for the three and six months ended June 30, 2018.

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

For the Three	For the Six
------------------	-------------

	Months Ended June 30, 2018		Months Ended June 30, 2017	
OTTI Recognized in Net Income (Loss)				
Fixed maturity AFS securities:				
Corporate bonds	\$ (1)	\$ (4)	\$ (3)	\$ (5)
ABS	-	-	-	(1)
RMBS	-	-	-	(1)
State and municipal bonds	-	-	-	(1)
Gross OTTI recognized in net income (loss)	(1)	(4)	(3)	(8)
Associated amortization of DAC, VOBA, DSI and DFEL	-	-	-	-
Net OTTI recognized in net income (loss), pre-tax	\$ (1)	\$ (4)	\$ (3)	\$ (8)

We recognized less than \$1 million of OTTI in OCI for the three and six months ended June 30, 2018 and 2017.

Determination of Credit Losses on Corporate Bonds and ABS

As of June 30, 2018, and December 31, 2017, we reviewed our corporate bond and ABS portfolios for potential shortfall in contractual principal and interest based on numerous subjective and objective inputs. The factors used to determine the amount of credit loss for each individual security, include, but are not limited to, near term risk, substantial discrepancy between book and market value, sector or company-specific volatility, negative operating trends and trading levels wider than peers.

Credit ratings express opinions about the credit quality of a security. Securities rated investment grade, that is those rated BBB- or higher by Standard & Poor's ("S&P") Rating Services or Baa3 or higher by Moody's Investors Service ("Moody's"), are generally considered by the rating agencies and market participants to be low credit risk. As of June 30, 2018, and December 31, 2017, 96% of the fair value of our corporate bond portfolio was rated investment grade. As of June 30, 2018, and December 31, 2017, the portion of our corporate bond portfolio rated below investment grade had an amortized cost of \$3.4 billion and \$3.5 billion, respectively, and a fair value of \$3.2 billion and \$3.5 billion, respectively. As of June 30, 2018, and December 31, 2017, 98% of the fair value of our ABS portfolio was rated investment grade. As of June 30, 2018, and December 31, 2017, the portion of our ABS portfolio rated below investment grade had an amortized cost of \$48 million and \$46 million, respectively, and a fair value of \$46 million and \$43 million, respectively. Based upon the analysis discussed above, we believe as of June 30, 2018, and December 31, 2017, that we would recover the amortized cost of each investment grade corporate bond and ABS security.

Determination of Credit Losses on MBS

As of June 30, 2018, and December 31, 2017, default rates were projected by considering underlying MBS loan performance and collateral type. Projected default rates on existing delinquencies vary between 10% to 100% depending on loan type and severity of delinquency status. In addition, we estimate the potential contributions of currently performing loans that may become delinquent in the future based on the change in delinquencies and loan liquidations experienced in the recent history. Finally, we develop a default rate timing curve by aggregating the defaults for all loans in the pool (delinquent loans, foreclosure and real estate owned and new delinquencies from currently performing loans) and the associated loan-level loss severities.

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

Payables for Collateral on Investments

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

	As of June 30, 2018		As of December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Collateral payable for derivative investments (1)	\$ 468	\$ 468	\$ 765	\$ 765
Securities pledged under securities lending agreements (2)	142	138	222	213
Securities pledged under repurchase agreements (3)	909	977	530	588
Investments pledged for Federal Home Loan Bank of Indianapolis (“FHLBI”) (4)	3,180	4,712	2,900	4,235
Total payables for collateral on investments	\$ 4,699	\$ 6,295	\$ 4,417	\$ 5,801

(1) We obtain collateral based upon contractual provisions with our counterparties. These agreements take into consideration the counterparties’ credit rating as compared to ours, the fair value of the derivative investments and specified thresholds that if exceeded result in the receipt of cash that is typically invested in cash and invested cash. See Note 6 for additional information.

- (2) Our pledged securities under securities lending agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We generally obtain collateral in an amount equal to 102% and 105% of the fair value of the domestic and foreign securities, respectively. We value collateral daily and obtain additional collateral when deemed appropriate. The cash received in our securities lending program is typically invested in cash and invested cash or fixed maturity AFS securities.
- (3) Our pledged securities under repurchase agreements are included in fixed maturity AFS securities on our Consolidated Balance Sheets. We obtain collateral in an amount equal to 95% of the fair value of the securities, and our agreements with third parties contain contractual provisions to allow for additional collateral to be obtained when necessary. The cash received in our repurchase program is typically invested in fixed maturity AFS securities.
- (4) Our pledged investments for FHLBI are included in fixed maturity AFS securities and mortgage loans on real estate on our Consolidated Balance Sheets. The collateral requirements are generally 105% to 115% of the fair value for fixed maturity AFS securities and 155% to 175% of the fair value for mortgage loans on real estate. The cash received in these transactions is primarily invested in cash and invested cash or fixed maturity AFS securities.

Increase (decrease) in payables for collateral on investments (in millions) consisted of the following:

	For the Six Months Ended June 30,	
	2018	2017
Collateral payable for derivative investments	\$ (297)	\$ 160
Securities pledged under securities lending agreements	(80)	(8)
Securities pledged under repurchase agreements	379	5
Investments pledged for FHLBI	280	(200)
Total increase (decrease) in payables for collateral on investments	\$ 282	\$ (43)

We have elected not to offset our repurchase agreements and securities lending transactions in our financial statements. The remaining contractual maturities of repurchase agreements and securities lending transactions accounted for as secured borrowings were as follows:

	As of June 30, 2018				
	Overnight and Continued	Up to 30 Days	30 - 90 Days	Greater Than 90 Days	Total
Repurchase Agreements					
Corporate bonds	\$ -	\$ 760	\$ -	\$ 149	\$ 909
Total	-	760	-	149	909
Securities Lending					
Corporate bonds	142	-	-	-	142
Total	142	-	-	-	142
Total gross secured borrowings	\$ 142	\$ 760	\$ -	\$ 149	\$ 1,051

	As of December 31, 2017				
	Overnight and Continued	Up to 30 Days	30 - 90 Days	Greater Than 90 Days	Total
Repurchase Agreements					
Corporate bonds	\$ -	\$ 100	\$ 280	\$ 150	\$ 530
Total	-	100	280	150	530
Securities Lending					
Corporate bonds	222	-	-	-	222
Total	222	-	-	-	222
Total gross secured borrowings	\$ 222	\$ 100	\$ 280	\$ 150	\$ 752

We accept collateral in the form of securities in connection with repurchase agreements. In instances where we are permitted to sell or re-pledge the securities received, we report the fair value of the collateral received and a related obligation to return the collateral in the financial statements. In addition, we receive securities in connection with securities borrowing agreements, which we are permitted to sell or re-pledge. As of June 30, 2018, the fair value of all collateral received that we are permitted to sell or re-pledge was \$531 million. As of June 30, 2018, we have re-pledged \$364 million of this collateral to cover initial margin on certain derivative investments.

Investment Commitments

As of June 30, 2018, our investment commitments were \$1.9 billion, which included \$801 million of LPs, \$570 million of mortgage loans on real estate and \$501 million of private placement securities.

Concentrations of Financial Instruments

As of June 30, 2018, and December 31, 2017, our most significant investments in one issuer were our investments in securities issued by the Federal Home Loan Mortgage Corporation with a fair value of \$1.4 billion and \$1.3 billion, respectively, or 1% of our invested assets portfolio, and our investments in securities issued by the Federal National Mortgage Association with a fair value of \$1.3 billion and \$1.0 billion, respectively, or 1% of our invested assets portfolio. These concentrations include fixed maturity AFS, trading and equity securities.

As of June 30, 2018, and December 31, 2017, our most significant investments in one industry were our investments in securities in the consumer non-cyclical industry with a fair value of \$14.2 billion and \$15.0 billion, respectively, or 13% of our invested assets portfolio, and our investments in securities in the utilities industry with a fair value of \$13.7 billion and \$14.3 billion, respectively, or 12% and 13%, respectively, of our invested assets portfolio. These concentrations include fixed maturity AFS, trading and equity securities.

6. Derivative Instruments

We maintain an overall risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings that are caused by interest rate risk, foreign currency exchange risk, equity market risk, basis risk and credit risk. See Note 1 in our 2017 Form 10-K for a detailed discussion of the accounting treatment for derivative instruments. See Note 6 in our 2017 Form 10-K for a detailed discussion of our derivative instruments and use of them in our overall risk management strategy, which information is incorporated herein by reference. See Note 14 for additional disclosures related to the fair value of our derivative instruments.

We have derivative instruments with off-balance-sheet risks whose notional or contract amounts exceed the related credit exposure. Outstanding derivative instruments with off-balance-sheet risks (in millions) were as follows:

	As of June 30, 2018			As of December 31, 2017		
	Notional Amounts	Fair Value Asset	Liability	Notional Amounts	Fair Value Asset	Liability
Qualifying Hedges						
Cash flow hedges:						
Interest rate contracts (1)	\$ 2,867	\$ 85	\$ 21	\$ 3,007	\$ 46	\$ 84
Foreign currency contracts (1)	2,028	93	73	1,804	79	79
Total cash flow hedges	4,895	178	94	4,811	125	163
Fair value hedges:						
Interest rate contracts (1)	1,275	46	128	1,438	254	174
Non-Qualifying Hedges						
Interest rate contracts (1)	90,678	393	195	72,937	657	127
Foreign currency contracts (1)	134	-	-	22	-	-
Equity market contracts (1)	31,049	521	427	31,090	562	557
Credit contracts (1)	-	-	-	52	-	-
Embedded derivatives:						
Guaranteed living benefit ("GLB")						
direct (2)	-	1,248	-	-	903	-
GLB ceded (2) (3)	-	41	131	-	51	67
Reinsurance related (4)	-	-	25	-	-	57
Indexed annuity and IUL contracts (2) (5)	-	29	1,400	-	11	1,418
Total derivative instruments	\$ 128,031	\$ 2,456	\$ 2,400	\$ 110,350	\$ 2,563	\$ 2,563

(1) Reported in derivative investments and other liabilities on our Consolidated Balance Sheets.

(2) Reported in other assets on our Consolidated Balance Sheets.

(3) Reported in other liabilities on our Consolidated Balance Sheets.

(4) Reported in reinsurance related embedded derivatives on our Consolidated Balance Sheets.

(5) Reported in future contract benefits on our Consolidated Balance Sheets.

The maturity of the notional amounts of derivative instruments (in millions) was as follows:

	Remaining Life as of June 30, 2018					Total
	Less Than 1 Year	1 - 5 Years	6 - 10 Years	11 - 30 Years	Over 30 Years	
Interest rate contracts (1)	\$ 13,347	\$ 14,517	\$ 46,210	\$ 19,533	\$ 1,213	\$ 94,820

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Foreign currency contracts (2)	165	260	601	1,113	23	2,162
Equity market contracts	18,813	8,864	390	14	2,968	31,049
Total derivative instruments with notional amounts	\$ 32,325	\$ 23,641	\$ 47,201	\$ 20,660	\$ 4,204	\$ 128,031

- (1) As of June 30, 2018, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was April 2067.
- (2) As of June 30, 2018, the latest maturity date for which we were hedging our exposure to the variability in future cash flows for these instruments was September 2049.

The change in our unrealized gain (loss) on derivative instruments in AOCI (in millions) was as follows:

	For the Six Months Ended June 30, 2018 2017	
Unrealized Gain (Loss) on Derivative Instruments		
Balance as of beginning-of-year	\$ (29)	\$ 49
Other comprehensive income (loss):		
Unrealized holding gains (losses) arising during the period:		
Cumulative effect from adoption of new accounting standard	(6)	-
Cash flow hedges:		
Interest rate contracts	106	1
Foreign currency contracts	(19)	45
Change in foreign currency exchange rate adjustment	50	(75)
Change in DAC, VOBA, DSI and DFEL	4	(8)
Income tax benefit (expense)	(29)	13
Less:		
Reclassification adjustment for gains (losses) included in net income (loss):		
Cash flow hedges:		
Interest rate contracts (1)	2	2
Interest rate contracts (2)	(2)	(9)
Foreign currency contracts (1)	11	9
Foreign currency contracts (3)	-	5
Associated amortization of DAC, VOBA, DSI and DFEL	(1)	(2)
Income tax benefit (expense)	(2)	(2)
Balance as of end-of-period	\$ 69	\$ 22

- (1) The OCI offset is reported within net investment income on our Consolidated Statements of Comprehensive Income (Loss).
- (2) The OCI offset is reported within interest and debt expense on our Consolidated Statements of Comprehensive Income (Loss).
- (3) The OCI offset is reported within realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).

The gains (losses) on derivative instruments (in millions) recorded within income (loss) from continuing operations on our Consolidated Statements of Comprehensive Income (Loss) were as follows:

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Qualifying Hedges				
Cash flow hedges:				
Interest rate contracts (1)	\$ 1	\$ 1	\$ 2	\$ 2
Interest rate contracts (2)	2	(5)	(2)	(9)
Foreign currency contracts (1)	5	4	11	9
Foreign currency contracts (3)	-	-	-	5
Total cash flow hedges	8	-	11	7
Fair value hedges:				
Interest rate contracts (1)	(4)	(6)	(9)	(13)
Interest rate contracts (2)	-	7	6	15
Interest rate contracts (3)	14	(9)	47	-
Total fair value hedges	10	(8)	44	2
Non-Qualifying Hedges				
Interest rate contracts (3)	(96)	193	(410)	143
Foreign currency contracts (3)	-	(2)	2	1
Equity market contracts (3)	(89)	(289)	(80)	(817)
Equity market contracts (4)	3	5	1	14
Embedded derivatives:				
GLB (3)	113	72	270	669
Reinsurance related (3)	9	(3)	32	-
Indexed annuity and IUL contracts (3)	(62)	(64)	(10)	(184)
Total derivative instruments	\$ (104)	\$ (96)	\$ (140)	\$ (165)

- (1) Reported in net investment income on our Consolidated Statements of Comprehensive Income (Loss).
- (2) Reported in interest and debt expense on our Consolidated Statements of Comprehensive Income (Loss).
- (3) Reported in realized gain (loss) on our Consolidated Statements of Comprehensive Income (Loss).
- (4) Reported in commissions and other expenses on our Consolidated Statements of Comprehensive Income (Loss).

Gains (losses) recognized as a component of OCI (in millions) on derivative instruments designated and qualifying as cash flow hedges were as follows:

For the Six

	For the Three Months Ended June 30, 2018		Months Ended June 30, 2017	
Offset to net investment income	\$ 6	\$ 5	\$ 13	\$ 11
Offset to realized gain (loss)	-	-	-	5
Offset to interest and debt expense	2	(5)	(2)	(9)

As of June 30, 2018, \$8 million of the deferred net gains (losses) on derivative instruments in AOCI were expected to be reclassified to earnings during the next 12 months. This reclassification would be due primarily to interest rate variances related to our interest rate swap agreements.

For the six months ended June 30, 2018 and 2017, there were no material reclassifications to earnings due to hedged firm commitments no longer deemed probable or due to hedged forecasted transactions that had not occurred by the end of the originally specified time period.

As of June 30, 2018, we did not have any exposure related to credit default swaps for which we are the seller.

As of December 31, 2017 information related to our credit default swaps for which we are the seller (dollars in millions) was as follows:

As of December 31, 2017

Credit Contract Type	Maturity	Reason for Entering	Nature of Recourse	Credit Rating of Underlying Obligation (1)	Number of Instruments	Fair Value (2)	Maximum Potential Payout
Basket credit default swaps	12/20/2022	(3)	(4)	BBB+	1	\$ 1	\$ 52
					1	\$ 1	\$ 52

- (1) Represents average credit ratings based on the midpoint of the applicable ratings among Moody's, S&P and Fitch Ratings, as scaled to the corresponding S&P ratings.
- (2) Broker quotes are used to determine the market value of our credit default swaps.
- (3) Credit default swaps were entered into in order to hedge the liability exposure on certain variable annuity products.
- (4) Sellers do not have the right to demand indemnification or compensation from third parties in case of a loss (payment) on the contract.

Details underlying the associated collateral of our credit default swaps for which we are the seller if credit risk-related contingent features were triggered (in millions) were as follows:

	As of June 30, 2018	As of December 31, 2017
Maximum potential payout	\$ -	\$ 52
Less: Counterparty thresholds	-	-
Maximum collateral potentially required to post	\$ -	\$ 52

Certain of our credit default swap agreements contain contractual provisions that allow for the netting of collateral with our counterparties related to all of our collateralized financing transactions that we have outstanding. If these netting agreements were not in place, we would have been required to post collateral if the market value was less than zero.

Credit Risk

We are exposed to credit losses in the event of non-performance by our counterparties on various derivative contracts and reflect assumptions regarding the credit or non-performance risk (“NPR”). The NPR is based upon assumptions for each counterparty’s credit spread over the estimated weighted average life of the counterparty exposure less collateral held. As of June 30, 2018, the NPR adjustment was zero. The credit risk associated with such agreements is minimized by entering into agreements with financial institutions with long-standing, superior performance records. Additionally, we maintain a policy of requiring derivative contracts to be governed by an International Swaps and Derivatives Association (“ISDA”) Master Agreement. We are required to maintain minimum ratings as a matter of routine practice in negotiating ISDA agreements. Under some ISDA agreements, our insurance subsidiaries have agreed to maintain certain financial strength or claims-paying ratings. A downgrade below these levels could result in termination of derivative contracts, at which time any amounts payable by us would be dependent on the market value of the underlying derivative contracts. In certain transactions, we and the counterparty have entered into a credit support annex requiring either party to post collateral when net exposures exceed pre-determined thresholds. These thresholds vary by counterparty and credit rating. The amount of such exposure is essentially the net replacement cost or market value less collateral held for such agreements with each counterparty if the net market value is in our favor. As of June 30, 2018 and December 31, 2017, our exposure was zero.

The amounts recognized (in millions) by S&P credit rating of counterparty, for which we had the right to reclaim cash collateral or were obligated to return cash collateral, were as follows:

S&P Credit Rating of Counterparty	As of June 30, 2018		As of December 31, 2017	
	Collateral Posted by Counter- Party (Held by LNC) Party)	Collateral Posted by Counter- Party (Held by LNC) Party)	Collateral Posted by Counter- Party (Held by LNC) Party)	Collateral Posted by Counter- Party (Held by LNC) Party)
AA-	\$ 79	\$ (6)	\$ 116	\$ (1)
A+	64	(67)	242	(453)
A	140	(17)	170	(120)
A-	184	-	237	(3)
BBB+	-	-	-	(4)
	\$ 467	\$ (90)	\$ 765	\$ (581)

Balance Sheet Offsetting

Information related to the effects of offsetting (in millions) was as follows:

	As of June 30, 2018		Total
	Derivative Instruments	Embedded Derivative Instruments	
Financial Assets			
Gross amount of recognized assets	\$ 911	\$ 1,318	\$ 2,229
Gross amounts offset	(327)	-	(327)
Net amount of assets	584	1,318	1,902
Gross amounts not offset:			
Cash collateral	(467)	-	(467)
Non-cash collateral	(78)	-	(78)

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Net amount	\$ 39	\$ 1,318	\$ 1,357
Financial Liabilities			
Gross amount of recognized liabilities	\$ 604	\$ 1,556	\$ 2,160
Gross amounts offset	(227)	-	(227)
Net amount of liabilities	377	1,556	1,933
Gross amounts not offset:			
Cash collateral	(90)	-	(90)
Non-cash collateral	(287)	-	(287)
Net amount	\$ -	\$ 1,556	\$ 1,556

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	As of December 31, 2017		
	Derivative	Embedded	
	Instruments	Instruments	Total
Financial Assets			
Gross amount of recognized assets	\$ 1,301	\$ 965	\$ 2,266
Gross amounts offset	(386)	-	(386)
Net amount of assets	915	965	1,880
Gross amounts not offset:			
Cash collateral	(765)	-	(765)
Net amount	\$ 150	\$ 965	\$ 1,115
Financial Liabilities			
Gross amount of recognized liabilities	\$ 955	\$ 1,542	\$ 2,497
Gross amounts offset	(296)	-	(296)
Net amount of liabilities	659	1,542	2,201
Gross amounts not offset:			
Cash collateral	(581)	-	(581)
Net amount	\$ 78	\$ 1,542	\$ 1,620

7. Federal Income Taxes

The effective tax rate is the ratio of tax expense over pre-tax income (loss). The effective tax rate was 15% for the three and six months ended June 30, 2018, compared to 23% and 16% for the corresponding periods in 2017. The effective tax rate on pre-tax income was lower than the prevailing corporate federal income tax rate. Differences in the effective rates and the U.S. statutory rates of 21% and 35% for the three and six months ended June 30, 2018 and 2017, respectively, were the result of the separate account dividends-received deduction, certain tax preferred investment income, foreign tax credits and other tax preference items.

The SEC previously issued rules that allow for a one year measurement period after the enactment of the Tax Act to finalize calculations and recording of the related tax impacts. Subsequent to the Tax Act, we have continued to review and analyze the provisions of the Tax Act, including the actual and potential impact of the reduction in the U.S. federal corporate income tax rate and the impact of specific life insurance provisions on our financial statements. While we do not anticipate any significant changes to amounts currently recorded, any additional adjustments to amounts recorded as a result of the Tax Act will be made during 2018.

8. Guaranteed Benefit Features

Information on the guaranteed death benefit (“GDB”) features outstanding (dollars in millions) was as follows:

	As of June 30, 2018 (1)	As of December 31, 2017 (1)
Return of Net Deposits		
Total account value	\$ 96,600	\$ 96,941
Net amount at risk (2)	126	81
Average attained age of contract holders	64 years	64 years
Minimum Return		
Total account value	\$ 103	\$ 108
Net amount at risk (2)	16	18
Average attained age of contract holders	76 years	76 years
Guaranteed minimum return	5%	5%
Anniversary Contract Value		
Total account value	\$ 26,046	\$ 26,596
Net amount at risk (2)	521	417
Average attained age of contract holders	70 years	70 years

(1) Our variable contracts with guarantees may offer more than one type of guarantee in each contract; therefore, the amounts listed are not mutually exclusive.

(2) Represents the amount of death benefit in excess of the account balance that is subject to market fluctuations.

The determination of GDB liabilities is based on models that involve a range of scenarios and assumptions, including those regarding expected market rates of return and volatility, contract surrender rates and mortality experience. The following summarizes the balances of and changes in the liabilities for GDBs (in millions), which were recorded in future contract benefits on our Consolidated Balance Sheets:

	For the Six Months Ended June 30, 2018 2017	
Balance as of beginning-of-year	\$ 100	\$ 110
Changes in reserves	18	(2)
Benefits paid	(7)	(11)
Balance as of end-of-period	\$ 111	\$ 97

Variable Annuity Contracts

Account balances of variable annuity contracts, including those with guarantees, (in millions) were invested in separate account investment options as follows:

Asset Type	As of June 30, 2018	As of December 31, 2017
Domestic equity	\$ 59,698	\$ 59,647
International equity	20,558	20,837
Fixed income	40,098	40,626
Total	\$ 120,354	\$ 121,110
Percent of total variable annuity separate account values	99%	99%

Secondary Guarantee Products

Future contract benefits and other contract holder funds include reserves for our secondary guarantee products sold through our Life Insurance segment. These UL and VUL products with secondary guarantees represented 35% of total life insurance in-force reserves as of June 30, 2018 and December 31, 2017. UL and VUL products with

secondary guarantees represented 30% and 33% of total sales for the three and six months ended June 30, 2018, respectively, compared to 28% and 27% for the corresponding periods in 2017.

9. Liability for Unpaid Claims

In connection with our acquisition of the Liberty Group Business, we expanded our financial statement disclosures related to changes in the liability for unpaid claims (in millions), which were as follows:

	For the Six Months Ended June 30,	
	2018	2017
Balance as of beginning-of-year	\$ 2,222	\$ 2,242
Reinsurance recoverable	57	69
Net balance as of beginning-of-year	2,165	2,173
Business acquired (1)	2,836	-
Incurred related to:		
Current year	986	686
Prior years		
Interest	50	37
All other incurred	(87)	(45)
Total incurred	949	678
Paid related to:		
Current year	(393)	(343)
Prior years	(517)	(356)
Total paid	(910)	(699)
Net balance as of end-of-period	5,040	2,152
Reinsurance recoverable	136	70
Balance as of end-of-period	\$ 5,176	\$ 2,222

(1) Represents Liberty group life and disability reserves, net, as of May 1, 2018, subject to finalization of acquisition date fair values. See Note 3 for additional information.

The majority of the reserves included in the roll forward are for long-term disability claims. The interest rate assumption is an important part of the reserving process due to the long benefit period for these claims. Interest accrued on prior year reserves has been calculated on the opening reserve balance less one-half of the prior year incurred period's claim payments at our average reserve discount rate for the respective periods.

"Incurred related to prior years - All other incurred" reflected in the preceding table is primarily impacted by the level of claim resolutions in the period compared to that which is expected by the reserve assumption. A negative number

implies a favorable result where claim resolutions were more favorable than assumed. Our claim resolution rate assumption used in determining reserves is our expectation of the resolution rate we will experience over the long-term life of the block of claims. It will vary from actual experience in any one period, both favorably and unfavorably.

A reconciliation of future contract benefits as reported in our Consolidated Balance Sheets to the liability for unpaid claims (in millions), was as follows:

	As of June 30,	
	2018	2017
Future contract benefits	\$ 33,718	\$ 22,293
Less:		
Life and annuity reserves and claims due	26,975	18,411
Accident and health active life reserves	1,567	1,660
Liability for unpaid claims	\$ 5,176	\$ 2,222

10. Contingencies and Commitments

Regulatory bodies, such as state insurance departments, the SEC, Financial Industry Regulatory Authority and other regulatory bodies regularly make inquiries and conduct examinations or investigations concerning our compliance with, among other things, insurance laws, securities laws, laws governing the activities of broker-dealers, registered investment advisors and unclaimed property laws.

LNC is involved in various pending or threatened legal or regulatory proceedings, including purported class actions, arising from the conduct of business both in the ordinary course and otherwise. In some of the matters, very large and/or indeterminate amounts, including punitive and treble damages, are sought. Modern pleading practice in the U.S. permits considerable variation in the assertion of monetary damages or other relief. Jurisdictions may permit claimants not to specify the monetary damages sought or may permit claimants to state only that the amount sought is sufficient to invoke the jurisdiction of the trial court. In addition, jurisdictions may permit plaintiffs to allege monetary damages in amounts well exceeding verdicts obtained in the jurisdiction for similar matters. This variability in pleadings, together with the actual experiences of LNC in litigating or resolving through settlement numerous claims over an extended period of time, demonstrates to management that the monetary relief which may be specified in a lawsuit or claim bears little relevance to its merits or disposition value.

Due to the unpredictable nature of litigation, the outcome of a litigation matter and the amount or range of potential loss at particular points in time is normally difficult to ascertain. Uncertainties can include how fact finders will evaluate documentary evidence and the credibility and effectiveness of witness testimony, and how trial and appellate courts will apply the law in the context of the pleadings or evidence presented, whether by motion practice, or at trial or on appeal. Disposition valuations are also subject to the uncertainty of how opposing parties and their counsel will themselves view the relevant evidence and applicable law.

We establish liabilities for litigation and regulatory loss contingencies when information related to the loss contingencies shows both that it is probable that a loss has been incurred and the amount of the loss can be reasonably estimated. It is possible that some matters could require us to pay damages or make other expenditures or establish accruals in amounts that could not be estimated as of June 30, 2018. While the potential future charges could be material in the particular quarterly or annual periods in which they are recorded, based on information currently known by management, management does not believe any such charges are likely to have a material adverse effect on LNC's financial condition.

For some matters, the Company is able to estimate a reasonably possible range of loss. For such matters in which a loss is probable, an accrual has been made. For such matters where a loss is believed to be reasonably possible, but not probable, no accrual has been made. Accordingly, the estimate contained in this paragraph reflects two types of matters. For some matters included within this estimate, an accrual has been made, but there is a reasonable possibility that an exposure exists in excess of the amount accrued. In these cases, the estimate reflects the reasonably possible range of loss in excess of the accrued amount. For other matters included within this estimation, no accrual

has been made because a loss, while potentially estimable, is believed to be reasonably possible but not probable. In these cases, the estimate reflects the reasonably possible loss or range of loss. As of June 30, 2018, we estimate the aggregate range of reasonably possible losses to be up to approximately \$50 million.

For other matters, we are not currently able to estimate the reasonably possible loss or range of loss. We are often unable to estimate the possible loss or range of loss until developments in such matters have provided sufficient information to support an assessment of the range of possible loss, such as quantification of a damage demand from plaintiffs, discovery from other parties and investigation of factual allegations, rulings by the court on motions or appeals, analysis by experts and the progress of settlement negotiations. On a quarterly and annual basis, we review relevant information with respect to litigation contingencies and update our accruals, disclosures and estimates of reasonably possible losses or ranges of loss based on such reviews.

Certain reinsurers have sought rate increases on certain yearly renewable term treaties. We are disputing the requested rate increases under these treaties. We have initiated and will initiate arbitration proceedings, as necessary, under these treaties in order to protect our contractual rights. Additionally, reinsurers may initiate arbitration proceedings against us. We believe it is unlikely the outcome of these disputes will have a material adverse effect on our financial condition. For more information about reinsurance, see Note 9 in our 2017 Form 10-K.

Cost of Insurance Litigation

TVPX ARS INC., as Securities Intermediary for Consolidated Wealth Management, LTD. v. The Lincoln National Life Insurance Company, filed in the U.S. District Court for the Eastern District of Pennsylvania, No. 2:18-cv-02989, is a putative class action that was filed on July 17, 2018. Plaintiff alleges that LNL charged more for non-guaranteed cost of insurance than permitted by the policy. Plaintiff seeks to represent all universal life and variable universal life policyholders who own policies issued by LNL or its predecessors containing non-guaranteed cost of insurance provisions that are similar to those of Plaintiff's policy and seeks damages on behalf of all such policyholders. We are vigorously defending this matter.

See Note 13 in our 2017 Form 10-K and Note 10 in our Form 10-Q for the quarter ended March 31, 2018, for additional discussion of commitments and contingencies, which information is incorporated herein by reference.

11. Shares and Stockholders' Equity

Common Shares

The changes in our common stock (number of shares) were as follows:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2018	2017	2018	2017
Common Stock				
Balance as of beginning-of-period	218,695,476	224,888,259	218,090,114	226,335,105
Stock issued for exercise of warrants	2,826	289,636	22,866	334,930
Stock compensation/issued for benefit plans	51,644	89,455	636,966	1,461,286
Retirement/cancellation of shares	(1,455,895)	(3,030,088)	(1,455,895)	(5,894,059)
Balance as of end-of-period	217,294,051	222,237,262	217,294,051	222,237,262
Common Stock as of End-of-Period				
Basic basis	217,294,051	222,237,262	217,294,051	222,237,262
Diluted basis	220,722,270	226,044,165	220,722,270	226,044,165

Our common stock is without par value.

Average Shares

A reconciliation of the denominator (number of shares) in the calculations of basic and diluted earnings (loss) per common share was as follows:

For the Three Months Ended June 30,		For the Six Months Ended June 30,	
2018	2017	2018	2017

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Weighted-average shares, as used in basic calculation	217,997,297	223,555,299	218,182,118	224,581,848
Shares to cover exercise of outstanding warrants	639,071	694,403	640,929	858,916
Shares to cover non-vested stock	1,475,976	1,426,550	1,534,469	1,551,173
Average stock options outstanding during the period	1,752,403	2,339,558	1,860,997	2,510,344
Assumed acquisition of shares with assumed proceeds from exercising outstanding warrants	(91,876)	(105,156)	(86,482)	(127,696)
Assumed acquisition of shares with assumed proceeds and benefits from exercising stock options (at average market price for the period)	(1,086,798)	(1,464,321)	(1,094,976)	(1,541,738)
Shares repurchasable from measured but unrecognized stock option expense	(16,356)	(59,959)	(20,467)	(68,519)
Average deferred compensation shares	934,869	927,508	928,466	938,661
Weighted-average shares, as used in diluted calculation	221,604,586	227,313,882	221,945,054	228,702,989

In the event the average market price of LNC common stock exceeds the issue price of stock options and the options have a dilutive effect to our earnings per share (“EPS”), such options will be shown in the table above.

We have participants in our deferred compensation plans who selected LNC stock as the measure for the investment return attributable to all or a portion of their deferral amounts. For the three and six months ended June 30, 2018 and 2017, the effect of settling this obligation in LNC stock (“equity classification”) was more dilutive than the scenario of settling in cash (“liability classification”). Therefore, for our EPS calculation for these periods, we added these shares to the denominator and adjusted the numerator to present net income as if the shares had been accounted for under equity classification by removing the mark-to-market adjustment included in net income attributable to these deferred units of LNC stock. The amount of this adjustment was \$8 million and \$10 million for the three and six months ended June 30, 2018, respectively, and \$(1) million for the three and six months ended June 30, 2017, respectively.

AOCI

The following summarizes the components and changes in AOCI (in millions):

	For the Six Months Ended June 30,	
	2018	2017
Unrealized Gain (Loss) on AFS Securities		
Balance as of beginning-of-year	\$ 3,486	\$ 1,784
Cumulative effect from adoption of new accounting standards	674	-
Unrealized holding gains (losses) arising during the period	(4,891)	2,058
Change in foreign currency exchange rate adjustment	(50)	69
Change in DAC, VOBA, DSI, future contract benefits and other contract holder funds	1,395	(356)
Income tax benefit (expense)	749	(626)
Less:		
Reclassification adjustment for gains (losses) included in net income (loss)	(29)	(13)
Associated amortization of DAC, VOBA, DSI and DFEL	(10)	(11)
Income tax benefit (expense)	8	8
Balance as of end-of-period	\$ 1,394	\$ 2,945
Unrealized OTTI on AFS Securities		
Balance as of beginning-of-year	\$ 44	\$ 25
(Increases) attributable to:		
Cumulative effect from adoption of new accounting standards	9	-
Gross OTTI recognized in OCI during the period	-	-
Change in DAC, VOBA, DSI and DFEL	-	-
Income tax benefit (expense)	-	-
Decreases attributable to:		
Changes in fair value, sales, maturities or other settlements of AFS securities	(7)	21
Change in DAC, VOBA, DSI and DFEL	(11)	(4)
Income tax benefit (expense)	4	(6)
Balance as of end-of-period	\$ 39	\$ 36
Unrealized Gain (Loss) on Derivative Instruments		
Balance as of beginning-of-year	\$ (29)	\$ 49
Cumulative effect from adoption of new accounting standard	(6)	-
Unrealized holding gains (losses) arising during the period	87	46
Change in foreign currency exchange rate adjustment	50	(75)
Change in DAC, VOBA, DSI and DFEL	4	(8)
Income tax benefit (expense)	(29)	13
Less:		
Reclassification adjustment for gains (losses) included in net income (loss)	11	7
Associated amortization of DAC, VOBA, DSI and DFEL	(1)	(2)

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Income tax benefit (expense)	(2)	(2)
Balance as of end-of-period	\$ 69	\$ 22
Foreign Currency Translation Adjustment		
Balance as of beginning-of-year	\$ (14)	\$ (27)
Foreign currency translation adjustment arising during the period	(4)	7
Balance as of end-of-period	\$ (18)	\$ (20)
Funded Status of Employee Benefit Plans		
Balance as of beginning-of-year	\$ (257)	\$ (265)
Cumulative effect from adoption of new accounting standard	(35)	-
Adjustment arising during the period	9	(7)
Balance as of end-of-period	\$ (283)	\$ (272)

The following summarizes the reclassifications out of AOCI (in millions) and the associated line item in the Consolidated Statements of Comprehensive Income (Loss):

	For the Six Months Ended June 30,		
	2018	2017	
Unrealized Gain (Loss) on AFS Securities			
Gross reclassification	\$ (29)	\$ (13)	Total realized gain (loss)
Associated amortization of DAC, VOBA, DSI and DFEL	(10)	(11)	Total realized gain (loss)
Reclassification before income tax benefit (expense)	(39)	(24)	Income (loss) from continuing operations before taxes
Income tax benefit (expense)	8	8	Federal income tax expense (benefit)
Reclassification, net of income tax	\$ (31)	\$ (16)	Net income (loss)
Unrealized OTTI on AFS Securities			
Gross reclassification	\$ -	\$ (1)	Total realized gain (loss)
Change in DAC, VOBA, DSI and DFEL	-	-	Total realized gain (loss)
Reclassification before income tax benefit (expense)	-	(1)	Income (loss) from continuing operations before taxes
Income tax benefit (expense)	-	-	Federal income tax expense (benefit)
Reclassification, net of income tax	\$ -	\$ (1)	Net income (loss)
Unrealized Gain (Loss) on Derivative Instruments			
Gross reclassifications:			
Interest rate contracts	\$ 2	\$ 2	Net investment income
Interest rate contracts	(2)	(9)	Interest and debt expense
Foreign currency contracts	11	9	Net investment income
Foreign currency contracts	-	5	Total realized gain (loss)
Total gross reclassifications	11	7	
Associated amortization of DAC, VOBA, DSI and DFEL	(1)	(2)	Commissions and other expenses
Reclassifications before income tax benefit (expense)	10	5	Income (loss) from continuing operations before taxes
Income tax benefit (expense)	(2)	(2)	Federal income tax expense (benefit)
Reclassifications, net of income tax	\$ 8	\$ 3	Net income (loss)

12. Realized Gain (Loss)

Details underlying realized gain (loss) (in millions) reported on our Consolidated Statements of Comprehensive Income (Loss) were as follows:

	For the Three Months Ended June 30, 2018		For the Six Months Ended June 30, 2017	
Total realized gain (loss) related to certain investments (1)	\$ (13)	\$ (18)	\$ (34)	\$ (31)
Realized gain (loss) on the mark-to-market on certain instruments (2)	23	(5)	24	5
Indexed annuity and IUL contracts net derivatives results: (3)				
Gross gain (loss)	(5)	(7)	(6)	(17)
Associated amortization of DAC, VOBA, DSI and DFEL	-	2	-	1
Variable annuity net derivatives results: (4)				
Gross gain (loss)	(11)	23	22	(5)
Associated amortization of DAC, VOBA, DSI and DFEL	(1)	(5)	(1)	(2)
Total realized gain (loss)	\$ (7)	\$ (10)	\$ 5	\$ (49)

(1) See “Realized Gain (Loss) Related to Certain Investments” section in Note 5.

(2) Represents changes in the fair values of certain derivative investments (not including those associated with our variable and indexed annuity and IUL contracts net derivatives results), reinsurance related embedded derivatives and trading securities.

(3) Represents the net difference between the change in the fair value of the S&P 500 Index ® call options that we hold and the change in the fair value of the embedded derivative liabilities of our indexed annuity and IUL contracts along with changes in the fair value of embedded derivative liabilities related to index call options we may purchase in the future to hedge contract holder index allocations applicable to future reset periods for our indexed annuity products.

(4) Includes the net difference in the change in embedded derivative reserves of our GLB riders and the change in the fair value of the derivative instruments we own to hedge the change in embedded derivative reserves on our GLB riders and the benefit ratio unlocking on our GLB and GDB riders, including the cost of purchasing the hedging instruments.

13. Stock-Based Incentive Compensation Plans

We sponsor stock-based incentive compensation plans for our employees and directors and for the employees and agents of our subsidiaries that provide for the issuance of stock options, performance shares (performance-vested shares as opposed to service-vested shares), stock appreciation rights (“SARs”), restricted stock units (“RSUs”) and deferred stock units (“DSUs”). We issue new shares to satisfy option exercises and vested performance shares and RSUs.

LNC stock-based awards granted were as follows:

	For the Three Months Ended June 30, 2018	For the Six Months Ended June 30, 2018
10-year LNC stock options	27,463	481,404
Performance shares	431	156,676
RSUs	103,769	694,269
Non-employee:		
SARs	-	14,692
Agent stock options	-	32,400
Director DSUs	7,845	14,498

14. Fair Value of Financial Instruments

The carrying values and estimated fair values of our financial instruments (in millions) were as follows:

	As of June 30, 2018		As of December 31, 2017	
	Carrying Value	Fair Value	Carrying Value	Fair Value
Assets				
AFS securities:				
Fixed maturity securities	\$ 93,060	\$ 93,060	\$ 94,840	\$ 94,840
Equity securities	-	-	246	246
Trading securities	1,450	1,450	1,620	1,620
Equity securities	112	112	-	-
Mortgage loans on real estate	12,217	12,060	10,762	10,877
Derivative investments (1)	584	584	915	915
Other investments	2,065	2,065	2,296	2,296
Cash and invested cash	1,775	1,775	1,628	1,628
Other assets:				
GLB direct embedded derivatives	1,248	1,248	903	903
GLB ceded embedded derivatives	41	41	51	51
Indexed annuity ceded embedded derivatives	29	29	11	11
Separate account assets	144,231	144,231	144,219	144,219
Liabilities				
Future contract benefits – indexed annuity and IUL contracts embedded derivatives	(1,400)	(1,400)	(1,418)	(1,418)
Other contract holder funds:				
Remaining guaranteed interest and similar contracts	(578)	(578)	(592)	(592)
Account values of certain investment contracts	(32,962)	(34,785)	(32,370)	(36,200)
Short-term debt	-	-	(450)	(452)
Long-term debt	(5,826)	(5,796)	(4,894)	(5,042)
Reinsurance related embedded derivatives	(25)	(25)	(57)	(57)
Other liabilities:				
Derivative liabilities (1)	(290)	(290)	(338)	(338)
GLB ceded embedded derivatives	(131)	(131)	(67)	(67)

(1) We have master netting agreements with each of our derivative counterparties, which allow for the netting of our derivative asset and liability positions by counterparty.

Valuation Methodologies and Associated Inputs for Financial Instruments Not Carried at Fair Value

The following discussion outlines the methodologies and assumptions used to determine the fair value of our financial instruments not carried at fair value on our Consolidated Balance Sheets. Considerable judgment is required to develop these assumptions used to measure fair value. Accordingly, the estimates shown are not necessarily indicative of the amounts that would be realized in a one-time, current market exchange of all of our financial instruments.

Mortgage Loans on Real Estate

The fair value of mortgage loans on real estate is established using a discounted cash flow method based on credit rating, maturity and future income. The ratings for mortgages in good standing are based on property type, location, market conditions, occupancy, debt-service coverage, loan-to-value, quality of tenancy, borrower and payment record. The fair value for impaired mortgage loans is based on the present value of expected future cash flows discounted at the loan's effective interest rate, the loan's market price or the fair value of the collateral if the loan is collateral dependent. The inputs used to measure the fair value of our mortgage loans on real estate are classified as Level 2 within the fair value hierarchy.

Other Investments

The carrying value of our assets classified as other investments approximates fair value. Other investments includes primarily LPs and other privately held investments that are accounted for using the equity method of accounting and the carrying value is based on our proportional share of the net assets of the LPs. Other investments also include FHLB stock carried at cost and periodically evaluated for impairment based on ultimate recovery of par value. The inputs used to measure the fair value of our LPs, other privately held investments and FHLB stock are classified as Level 3 within the fair value hierarchy. The remaining assets in other investments include

cash collateral receivables and securities that are not LPs or other privately held investments. The inputs used to measure the fair value of these assets are classified as Level 1 within the fair value hierarchy.

Separate Account Assets

Separate account assets are primarily carried at fair value. A portion of our separate account assets includes LPs, which are accounted for using the equity method of accounting and the carrying value is based on our proportional share of the net assets of the LPs. The inputs used to measure the fair value of the separate account asset LPs are classified as Level 3 within the fair value hierarchy.

Other Contract Holder Funds

Other contract holder funds include remaining guaranteed interest and similar contracts and account values of certain investment contracts. The fair value for the remaining guaranteed interest and similar contracts is estimated using discounted cash flow calculations as of the balance sheet date. These calculations are based on interest rates currently offered on similar contracts with maturities that are consistent with those remaining for the contracts being valued. As of June 30, 2018, and December 31, 2017, the remaining guaranteed interest and similar contracts carrying value approximated fair value. The fair value of the account values of certain investment contracts is based on their approximate surrender value as of the balance sheet date. The inputs used to measure the fair value of our other contract holder funds are classified as Level 3 within the fair value hierarchy.

Short-Term and Long-Term Debt

The fair value of short-term and long-term debt is based on quoted market prices. The inputs used to measure the fair value of our short-term and long-term debt are classified as Level 2 within the fair value hierarchy.

Financial Instruments Carried at Fair Value

We did not have any assets or liabilities measured at fair value on a nonrecurring basis as of June 30, 2018, or December 31, 2017, and we noted no changes in our valuation methodologies between these periods.

The following summarizes our financial instruments carried at fair value (in millions) on a recurring basis by the fair value hierarchy levels described in “Summary of Significant Accounting Policies” in Note 1 of our 2017 Form 10-K:

	As of June 30, 2018			
	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total Fair Value
Assets				
Investments:				
Fixed maturity AFS securities:				
Corporate bonds	\$ -	\$ 76,860	\$ 3,181	\$ 80,041
ABS	-	987	31	1,018
U.S. government bonds	402	20	-	422
Foreign government bonds	-	363	108	